

GAZETTE NOTICE NO.....

GUIDELINES ON FINANCIAL RESOURCE REQUIREMENTS FOR MARKET INTERMEDIARIES

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DATE: 09 NOV 2022	
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CLERK-AT THE-TABLE:	<i>Marna Wangiku</i>

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THE CAPITAL MARKETS ACT
(Cap.485A)

GUIDELINES ON FINANCIAL RESOURCE REQUIREMENTS FOR MARKET INTERMEDIARIES

IN EXERCISE of the powers conferred by section 12 (1) of the Capital Markets Act, the Capital Markets Authority, in consultation with the Minister for Finance, issues the Guideline set out in the Schedule, to be adhered to by Market intermediaries in Kenya in order to enhance the implementation of Risk Based Supervision.

SCHEDULE-

PRELIMINARY

1. Introduction

Title - Financial Resource Requirements for capital market intermediaries

2. Interpretation-

In this Guideline –

“Act” means the Capital Markets Act *Cap. 485A*;

“adjusted liabilities”, for the purposes of calculating the variable required liquid capital in relation to a licensed entity, means the sum of its on-balance sheet liabilities including provisions made for liabilities already incurred or for contingent liabilities, but excludes an approved subordinated loan provided to it;

“approved securities borrowing and lending counterparty” means-

- (a) a licensed clearing house; or
- (b) a person approved as such under paragraph 47(1) (c);

“approved subordinated loan” means a subordinated loan obtained by a licensed entity as approved by the Authority;

“Authority” means the Capital Markets Authority established under section 5 of the Act;

“clearing house” means an entity approved by the Authority to provide depository and clearing services;

“collateral”, in relation to a licensed entity, means-

- (a) any listed shares;
- (b) any specified securities;

- (c) any qualifying debt securities; or
- (d) any special debt securities, which-
 - (i) are deposited as security by the licensed entity with another person; or
 - (ii) are deposited as security with the licensed entity by another person, and are unencumbered in its possession and readily realizable by it; or
 - (iii) are encumbered only by virtue of being lent, deposited or pledged by the licensed entity with a clearing house or any of its clearing participants to secure its obligation to meet its clearing obligations or liabilities;

“collective investment scheme” has the meaning assigned to it under the Act;

"dealer" means-

- (a) an entity licensed for dealing under the (Capital Markets)(Licensing Requirements) (General) Regulations, 2002; or
- (b) a person licensed, registered or authorized by a regulatory organization outside Kenya for an activity which, if carried out in Kenya, would constitute dealing under the Capital Markets Act;

"derivative contract" means an agreement which its purpose or effect is to obtain a profit or avoid a loss by reference to the value or price of property of any description or an index or other factor designated for that purpose in the agreement, and includes a futures contract or an options contract;

"exchange participant" means-

- (a) in relation to a licensed securities exchange in Kenya, a trading participant of that exchange; or
- (b) in relation to an exchange outside Kenya, a person who-
 - (a) in accordance with the rules of that exchange, may trade through that exchange; or
 - (b) is licensed by that exchange and may trade through that exchange;

"financial institution" means a bank as defined under section 5 of the Banking Act (*Cap 488*);

"haircut amount"-

- (a) in relation to any shares listed in Kenya, as set out in Schedule 2 , means an amount derived by multiplying the market value of the

shares by the haircut percentage in relation to such shares;

- (b) in relation to specified investments, means an amount derived by multiplying the market value of the specified investments by the haircut percentage in relation to such specified investments;
- (c) in relation to specified securities, means an amount derived by multiplying the market value of the specified securities by the haircut percentage in relation to such specified securities;
- (d) in relation to qualifying debt securities, means an amount derived by multiplying the market value of the qualifying debt securities by the haircut percentage in relation to such qualifying debt securities;
- (e) in relation to special debt securities, means an amount derived by multiplying the market value of the special debt securities by the haircut percentage in relation to such special debt securities;

"haircut percentage" in relation to-

- (a) any shares which are listed in Kenya;
- (b) specified securities; or
- (c) qualifying debt securities;

means the percentage as set out in Schedule 2;

"interest rate swap agreement" means an agreement where the parties agree to exchange a series of interest payments over time;

"liquid assets" in relation to a licensed entity, means the aggregate of the amounts required to be included in the liquid assets of a licensed entity under this Guideline;

"liquid capital", in relation to a licensed entity, means the amount which the liquid assets of a licensed entity exceed its ranking liabilities;

"listed", in relation to securities, means listed or traded on a securities exchange;

"licensed entity" means a company licensed under Part IV of the Act;

"margin client" –

- (a) in relation to a licensed entity, means a client to whom the licensed entity provides securities margin financing; or
- (b) in relation to a licensed margin lender, means any of its clients;

"marking to market" means the method or the procedure of adjusting the valuation of an open position in-

- (a) any securities;

- (b) a derivative contract;
- (c) a foreign exchange agreement; or
- (d) an interest rate swap agreement,

to reflect its current market value;

"money" includes any form of money, whether represented by a cheque or other payable order, or otherwise;

"off-exchange traded derivative contract" means a derivative contract which is traded other than on an exchange;

"qualifying debt securities" means a debenture stock, loan stock, debentures, bonds, notes and any securities or other instruments acknowledging, evidencing or creating indebtedness-

- (a) which are issued or guaranteed by the Government; or
- (b) which are listed on a licensed securities exchange;

but does not include-

- (i) any special debt securities;
- (ii) any I-owe-you; and
- (iii) any securities or any instrument acknowledging, evidencing or creating a subordinated loan or a debt due from an entity within a group of companies of which the holder of the securities or instrument is a member; or
- (iv) certificates of deposit issued by an authorized financial institution;

"ranking liabilities" in relation to a licensed entity, means the aggregate of the amounts required to be included in its ranking liabilities under paragraphs 29 - 42 of this Guideline;

"redeemable shares" means shares in the share capital of a company which are redeemable at the option of the holder of the shares or that company;

"reporting currency" in relation to a licensed entity, means the currency in which its financial statements, required under the Capital Markets (Conduct of Business)(Market Intermediaries) Regulations, 2011 to be submitted to the Authority, are denominated, or intended to be denominated;

"repurchase transaction" means a transaction which there is a sale of securities and a further arrangement obliging the seller of the securities to repurchase from the purchaser, or obliging the purchaser to resell to the seller, securities of the same description as the securities first sold, at a pre-determined consideration and date;

"required liquid capital", in relation to a licensed entity, means an amount equal to

the higher of-

- (a) where the licensed entity is-
 - (i) licensed for only one activity, as specified in Table 2 as set out in Schedule 1; or
 - (ii) licensed for two or more activities, the amount which is the higher of the two or more licensed activities; and
- (b) the variable required liquid capital of the licensed entity;

"required liquid capital deficit", in relation to a licensed entity, means the amount which the liquid capital is less than the required liquid capital;

"Rules" –

- (a) in relation to an exchange other than a licensed securities exchange, includes its constitution and any rules, guidelines or directions, by whatever name they may be called and wherever they may be contained, governing-
 - (i) its exchange participants;
 - (ii) the persons who may participate in any of the services it provides or trades on it;
 - (iii) the setting and levying of fees;
 - (iv) the listing of securities;
 - (v) the trading of securities, through or on it;
 - (vi) the provision of other services ; or
 - (vii) generally, its management, operations or procedures;
or
- (b) in relation to a clearing house other than an approved clearing house, includes its constitution and any rules, guidelines or directions, by whatever name they may be called and wherever they may be contained, governing-
 - (i) its clearing participants;
 - (ii) the persons who may participate in any of the services it provides;
 - (iii) setting and levying of fees;
 - (iv) the clearing and settlement of transactions, whether or not executed on an exchange, of which it is the clearing house;
 - (v) the imposition of margin requirements and matters pertaining to the deposit or collection of margin;

(vi) the manner of making and receiving payment of monies in respect of the provision by it of any service, including the setting-off of such amounts receivable and amounts payable to it;

(vii) the provision of other services; or

(viii) generally, its management, operations or procedures;

"securities margin financing" means the provision of financial accommodation by a licensed entity to its client to facilitate-

(a) the acquisition of securities traded on any securities market, whether licensed in Kenya or outside Kenya; or

(b) the continued holding of those securities;

"segregated account" means an account for holding client's money which is separate from the accounts of a licensed entity;

"settlement date", in relation to any dealing in securities, means-

(a) in case of a transaction effected on an exchange, the date which payment for securities is first due in accordance with the Rules of the exchange; or

(b) in any other case, the date on which payment for the securities is first due as agreed between the parties to the transaction; and

(c) in either case, the date not exceeding fifteen business days after the trade date;

"short selling" means a sale of securities where at the time of the sale-

(a) the seller does not have a presently exercisable and unconditional right to vest the securities in the purchaser of them; or

(b) the seller has a presently exercisable and unconditional right to vest the securities in the purchaser of them by virtue of having entered into a securities borrowing and lending agreement;

"special debt securities" means indexed bonds, convertible debt securities, bonds with non-detachable warrants and non-interest bearing debt securities-

(a) which are issued or guaranteed by the Government; or

(b) which are listed on a licensed securities exchange;

but does not include-

(i) any I-owe-you; and

- (ii) any securities or any instrument acknowledging, evidencing or creating a subordinated loan or a debt due from an entity within a group of companies of which the holder of the securities or instrument is a member; or
- (iii) certificates of deposit issued by an authorized financial institution;

"specified licensing condition", means a licensing condition issued to a licensed entity prohibiting that entity from holding client assets;

"specified securities" means the securities as set out in Schedule 2;

"standby subordinated loan facility" means a loan facility provided to a licensed entity under which the claim of the lender in respect of any drawdown by the licensed entity is subordinated to the prior payment, or provision for payment, in full of all claims of all other present and future creditors of the licensed entity;

"subordinated loan", means a loan provided to a person under which the claim of the lender in respect of the loan is subordinated to the prior payment, or provision for payment, in full of all claims of all other present and future creditors of that person;

"trade date", in relation to a transaction in-

- (a) any securities;
- (b) a derivative contract;
- (c) a foreign exchange agreement; or
- (d) an interest rate swap agreement;

means-

- (i) in case of a transaction on any exchange, the date on which the transaction is executed; or
- (ii) in any other case, the date on which the agreement is made;

"unrealized losses" means un-actualized losses calculated by marking to market an open position in-

- (a) any securities;
- (b) a derivative contract;
- (c) a foreign exchange agreement; or
- (d) an interest rate swap agreement;

"unrealized profits" means un-actualized profits calculated by marking to market an open position in-

- (a) any securities;

- (b) a derivative contract;
- (c) a foreign exchange agreement; or
- (d) an interest rate swap agreement;

and

"variable required liquid capital", in relation to a licensed entity, means eight per cent of the aggregate of its adjusted liabilities.

A reference to an exchange in this Guideline includes a reference to any market operated by that exchange.

3. Accounting treatment

A licensed entity shall, for the purposes of this Guideline, account for all assets and liabilities-

- (a) in accordance with International Financial Reporting Standards, unless otherwise specified in this Guideline; and
- (b) in a way that recognizes the substance of a transaction, arrangement or position including accounting for a structured bond as a derivative product and not as a debt security.

4. Financial Resource Requirements

A licensed entity shall maintain, at all times, financial resources required under this Guideline.

5. Paid-up share capital requirement for licensed entities

For the purposes of paragraph 4, a licensed entity shall maintain, at all times, a paid-up share capital, unimpaired by losses, of not less than-

- (a) where it is licensed for one activity, the amount as set out in the First Schedule for that licensed activity; or
- (b) where it is licensed for two or more activities, the amount which is the higher or highest upon comparing each amount as set out in the First Schedule for any of such licensed activities.

6. Liquid capital requirement for licensed entities

For the purposes of Paragraph 4, a licensed entity shall maintain, at all times, a liquid capital which is not less than its required liquid capital.

7. Calculation of liquid capital and required liquid capital

A licensed entity shall, for the purposes of calculating its liquid capital and the required liquid capital, account for all its assets, liabilities and transactions in

accordance with this Guideline.

8. Accounting for transactions on trade date basis

A licensed entity shall, for the purposes of calculating its liquid capital and required liquid capital, account on a trade date basis for all transactions effected by it, whether as principal or agent, in relation to any dealing in-

- (i) any securities;
- (ii) a derivative contract;
- (iii) entering into any foreign exchange agreement; or
- (iv) interest rate swap agreement.

9. Valuation of proprietary position

(1) Subject to subparagraph (2), a licensed entity shall, for the purposes of calculating its liquid capital and required liquid capital, value any open position in-

- (i) any securities;
- (ii) a derivative contract;
- (iii) a foreign exchange agreement; or
- (iv) an interest rate swap agreement;

entered into for its own account at market value.

(2) Notwithstanding subparagraph (1), for the purposes of calculating the liquid capital and required liquid capital of a licensed entity, any reference in this Guideline to the market value of the securities referred to in this subparagraph shall be construed as referring to the value (including any nil value) at which they are required to be valued under this subparagraph, namely-

- (a) debt securities other than a certificate of deposit, in respect of which there is no published market price, shall be valued-
 - (i) at the average value of quotations obtained in respect of those debt securities from-
 - (A) at least two market makers; or
 - (B) where in relation to any debt securities there are less than two market makers, at least two banks, dealers outside Kenya or licensed entities, who customarily deal in such debt securities, or at least two of the persons referred to in this

subparagraph; or

- (ii) if the quotations referred to in subparagraph (i) are not available-
 - (A) in the case of long positions, at nil; or
 - (B) in the case of short positions, at the face value of the debt securities;
- (b) listed securities which have been suspended from trading for at least three business days or ceased trading on any exchange on which the securities were listed, shall, unless the securities can continue to be traded on any other exchange on which the securities are listed, be valued-
 - (i) in the case of long positions, at nil; or
 - (ii) in the case of short positions, at the last closing price before the suspension or cessation of trading;
- (c) certificates of deposit issued by an authorized financial institution or an approved bank incorporated outside Kenya, in respect of which there is no published market price, shall be valued at the value quoted by the issuer.

10. Pairs of transactions

A licensed entity which enters into separate transactions which have identical or similar terms, shall account for the transactions as separate transactions.

11. No set-off

(1) Subject to subparagraphs (2), and paragraph 38(2), the assets and liabilities of a licensed entity shall be treated separately on a gross basis and shall not be set-off against each other.

(2) Subparagraph (1) shall not apply to-

- (a) any amounts receivable by a licensed entity from, and any amounts payable by that entity to a licensed clearing house, where the regulations of the clearing house permit the setting-off of such amounts against each other for settlement purposes; and
- (b) any amounts receivable by a licensed entity from, and any amounts payable by that entity to a person, where-
 - (i) such amounts do not arise from the carrying on of any activity for which it is licensed; and

- (ii) it has a legally enforceable right to set-off such amounts against each other;
- (c) any amounts receivable by a licensed entity from and any amounts payable by it to a client, where such amounts arise from the purchase and sale by the client of securities of the same description and the client has authorized the licensed entity in writing to set-off such amounts.

12. Transactions in margined accounts

(1) A licensed entity shall not set-off amounts receivable by the licensed entity from, and amounts payable by the licensed entity to its client arising from transactions in different margined accounts maintained with the licensed entity by the client.

(2) Where a licensed entity has a client who-

- (a) maintains with it more than one margined account;
- (b) has deposited security against the liabilities of that client in the form of-
 - (i) cash;
 - (ii) collateral; or
 - (iii) a bank guarantee issued by an authorized financial institution or an approved bank incorporated outside Kenya; and
- (c) has authorized the licensed entity to apply such security to satisfy any liabilities arising from the execution by the client of any transaction in relation to any of the margined accounts of the client,

the licensed entity may, subject to subparagraphs (3) and (4)-

- (i) for the purpose of calculating-
 - (A) a specified shortfall amount in relation to a margined account of the client; or
 - (B) a margin shortfall amount under paragraph 21(1)(b) in relation to the client,

consider all or part of such security to be deposited by the client as security to the margined account in relation to

which such shortfall amount is calculated; or

- (ii) for the purpose of calculating any amount to be included in its ranking liabilities under paragraph 35 or 36 in relation to a margined account of the client, reduce any such amount by-

- (A) where the client has deposited cash referred to in subparagraph (b)(i), the amount of such cash;

- (B) where the client has deposited collateral referred to in subparagraph (b)(ii), the amount of the market value of such collateral, less the haircut amount in relation to the collateral; or

- (C) where the client has deposited a bank guarantee referred to in subparagraph (b) (iii), the amount that it can draw down under such bank guarantee.

(3) A licensed entity shall not-

- (a) under subparagraph (2)(c)(i), consider-

- (i) any amount of cash;

- (ii) any collateral; or

- (iii) any amount that it can draw down under a bank guarantee,

to be security to the margined account concerned; or

- (b) effect any reduction under subparagraph (2)(c)(ii) in respect of such security, if-

- (i) such security has been considered under subparagraph (2)(c)(i) to be deposited as security to another margined account of the client; or

- (ii) in respect of such security a reduction under subparagraph (2)(c)(ii) has been effected in relation to another margined account of the client.

(4) For the purposes of this Guideline, a licensed entity shall cease to treat-

- (a) any cash referred to in subparagraph (2)(b)(i);

- (b) any collateral referred to in subparagraph (2)(b)(ii); or

- (c) any bank guarantee referred to in subparagraph (2)(b)(iii),

as security in relation to the margined account of the client into which it was deposited, to the extent that such security-

- (a) has been considered under subparagraph (2)(c)(i) to be deposited as security to another margined account of the client; or
- (b) has been utilized to effect a reduction under subparagraph (2) (c)(ii).

(5) For the purposes of subparagraph (2), "specified shortfall amount means an amount to be included in the ranking liabilities of a licensed entity under-

- (a) paragraph 34;
- (b) paragraph 35; or
- (c) paragraph 36.

(6) In this paragraph, "margined account", in relation to a client of a licensed entity, means-

- (a) an account maintained by a client with an entity licensed for Margin Lending activity, for the provision of securities margin financing; or
- (b) an account maintained with the licensed entity by the client for-
 - (i) short selling;
 - (ii) securities borrowing and lending; or
 - (iii) entering into repurchase transactions.

13. Assignments

(1) A licensed entity shall not include, in its liquid assets, any amount receivable by that licensed person from any of its clients if such amount has been assigned by the licensed person to another person.

(2) A licensed entity shall not treat any collateral or any other type of security deposited with the licensed entity by any of its clients as so deposited where such collateral or other type of security has been assigned by the licensed person to another person.

14. Treatment of securities borrowing and lending agreements

(1) A licensed entity which is a borrower of any securities under a securities borrowing and lending agreement, shall be considered for the purposes of this Guideline-

- (a) to remain the owner of any collateral beneficially owned by the licensed entity and provided by the licensed entity as security to the lender of the securities under the agreement;

- (b) to have an amount receivable from that lender equal to the amount of cash provided as security to that lender; and
- (c) not to own the securities borrowed under the agreement.

(2) A licensed entity which is the lender of any securities under a securities borrowing and lending agreement, shall be considered for the purposes of this Guideline-

- (a) where the securities lent under the agreement are beneficially owned by it, to remain the beneficial owner of the securities for the purposes of paragraph 24;
- (b) not to own any collateral deposited with it as security by the borrower of the securities under the agreement; and
- (c) to have an amount payable to that borrower equal to the amount of cash deposited with it as security by that borrower, unless the cash-
 - (i) is not included in its liquid assets under paragraph 19; and
 - (ii) is held in a segregated account.

15. Treatment of repurchase transactions

(1) Where a licensed entity is the purchaser in the first instance of any securities under a repurchase transaction, it shall be considered for the purposes of this Guideline-

- (a) to have an amount receivable from the seller of the securities equal to the consideration for which it purchased the securities; and
- (b) not to own the securities purchased and shall not include them in its liquid assets under paragraph 24.

(2) Where a licensed entity is the seller in the first instance of any securities beneficially owned by the licensed entity under a repurchase transaction, the licensed entity shall be considered, for the purposes of this Guideline-

- (a) to remain the owner of the securities sold by the licensed entity; and
- (b) to be liable to the purchaser of the securities for an amount equal to the consideration for which the licensed entity sold the securities.

LIQUID ASSETS

16. Liquid assets

A licensed entity shall apply the computation basis prescribed in this Guideline in calculating its liquid assets.

17. Exclusions from liquid assets

(1) A licensed entity which operates a branch outside Kenya shall not include in its liquid assets, any asset which is required by an authority or a regulatory organization in, or under the law of that country, to maintain in that country in order for the branch to obtain or maintain a licence, registration, membership or authorization to carry on an activity which, if carried on in Kenya, would constitute a licensed activity.

(2) A licensed entity shall not include in its liquid assets-

- (a) any asset in a currency which is subject to exchange control; or
- (b) any assets whose proceeds are not freely remittable to Kenya, unless the licensed entity reasonably believes that approval for remittance of such currency or proceeds to Kenya can be obtained from the relevant authority within one week of application by it for such approval; and
- (c) any asset not provided for under Paragraphs 19 to 28 of this Guideline.

18. Assets provided to others as security

(1) Subject to subparagraph (2), a licensed entity shall not, for the purposes of calculating its liquid capital, be considered as the owner of any asset which the licensed entity beneficially owns and has provided to another person as a security for any liabilities or obligations.

(2) A licensed entity shall be considered to remain the owner of any asset which the licensed entity beneficially owns and has provided as security-

- (a) to-
 - (i) a financial institution;
 - (ii) an approved bank incorporated outside Kenya;
 - (iii) another licensed entity, for credit facilities provided to that licensed entity by the institution, bank or company as the case may be; or
- (b) under a securities borrowing and lending agreement under which the licensed entity is the borrower of securities;
- (c) in the form of margin deposited in respect of any short selling by the licensing entity; or
- (d) to, or to obtain a bank guarantee in favour of an

approved clearing house for the purpose of enabling the licensed entity fulfil its obligations under the rules of that clearing house.

19. Cash in hand and cash at bank

A licensed entity shall include in its liquid assets-

- (a) cash in hand which the licensed entity beneficially owns;
- (b) money which the licensed entity beneficially owns and holds in its name, or in a segregated account, with an authorized financial institution or an approved bank incorporated outside Kenya in the form of-
 - (i) a demand deposit; or
 - (ii) a time deposit which matures in six months or less; and
 - (iii) interest accrued on any deposit under subparagraph (b)(ii).

20. Amounts receivable from clients in respect of purchase of and subscription for securities

(1) Subject to subparagraph (3), a licensed entity shall include in its liquid assets the following amount receivable from any of its clients arising from purchase by the client of securities on a cash-against-delivery basis-

- (a) any such amount receivable which is not yet due for settlement according to the settlement date; or
- (b) where any such amount receivable has been outstanding for more than one business day after the settlement date, the amount which is the lower of-
 - (i) such outstanding amount receivable less any specific provision for bad or doubtful debts made in respect of such outstanding amount; and
 - (ii) fiftypercent of such outstanding amount.

(2) A licensed entity may, in respect of all its clients, set-off, on a client-by-client basis, any amount receivable from, and amount payable to a client where such amounts arise from the purchase and sale of securities by the client, and the licensed entity has obtained from the client a written authorization to-

- (a) set-off such amounts against each other; and
- (b) dispose securities held for the client for the purpose of settling any amounts payable by the client to the licensed entity.

(3) A licensed entity shall include, in respect of securities subscribed for on behalf of any of its clients, prior to the commencement of trading of the securities

on any exchange on which they are listed, in the liquid assets of the licensed entity the amount which is the lower, when calculated on a transaction-by-transaction basis, of-

- (a) ninety percent of the total costs to the client of subscribing for the securities; and
- (b) the amount receivable from the client for subscribing for the securities.

(4) The aggregate of amounts that a licensed entity includes in its liquid assets under subparagraphs (1) and (2), shall not exceed the aggregate of amounts receivable from its clients referred to in those subparagraphs less the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of amounts receivable.

21. Amounts receivable in respect of providing securities margin financing

(1) Subject to subparagraphs (2) and (3), a licensed entity shall include in its liquid assets any net amount receivable from any of the margin clients of a licensed entity, calculated as the amount by which the amount receivable from the margin client exceeds the amount payable by the licensed entity to the margin client arising from the provision by the licensed entity of securities margin financing, after deducting the higher of-

- (a) any specific provision for bad or doubtful debts made in respect of such net amount receivable; and
- (b) the margin shortfall amount, calculated as the amount by which the net amount receivable exceeds the aggregate of-
 - (i) the market value of collateral, other than illiquid collateral, provided by the client, less the haircut amount in relation to such collateral;
 - (ii) the market value of all illiquid collateral provided by the client, multiplied by 20% in the case of listed shares and 0% in the case of other equity securities;
 - (iii) the amount of cash deposited as security by the client; and
 - (iv) the maximum amount that the licensed entity can draw under a bank guarantee provided to the licensed entity by the client and issued by an authorized financial institution or an approved bank incorporated outside Kenya.

(2) for the purposes of subparagraphs (1)(b)(i) and (ii), "illiquid collateral", means any listed share which is of the same description as that identified as top three collateral provided by any top margin client of the licensed entity, where-

- (a) if it is a share, the aggregate market value of all shares of the same description as that share provided to the licensed entity by its margin

clients as collateral is equal to or greater than-

- (i) the average monthly turnover of that share; or
- (ii) five percent of the market capitalization of that share as at the end of the month immediately preceding the month prior to the month in which the calculation is made;

but does not include-

(A) any listed share which has been listed for less than six consecutive months (including any period during which the share is suspended from trading) immediately preceding the month prior to the month in which the calculation is made; and

(B) any listed share which is a constituent stock of the NSE 20 Index.

(3) "average monthly turnover", in relation to a listed share, means one sixth of the aggregate value of transactions in that share or warrant on any exchange on which it is listed for a period of six consecutive months (including any period during which the share or warrant is suspended from trading) immediately preceding the month prior to the month in which the calculation is made;

(4) "calculation" means a calculation made for the purposes of subparagraph (1);

(5) "market capitalization", in relation to a listed share, means the amount of the total number of shares of the same description as that share issued by the issuer of that share, multiplied by their market price;

(6) "top 3 collateral", in relation to a top margin client, means any of the three highest listed shares in terms of market value among all listed shares and listed warrants provided by him to the licensed entity as collateral;

(7) "top margin client", means-

- (a) where a licensed entity has less than twenty margin clients, all the margin clients with outstanding margin loan balance; or
- (b) where the licensed entity has twenty or more margin clients, the twenty margin clients with the largest outstanding margin loan balance.

(8) In the definition of "top 3 collateral" in subparagraph (3), "market value", in relation to a listed share provided by a margin client to the licensed entity, means the market value of all such listed shares of the same description as the share provided by the margin client to the licensed entity.

22. Amounts receivable from counterparties in respect of dealings in securities

(1) Subject to subparagraph(2), (3) and (5), a licensed entity shall include in its liquid assets the following amounts receivable from any client or dealer which arise from the buying and selling of securities by the licensed entity to the dealer or client-

- (a) any such amount receivable which has been outstanding for fifteen days or less after the settlement date;
- (b) where any such amount receivable has been outstanding for more than fifteen days but less than one month after the settlement date less a haircut of fifteen percent;
- (c) where any such amount receivable has been outstanding for more than a month but less than two months after the settlement date less a haircut of fifty percent; and
- (d) where any such amount receivable has been outstanding for more than two months after the settlement date less a haircut of one hundred percent.

(2)Subparagraph (1)applies to any securities purchased on behalf of a client which has not been booked to the client's account but may be held by the licensed entity.

(3) The aggregate of amounts included in liquid assets under paragraph 18(1) shall not exceed the aggregate of amounts receivable from clients or dealers referred in that paragraphless the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of amounts receivable.

(4) Where any amount is due to the licensed entity by an agent which the licensed entity is responsible for, the amount will be subject to a one hundred percent haircut.

(5) This paragraph is only applicable to clients' receivables where a written agreement has been obtained from the client which provides for funding arrangements envisaged in regulation 23 of the Capital Markets (Licensing Requirements) (General) Regulations, 2002.

23. Cash provided as security for short selling

A licensed entity shall include in its liquid assets an amount receivable in the amount of any cash (including interest accrued on it) provided by the licensed entity as a security to the counterparty in respect of a short selling of securities by the licensed entity where the licensed entity has not yet delivered securities to the counterparty for settlement, where the counterparty is-

- (a) a dealer;
- (b) a clearing house of a specified exchange; or
- (c) a clearing participant of a clearing house referred to in subparagraph (b).

24. Proprietary positions of licensed entities

(1) A licensed entity shall include in its liquid assets any of the following assets which it beneficially owns-

- (a) listed shares;
- (b) qualifying debt securities;
- (c) special debt securities; and
- (d) specified securities;

at market value, less the haircut amounts in relation to the securities or specified investments concerned.

(2) A licensed entity shall include in its liquid assets any derivative contract which the licensed entity beneficially owns –

- (a) listed shares;
- (b) qualifying debt securities;
- (c) special debt securities;
- (d) specified securities; and
- (e) specified investments,

at market value, less twice the haircut amounts in relation to the securities or specified investments concerned.

25. Amounts receivable from clearing houses, etc

A licensed entity shall include in its liquid assets-

- (a) amounts receivable from a licensed clearing house; and
- (b) cash deposited with such clearing house,

other than-

- (i) admission fees which the licensed entity has paid to such clearing house;
- (ii) contributions which the licensed entity has made to the Guarantee

Fund or Reserve Fund of such clearing house; and

- (iii) client money held in a segregated account maintained with such clearing house.

26. Amounts receivable under securities borrowing and lending agreements

A licensed entity, which is the borrower of securities under a securities borrowing and lending agreement, shall include in its liquid assets, any amount receivable from the lender of the securities which it is considered under paragraph 14(1) (b) to have in respect of any cash provided by the licensed entity as a security to the lender

27. Amounts receivable under repurchase transactions

A licensed entity which is the purchaser in the first instance of any securities under a repurchase transaction, shall include, in its liquid assets, any amount receivable from the seller of the securities which is considered under paragraph 15(1)(a) to have in respect of the consideration for which the licensed entity purchased the securities.

28. Miscellaneous assets

A licensed entity shall include in its liquid assets any of the following-

- (a) the amount of any fees, commissions, commission rebates and interest charges to which the licensed entity is beneficially entitled which arise from the carrying on of any activity for which it is licensed and-
 - (i) which have accrued and will first be due for billing or payment within the next three months; or
 - (ii) which have been billed or fallen due for payment and remain outstanding for one month or less after the date on which they were billed or fell due;
- (b) deposits which the licensed entity beneficially owns and maintained with, and in accordance with the rules or requirements of a licensed securities exchange as security for its obligations or liabilities owed to the licensed securities exchange for stamp duty chargeable under the Stamp Duty Act (*Cap 480*) on contract notes specified in an agreement under that Act;
- (c) prepaid operating expenses to be incurred within the next three months;
- (d) interest accrued to the licensed entity under an interest rate swap agreement to which the licensed entity is a party, other than interest which remains outstanding after it is first due for payment;

(e) amounts paid by the licensed entity for its own account for subscribing for-

- (i) listed shares or shares pending listing;
- (ii) qualifying debt securities;
- (iii) special debt securities;
- (iv) specified securities,

less an amount equal to such amounts as multiplied by fifty percent of the haircut percentages in relation to such shares or securities;

- (f) dividends receivable on shares listed on a licensed securities exchange or on a specified exchange which are traded on an ex-dividend basis and which the licensed entity beneficially owns;
- (g) interest accrued on qualifying debt securities or special debt securities which are traded on an ex-interest basis and which the licensed entity beneficially owns.

RANKING LIABILITIES

29. Ranking liabilities

A licensed entity shall, for the purposes of calculating its ranking liabilities, apply the computation basis prescribed in this Guideline.

30. Amounts payable to clients, etc

A licensed entity shall include in its ranking liabilities, any amount payable to any of its clients or any counterparty or clearing house which arises from the carrying on of any activity for which it is licensed, other than an amount payable to any of its clients which is set-off against an amount receivable from the client under paragraph 20 (2).

31. Amounts payable in respect of dealing in securities

A licensed entity shall include in its ranking liabilities, in respect of a sale of securities-

- (a) by the licensed entity for a client who is in default of his obligation to deliver the securities for more than ten days after the settlement date; and
- (b) which the licensed entity has not settled with securities purchased at the expense of that licensed entity,

one hundred percent of the original value of the securities not delivered by the client.

32. Provision of securities margin financing

(1) An entity licensed to carry out margin lending activity shall include in its ranking liabilities the amount, when calculated on a client-by-client basis, by which-

- (a) any amount receivable from any of the margin clients of a licensed entity; or
- (b) in the case of a group of related margin clients, the aggregate of amounts receivable from the group;

included in its liquid assets under paragraph 21(1), exceeds ten percent of the aggregate of amounts receivable from its margin clients included in its liquid assets in accordance with that paragraph.

(2) Where a licensed entity obtains any financial accommodation wholly or partly secured by collateral provided by any of its margin clients, it shall include in its ranking liabilities, the amount by which such financial accommodation exceeds 70% of the aggregate of amounts receivable from the margin clients of that licensed entity arising from the provision of securities margin financing.

(3) For the purposes of subparagraph (1), "group of related margin clients" means any two or more margin clients of a licensed entity and where-

- (a) it is a group of two margin clients, one is the spouse of the other;
- (b) one or more of the margin clients are corporations, one is in control, either alone or with the spouse, of thirty five percent or more of the voting rights of that other margin client or each of the other margin clients (as the case may be); or
- (c) the margin clients are corporations; they are members of the same group of companies.

33. Short positions in securities and specified investments

(1) Subject to subparagraph (2), a licensed entity which holds a short position on its own account in securities, whether by short selling or otherwise, shall include in its ranking liabilities the market value of those securities or specified investments.

(2) A licensed entity which holds a short position on its own account, whether by short selling or otherwise, shall increase by twenty percent, the amount required to be included in its ranking liabilities under subparagraph (1).

(3) A licensed entity shall include in its ranking liabilities, in respect of the short selling of securities for any of its clients, save where such securities have been delivered to the licensed entity by the client or are not yet due for settlement according to the settlement date, twenty percent of the market value of such securities.

34. Concentrated proprietary positions

(1) Where a licensed entity holds for its own account-

- (a) listed shares;

- (b) qualifying debt securities;
- (c) special debt securities; or
- (d) specified investments,

and the net market value of any such securities which are of the same description equals twenty five percent or more of its required liquid capital, the licensed entity shall include in its ranking liabilities, twenty five percent of such net market value.

(2) For the purposes of subparagraph (1), "net market value", means the market value remaining after netting each long and short positions in securities of the same description.

35. Securities borrowing and lending agreements

A licensed entity which is a borrower or a lender of securities under a securities borrowing and lending agreement, shall include in its ranking liabilities twenty percent of the aggregate of-

- (a) the market value of securities borrowed by it, and
- (b) the market value of securities lent by it.

36. Repurchase transactions

A licensed entity which is-

- (a) the purchaser in the first instance of any securities in a repurchase transaction shall include in its ranking liabilities twenty five percent of the securities market value;
- (b) the seller in the first instance of any securities in a repurchase transaction shall include in its ranking liabilities twenty five percent of the securities market value; and
- (c) the seller in the first instance of any securities in a repurchase transaction shall include in its ranking liabilities the amount of the consideration for which the securities were sold.

37. Net underwriting commitments

A licensed entity which underwrites or sub-underwrites an issue or a sale of securities shall include in its ranking liabilities twenty percent multiplied by the net underwriting commitment.

For the purposes of this paragraph, "net underwriting commitment" means the total costs of subscribing for, or purchasing securities underwritten or sub-underwritten by a licensed entity other than-

- (a) securities which are sub-underwritten; and
- (b) securities which are the subject of a legally binding contract for the subscription for, or purchase of such securities, through, or from that licensed entity, by another person.

38. Off-exchange traded derivative contracts

(1) Subject to subparagraph (2), a licensed entity shall include in its ranking liabilities, the amount of any unrealized losses incurred in respect of any position in an off-exchange traded derivative contract.

(2) Where a licensed entity has entered into a bilateral netting agreement in respect of two or more off-exchange traded derivative contracts with the counterparty with whom the licensed entity maintains the positions, the licensed entity shall include in its ranking liabilities, the difference by which the amount of any unrealized losses incurred exceeds the amount of any unrealized profits made by the licensed entity in respect of the contracts.

(3) For the purposes of subparagraph (2), a "bilateral netting agreement" means an agreement between a licensed entity and a counterparty with whom the licensed entity maintains positions in off-exchange traded derivative contracts, where each party has a single obligation to the other in respect of all such contracts covered by the agreement which provides that, where a counterparty fails to comply with its obligation under the agreement, the licensed entity shall have-

- (a) a single claim to receive the net amount of the aggregate positive mark-to-market value of any contract covered by the agreement, calculated by deducting from the aggregate positive mark-to-market value, of any contract covered by the agreement the aggregate negative mark-to-market value of any other contract covered by the agreement; or
- (b) a single obligation to pay the net amount of the aggregate negative mark-to-market value of any contract covered by the agreement, calculated by deducting from the aggregate negative mark-to-market value of any contract covered by the agreement the aggregate positive mark-to-market value of any other contract covered by the agreement.

39. Interest rate swap agreements

A licensed entity which is a party to an interest rate swap agreement shall include in its ranking liabilities, the notional principal amount multiplied by five percent.

For the purposes of this paragraph "notional principal amount" means the theoretical amount agreed upon by the parties to an interest rate swap agreement on the basis of which any interest payment to be made under the agreement is calculated.

40. Foreign exchange agreements

A licensed entity which is a party to a foreign exchange agreement shall include, in

its ranking liabilities, the amount of currency to be delivered by the licensed entity under the agreement, multiplied by five percent.

MISCELLANEOUS

41. Miscellaneous

A licensed entity shall include in its ranking liabilities-

- (a) twenty per cent of the amount of any guarantee, indemnity or other similar financial commitment provided by the licensed entity, directly or indirectly (including the pledging of assets for the purpose of obtaining a bank guarantee), other than a guarantee, an indemnity and other financial commitment provided in respect of its own liabilities and obligations;
- (b) the amount by which the liabilities of any subsidiary of the licensed entity (excluding any amounts due to it from the subsidiary) exceed the assets of the subsidiary; and
- (c) the consideration which the licensed entity is obliged to pay for the redemption of redeemable shares, other than approved redeemable shares, which have not been redeemed.

42. Other liabilities

(1) Subject to subparagraph (2), a licensed entity shall include, in its ranking liabilities, all its liabilities not otherwise required to be included in its ranking liabilities under any other provision of this Guideline including-

- (a) any amount payable by the licensed entity in relation to any overdraft obtained;
- (b) any amount payable by the licensed entity in relation to any loan obtained;
- (c) any accrued interest payable by the licensed entity to any other person;
- (d) any accrued expenses incurred by the licensed entity;
- (e) any tax payable by the licensed entity, less any tax prepaid, to the extent that the tax payable and the tax prepaid are of the same description and levied by the same taxation authority;
- (f) any provision made by the licensed entity for contingent liabilities;
- (g) any provision made by the licensed entity for unrealized losses in respect of open positions held for its own account; and

(h) any other liabilities provided for in accordance with International Financial Reporting Standards.

(2) A licensed entity shall not include in its ranking liabilities any approved subordinated loan provided to the licensed entity.

43. Licensed entities to notify the Authority of failure to comply with this Guideline

(1) A licensed entity shall, by notice in writing, notify the Authority if-

(a) it is unable to maintain, or to ascertain whether it maintains, financial resources in accordance with the specified amount requirements which is applicable to it; or

(b) it is unable to comply with, or to ascertain whether it complies with all or any of the requirements of this Guideline, other than the specified amount requirements.

(2) A notice under subparagraph (1) shall contain-

(a) full details of the matter and the reason thereof; and

(b) full details of any steps the licensed entity is taking, has taken or proposes to take to redress the inability.

(3) The Authority may, where a licensed entity gives notice under subparagraph (1), request the licensed entity to provide, in such form and within such time as the Authority may specify, any additional information and documents as the Authority may require.

(4) For the purposes of this Guideline, "specified amount requirements", means the applicable requirements to maintain –

(a) a paid-up share capital required under Paragraph4; and

(b) a liquid capital not less than the liquid capital required under Paragraph5.

44. Licensed entities to notify the Authority of circumstances relating to financial resources and trading activities and to submit returns in certain cases

(1) A licensed entity shall notify the Authority, in writing, within one business day, or as soon as reasonably practicable, of becoming aware of any of the following matters-

(a) its liquid capital falls below one hundred and twenty percent of its required liquid

capital;

- (b) a required liquid capital deficit occurs, but the licensed entity is regarded as having complied with Paragraph 6;
- (c) its liquid capital falls below fifty percent of the liquid capital stated in its last return submitted to the Authority under Paragraph 45(1);
- (d) any information contained in any of its previous returns submitted to the Authority in accordance with this Guideline is false or misleading in a material particular;
- (e) the aggregate of the amounts the licensed entity draws down on any loan, advance, credit facility or other financial accommodation provided to that licensed entity by banks exceeds the aggregate of the credit limits thereof;
- (f) it has been or will be unable, for three consecutive business days, to meet in whole or in part any calls or demands for payment or repayment, as the case may be, from any of its lenders, credit providers or financial accommodation providers;
- (g) any of its lenders or any person who has provided credit or financial accommodation to the licensed entity has exercised, or has informed the licensed entity that that person will exercise the right to liquidate security provided by the licensed entity to that person in order to reduce its liability or indebtedness to him under any outstanding loan, advance, credit facility balance or other financial accommodation provided;
- (h) the aggregate of the maximum amounts that can be drawn down against that licensed entity under any guarantee, indemnity or any other similar financial commitment provided by it-
 - (i) exceeds ten million shillings; or
 - (ii) would, if deducted from its liquid capital, cause its liquid capital to fall below one hundred and twenty

percent of the required liquid capital;

- (i) the aggregate of amounts of any outstanding claim made in writing by the licensed entity or against the licensed entity (whether disputed or not) exceeds or is likely to exceed ten million shillings;
- (j) the aggregate of amounts of any outstanding claim made in writing by the licensed entity or against the licensed entity (whether disputed or not) would, if deducted from its liquid capital, cause its liquid capital to fall below one hundred and twenty percent of the required liquid capital;
- (k) any claim is made by the licensed entity under any professional indemnity or other insurance policy that is required to maintain under any rules or conventions of any exchange or clearing house;
- (l) any financial commitment, including a guarantee, provided for the licensed person in favour of an exchange or a clearing house, by a company which is a member of a group of companies of which the licensed entity is a member; or
- (m) any situation which may impact on the ability of a licensed entity to undertake, on a continuing basis, the timely calculation of its liquid capital or the occurrence of an event which, within one business day, it has not been able to accurately quantify but which it believes may have a negative impact of more than ten percent on its liquid capital.

(2) A notice under subparagraph (1), shall contain,-

- (a) full details of the matter and the reason thereof; and
- (b) in the case of a notification under subparagraphs(1) (a), (b), (c), (e), (f), (g) or (m), full details of any steps the licensed entity is taking, has taken or proposes to take to prevent its liquid capital from falling below the required liquid capital or to improve its liquidity.

(3) A licensed entity shall, where it has, prior to the commencement of this Guideline, entered into any position in an off-exchange traded derivative contract

other than-

- (a) an options contract written by the licensed entity on its own account;
- (b) an interest rate swap agreement; and
- (c) a foreign exchange agreement,

within one business day of the commencement of this Guideline, notify the Authority, in writing, of the details of such position.

(4) A licensed entity shall, where the licensed entity intends to enter into any position in an off-exchange traded derivative contract other than-

- (a) an options contract written by the licensed entity on its own account;
- (b) an interest rate swap agreement; and
- (c) a foreign exchange agreement,

notify the Authority, in writing, of the details of the position it intends to enter into, at least ten business days before entering into such position.

(5) A licensed entity shall, where it intends to change any of its accounting policies which may materially affect the liquid capital or paid-up share capital which it maintains or is required to maintain under this Guideline, notify the Authority in writing, of the details and the reasons for the intended change not less than ten business days prior to effecting the change.

45. Licensed entities to submit returns to the Authority

(1) A licensed entity shall, at the end of each month, and not later than fifteen days after the end of each month, submit to the Authority, monthly returns in the manner specified under subparagraph (5), and in a form specified by the Authority and signed in the manner specified under subparagraph (6).

(2) A return made under subparagraph (1) shall include-

- (a) the liquid capital computation, as at the end of the month;
- (b) the required liquid capital computation, as at the end of the month;
- (c) a summary of bank loans, advances, credit facilities and other financial accommodation available to the licensed entity, as at the end of the month;
- (d) an analysis of its profit and loss account (statement of comprehensive income); and

- (e) an analysis of its client assets, as at the end of the month.

(3) A licensed entity shall, at the end of each quarter, and not later than fifteen days after the end of that quarter, submit quarterly returns to the Authority, in the manner specified under subparagraph (5) and in a form specified by the Authority and signed in the manner specified under subparagraph (6).

(4) A return made under subparagraph (3) shall contain-

- (a) an analysis of its clientele, as at the end of the three month period;
- (b) an analysis of its proprietary derivative positions, as at the end of the three month period; and
- (c) where it is licensed as a Fund Manager, an analysis of the assets under its management, as at the end of that period.

(5) For the purposes of this paragraph, a licensed entity shall submit a return referred to in this Guideline to the Authority in paper and electronically by means of an online communication system approved by the Authority.

(6) A return made under this paragraph shall be signed by the chief executive officer of the licensed entity or by an officer duly authorized by the chief executive officer to carry out such mandate.

(7) A licensed entity shall submit, to the Authority, a copy of its monthly management accounts in paper and electronically by means of an online communication system approved by the Authority.

(8) The Authority may, for the purposes of subparagraph (5), approve an online communication system for the submission of returns.

46. Licensed entities to provide information

The Authority may at any time, by notice in writing, request a licensed entity to provide within the time and in a manner specified in the notice, such information, including any record or document, as it may specify in the notice, relating to the financial resources or trading activities of the licensed entity.

47. Approvals

(1) The Authority may, on application in writing by a licensed entity, approve-

- (a) as an approved subordinated loan, any subordinated loan obtained by the licensed entity;
- (b) as an approved standby subordinated loan facility, any standby subordinated loan facility

obtained by the licensed entity; and

- (c) as an approved securities borrowing and lending counterparty.

(2) An approval granted by the Authority under this paragraph shall be subject to reasonable conditions as the Authority may impose.

(3) The Authority may at any time-

- (a) revoke or amend the approval; or

- (b) revoke any such conditions or impose new conditions as may be reasonable in the circumstances.

48. Remedial measures and administrative sanctions

Where a licensed entity contravenes any provision of this Guideline,-

- (a) the officers of the licensed entity shall be jointly and severally liable to indemnify the licensed entity against any loss arising from the contravention; and
- (b) the licensed entity shall be liable to the sanctions or penalties prescribed in the Act.

SCHEDULES

Schedule 1

FINANCIAL RESOURCES REQUIREMENTS

TABLE 1

PAID-UP SHARE CAPITAL

Licensed activity	Minimum amount of paid-up share capital
Stock Broker	Kshs 50 million
Investment Bank	Kshs 250 million
Investment Adviser	Kshs 2.5 million
Fund Manager	Kshs 10 million

TABLE 2

REQUIRED LIQUID CAPITAL

Licensed activity	Minimum amount of required liquid capital
Stock Broker	Kshs 30 million
Investment Bank	Kshs 30 million
Investment Adviser	Kshs 1 million
Fund Manager	Kshs 5 million

SCHEDULE 2

HAIRCUT PERCENTAGES

ITEM	DESCRIPTION	HAIRCUT PERCENTAGE %
HAIRCUT PERCENTAGES FOR SHARES LISTED IN KENYA FOR THE PURPOSES OF THESE REGULATIONS		
1.	Shares which are listed on a licensed securities exchange	
(a)	being a constituent of the NSE20 Index	15
(b)	to the extent not already covered in paragraph (a), being a constituent of the NSE All Share Index and not suspended from trading	25
(c)	being any share not referred to in paragraph (a) or (b)	50
2. (a)	Shares which are listed on a licensed stock market but are not stratified according to stock indices	50
HAIRCUT PERCENTAGES FOR QUALIFYING DEBT SECURITIES, BY ISSUER OR GUARANTOR, ETC		

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Job name: (none)
Document name: (none)
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