

REVISED KASNEB STUDY TEXT

REGULATION OF FINANCIAL MARKETS STUDY TEXT

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REGULATION OF FINANCIAL MARKETS

STUDY TEXT

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PAPER NO.3 REGULATION OF FINANCIAL MARKETS

UNIT DESCRIPTION

This paper is intended to equip the candidate with knowledge, skills, understanding and attitudes that will enable him/her to comply with and implement the regulatory framework governing financial markets in practice.

LEARNING OUTCOMES

A candidate who passes this paper should be able to:

- Identify the key elements of the legal and regulatory framework relating to financial markets
- Demonstrate understanding of the licensing requirements of intermediaries in the financial market
- Relate with and enforce requirements of market regulators, the securities exchange and other financial market players
- Demonstrate an understanding of the processes and law on anti-money laundering and financing of Terrorism;
- Apply corporate governance principles in the management of market intermediaries

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CHAPTER ONE

INTRODUCTION TO LAW

NATURE PURPOSE AND CLASSIFICATION OF LAW

MEANING OF LAW, NATURE AND PURPOSE OF LAW

MEANING OF LAW

Law, simply put, refers to the set of rules which guide our conduct in the society and is enforceable by the state via public agencies.

Law in its general sense tends to be as a result of the necessary relations arising from the nature of things. In this sense all things have their laws. Humans, material world, superior beings and even animals all have their own laws. Simply put, the nature of these relationships tends to determine the nature of the laws.

But the intelligent world is far from being so well governed as the physical. This is because intelligent beings are of a finite nature, and consequently liable to error; and on the other, their nature requires them to be free agents. Hence, they do not steadily conform to their primitive laws.

Law in general is human reason, inasmuch as it governs all the inhabitants of the earth: the political and civil laws of each nation ought to be only the particular cases in which human reason is applied.

According to the oxford dictionaries law can be defined as; The system of rules which a particular country or community recognizes as regulating the actions of its members and which it may enforce by the imposition of penalties

NATURE OF LAW

The different schools of thought that have arisen are all endeavors of jurisprudence: Natural law school Positivism, realism among others. It is these schools of thoughts that have steered debates in parliaments, courts of law and others.

- **Natural law** theory asserts that there are laws that are immanent in nature, to which enacted laws should correspond as closely as possible. This view is

frequently summarized by the maxim: an unjust law is not a true law, in which 'unjust' is defined as contrary to natural law

- **Legal positivism** is the view that the law is defined by the social rules or practices that identify certain norms as laws
- **Legal realism**- it holds that the law should be understood as being determined by the actual practices of courts, law offices, and police stations, rather than as the rules and doctrines set forth in statutes or learned treatises. It had some affinities with the sociology of law.
- **Legal interpretivism**- is the view that law is not entirely based on social facts, but includes the morally best justification for the institutional facts and practices that we intuitively regard as legal.

Generally speaking law has the following characteristics

1. It is a set of rules.
2. It regulates the human conduct
3. It is created and maintained by the state.
4. It has certain amount of stability, fixity and uniformity.
5. It is backed by coercive authority.
6. Its violation leads to punishment.
7. It is the expression of the will of the people and is generally written down to give it definiteness.
8. It is related to the concept of 'sovereignty' which is the most important element of state.

FUNCTIONS/PURPOSES OF LAW

1. It promotes peaceful coexistence/ maintenance of law and order/ prevents anarchy
2. It is a standard setting and control mechanism. Law sets standards of behaviour and conduct in various areas such as manufacturing, construction, trade e.g. The law also acts as a control mechanism of the same behaviour
3. It protects rights and enforces duties by providing remedies whenever these rights or duties are not honoured.
4. Facilitating and effectuating private choice. It enables persons to make choices and gives them legal effect. This is best exemplified by the law of contracts, marriage and succession.
5. It resolves social conflicts. Since conflicts are inevitable, the rule of law facilitates their resolution by recognizing the conflicts and providing the necessary resolution mechanism.

6. It controls and structures public power. Rules of law govern various organs of
7. Government and confer upon them the powers exercisable by them. The law creates a limited Government. This promotes good governance, accountability and transparency. It facilitates justice in the society.

CLASSIFICATION OF LAW

Law may be classified as:

1. Written and Unwritten.
2. Municipal (National) and International.
3. Public and Private.
4. Substantive and Procedural.
5. Criminal and Civil.

Written law

This is codified law. These are rules that have been reduced to writing i.e. are contained in a formal document e.g. the Constitution of Kenya, Acts of Parliament, Delegated Legislation, International treaties etc.

Unwritten law

These are rules of law that are not contained in any formal document.

The existence of such rules must be proved. E.g. African Customary law, Islamic law, Common law, Equity, Case law e.t.c

Written law prevails over unwritten law.

Municipal/ national law

This refers to rules of law that are applicable within a particular country or state. This is state law.

It regulates the relations between citizens inter se (amongst themselves) as well as between the citizens and the state.

It originates from parliament, customary and religious practices.

International law

This is a body of rules that generally regulates the relations between countries or states and other international persons e.g. United Nations.

It originates from international treaties or conventions, general principles and customary practices of states.

Public law

It consists of those fields or branches of law in which the state has a direct interest as the sovereign.

It is concerned with the Constitution and functions of the various organizations of government including local authorities, their relations with each other and the citizenry.

Public law includes:

- Criminal Law
- Constitutional Law
- Administrative Law

Public Law asserts state sovereignty.

Private law

It consists of those branches of law in which the state has no direct interests as the state sovereign.

It is concerned with the legal relationships between persons in ordinary transaction e.g.

- Law of contract
- Law of property
- Law of succession
- Law of marriage
- Law of torts

Substantive law

It consists of the rules themselves as opposed to the procedure on how to apply them.

It defines the rights and duties of the parties and prescribes the remedies applicable.

Substantive law defines offences and prescribes the punishment, for example:

- The Law of torts
- The Law of succession
- The Law of contract
- The Law of marriage
- The Penal Code

Procedural law

This is adjectival law. It consists of the steps or guiding principles or rules of practice to be complied with in the administration of justice or in the application of substantive law. For example:

- The Civil Procedure Code
- The Criminal Procedure Code

Criminal law

This is the law of crimes. A **crime** is an act or mission committed or omitted in violation of public law e.g. murder, treason, theft, e.t.c. All crimes are created by parliament through statutes

A person who is alleged to have committed a crime is referred to as a **suspect**.

As a general rule, suspects are arrested by the state through the police at the instigation of the **complainant**. After the arrest, the suspect is charged in an independent and impartial court of law whereupon he becomes the **accused**.

Criminal cases are generally prosecuted by the state through the office of the Attorney General (AG) hence they are framed as R (the State) Vs Accused E.g. **R v Kamenchu**

Under the Constitution, an accused person is presumed innocent until proven or pleads guilty.

If the accused pleads not guilty, it is the duty of the prosecution to prove its case against him by adducing evidence i.e. the burden of proof in criminal cases is borne by the prosecution.

The standard of proof is beyond any reasonable doubt i.e. the court must be convinced that the accused committed the offence as charged.

In the event of reasonable doubt, the accused is acquitted. If the prosecution proves its case i.e. discharges the burden of proof, then the accused is convicted and sentenced.

The sentence may take the form of:-

1. Imprisonment
2. Fine
3. Probation
4. Corporal punishment
5. Capital punishment

6. Community service
7. Conditional or unconditional discharge

Under the Constitution, a person cannot be held guilty of an act or omission which was not a criminal offence on the date of omission or commission.

Civil law

It is concerned with the rights and duties of persons i.e. individuals and corporations. Branches of civil law include:-

- Law of contract
- Law of torts
- Law of property
- Law of marriage
- Law of succession

When a person's civil or private rights are violated, he is said to have a cause of action. Examples of causes of action:

- Breach of contract
- Defamation
- Assault
- Negligence
- Trespass to goods e.t.c

Causes of action are created by parliament through statutes as well as the common law and equity.

The violation of a person's civil rights precipitates a civil case or action. The person whose rights are allegedly violated sues the alleged wrongdoer hence civil cases are framed as ***Plaintiff v Defendant***.

It is the duty of the plaintiff to prove his allegations against the defendant. This means that the burden of proof is borne by the plaintiff. The standard of proof in civil cases is on a balance of probabilities or on a preponderance of probabilities i.e. the court must be satisfied that it is more probable than improbable than the plaintiff's allegations are true.

If the plaintiff proves his allegations by evidence, he wins the case and is awarded judgment which may take the form of:-

1. Damages (monetary compensation)

2. Injunction
3. Specific performance
4. Account
5. Tracing
6. Winding up a company
7. Appointment of receiver

Differences between civil wrong and crime

	CIVIL WRONG	CRIME
Definition	offence against another individual	Offence against the state
Purpose	To deal with the disputes between individuals, organizations, or between the two, in which compensation is awarded to the victim.	To maintain the stability of the state and society by punishing offenders and deterring them and others from offending.
Standard of proof	Claimant must produce evidence beyond the balance of probabilities.	Beyond reasonable doubt
Parties involved	The plaintiff, the party that is suing The defendant, the one being sued	Prosecution which represent the state and the accused
Burden of proof	Claimant must give proof however, the burden may shift to the defendant in situations of <i>Res Ipsa Loquitur</i> (The fact speaks for itself).	"Innocent until proven guilty": The prosecution must prove defendant guilty.
Type of punishment	Compensation (usually financial) for injuries or damages, or an injunction in nuisance.	A guilty defendant is subject to Custodial (imprisonment) or Noncustodial punishment (fines or community service). In exceptional cases, the death penalty.

The rule of law

The concept of the Rule of Law is a framework developed by Dicey on the basis of the English Legal system. It is also described as the due process.

According to Dicey, rule of law comprises three distinct conceptions namely:

1. **Absolute supremacy or predominance of regular law:** this means that all acts of The State are governed by law. It means that a person can only be punished for disobedience of the law and nothing else.

2. **Equality before the law:** this means equal subjection of all persons before the law. It means that no person is exempted from obeying the law. All classes of persons are subjected to the same judicial process regardless of their age, sex, creed, gender or race.
3. **The law (Constitution) is a consequence and not the source of rights:** means that the law is a manifestation of the will of the people.

Factors undermining rule of law

- Excessive power of the Executive
- Non - independent Judiciary
- Corruption
- Selective prosecution
- Civil unrest
- Ignorance of the law

PROFESSIONAL ETHICS AND THE LAW

Principles that have to be followed by a professional accountant include:

a) Integrity

It refers to the character of the accountant. The accountant should be one who is of unquestionable morals, honest, trustworthy and forthright.

b) Professional Independence

This refers to the ability of the accountant to do his work without following any instructions from the client or any other person for any reason.

The independence ensures that the accountant will be truthful and will carry out his duties in accordance with the dictates of the profession as opposed to personal whims.

c) Confidentiality

This is the duty of secrecy. It is the duty not to divulge to third parties any information that has been received by the accountant in his capacity as such or to use such information in any way for any other purpose without the consent of the client or express authority of the law.

d) Professional Competence