Legal Aspects of Promoting the Participation of Collective Investment Schemes in Eastern and Southern African Frontier Securities Markets

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DOI: https://doi.org/10.47772/IJRISS.2023.7410

Received: 21 January 2023; Revised: 18 March 2023; Accepted: 22 March 2023; Published: 26 April 2023

ABSTRACT

African Frontier Securities Markets (FSMs) suffer from low capitalization and inadequate liquidity. They are also perceived as risky and volatile and, as such, are not often included in international institutional portfolios. The central argument of this article is that, the capitalization and liquidity of African FSMs could possibly be enhanced by promoting formation, and participation of various styles of successful and vibrant Collective Investment Schemes (CISs)—more especially the open-ended CISs—which could provide a platform for participation of small investors in the domestic securities markets. Open-ended CISs could also increase the supply of securities to securities markets through further issues to the existing investors as well as the general public. Using the qualitative approach, the study assesses the regulatory and institutional framework for Collective Investment Schemes (CISs) so as to establish whether or not the said framework provides adequate incentives for the formation, and participation of various styles of CISs on domestic securities exchanges. The study employs the doctrinal, non-doctrinal and comparative approaches to examining the effectiveness of legal and regulatory rules. The main findings of the study were that: (a) the legal and regulatory framework permits the formation, and participation of various styles of CISs on domestic securities exchanges (b) both domestic and foreign CISs are permitted to participate on domestic securities exchanges (c) the domestic securities regulator has power to conduct continuous investor education (d) the participation of CISs on securities exchanges stimulates growth in liquidity, and accelerates the development of the exchange.

Key Words: Collective, Investment, Schemes, Frontier, Securities, Markets, Venture Capital Fund

INTRODUCTION

The article examines the Zambian regulatory and institutional framework for collective investment schemes (hereinafter ‘CISs’) so as to establish whether or not the said framework provides adequate incentives for the formation, and participation of various styles of CISs on Zambian securities exchanges. The article makes an international comparative analysis by discussing parallel developments in other common law jurisdictions in the Common Market for Eastern and Southern Africa (hereinafter ‘the COMESA region’).International comparatives are also drawn from the parallel developments which have taken place in England. The paper explores the possibility of using CISs as a vehicle for stimulating the growth ofthe liquidity of Frontier Securities Markets (hereinafter ‘FSMs’) in the COMESA region. As a possible way of putting the legal arguments, which have been made in this article, in proper socio-economic context, theoretical literature and empirical evidence on the constraints which affect the efficacy of the saidframe work in promoting the formation and growth of CISs are introduced.

The central argument of this article is that, the low capitalisation and inadequate liquidity of COMESA FSMs could be enhanced by promoting the formation and participation of vibrant and successful CISs on domestic securities exchanges. This argument is rationalised by view that the participation of CISs—especially open-ended investment companies—on domestic securities exchanges is likely to increase not only the supply of securities to securities markets in the event that they are subsequently listed, but also the demand for the listed securities through their investment in transferable listed securities. It is also argued that, the rise in supply and demand for securities is likely to enhance the capitalization and liquidity of COMESA FSMs. It is also argued that with the increase in the participation of foreign CISs in domestic securities exchanges, cross-border trade in securities in the region is likely to increase—a condition which is also critical to growth of liquidity of securities markets.[1]

BACKGROUND TO THE PROBLEM

African FSMs suffer from low capitalization and inadequate liquidity. They are also perceived as risky and volatile and, as such, are not often included in international institutional portfolios.[2]Since their formation in the early 1990s, most COMESA securities exchanges have relied on the privatization of state-owned enterprises (SOEs) as a source of listings.[3]Their other,albeit misguided, source of listings are cross-border cross-listings. The challenge with SOEs is that they bring along the poor culture of management which in most cases in the reason for their privatisation. Quite often, their maladministration, poor performance and bad books do not enhance the capitalization, and attractiveness of the listing securities exchange.[4] Elsewhere, the author has observed that cross-listings, in the cross-border sense, do not make any real addition to the capitalisation of the host securities exchange simply because the cross-listed securities are foreign assets on which the issuer's state has a primary tax claim.[5] Besides, the cross-listed issuers are foreign entities which pay their corporate tax to the home state.[6] Likewise, their capital is foreign capital which makes a real addition to the capitalisation of the primary exchange—the home exchange.[7] The poor issuer and investor participation which characterises the COMESA securities markets explains their low capitalisation, and inadequate liquidity. Consequently, in this article, the author argues that, the low capitalisation and inadequate liquidity of COMESA FSMs could be enhanced by promoting the formation and participation of vibrant and successful CISs on domestic securities exchanges. As noted earlier, this argument is rationalised by view that the participation of CISs—especially open-ended investment companies—on domestic securities exchanges is likely to increase not only the supply of securities to securities markets in the event that they are subsequently listed, but also the demand for the listed securities through their investment in the listed transferable securities.Against the background to problem which has been given above, the statement of the problem which is under investigation may be phrased as follows:

To what extent has the Zambian legal and regulatory framework for Collective Investment Schemes provided incentives for the formation, and participation of various styles of Collective Investment Schemes on domestic securities exchanges?

LITERATURE REVIEW

Very few studies have examined the role of Collective Investment Schemes (CISs) in the development of African securities exchanges. Even fewer studies have examined the said aspect in the Eastern and Southern African Region (the COMESA Region). And, only one study has examined the role of collective in promoting the participation of small and risk-averse investors on Zambia's Lusaka Securities Exchange (the LuSE). A report which was made by the United Nations Economic Commission for Africa (UNECA),[8] indicates that African securities exchanges, with the exception of South Africa's Johannesburg Securities Exchange (the JSE) are less capitalized as a percentage of the Gross Domestic Product (GDP) than the markets of comparable emerging economies. The UNECA Report indicates that transaction costs (brokerage fees, listing and other exchange fees, and clearing and settlement fees) are a major constraint on the development of African securities exchanges. In particular, the Report shows that while the transaction costs in African exchanges are well-over 1 per cent of the value of a trade, these costs are around 1 per cent in developing exchanges, and well-below 1 per cent in developed exchanges. The present study argues that the increased participation of CISs in African securities markets is likely to increase the number of trades and reduce the real frictional costs by spreading the fixed real costs over a large number of trades, and reduce the transaction costs. Walter's study examines the efficacy of the Collective Investment Scheme in maximizing investment returns.[9] The results of Walter's study show that the CIS has become a very important investment vehicle in South Africa because it is, among other things, transparent, liquid and easily accessible. Walter observes that the growing investor knowledge, good market returns and its suitability for market diversification (which minimizes risk) also contribute to its popularity in South Africa. The present study proposes that besides the implementation of remedial regulatory and institutional reform, the Zambian Securities Exchange Commission, and other regulators in the region, should embark on financial education of the general public, and publicity of the CIS as a possible way of popularizing the CIS as an investment vehicle.A study by the International Organization of Securities Commissions (IOSCO) examines the constraints on the growth of the mutual fund industry in emerging markets.[10] For the purposes of this study, the Emerging Market Committee of IOSCO distributed questionnaires to its membership which includes African emerging markets.[11] The main object of the survey was to make both quantitative and qualitative assessments of the growth and development of the mutual fund industry in emerging markets. The results of the study show that most African emerging securities markets are characterized by very poor participation of CISs. The results of the IOSCO study also show that African emerging markets such as Egypt, Nigeria, Kenya and South Africa have vibrant Venture Capital Funds (VCFs). The results of the IOSCO study provides the emerging markets with a basis of planning the areas of further study. One of the critical constraints on the growth of Frontier Markets (a sub-set of emerging markets), is the poor participation of institutional investors such as VCFs. The present study examines the possible ways of promoting the participation of foreign VCFs in domestic securities markets as way of increasing demand for the listed securities in Frontier Securities Markets in the COMESA Region. An earlier study which was conducted by Mwenda,[12] examines the legal aspects of using CISs to accommodate small and risk-averse investors on Zambia's LuSE. Mwenda's study examines the efficacy of the Zambian regulatory framework for CISs in promoting small investor participation on the LuSE.[13]Mwenda's study shows that the limited participation of the Zambian rural population on the LuSE is a constraint which affected the old regulatory framework in promoting the participation of small and risk-averse investors in CISs. The present study argues that effective general education, financial education and inclusion are likely to promote the participation of both the rural and the urban population on LuSE, and other securities exchanges in the region. The present study also complements Mwenda's study by examining other regulatory constraints such as the restrictive definition of 'Collective Investment Scheme'. The present study also examines the impact which the institutional constraints such as the limited participation of VCFs have on the growth of the participation of CISs in securities markets. It is noted that Mwenda's study examines the constraints which affect the demand for the listed securities and proposes remedial demand-side regulatory interventions. The present study examines both the regulatory and institutional constraints which affect he supply and demand for listed securities. In the present study, CISs (open-ended investment companies) are viewed as a possible vehicle through which the supply and demand for listed securities could be enhanced. The VCFs are viewed as a possible vehicle for enhancing demand for the listed securities. The approach of the present study is rationalized by the position that steady supply of securities to securities exchanges, and real demand for those securities are critical to the growth of liquidity—without which no securities exchange can develop.[14]

METHODOLOGY

This study falls into the qualitative research category. It focuses on answering specific questions which relate to the problem which is under investigation by using both primary and secondary data. The research is underpinned by the doctrinal, the non-doctrinal and the comparative approach to examining the effectiveness of the regulatory and institutional framework which governs the participation of Collective

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VII Issue IV April 2023

Investment Schemes in Zambian securities markets. By the doctrinal approach the author gives a descriptive exposition of the applicable legal rules, and offers a complete statement of the law were applicable.[15] By the non-doctrinal approach, the author identifies the legal problem, analyses it and proposes remedial changes to the regulatory and the institutional framework which governs the participation of CISs in securities markets in Zambia.[16] By the comparative approach, the author examines how different legal systems and cultures have ensured the effective participation of CISs in the domestic securities markets.[17] These three methods were used in analysing both primary and secondary data. Primary sources of data such as relevant legislation and case law which relate to the subject/problem which is under investigation were used.

For the purpose of collecting primary data, random interviews were conducted with five hundred (500) individuals (potential securities market investors) who were drawn from four provinces of the Republic of Zambia, namely, the Lusaka, Central, Copper-belt and North Western provinces.Secondary sources of information such as journals and other written commentaries on the primary sources were also used. A checklist of documentary sources was used, as well. And, as a possible way of avoiding subjectivity in the selection of documentary sources, the study employed non-probability sampling method—purposive sampling. Both primary and secondary sources of data were used as aids to drawing inferences, making deductions and comparisons.

The main objective of the study is to answer the question whether or not the regulatory and institutional framework for Collective Investment Schemes (CISs) provides adequate incentives for the formation, and participation of different styles of CISs on Zambian securities exchanges. The study fleshes out some shortcomings in the said framework, and makes necessary proposals for remedial reform.

The research questions which were used are:

1. To what extent does the law and policy permit the formation of various types of Collective Investment Schemes?
2. To what extent does the law permit the participation of domestic Collective Investment Schemes on domestic securities exchanges?
3. What is law and policy on the participation of foreign Collective Investment Schemes on domestic securities exchanges?
4. To what extent does the law and policy empower the domestic securities markets regulator to conduct continuous investor education?

RESULTS OF THE STUDY

The results of the study are presented in tabular form as shown below.

Question	**Findings**	
	Domestic Law	**International Best Practice**
1. Does the law and policy permit the formation of various types of Collective Investment Schemes?	YES	YES
2. Does the law permit the participation of domestic Collective Investment Schemes on domestic securities exchanges?	YES	YES
3. Does the law and policy permit the participation of foreign Collective Investment Schemes on domestic securities exchanges?	YES	YES
4. Does the law and policy empower the domestic securities markets regulator to conduct continuous investor education?	YES	YES

AN OVERVIEW OF FRONTIER SECURITIES MARKETS IN AFRICA

Frontier Securities Markets (FSMs) are characterized by low capitalization and inadequate liquidity.[18] FSMs are also perceived as risky and volatile.[19]As a result, they are often excluded from international institutional portfolios. However, in the last two decades, their performance has been impressive so much so that they can no longer be ignored nor continue to be treated as an insignificant part of the investment universe.[20] FSMs constitute a segment of the global equity market which is missing in institutional portfolios. [21] From a developmental perspective, these markets represent developing countries which boast high economic growth rates. Although these markets are in their infancy, and are often small and relatively illiquid,[22]they have attracted the attention of the investing community due to their growth potential, and the opportunities for international portfolio diversification which they present.[23]As Oey observes:

[Although] frontier markets represent a tiny segment of the investment universe, interest in this assets class has been growing as investors search further afield for better growth opportunities and pursue new ways to diversify their portfolios…One of the main reasons frontier market equities, a very tiny and relatively inaccessible asset class, are gaining interest among certain investors [is] their outperformance versus emerging markets… This is often attributed to frontier markets' rosier growth outlook relative to emerging markets, especially as larger economies such as China, Brazil and Russia have begun to slow.[24]

The Geographical Distribution of Frontier Securities Markets (FSMs).

The object of this section is to put the legal arguments which have been made in this article in proper socio-economic context. This is achieved by introducing empirical evidence on the geographical distribution of FSMs around the globe, in Africa and the COMESA region.

Based on the indexes which have been developed by Financial Times Stock Markets, Morgan Stanley Capital International, Russell Investments, Standards and Poors, and Dow Jones, FSMs are geographically distributed all over the world as shown in Table 1 below.

TABLE 1: Geographical Distribution of Frontier Stock Markets.

EUROPE	AFRICA	MIDDLE EAST	ASIA	AMERICAS
Romania	Zambia	Qatar	Bangladesh	Argentina
Malta	Kenya	Jordan	Pakistan	Ecuador
Serbia	Mauritius	Kuwait	Sri Lanka	Jamaica
Ukraine	Ghana	United Arab Emirates	Vietnam	Trinidad
Bulgaria	Morocco	Bahrain		
Croatia	Nigeria	Oman		
Cyprus	Tunisia	Lebanon		
Estonia	Botswana			
Lithuania	Cote d'Ivoire			
Kazakhstan	Namibia			
Slovakia	Tanzania			
Macedonia				
Slovenia				

Source: Financial Times Stock Exchange (2014), Morgan Stanley (2013), Standards and Poors (2011), Dow Jones (2011) and Russell Investments (2013).

Table 2 below gives the distribution of frontier securities markets in COMESA and SADC regions.

TABLE 2: Distribution of Frontier Markets in COMESA and SADC Region

COUNTRY	REGIONAL BLOCK
Zambia	COMESA/SADC
Kenya	COMESA/EAC[25]
Mauritius	COMESA/SADC
Egypt	COMESA
Namibia	SADC
Botswana	SADC
Tanzania	SADC/EAC

Source: Collected from Table 1 above.

Table 2 above, shows that Eastern and Southern Africa is home to most of Africa's FSMs. With respect to this wealth of FSMs in the region, the author has argued elsewhere that:

[T]his positive feature makes the region even more attractive to emerging and developed market investors who are looking to the African side of the frontier universe for international portfolio diversification purposes. The promotion of cross-listings between these markets and the smaller markets in the region is likely to enhance the liquidity of those smaller markets, and increase cross-border trade in securities in the region.[26]

EMPIRICAL EVIDENCE ON THE RELATIONSHIP BETWEEN COLLECTIVE INVESTMENT SCHEMES AND SECURITIES MARKET PERFORMANCE

Empirical evidence shows that the participation of CISs on securities exchanges contributes to growth and development of securities markets, and the Gross Domestic Product.[27] There is also a positive relationship between the performance of the listed CISs and the performance of the securities exchange on which they are listed.[28]

CONSTRAINTS AFFECTING THE EFFICACY OF THE LEGAL FRAMEWORK TO PROMOTE GROWTH OF COLLECTIVE INVESTMENT SCHEMES

This subsection introduces empirical evidence on some of the constraints which affect the efficacy of the regulatory and institutional framework for CISs in promotingthe formation and success of CIS in Zambia. This puts the legal arguments which have been made in this study in proper socio-economic context.

One of the major constraints which affects the formation and success of CIS in Zambia and other jurisdictions in region is the poor financial education and literacy which exists among the potential securities-market investors.

Constraints relating to Limited Financial Education on the part of the Investing Public

For the purpose of collecting primary data, random interviews were conducted with five hundred (500) individuals who were drawn from four provinces of the Republic of Zambia, namely, the Lusaka, Central, Copper-belt and North Western provinces. The respondents were asked whether or not they knew a stock exchange existed in Zambia and what kind of financial products could possibly be purchased from the exchange. Three hundred and fifteen (315) of the respondents indicated that they did not know what a stock exchange was and whether or not one existed in Zambia let alone what sort of financial products could be bought on it. One hundred and eighty-five (185) of the respondents stated that they knew a stock exchange existed in Zambia. Out of the 185 respondents who said they knew a stock exchange existed in Zambia, fifty-five (55) indicated that they did not know what sought of financial products could be purchased on the Zambian stock exchange. Thirty-nine (39) indicated that 'shares' could be bought on the stock exchange while ten (10) indicated 'bonds and stock' could be bought alongside shares. The 185 respondents who indicated that they knew a stock exchange existed in Zambia were also asked if they had ever bought securities on the LuSE or indeed any other exchange in other jurisdictions within the COMESA region. Four hundred and sixty-three (463) of the respondents indicated that they had not purchased shares on the Zambian stock exchange while thirty-seven (37) indicated that they had done so. All the respondents who indicated that they had purchased securities on the Zambian exchange indicated that they had not purchased any securities on foreign securities exchanges within the COMESA region. Out of the 463 respondents who had indicated that they had not purchased any securities on the Zambian securities exchange, three hundred and twelve (312) attributed their situation to lack of knowledge on the existence a stock exchange in Zambia. Out of 312 respondents who attributed their absence on the LuSE to ignorance about the existence of the exchange, one hundred and eight (108) indicated that even they knew a stock exchange existed in Zambia,they would probably not invest in securities on the exchange as they did not earn enough money to save for such investment.

Subject to the limitations which are inherent in the small sample size, the general conclusion which has been drawnby the researcher from the results of the study is that the retail/small investors do not have enough knowledge on the existence of the LuSE and the nature of its business and financial products which could possibly be purchased on it. As a possible way of enhancing retail/small-investor as well as institutional-investorparticipation in securities markets in the region, it is proposed that the domestic securities exchange commissions be encouraged to embark on financial education of the general public—and not just the investing public.[29]It is recommended that the domestic securities markets regulators be encouraged to cooperate with foreign regulators as they deliver financial education and literacy to the general public.[30] As noted earlier, enhanced financial education and literacy on the part of the general public is likely to encourage retail/small and institutional investors alike, to participate in domestic and foreign securities markets. This proposal is informed by the findings of an empirical study, which was conducted in Kenya by Kisala and Kimani, which indicate that poor investor education has been a major constraint on the growth and success of Collective Investment Schemes, and the attainment of meaningful financial inclusion in Kenya.[31] On the importance of financial education and literacy to securities market participation and development, El-Wassal explains that:

Poor understanding of issues on the part of the public discourages potential investors from participation in stock markets…The propensity to invest in shares rises with the level of education.[32] That is, a higher level of education increases confidence in stock markets by contributing to a higher level of knowledge concerning financial activities. Without an educated public which understands the fundamental rules, benefits, and potential pitfalls of participating in financial investment, stock markets may not be able to develop.[33]

Sound financial education and literacy have also the potential to deter securities market misconduct and enhance investor confidence. As Hogarth explains, 'well-informed and educated financial consumers lead to better financial markets where rogue products are forced from the marketplace and confidence is raised'.[34]

Particularly, in Zambia where one hundred and eight (108) out of the four hundred and sixty-three (463) respondents who had indicated that they had not participated on the LuSE or any other securities exchange in the region on account of low income, emphasis should be placed—among other possible solutions—on long-term saving for investment.

Empirical Evidence on the Positive Relationship between Financial Literacy and Investor Stock Market Participation

An empirical study which was conducted by Rooij, Lusardi and Alessie investigated the relationship between financial literacy and investor stock market participation.[35] Among other findings, the results of the study show an independent effect of financial literacy on securities market participation. In particular, the results of the study show that those who have low financial literacy are significantly less likely to invest in stocks.[36]

Constraints Relating to Financial Exclusion of the Youths and the Women—The Population of Zambia and Financial Inclusion/Exclusion.

As at 14th September, 2020, the population of Zambia was estimated at 18, 383, 955 people.[37] The population of Zambia is equivalent to 0.24 per cent (0.24%) of the total world population.[38] The median age in Zambia is 17.6 years.[39] From the said population, 78 per cent (78%) are aged 16-45 years.[40] Sixty per cent (60%) of the Zambia's population are aged between 16-35 years.[41]The statistics also show that sixty two (62%) of the population of Zambia are financially excluded.[42] Thus, only forty eight per cent (48% of the population is financially included.[43] From the excluded population, fifty two per cent (52%) are female while forty eight per cent (48%) are male.[44]

Some proposals for the acceleration of financial education and inclusion.

As a possible way of increasing investor participation in domestic securities markets, it is proposed that SECs within the COMESA Region embark on financial education of the general public. In jurisdictions which have the Twin-peak or Triple-Pick Regulatory Models, the Banking and Financial Sector regulator and supervisor(s) should complement the efforts of the SEC in administering and ensuring financial education and inclusion.[45]Such efforts should not be confined to the investing public.[46] Particularly in Zambia where non-participation is partly attributed to low income and irregular payment of pensions, emphasis should be placed on prompt payment of pensions and long-term saving for investment.[47]Also, particular attention should be paid to financial education and inclusion of women and young adults. Further, financial education programs should be incorporated in the curriculum of secondary schools, colleges and university so that young people embrace the culture of saving and investment from an early age. The proposals for policy reform which we have made above are in line with the National Financial Education Strategy II (NFES II) of the Government of the Republic of Zambia.[48] In the said Strategy, the Zambian Government aims to accelerate financial education by targeting the following groups:[49]

i) Children;

ii) Youths;

iii) Adults;

iv) All age groups; and

v) Small and Medium scale Enterprises (SMEs);

The Ministry of General Education and the Curriculum Development Centre have collaborated in incorporating financial education in the curriculum for primary and secondary schools (from grades 1 to 12). The author argues that such a policy is likely to enhance financial education of the Zambian population and accelerate financial inclusion. It is argued further that meaningful financial inclusion and education are likely to promote issuers and investor participation in financial markets. The author also argues that sound financial education of SMEs is likely to promote the formation of collective investment schemes (CISs), and accelerate the development of the LuSE Alternative Investment Market.[50] However, one of the major constraints on effective implementation of the NFES II is erratic funding.[51] It is also observed that although the NFES II targets the children and youths, it does not have a deliberate focus on financial inclusion of girls and women. A deliberate policy on women is important because, as empirical evidence indicates, girls and women outnumber boys and men in Zambia. Also, girls and women are more excluded from the financial services sector than boys and men. It is therefore strongly recommended that the Zambian Government increases funding to NFES II. It is also strongly recommended that deliberate focus on the inclusion of girls and women be introduced in the NFES II.

THE ZAMBIAN REGULATORY FRAMEWORK FOR COLLECTIVE INVESTMENT SCHEMES

Zambia is simply selected as a case study, here. In order to put the examination of the efficacy of the Zambian regulatory and institutional framework in promoting the formation, and participation of CISs on Zambian securities exchanges in proper perspective, international comparatives are also given.

Currently, there are seven CISs which have been authorized to operate in Zambia.[52]Although all CISs can be loosely defined as pools of assets in which investors share in the results of a specific portfolio, the legal forms of CIS differ.[53] There are three basic legal forms which a CIS could possibly take, namely:[54]

i) The corporate form where the CIS is a separate corporate entity and the investors are shareholders;

ii) The trust form where the CIS is organised as a ‘trust’;[55]

iii) The contractual form, which is arrangement under which the investment manager invests funds on behalf of the final investor.

Some countries restrict the formation of CISs to one legal form for collective investments, while others allow the use of more than one form.[56]

The Zambian Legal Framework for Regulation of Collective Investment Funds as a Case Study

The Zambian Securities Act 2016 defines a collective investment scheme as a scheme in whatever form, which includes an open-ended investment company, where members of the public are invited or permitted to invest money or other assets in a portfolio.[57] The terms of investing in a CIS are as follows:

1. two or more investors contribute money or other assets to, and hold a participatory interest in a portfolio of the scheme through shares, units or other form of participatory interest;[58] and
2. the investors share the risk and the benefit of investment in proportion to their participatory interest in which they hold in the portfolio of the scheme or other property as may be specified in the trust deed. [59]

Thus, in Zambia, a CIS could take the form of a trust, or an investment company or indeed a contract. Under the trust structure, a CIS could assume the form of a unit trust.The following segments discuss the nature of these forms of CIS in brief.

Unit Trusts

Unit Trust means 'any scheme or arrangement in the nature of a trust where members of the public are invited or permitted, as beneficiaries under the trust, to acquire an interest or undivided share in one or more groups or blocks of specified securities and to participate proportionately in the income or profits which may be generated under the trust'.[60]

Investment Companies

Under the corporate structure, the scheme may take any of the following forms, namely:

i) investment company; or

ii) a closed-ended investment company; or

iii) an open-ended company.

An investment company is 'a company which has, as its purpose, the investment of its funds with the aim of spreading the investment risk and giving its members the benefit of the results of the management of those funds by or on behalf of the company'.[61]An open-ended investment company is 'an investment company whose articles of association authorise the acquisition of its own shares which are structured in such a way that the company is permitted toissue different classes of shares to investors.[62] In an open-ended investment company, each class of issued shares represents a separate portfolio which has a distinct investment policy'.[63] A closed-ended investment company is the obverse of an open-ended investment company. This form of a CIS does not allow the company to purchaseits own share or interests.[64] Besides, a closed-ended investment company does not allow the issueof securities to the existing shareholders or the investing public.

The Contractual Structure of a Collective Investment Scheme

Under the contractual structure, a CIS could take the form of a bond scheme. A bond scheme is a 'scheme whose primary objective is to invest in debt securities which have a remaining term to maturity of one year or more'.[65]

The Open-ended Investment Company as the possible Vehicle for Stimulating Growth in Securities Market Activity

As noted earlier in this article, all the CISs which have been authorized to operate in Zambia are currently operating as unit trusts. Therefore, this segment argues that the formation, and participation of CISs in the form of open-ended investment companies on securities markets in Zambia, and within the COMESA region is likely to increase the supply of securities, and demand as small investors come on board. It is also likely to enhance general trading activity and, enhance the liquidity of the underlying securities markets.

It is worth noting that an open-ended investment company has two attractive features which are likely to stimulate growth in securities market activity, namely:

1. the acquisition of its own securities; and
2. further issues of securities to the existing shareholders, and the investing public.

What could be collected from the foregoing is that open-ended investment companies enhance the supply of securities to securities markets through further-issues of securities to the existing shareholders and the investing public. Also, this investment vehicle increases demand for the listed securities by providing an investment platform to small investors. The positive shifts in the demand and supply of securities is what is likely to stimulate growth in the liquidity of securities markets.[66] Also, the increase in trading activity—actual and potential orders and executed orders—which would come with the participation of numerous small investors is likely to reducethe real frictional costs by spreading the fixed real costs over more trades. Provided the regulatory and institutional framework is so efficient as to ensure the immediate execution of trades, it could be argued that the enhanced breadth and depth, and the reduced transaction costs which come with increased market activity are likely to enhance the liquidity of the underlying securities markets, and accelerate their development. As Mwenda explains:

Firstly, liquidity refers to "a market's ability to provide immediate execution for an incoming market order (often called 'immediacy') and the ability to execute small market orders without large changes in the market price (often called 'market depth' or 'resiliency')."[67]These simple definitions of market liquidity reflect two dimensions of a desired transaction – namely, speed (transaction time) and price (transaction cost). The speed dimension involves the timeliness of liquidity. Based on this dimension, the liquidity of a stock issue means that transactions of its shares are immediately available. Yet, demanders of immediacy can usually get rapid trade execution if they are willing to incur inferior trading terms. Therefore, the second dimension of a liquidity market is achieving immediacy at minimal cost."[68] It must be observed, however, that liquidity, like market depth, ultimately affects the success or failure of a stock market.[69]

Some Constraints on the Formation of Open-Ended Investment Companies in Zambia

Although the Securities Act defines an open-ended investment company as 'a company whose articles of association allow the acquisition of its own shares or interests, it does not regulate the formation of companies. The formation of companies, the types of companies which could be incorporated, the powers and constitution of companies and their winding up are governed by a separate Act of Parliament—the Companies Act 2017. The objective of the Securities Act is to [effectively and efficiently] regulate the issue of securities by the companies, once they are formed. Thus, the Securities Act takes the listed companies as they are. Consequently, the Securities and Exchange Commission or the listing securities exchange will not register or admit any entity, as 'a company', to its Official List if that entity does not meet the criterion which is provided by the Companies Act for the formation and operation of companies.

Constraints on the formation of open-ended investment companies under the Companies Act of 1994

With respect to acquisition of own shares and interests which the Securities Act permits, the Zambian Companies Act 1994 prohibited such capital adjustment techniques.[70] To this end, the Companies Act 1994 provided as follows:

46. (1) Except as provided in this section, a company shall not be a member of itself or of a body corporate which is its holding company.

(2) A company may, in the capacity of personal representative or trustee, be a member of itself or a body corporate which is its holding company unless it or the holding company or a subsidiary of either of them has a beneficial interest in the membership.

(3) A company may be a member of itself or a body corporate which is its holding company by way of security for the purposes of a transaction entered into in the ordinary course of a business which includes the lending of money, but in that case shall have no right to vote at meetings of the holding company or of any class of members thereof.

Thus, under the 1994 regulatory framework, a company could not allot its own securities to itself nor acquire them from existing shareholders. However, a company could hold its own securities in the capacity of personal representative or trustee or collateral taker for the monies it may have lent out. Arguendo, even if the Articles of Association of an open-ended investment company permittedthe acquisition, and holding of own shares, the Articleswould have been void to the extent to which they were inconsistent with the Companies Act 1994.[71]

The March Towards Financial Inclusion of Small Investors: Purchase of own shares by Listed Issuers under the Zambian Companies Act 2017

A Collective Investment Scheme (CIS) which operates as a private company (unlisted) may by way of special resolution acquire fully-paid shares from its shareholders.[72] Similarly, a CIS which operates as a listed public company may by way of a decision of its Board of Directors acquire its own shares from its shareholders.[73] Shares which are acquired by the company may be cancelled, or held by the company if so authorized by its the articles.[74] Share which are acquired by a company, whether they are held by the company or cancelled thereafter, may be reissued by the company.[75]An argument is made that these positive features in the new regulatory framework,[76] are not only likely to increase the capitalization of the LuSE, but also the supply and demand for listed securities. An argument is also made that the increasing trading activity is, in turn, likely to stimulate growth in the liquidity of the LuSE by reducing the real frictional costs as the fixed real costs get spread over a large number of trades.[77]

Purchase of own shares by Listed Issuers in England

As a possible way of promoting the participation, and growth of CIS and overall success of securities markets—especially the Alternative Investment Market—in England, a listed company may purchase its own shares provided three conditions are met, namely:[78]

i) a limited company makes a purchase of its own shares in accordance with Chapter 4 of the English Companies Act 2006;

ii) the purchase is made out of distributable profits; and

iii) the shares are qualifying shares.[79]

It is submitted that this positive feature in the English regulatory framework, is likely to encourage formation, and success of open-ended investment companies as they participate in securities markets. Such a progressive feature is also likely to stimulate the growth of liquidity through increased trading activity in the main market or the Alternative Investment Market. It is submitted that the introduction of such a positive feature in the regulatory frameworks of other COMESA jurisdictions is likely to accelerate the growth of the Alternative Investment Markets which are regarded as a viable vehicle through which the capitalization and liquidity of African frontier securities markets could be improved.[80]

Authorization of Collective Investment Schemes

The Zambian Securities and Exchange Commission has power to authorize the establishment of CISs on the application of a dealer or an investment advisor.[81] It is an offence to enter into or offer to enter into an agreement for the acquisition or disposition of shares or units or securities in a CIS which is unauthorized.[82] Any person who is found guilty of promoting or inviting members of the public to participate in an unauthorized CIS is liable to a fine which does not exceed five hundred thousand penalty units or to imprisonment for a term which does not exceed five years or to both.[83]

The Authorization of Foreign Collective Investment Schemes

The Zambian regulatory framework also allows the participation of foreign CISs in domestic securities exchanges.[84] Currently, there are three foreign CISs which are authorised to operate in Zambia.[85] An argument is made that the admission of foreign CISsin the form of mutual funds and venture capital funds is likely to stimulate the growth ofthe liquidity of the LuSE. Further, when mutual funds and venture capital funds are listed, and their securities are traded on the LuSE, the increasing foreign trades are likely to sustain the improvement in the liquidity of the LuSE which may be recorded.[86]As Ding, Nilsson and Suardi observe:

There are two primary mechanisms through which foreign institutional investors can affect market liquidity: (1) by changing the level of trading activity on the market and (2) by altering the information environment on the market. Stoll,[87] refers to the former mechanism as a real frictions effect and to the latter as an informational frictions effect. The presence of foreign institutional investors can affect the real friction component of liquidity by changing the level of trading activity in the market. In particular, if participation by foreign institutional investors elicits more trade, the increase in trading activity will reduce real friction costs by spreading fixed real costs over more trades.[88]

With regard to the informational friction component of liquidity, a common argument is that foreign institutional investors are better informed and as such, are regarded as informed traders. Thus argument is rationalized by the view that market makers are concerned about the potential losses of trading against informed traders. Thus, market makers tend to increase their spreads (an adverse selection effect). In this context, Stulz,[89] argues that liquidity in domestic financial markets is likely to improve as a result of the better information disclosure and higher trading activity which are engendered by the participation of international financial institutions. When better and more relevant information is reflected in prices, market makers are likely to decrease their spreads due to the lower price uncertainty (a price discovery effect).[90]

However, as observed earlier in this article, without a corresponding improvement in investor education and financial literacy, as proposed above, the increased participation of domestic and foreign CISs in securities markets is likely to have limited success in stimulating the growth of liquidity in COMESA Frontier Securities Markets.

CONCLUSION

This article has examined the Zambian regulatory and institutional framework for collective investment schemes so as to establish whether or not the said framework provides adequate incentives for the formation, and participation of various styles of CISs on Zambian securities exchanges. The general conclusion which has been reached in this article is that, in line with international best practice, the said framework provides adequate incentives for the formation, and participation of various styles of CISs on Zambian securities exchanges. It was noted that both domestic and foreign CISs are allowed to participate on Zambian securities exchanges. It was also noted that, in Zambia, CISs could take the form of a company, a unit trust or a contract whereby the manager of the CIS invests the funds on behalf of the final investor. It was noted that although, the framework permits a variety of forms, all the CISs which are currently operating on the Lusaka Securities Exchange are unit trusts. It was noted further that COMESA Frontier Securities Markets (FSMs) are characterised by low capitalized and inadequate liquidity. A central argument was made that the capitalization and liquidity of COMESA FSMs could be enhanced by promoting the participation of CISs especially open-ended CISs. It was also argued that, the positive feature which have been included in the Zambian regulatory framework whereby listed CISs could acquire their own shares and reissue the acquired shares, and make fresh issue of securities to the existing shareholders and the investing public is likely to increase the demand and supply of securities to the LuSE. A corollary argument was made that the high trading activity which would come with the increased participation of CISs in domestic securities exchanges is likely to enhance the liquidity of the securities markets by reducing the real frictional costs as the real fixed costs get spread over a large number of trades. It was recommended that the efficacy of the remedial legislative and policy reforms (which has been proposed in this article) be enhanced by continuous investor-financial-education and inclusion.

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FOOT NIOTES

[1] See, Samamba, L.T. (2020). Legal Aspects of Cross-border Trade in Securities: The Case of Eastern and Southern Africa (PhD Thesis, The University of Lusaka), [Samamba, L.T., I]; Wolburgh, S. (2007). Commentary on a Blueprint for Cross-border Access to U.S. Investors: A New International Framework. Harvard International Trade Law Journal, 48:1, 69-83.

[2] Samamba, L.T., I, *op.cit*

[3] Samamba, L.T. (2023). Legal Aspects of Securities Exchange Listing—The Case for African Securities Exchanges and the Alternative Investment Market. Int'l J. Res. &Innov. Soc. Sci. VII, II, 538-565 [Samamba, L.T., II]

[4] Elsewhere, the author has argued that unless a good culture of corporate governance is instilled in state-owned enterprises (SOEs), the heavy reliance on SOEs as a source of listings will only have limited success in enhancing the capitalization of domestic securities exchanges. The author argues further that a successful and vibrant Alternative Investment Market could in some cases serve as a valuable source of listings for the securities exchange as the growth-entities migrate to the Main List: See, Samamba, L.T., II, *op.cit*

[5] A foreign investor who holds the cross-listed securities will not pay property transfer tax to the home state, and where such an obligation arises, the Double Taxation Agreements which may exist between the home state and the host state often negate it: See, Samamba, L.T., II, *op.cit*

[6] Samamba, L.T., II, *op.cit*

[7] *ibid*

[8] United Nations Economic Commission for Africa. (2020). Tapping into the Potential of African Markets. in United Nations Economic Commission for Africa. (2020). 2020 Economic Report on Africa—Innovative Finance for Private Sector Development in Africa. New York. UNECA 2020. 1-24.

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ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VII Issue IV April 2023

[13] The Securities Act 1993 which was examined in 1999 was repealed in 2016 by the Securities Act 2016: See, Zambian Securities Act 2016, s 222

[14] Balogun et al, observe that for the securities exchange to contribute to economic development, its capitalization must grow to about the size of the national economy: Balogun, W.O., Dahalan, J.B. & Hassan, S.B. (2016). Long-Term Effects of Liquidity on Stock Market Development. J. Econ. &Sust. Dev. 7:4, 26-46; See also, Samamba, L.T., II, *op.cit*

[15] For a detailed discussion of this approach, see, Salter, M. & Mason, J. (2007). Writing Law Dissertations: An Introduction and Guide to the Conduct of Legal Research. Essex. Pearson Education Limited.

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[18] Samamba, L.T., I, *op.cit*

[19] *ibid*

[20] *ibid*, at 38

[21] Financial Times Stock Exchange & Russell. (2014). Frontier Markets: Accessing the Next Frontier. 2

[22] *ibid*

[23] Financial Times Stock Exchange-Russel, 2,

[24] Oey, P. (2014). Frontier Markets Begin to Emerge. 17 December, 2014, *Morningstar* (London, 17 December 2014), 2-5

[25] ‘EAC’ stands for the East African Community.

[26] Samamba L.T., I, at 42, 43, *op.cit*

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[29] The Zambian SEC has statutory mandate to "provide, promote or otherwise support financial education, awareness, and confidence with regard to financial products, institutions and services: Zambian Securities Act 2016, s 9(2)(r). Although the Securities Act 2016 does not define 'financial education', the Standing Committee for Commercial and Economic Cooperation of the Capital Market Regulators Forum (COMCEC Capital Market Regulators Forum), defines 'financial education' as "the process by which financial consumers/ investors improve their understanding of financial products and concepts and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being. Although the term 'financial education is often used interchangeably with terms such as 'financial literacy' and 'financial capability', it is distinct from the two terms. 'Financial literacy' is "means different things to different people, and this is reflected most clearly in the many definitions which are used in the literature. For some it is quite a broad concept, encompassing an understanding of economics and how household decisions are affected by economic conditions and circumstances. For others, it focuses quite narrowly on basic money management: budgeting, saving, investing and insuring. 'Financial capability' a set of financial knowledge, skills, and behaviours among individuals: COMCEC Capital Market Regulators Forum. Report of the 2nd COMCEC Capital Market Regulators Forum 2013 (Enhancing Financial Literacy in Capital Markets, Instanbul, 19 September, 2013) 5 <http://www.comceccmr.org/media/10033/comcec_2ndcmrforumreport.pdf> accessed 17 November 2022.

[30] COMESA states are under an obligation to cooperate with one another in creating an enabling environment for foreign and cross-border trade in securities: COMESA Treaty 1993, Art. 3(c). In order to create such an enabling environment, COMESA states are also obligated to establish domestic securities exchanges and encourage the formation of domestic and regional associations of those exchanges: COMESA Treaty 1993, Art. 80(b). COMESA states are under a further obligation to encourage their citizens and residents to participate in domestic and foreign securities markets: COMESA Treaty 1993, Art. 81(b)(c). The author argues here that a possible way of encouraging citizens and residents to participate in domestic and foreign securities markets is the delivery of financial education and literacy to the general public, especially the investing community. As a possible way of complementing the efforts of the domestic securities market regulatory authorities, it is proposed that the domestic governments incorporate financialeducation into the general and tertiary education curricula.

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[37] The United Nations. (2020). Zambia Demographics 2020: Population, Age, Sex and other trends. 1-120

[38]*ibid*

[39] *ibid*

[40] Chileshe C. (2020). A Review of Financial Inclusion in Zambia. 1-20.

[41]*ibid*

[42]*ibid*. See also, Fin Scope Zambia Survey 2015.

[43]*ibid*

[44] *ibid*. According to a World Bank Report, 63 per cent (63%) of the female population are excluded while only fifty-seven percent (57%) of the male population is excluded: The World Bank. (2017). Zambia: Enhancing Financial Capability. 1-127), [World Bank Financial Capability Report 2017].

[45] In a Twin-Peak Model of financial services regulation, a central authority, usually the Central Bank, regulates the banking and financial services, and the securities services segments. The insurance and pensions segments are regulated by the Pensions and Insurance Authority: See, Mwenda, K.K. (2006). Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator. Washington DC. The World Bank. In Zambia, the Triple-Peak Model is in force. In this model, the Bank of Zambia regulates the banking and financial services segment of the financial services industry, while the Securities and Exchange Commission regulates capital (securities markets). The pensions and insurance segment of the financial services industry is regulated by the Pensions and Insurance Authority: *ibid*; See, Zambian Constitution 1991/2016, art 213(1)(2)(c); Bank of Zambia Act 2022; Banking and Financial Services Act 2017; Zambian Securities Act 2016, s 9; Pensions Scheme Regulation Act 1996 (as amended by Act No. 27 of 2005); Insurance Act 2021, Part II; Abrams, R.K. and Taylor, M.W. (2000). Issue in the Unification of Financial Sector Supervision. Washington DC. International Monetary Fund. IMF Working Paper WP/00/213, 1-34.

[46] The Zambian SEC has statutory mandate to "provide, promote or otherwise support financial education, awareness, and confidence with regard to financial products, institutions and services: Zambian Securities Act 2016, s 9(2)(r).

[47] See, Samamba, L.T. I, at 290-299, *op.cit*; See also, section 7.0. above

[48] Government of the Republic of Zambia, Ministry of Finance, 'The National Strategy on Financial Education in Zambia 2019-2024, (NSFE II).

[49] *ibid*

[50] For the role of alternative investment markets in accelerating stock market development see, Samamba Lennox Trivedi, 'Promoting Success of African Securities Markets through the Alternative Investment Markets' (2020) International Political Economy: Investment & Finance eJournal; DOI: 10.2139/ssrn.3497846; Corpus ID: 219372665.

[51] *ibid*

[52] (1) African Banking Corporation Unit Trust (which is managed by African Banking Corporation Investment Services Limited), (2)Mpile Unit Trust Umbrella Fund (which is managed by African Life Financial Services Limited)(3) Intermarket Unit Trust (which is managed by Intermarket Securities Zambia Limited(4) Kukula Fund 1 (which is managed by Kukula Capital Plc)(5) Equity Capital Resources Unit Trust (which is managed by Equity Capital Resources Plc)(6) Madison Unit Trust Fund (which is managed by Madison Asset Management Company Limited)(7) Laurence Paul Unit Trust (which is managed by Laurence Paul Investment Services Limited) (8), and Banc ABC Unit Trust: Securities and Exchange

Commission. (2014). Collective Investment Schemes as an Instrument for Savings. Zambia Daily Mail (Lusaka, 24 September 2014) SEC Column. <https://www.daily-mail.co.zm/collective-investment-schemes-instrument-savings/> accessed 20 August 2022. The following foreign CISs have been authorized to participate on Zambian stock exchanges, namely (1) Imara Global Fund, (2)Imara African Opportunity Fund, and (3) Franklin Templeton Investment Fund.

[53] Thompson, J.K. & SM Choi, S.M. (2001). Governance Systems for Collective Investment Schemes in OECD Countries. 4, <http://www.oecd.org/finance/financial-markets/1918211.pdf> Accessed 19 August 2022.

[54]*ibid*, 4-5

[55]As conceived under the English Law of Trusts, and Equity.

[56]*ibid*, 5

[57]Zambian Securities Act 2016, s 2 (Definition of the phrase 'Collective Investment Scheme')

[58]*ibid*

[59] *ibid*

[60] Zambian Securities Act 2016, s 2

[61] Zambian Securities Act 2016, s 2 (Definition of 'Open-ended Investment Company')

[62] *ibid*

[63] Zambian Securities Act 2016, s 2

[64] Zambian Securities Act 2016, s 2 (Definition of the phrase 'Closed-ended Investment Company')

[65] Securities (Collective Investment Schemes) Rules, Statutory Instrument No. 161 of 1993, r 2, Zam

[66] See, Samamba L.T., II, 64-74, *op.cit*

[67] Massimb, M.N. & Phelps, B.D. (1994). Electronic Trading, Market Structures and Liquidity.Financial Analysts Journal, 50:1, 39-48, 41

[68] Baker, H.K. (1996). Trading Location and Liquidity: An Analysis of U.S. Dealer and Agency Markets for Common Stocks. Financial Markets, Institutions and Instruments, 5:4, 2

[69]Mwenda, K.K. (1999). 492, fn 1

[70] The Companies Act 1994 was repealed and replaced by Companies Act No. 10 of 2017 which entered into force in July 2018: Companies Act 2017, s 376(1)

[71] Zambian Companies Act 1994, s 7(2) *(repealed)*. Under the current regulatory framework—the Companies Act 2017, the articles of association are still inferior to the provisions of the Companies Act: See, Zambian Companies Act 2017, s 25(4)

[72] Zambian Companies Act 2017, s 163(1)

[73] Zambian Companies Act 2017, s 170(1)(a)(i)-(iii)(b)

[74] Zambian Companies Act 2017, ss 173(1)(a)-(c)(2), 171

[75] Zambian Companies Act 2017, s 175

[76] The listing of Collective Investment Schemes (CISs) on the LuSE, the acquisition of own shares by CISs, the reissue of shares, which are acquired by the company, to the existing shareholders and the investing public, and the trading opportunities which are provided to the investing public in listed CISs.

[77] The second dimension of a liquidity market is achieving immediacy at minimal cost: H.K. Baker, H.K. (1996). Trading Location and Liquidity: An Analysis of U.S. Dealer and Agency Markets for Common Stocks. Financial Markets, Institutions and Instruments, 5:4, 2

[78] English Companies Act 2006, s 724(1); see also Chapter 4 thereof

[79] For this purpose, 'qualifying shares' means shares that—(a) are included in the official list in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000 (c. 8), (b) are traded on the market as the Alternative Investment Market established under the rules of London Stock Exchange plc, (c) are officially listed in an EEA State, or (d) are traded on a regulated market: English Companies Act 2006, s 724(2)

[80]For an examination of the possible role of the Alternative Investment Market in the enhancement of the capitalization and liquidity of African securities markets, see, Samamba, L.T., II, *op.cit*. Zambia, Mauritius and Kenya have established Alternative Investment Markets for small and medium scale issuers. Encouraging investment by mutual funds and venture capital funds (both local and foreign) in growth companies on these alternative markets is likely to increase trading activity and increase liquidity.

[81] Zambian Securities Act 2016, s 121(1)(2)

[82] Zambian Securities Act 2016, s 121(5), 122(1)(a)(b)

[83] *ibid*, ss 121(5), 122(1)(a)(b)

[84] Zambian Securities Act 2016, s 125(1)(a)(b).

[85]The following foreign CISs have been authorized to operate in Zambia, namely (1) Imara Global Fund (2) Imara African Opportunity Fund and (3) Franklin Templeton Investment Funds: Securities and Exchange Commission, 'Collective Investment Schemes' (2018) <https://www.seczambia.org.zm/registration/authorization-of-collective-investment-schemes/> Accessed 22 August 2018

[86] See, Peranginangin, Y.A. (2013). How Foreign Trades Affect Stock Market Liquidity: a Transactional Level Analysis (PhD Thesis, The University of Adelaide) <https://digital.library.adelaide.edu.au/dspace/bitstream/2440/84758/8/02whole.pdf> Accessed 22 August 2018

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