Beware dirty money

By **Jackson Okoth**

An Anti-Money Laundering Bill is being drafted to empower commercial banks as well as the Central Bank of Kenya (CBK) to monitor, sanitize and lock out 'dirty' money from the country's financial system, *The Financial Post (FP)* has established.

The draft Bill, if passed into law, is expected to amend the Banking Act, empowering monetary authorities as well as commercial banks and other financial institutions to disclose information on 'suspicious transactions' by their clients as well as seize property or any economic advantage derived from money laundering activities.

Highly placed sources at both the Treasury and Central Bank of Kenya (CBK) confirmed to *FP* that the Act is still inadequate in addressing the problem of money laundering activities hence the need to amend it.

Further, CBK officials revealed that recent technological advances in the banking industry, including Internet and cyber banking, have added a new dimension to banking risks, opening up new opportunities to fraudsters and criminal money laundering rings.

"The Bill is already at the final drafting stages at the Attorney General (AG)'s Chambers and will soon be published and introduced in Parliament for debate," said an official.

But fears are already being expressed in financial circles that delay in bringing the anti-money laundering legislation into effect is rendering banks helpless in combating money laundering activities. "We are unable to sanitize the system due to inadequacy of the Banking Act," says a bank employee.

Analysts contend that Kenya's banking sector is indeed slowly catching up with the global system in which "megabyte money" can move anywhere in the world with speed and ease.

Gerald Nyaoma, the CBK Bank Supervision Director, agrees that financial institutions, including commercial banks, are vulnerable in the absence of an AML law.

"It is not only commercial banks but the equity market, real estate, insurance and the whole financial sector facing a high risk from money laundering rackets," says Nyaoma. The effect would be a distortion of demand, supply and price levels.

According to Nyaoma, financial institutions, including banks, are unable to disclose confidential client information to law enforcement agencies, including the courts, due to secrecy provisions in the law. "We have been holding workshops in a bid to harmonize the various conflicting provisions in the law and all this is captured in the Bill."

He mentions further that the Bill will not only curb money laundering within the banking system but also prevent crooks from penetrating and buying shares in the equity market, real estate or insurance products. "The AML Bill also aims to prevent laundered cash arising from tax evasion activities, robbery and corruption, drugs and other criminal activities from finding their way into the financial system", says Nyaoma.

In the absence of an AML law, banks have been issued with guidelines in a bid to help them monitor and report suspicious transactions and then report to CBK for further direction.

J.K Wanyiela, the Executive Director of Kenya Bankers' Association (KBA), adds that while commercial banks have been issued with CBK guidelines concerning prevention of crime and money laundering activities, there is need for an Anti-money laundering Act to specifically deal with the problem. "The Banking Act, in its present form, prevents commercial banks from fully disclosing confidential client information," observes Wanyiela.

While commercial banks have made steps to combat fraud through implementation of KYC (Know Your Customer) checks and internal controls, the Anti-Money laundering policy is yet to take effect due to an inadequate legal infrastructure.

Thus it remains a daunting challenge as the industry speeds up legislation to criminalize the activity. For instance, finding, freezing and forfeiting of criminally-derived income and assets are all the more difficult, according to KBA officials.

A teller at one of the local niche banks disclosed that instructions have been issued by CBK with regard to money laundering activities. "When we notice any suspicious transactions or movements in our accounts, we usually inform the CBK who will then decide the next course of action," says this bank employee.

But while commercial banking institutions are required by law to have in place internal control measures which ensure detection of money laundering activities and disclosing this information to CBK, banks have been reluctant to use this avenue due to limitations under the Act, which could expose them to legal pitfalls.

A case in point is a recent incident at the Westlands Branch of Standard Chartered Bank Limited, where a client's account, which contained an estimated Kshs 2 billion, attracted the attention of the bank and CBK officials. But when this client was cleared of any suspicion, he in turn sued the bank, with Standard Chartered being asked to pay a huge sum in damages.

"The Act does not empower banks to freeze one's account or even to disclose confidential client information without a court order," says Wanyiela.

CBK prudential guidelines for institutions licensed under the Banking Act issued in March 2006, define money laundering as the act of a person who engages in a transaction that involves proceeds of any unlawful activity. The guidelines are issued under section 33(4), which empowers CBK to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

According to the guidelines, banks shall ensure that they obtain and maintain proper identification of customers wishing to open accounts or make transactions whether directly or through proxy.

Banks are also required to obtain and maintain adequate records for a minimum of seven years, regarding the sources of funds and details of transactions in order to enable the identification of unusual or suspicious transactions and reconstruct individual transactions.

Other measures that CBK requires are submission of reports of any suspicious transactions or activities that may indicate laundering or other attempts to conceal the true identity of customers or ownership of assets.

Each bank is also required to establish internal control measures to assist in detection and prevention of money laundering activities.

The guidelines also stipulate that if an institution becomes suspicious of activities or transactions that indicate possible money laundering, it shall report the same to CBK immediately.

These set of regulations, covering reporting rules, confidentiality, identification and verification procedures as well as account transactions, are however, still considered inadequate as banks have their hands tied by the archaic Banking Act.

Perhaps, a recent move by CBK to place Charter House Bank under statutory management could provide some pointers as to how porous the system works. The bank had its doors closed after it was accused of tax evasion and money laundering.

But while efforts to combat money laundering remains a challenge for the country's banking industry, success has been recorded in shutting out fraudsters from the banking system.

Rob Warlow, Head of Risk at Fina Bank Limited, says commercial banks are gradually moving cash and cheques away from the system in favour of plastic cards. Fina bank is one of the players in the industry that have achieved a measure of success in combating fraud.

"We know that fraudsters are clever and innovative and that any new process lasts for only a while before they find ways round it," says Warlow.

In a bid to lock out fraudsters, banks are now adopting the microchip and PIN technology in credit cards as part of an initiative to combat fraud. At the moment, incidences where use of signatures is required have been reduced. "Instead, one is merely required to punch in a 4-digit PIN number on a credit slip to verify payment, effectively putting commercial banks a step ahead of fraudsters," observes Warlow.

Players in the banking industry, however, admit that inspite of current smart technology advances, customers still fall prey to fraudsters. This is especially when one gets careless with chequebooks, cards or PIN numbers.

Fina Bank is among those that have in-built KYC (Know your customer) models in their internal control systems, aimed at combating fraud. For instance, the bank requires proof of address, past utility bills, copies of passports and IDs while profiling potential customers intending to open accounts.

"We also have an anti-money laundering scheme within our internal control systems, which flags up when an unusual activity is noticed in our accounts," says Warlow.

Fina, like all other commercial banks, have in-built checks and internal controls to spot fraudulent and stolen cheques.

KYC guidelines requires that a financial institution takes reasonable measures to identify an applicant seeking to open an account with it by requiring that the said person produces an ID, birth certificate, passport, drivers license or other official means of identification.

Also required is the current physical address verified by a referee or a utility bill, verified employment and source of income and written confirmation from customer's prior bank, attesting to customer identity and history of account relationship

The country's banking landscape, while developing rapidly, has not yet seen the exit of cheques, though. This paper document still remains the dominant payment, with fraudsters constantly trying new techniques to beat the banking system and steal money from unsuspecting depositors. While statistics on cheque frauds is unavailable, commercial banks acknowledge that the problem exists.

Charles Amanga, Compliance Officer at Fina Bank, traces the history of cheque fraud in Kenya to the early and late 1990's when commercial banks got concerned. This was especially to do with issuance of third-party cheques.

It was during this period that major commercial banks took the drastic step of not honouring third-party cheques. What followed was a significant drop in cheque frauds.

"The possibility that a person could merely move to the counter, present an ID and get paid was phased out," says Amanga. Commercial banks tightened controls on issuance of cheques to third parties, locking fraudsters out of the system.

"Then between the year 2000 and 2002, fraudsters, on realizing that these had been done away with, changed tact and moved on to target smaller banks. The plan involved opening fraudulent accounts, from where they could draw, deposit or clear fraudulent and stolen cheques and then close them altogether," Amanga explains.

The banks then went ahead to review the process of opening accounts. Over the last few years, banks moved a step backwards in a bid to combat fraud by going to the initial stages, that of opening an account. Thus they have adopted KYC in line with international standards.

Available information indicates that in today's globalized economy, organized crime groups generate huge sums of money through drug trafficking, arms smuggling and financial crime. "Dirty money", however, is of little use to organized crime because it raises the suspicions of law enforcement agencies and leaves a trail of incriminating evidence. Criminals who wish to benefit from the proceeds of large-scale crime have to disguise their illegal profits without compromising themselves. This process is known as money laundering.

Every criminal needs to "launder" the proceeds of crime, but where organized crime, drug trafficking and corruption are involved, the consequences are bad for business, development, government and the rule of law.

Kenya is said to be a prime target for international criminal money laundering rings, perhaps attracted by the country's relatively sophisticated and well-developed financial system.

Analysts point out that instability in neighbouring Somalia and Sudan has made Nairobi a hub for drug traffickers, arm dealers and criminal underworlds from these countries. "For instance, Somalia has not had a central bank for the last decade, implying that a lot of dollars from that country is circulating in the local economy," said a source that requested anonymity.

With the ongoing renovations and expansion programme at the Jomo Kenyatta International Airport (JKIA), opening up of Kenya's international gateway implies that direct flights to the United States of America (USA) will now be possible from Nairobi. This development is bound to open up new avenues for money laundering and international criminal gangs as human and cargo traffic increases between Nairobi, Mombasa and international markets, including USA.

CBK maintains that it is still difficult to ascertain whether laundered cash is circulating around. "We are unable to confirm this until proper anti-laundering structures are put in place," says Nyaoma.

Apart from lack of adequate legislation to combat money laundering, the absence of established credit rating bureaus has also made policing laundered money difficult. The Anti-narcotics Act, which has already come into effect, is also ill-equipped to deal with criminal money laundering activities due to loopholes in the Banking Act, industry officials say.

Reports indicate that criminals are now taking advantage of the globalization of the world economy by transferring funds quickly across international borders. Rapid developments in financial information, technology and communication allow money to move anywhere in the world with speed and ease. This makes the task of combating money laundering more urgent than ever.

Because of the clandestine nature of money laundering, it is difficult to estimate the total amount of money that goes through the laundry cycle. Estimates of the amount of money laundered globally in one year have ranged between USD 500 billion and USD 1 trillion. Though the margin between those figures is huge, even the lower estimate underlines the seriousness of the problem.

Most disturbing of all, money laundering empowers corruption and organized crime. Corrupt public officials need to be able to launder bribes, kickbacks, and public funds and, on occasion, even development loans from international financial institutions. Organized criminal groups need to be able to launder the proceeds of drug trafficking and commodity smuggling. Terrorist groups use money-laundering channels to get cash to buy arms. The social consequences of allowing these groups access to the capacity to launder money can be disastrous. Taking the proceeds of crime from corrupt public officials, traffickers and organized crime groups is one of the best ways to stop them in their tracks.

Entrepreneur

Riding on the wave of community micro-financing ...

It pays off handsomely, says Embu matatu owner

By **Githuku Gacheru**

His is a story of youthful enthusiasm, business and the community's role.

For as the youth lament while they wait for the Government to offer them jobs, one of their own in Embu has made a step towards self-reliance.

John Kamau has ventured into the informal sector and his efforts are remarkable.

At 26, married, and out of self drive, Kamau boasts two Nissan *matatus*, an undeveloped half acre land and a newly constructed Ksh 650, 000 residential house on a plot he bought at Ksh 60, 000 in the outskirts of Embu.

The half-acre land cost him Ksh 120, 000, Ksh 10, 000 of which is still outstanding.

Kamau married Francisca Mukami at the age of 19 when they worked for a beer distributor in Embu town. They have two issues, with their first born being a standard one pupil at a local private school.

At the distributor, Kamau worked as a loader before getting promoted to sales representative in charge of Siakago stores in Mbeere district. Mukami was a sales woman.

He then proceeded to Larmudiac Secondary in Nakuru where he left in 1998 to join Nairobi Technical Institute and graduated with a Diploma in sales and marketing, credentials that earned him the beer job.

Two years into it, Kamau decided to quit and venture into the taxi business but the Ksh 52, 000 he had saved was scarcely enough to start off.

The price tag of the taxi he had identified read Ksh 80, 000 and Mukami readily provided the balance. His earlier driving course came in handy to the business.

Diligence paid off and after a while, Kamau bought another taxi at Ksh 100, 000.

He later sold the two taxis at Ksh 160, 000 in favour of a pick-up for hire by those in the horticultural industry transporting produce to the market.

Kamau approached his mother-in- law for a Ksh 100, 000 that together with the amount he had saved, enabled him buy a pick-up at Ksh 250, 000.

The in-law was a member of Mbeere and Embu Savings and Credit Association (MBEU), a Catholic diocese of Embu micro finance project started five years ago to enhance economic empowerment of low income earners in the rural set ups of the diocese.

MBEU is a programme of Development and Social Service Department (DSSD) of the diocese, which strives to provide financial services to low income communities.

"MBEU's main objective is to promote the culture of saving among the poor and encourage economic self-reliance," Fr Vincent Ireri, the diocesan development co-ordinator, says.

Currently, MBEU has 8,382 members with a share capital of Ksh 38.8 million. It has disbursed Ksh 29 million in form of loans to 2,655 members, Ksh 17 million of which has been repaid.

"It is a poverty reduction strategy for the church and it is doing remarkably well," Joseph Kibuti, the general manager, told *The Financial Post* at his Waumini Plaza Office.

Kibuti joined MBEU upon retirement from Barclays Bank where he had served for 25 years in various capacities, including manager and chief training officer.

The former banker says MBEU has improved the lives of the rural poor who have embraced the services offered by the micro- finance venture.

Kamau was advised by his mother-in-law to join MBEU in order to enhance his success in business.

He joined the micro finance one and a half year ago and is getting good returns. It is while in it that he has managed to buy his two *matatus* through borrowed loan which he is comfortably servicing.

"I bought my first second hand *matatu* at Ksh 250, 000 and out of the accruing profit, I have managed to buy another at Ksh 220, 000. Both operate along the Embu-Muthatari- Kiritiri routes."

"We loan our members three times their savings subject to guarantee by one's own group," notes Kibuti. The repayment period is between one and twenty four months and borrowing is at twelve percent."

Separately, Kamau adds: "I have no difficult in repaying my loans although the *matatu* business is a risky undertaking. I have not encountered obstacles so far save for police harassment, heavy taxation by the government, poor road infrastructure and vehicle maintenance. "

He has six people in his employ.

Apparently, Kamau believes in the Chinese wisdom that a journey of a thousand miles starts with a step. For the burning ambition to scale the heights of business success is unmistakable in both his word and deed.

Listen to him, for instance: "*Matatu* business is a paying investment if one is not extravagant. It requires self-discipline. That is my driving force."

Kamau, who is a teetotaler, hopes the minister for Youth Affairs Dr Mohammed Kuti will consider those of his ilk when disbursing the Kshs 1 billion Youth Enterprise Fund.

"I have ideas and I can invest well," Kamau says with a tinge of pride.

Kamau's efforts towards self-reliance are evident and as Fr Ireri said, such youths need to be given incentives to progress in small-scale enterprise.

As the priest in charge of social programmes in the diocese, Fr Ireri says there is need for the church and the government to address the economic concerns of the poor in the rural areas, especially the youth.

The man of cloth has been the development coordinator in the church since the creation of the diocese in 1986.

Most of the development programme in the diocese are sponsored jointly with donor partners and include soil and water conservation, afforestation, livestock and bee-keeping activities as well as food security intervention in drought prone arid and semi arid lands [ASAL].

The Church and Calitas of Australia, an international Non-Governmental Organization (NGO) working with the Catholic Church to achieve the United Nations Millennium Development Goals of poverty reduction by 2015, jointly sponsor MBEU.

Kibuti explains that the NGO agreed to sponsor the micro finance initiative as a pilot project to be replicated in other districts upon assessment of its viability and success in Embu and Mbeere, where it is operating in 16 parishes.

As an entity affiliated to the church, MBEU is managed by members of a board of directors vetted by the diocesan bishop.

The directors oversee all aspects of the project, shape and approve its policies and stay in office for a period of three years.

Kibuti said the project has shown consistent growth and has achieved a great deal in the promotion of a saving culture in the rural communities besides creation of employment- formal and informal.

In December 2002, membership stood at 1,411 and over 8,382 currently access affordable financial services.

In 2005, MBEU was elected a board member of Micro finance Africa Institution Network (MAIN) in a meeting of member countries held in Cameroon.

MAIN is a network of 70 countries from Asia, Africa, Europe and Middle East that emphasize micro finance entrepreneurship mostly among the rural poor.

To enhance advancement in the field, two of MBEU staff have enrolled for a special degree on micro finance and community economic development at Uganda Martyrs' University.

"MBEU is an agent of social change and is tailored to improve the economic status of the poor irrespective of religion," Kibuti says, adding that any person within the diocesan jurisdiction is eligible to become a shareholder and enjoy its financial services.

Kamau did and it is paying off handsomely.

Political Analysis

With the resumption of Parliament and dim hopes of successful continuation of its legislative function before Xmas break...

Is House Business in jeopardy?

By **Bosire Nyairo**

Barring any miracle- they are few and far between- and if history counts for anything, serious House Business is likely to be relegated to the back-burner following Parliament's recent resumption of sittings.

Put another way, to say that Parliament will not, within twenty-three *working* days, pass the 17 Bills lined up for debate would be to say that a zoo houses animals.

Indeed, no lesser a person than President Mwai Kibaki has in the past chastised the Ninth Parliament for what he suggested is its sorry record in passing legislation.

For example, while opening the Fifth Session on March 21, 2006, the President spoke with candour: "There are a number of (other) areas where we were unable to fulfil our commitments because of failure to pass appropriate legislation. As we commence this Session, therefore, I would like to appeal to honourable Members to focus more on the legislative priorities of our country. It is only by doing so that we will succeed in improving the lives of our people and advancing our national goals of socio-economic development."

Of course, the jury is still out on the legislators' performance, but suffice it to say that their legislative performance has yet to meet Kenyans' expectations.

For instance, out of the 25 Bills that were presented before the House for debate and possible enactment at the start of the Fourth Session, only seven were concluded- a sad commentary indeed on the commitment of the 222 men and women each of whom takes home every month a staggering Ksh 850, 000.

Prospects are even dimmer today. Undeniably, politicians seem to have put the country on a premature electioneering mood ahead of the upcoming General elections next year.

And with Parliament's re-opening, this is sure to hit fever pitch. Predictably, the Narc-Kenya and ODM-Kenya divide will sharply be illuminated on the floor of the House.

Yet there is important business to undertake.

Aside from Bills, the Members are expected to complete scrutinising the budgetary allocations of at least 10 ministries by October 31, as required by the Constitution.

For instance, significant is Nominated MP Dr Julia Ojiambo's Private Member's Supplies and Practitioners Management Bill, whose passage would be critical to the successful implementation of the Public Procurement and Disposal Act assented to by the President last November.

The spirit of the procurement law is the radical reform of the current public procurement system that is a big drag on public sector efficiency in order to reduce the cost of production and conducting business. Ultimately, this would engender broader participation.

Which is why Dr Ojiambo's Bill, which seeks to have professionals handle procurement and supplies, is critical.

Indeed, the President has in the past criticised his ministers for apparent lethargy in House work and of being largely ignorant of the legislative process.

Cases are legion of 'absentee' ministers supposed to answer Members' Questions.

For good measure, Speaker Francis ole Kaparo, apparently alarmed by the lack-of-quorum hitches that had become a constant feature in Committees, not too long ago warned that those culpable wont be eligible for the sitting allowance.

Currently, committee chairmen are entitled to a Ksh 8, 000 sitting allowance while members pocket Ksh 5, 000. Of course, some MPs belong to more than two committees while others belong to none.

The Banking (Ammendment) Bill, 2004 is another crucial piece of legislation that demands urgent attention.

The proposed law seeks to put a cap on the rate of interest banks and other lending institutions charge on loans and that upon enactment, the law should apply retroactively, that is, into the past when banks experienced bad trade portfolios and most indigenous businesses were driven out of town.

Last year, the Bill did not merit presidential assent. The President referred it back to Parliament with amendments for further debate. The President's memorandum to the House says the law cannot apply retroactively.

Of course, the MPs argue that given the banks' current blank cheque in fixing their interest rates, the cost of borrowing is too high and out of reach for the ordinary Kenyans, especially existing and potential business people.

In an interview, Gachoka Narc MP Joseph Nyagah argues that the rate of interest charged by banks is unconscionable and should therefore be checked by law.

Argues Nyagah: "In a private-sector world, it is important to give freedom to the banking sector. But the banks have become irresponsible and co-ordinated their activities to put interest rates too high; these should be controlled. The deposit-taking rates are very low but banks have sometimes tripled the rate at which they charge their customers, citing risks and a huge portfolio budget. But at the end of the day, I think the President, Parliament, government and the public should exert pressure on the local banking sector to become more modern and operate like the rest of the civilised world. The kind of margins they are making today are unreasonable and do not make sense. Who else makes such kind of profits for doing so little?"

Former Gem MP Joe Donde in 2000 unsuccessfully moved the Donde Bill that sought CBK regulation of interest rates. The legislator then argued that the interests charged on loans were too high for ordinary Kenyans. This, Donde argued, did not take into consideration the ability of borrowers to service the loans.

But bankers argue that to seek to introduce controls amounts to a disincentive to foreign investment locally.

The Kenya Bankers' Association Chairman Terry Davidson, for instance, suggests that it is not prudent for government to seek to control interest rates in a free-market economy and that the proposed law, if enacted, should not have retrospective effect.

"We hope that the Bill will not be made retrospective because if implemented as it is, it will hurt indigenous banks, particularly those that the government has a stake in," says the Kenya Commercial Bank boss.

Also lined up is the Fiscal Management and Accountability Bill, 2006, which seeks to confer on Parliament a greater role in the preparation, scrutiny and evaluation of the Budget.

The rationale is to ensure that Kenyans' representatives, through their oversight role, take a keen interest on the utilization of taxpayer money for accountability and as a safeguard against corruption rampant in the past.

Ultimately, resources have to be allocated on the basis of the development needs of the recipient areas. In his era, it will be recalled, former President Daniel arap Moi perfected it to almost an art form the asymmetrical allocation of resources on the basis of loyalty for political capital.

As it is currently, MPs have a minimal, if any, role in the preparation of the Budget.

The proposed law seeks to create the Budget Office, with experts on fiscal matters, who will advise Parliament.

Yet hanging over all these like the sword of Damocles is the contentious issue of constitutional reforms- minimum or comprehensive- that, given the present grandstanding on either side of the political divide, is sure to manifest itself for considerable time in the House.

So, will MPs then walk six feet tall and thump their chests for job well done after all as they will be heading for the festive season break on December 7?