THE EFFECT OF ANTI-MONEY LAUNDERING REGULATION IMPLEMENTATION ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

BY

ROSALIND RIMA MURITHI

A RESEARCH PROJECT SUMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENT OF THE AWARD OF THE DEGREE OF MASTERS OF BUSINESS ADMINISTRATION, UNIVERSITY OF NAIROBI

2013

DECLARATION

This research project is my original work and has not been submitted for a degree in any other university.

Signature: .... Date....................................

ROSALIND R. MURITHI

D61/67022/2011

This research project has been submitted for examination with my approval as the University supervisor.

Signature: .... Date....................................

MRS. WINNIE NYAMUTE

LECTURER: DEPARTMENT OF FINANCE AND ACCOUNTING

SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI

ACKNOWLEDGEMENT

I would like to express my deepest appreciation to the following people for their support that made this research paper a success.

I am sincerely grateful to Almighty God for giving me the knowledge, strength and divine health to complete my studies from the beginning of the course to its completion.

My appreciation goes to my academic Supervisor; Mrs. Winnie Nyamute for her great contribution and support offered that enabled this research project to take its present form, without her guidance and persistent help, this research would not have been successfully completed.

My gratitude to Cyrus Iraya for valuable insights and suggestions in the development of this research paper.

I am also grateful to Dr. Josiah Aduda and the University of Nairobi, School of Business to for the opportunity accorded to further my studies in this programme and complete this research project.

My special thanks to my employer, ERC and Director General Eng. Kaburu Mwirichia who granted me study leave to complete this research.

I must admit humbly that the success of this research has been largely due to collaborative efforts and devotion of many people to who I owe a lot of gratitude.

I humbly say Thank You.

DEDICATION

This work is dedicated to Almighty God, my dear husband Elias M. Riungu, for his love, patient and support. To my children, Dorcas Nkirote, Emmanuel Mutethia, Esther Gatwiri and Emily Kinya for their perseverance, understanding and continued prayers towards successful completion of this course.

I pay glowing gratitude and tribute to my late father James Kaburu and to my Mom Florence Kaburu for their great encouragement and always being proud to see me continuing with higher education. My Cousin Carol and Gertrude Gitonga for setting the pace. My siblings, Kinoti, Kimathi and Makena for understanding me during the entire period of study.

To you all I am deeply and sincerely grateful.

ABSTRACT

Money laundering is an economic crime that has adversely affected the level of economic development in the economies of African countries. Money laundering has a notorious tendency to discourage or frustrate legitimate business enterprise, corrupt the financial systems and ultimately collapse the economy. This paper examined the effect of anti-money laundering regulation implementation on the financial performance of commercial banks in Kenya.

The study focused on 31 Commercial banks who responded to the questionnaire which was used to collect data. The research was conducted through a descriptive survey. The study used both primary and secondary sources of data. Data was analyzed using Statistical Package for Social Sciences and findings presented by of tables.

From the findings, the study concludes that bank reporting affects AML these has lead to increased transactional costs due to screening and the reporting frequency that the bank has instituted as well broadened the types of reports prepared. The study further concludes that operational costs affect the performance of commercial banks in Kenya to a very great extent due to increased/high transaction costs that the bank incur including training staff on identification of suspicious activities. In view of the findings, the study recommended that to ensure the stability and integrity of the financial system the financial action task force (FATF) should continue to be implemented in addition to regulatory and institutional framework under the AML Act, in collaboration with the Central Bank of Kenya (CBK).

TABLE OF CONTENTS

DECLARATION .... **II**

ACKNOWLEDGEMENT .... **III**

DEDICATION .... **IV**

ABSTRACT .... **V**

TABLE OF CONTENTS .... **VI**

LIST OF ACRONYMS AND ABBREVIATIONS .... **IX**

LIST OF TABLES .... **X**

CHAPTER ONE: INTRODUCTION **1**

1.1 Background of the Study 1

1.1.1 Anti-Money Laundering Regulation Implementation 2

1.1.2 Financial Performance 3

1.1.3 Relationship between Anti-Money Laundering Regulation on Financial Performance 3

1.1.4 Commercial Banks in Kenya 4

1.2 Statement of the Problem 5

1.3 Objective of the Study 7

1.4 Value of the Study 7

CHAPTER TWO: LITERATURE REVIEW **9**

2.1 Introduction 9

2.2 Theoretical review 9

2.2.1 Theory of “Crying Wolf” 9

2.2.2 Transparency-Stability Theory 11

2.2.3 Economic Theory 12

2.3 Empirical Review 13

2.3.1 Money Laundering 16

2.3.2 Effects of Money Laundering on Financial Institutions in Developing Countries 16

2.3.3 Anti-Money laundering in Kenya 17

2.4 Conclusion 17

CHAPTER THREE: RESEARCH METHODOLOGY 19

3.1 Introduction 19

3.2 Research Design 19

3.3 Population of the Study 19

3.4 Data Collection 20

3.5 Data Analysis 20

3.5.1 Research Model 20

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION 23

4.1 Introduction 23

4.2 Bank Reporting 23

4.3 Operational Costs 24

4.4 Cost of Monitoring Transactions 26

4.5 AML Measures Taken by Commercial Banks 28

4.6 Regression Analysis 31

4.7 Discussions and Interpretation of Findings 34

CHAPTER FIVE 36

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS 36

5.1 Introduction 36

5.2 Summary 36

5.3 Conclusion 37

5.4 Limitations of Study 38

5.5 Policy Recommendations.. 39

5.6 Recommendations for Further Research.. 40

REFERENCES...41

APPENDIX I.. I

APPENDIX III: QUESTIONNAIRE.. I

LIST OF ACRONYMS AND ABBREVIATIONS

AML	Anti-Money Laundering
CBK	Central Bank of Kenya
CDD	Customer Due Diligence
CFT	Combating Financial Terrorism
CIP	Customer Identification Programme
CIV	Customer Identification and Verification
FATF	Financial Action Task Force
FI	Financial Institution
FIU	Financial Intelligence Unit
FRC	Financial Reporting Centre
KYC	Know Your Customer
ML	Money Laundering
NSE	Nairobi Securities Exchange
PEPS	Politically Exposed Person
SARs	Suspicious Activity Reporting
STR	Suspicious Transaction Reporting
ROA	Return on Assets
ROE	Return on Equity

LIST OF TABLES

Table 4.1: Effects of AML on bank reporting 23

Table 4.2: Extent to which the bank reporting affects AML in Kenya 24

Table 4.3: Operational costs on money laundering 25

Table 4.4: Operational Costs on AML 26

Table 4.5: Cost of Monitoring Transactions on AML 27

Table 4.6: Cost of monitoring transactions on AML in Kenya 28

Table 4.7: AML Measures Taken By Commercial Banks 29

Table 4.8: Effectiveness of AML policies in the bank today 31

Table 4.9: Model Summary 31

Table 4.10: ANOVA 32

Table 4.11: Coefficients 33

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The process of money-laundering includes a series of multi-specialized deals designed to disguise the source of financial assets so that these assets and funds can be used as a legitimate sources resulting from legitimate business operations (Agarawal and Agarawal, 2005). Money laundering is a process the aim of which is to cover traces leading to the real source of illegally acquired money, in which, more and more often, the non-financial sector and the professions become involved (Giunio, 1998). According to the definition of Directive 2005/60/ EC this process includes covering up the real nature, the source of money, its transformation and transmission in order to conceal its illegal origin. This may involve purchasing, possessing or using property derived from illegal activities or participation in, connection with, abetting, stimulating and facilitating any of the aforementioned activities (Claessens, 2000).

Anti-Money Laundering (AML) can be defined as an activity which prevents, or aims to prevent money laundering from happening. The definition of 'criminal income' varies by jurisdiction (some activities are illegal in some countries and not in others). Similarly, the aims of AML are not necessary the same in different jurisdictions. The aims might include deterring and detecting organized crime, to reduce drug dealing, to deter terrorism or to maintain the reputation of the financial services industry (Yeandle, *et al.* 2005).

The technological innovation that has made once-exclusive devices such as personal computers and mobile telephones prevalent across much of the globe has inevitably led to their exploitation by criminals wishing to launder funds, allowing for the anonymous transfer of assets across the

world in seconds (Strasbourg, 1990). This rapid technological advancement has further facilitated ML and has presented huge challenges for the authorities. Money laundering is harmful to a nation's economy because money that is in need of laundering is a result of illegal activities that harm the economy. Therefore fighting money laundering requires government intervention. Money launderers have greatly diversified their operations across financial services sectors and, increasingly, across the core and non-core financial activities of non-financial services businesses.

1.1.1 Anti-Money Laundering Regulation Implementation

In the wake of high-profile corporate scandals as well as new regulations, commercial banks are increasingly aware of the need to create company-specific AML and Anti-fraud measures to address internal corporate fraud and misconduct. For a variety of reasons including the increasing number of lawsuits, organisations are focusing a great deal of attention to policies that minimise risk, avoid liabilities and ensure safety of organisation and employees'. Once policies and procedures are strictly followed, the organisation is able to free itself from any arising operational issues, be they legal or otherwise and avoid incurring unnecessary costs (Dixit, 1991).

Most FATF governments and many others have enacted and implemented, or are in the process of implementing, Suspicious Activity Reporting (SAR) or Suspicious Transaction Reporting (STR) models as an essential component of their overall anti-money-laundering regimes (FATF, 2003).

1.1.2 Financial Performance

Financial performance evaluation is multifaceted involving ratio analysis, financial statements, trend analysis and consideration of additional data not always found in published reports. Integrated models, such as the Return on Equity (ROE) Model DuPont Model disaggregate ROE into several basic components in order to isolate the sources of a bank's profitability. ROE is decomposed as a function of a bank's cost management (as measured by its net profit margin), its revenue management (as measured by its assets utilization), and its financial leverage (as measured by its equity multiplier). This assists observers to determine why bank's performance has deteriorated or improved in comparison to its peers or its own past records. Utilizing trends analysis may assist in revealing long-term patterns in the profitability and cost efficiency. ROE is the closest an accounting measure comes to revealing how well managers have done in maximizing shareholder wealth.

Return on Assets (ROA) is a measure of efficiency, indicates management's ability to use financial and real resources to generate net revenue. The return on Assets (ROA) is a function of both its cost management, reflected by the net profit margin and its revenue management captured by its utilization ratio. The net margin calculated by operating income after tax, divided by interest income, measures the net profit margin, that is, what is left out of one shilling's revenue after all costs have been taken out.

1.1.3 Relationship between Anti-Money Laundering Regulation on Financial Performance

The integrity of the banking and financial services marketplace depends heavily on the perception that it functions within a framework of high legal, professional and ethical standards. A reputation for integrity is the one of the most valuable assets of a financial institution. If funds

from criminal activity can be easily processed through a particular institution – either because its employees or directors have been bribed or because the institution turns a blind eye to the criminal nature of such funds – the institution could be drawn into active complicity with criminals and become part of the criminal network itself. Evidence of such complicity will have a damaging effect on the attitudes of other financial intermediaries and of regulatory authorities, as well as ordinary customers (FATF, 2006).

Potential negative macroeconomic consequences of unchecked money laundering, one can cite inexplicable changes in money demand, prudential risks to bank soundness, contamination effects on legal financial transactions, and increased volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers. Also, as it rewards corruption and crime, successful money laundering damages the integrity of the entire society and undermines democracy and the rule of the law. Full implementation of anti-money regulations will make the bank more credible and attract more clients and in return the bank will make substantial profits (FATF, 2003).

1.1.4 Commercial Banks in Kenya

The Banking industry in Kenya is governed by the Banking Act, the Companies Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). Regulations of commercial banks refer to the laid down rules under which the commercial banks operate. These regulations are clearly set out in the banking Act chapter 488.

Commercial banks should be aware that the statutory definitions of the crime of money laundering and, even more so, the predicate offenses that are held to generate illicit proceeds, vary considerably among jurisdictions (Hutter, 2005). Accordingly, and not always in a clear a

priori manner, there can be wide variation in what constitutes unusual and suspicious activity and legally reportable conditions of suspicious activity. For these reasons, commercial banks should familiarize themselves with the legal and operative definitions of money laundering, predicate offenses, unusual and suspicious activity and reportable conditions that apply to the entities in question in jurisdictions of consequence. Because governments are increasingly broadening the spectrum of reportable conditions, commercial banks should be aware that entities may need to expand their scope of monitoring for, and reporting of, suspicious activity to cover certain types of frauds, including even identity theft and computer intrusion (FATF, 2003).

Until recently, core banks, or conventional deposit taking and lending institutions, were the primary targets of money launderers. As banks improved their controls for preventing, detecting and reporting money laundering, however, and as law enforcement has made similar strides, criminals have learned to diversify their operations and to expand into other financial institutions or conduits of financial activity (FATF, 2006).

1.2 Statement of the Problem

Money launderers are employing increasingly sophisticated techniques, through a variety of transactions and firms in order to legitimize the benefits of crime. To combat money laundering activities, commercial banks have been given a greater role by Anti- Money Laundering legislations (Dan, 2009). The financial services industry provides an important means through which 'dirty money' can be laundered. New technologies such as the internet offer speed and anonymity, potentially providing distance between launderer and law enforcement. A dramatic increase in the use of offshore financial centers and less well-regulated jurisdictions highlights the alternative channels that can facilitate the laundering process. Money laundering enables those who break the law to benefit from their illegal activities which damages society.

Some scholars, such as Robin Thomas Naylor (1999) and Petrus C van Duyne (1998), have suggested that relatively little is actually known about money laundering, and what is known is often ignored by law enforcers and the media. The issue is highly emotional, and increasingly the phrase “money laundering” is a stimulus eliciting unreflective conditioned responses rather than thought or insight. Anti-laundering measures make citizens feel better (with cleaner consciences) and it may not be in the interests of well-funded law enforcement agencies and their allies in the media to develop a more accurate and rational view of the issue. The threat of money laundering is politically, economically, and socially constructed (Duyne 1998).

International efforts to combat money laundering have gained momentum in the past decade. One United Nations Convention and another planned convention, along with numerous multilateral governmental initiatives and bilateral agreements, have contributed to the development of a broad set of national and international legal standards. Blum (1998) conducted a study the examined the world of offshore financial centers and bank secrecy jurisdictions in the context of the control of money laundering and financial crime. It looked at offshore financial centers and bank secrecy jurisdictions as facilitators of money laundering and other forms of crime, elucidates the ways in which they are used by criminals and identifies a series of remedies or counter-measures that would block or at the very least diminish the attractions of these havens.

Locally, Bwayo (2004) wrote a paper on the Strategies Applied by Commercial Banks in Kenya in Anti Money Laundering Compliance Programs; Mutheu (2008) examined the Perceived Effects of Money Laundering on International Business using a case study of banks in Kenya. Njagi (2009) investigated the effectiveness of Know Your Customer (KYC) polices adopted by commercial banks in Kenya in reducing money laundering and fraud incidences. Most recently,

Toroitch (2010) conducted a research on the challenges faced by the Central Bank of Kenya in combating money laundering.

None of these papers present an assessment of regulatory implementation and performance of commercial banks in as far as the use of regulatory policies in the fight against money laundering is concerned. In addition, though there are numerous studies in the literature that critically examine factors that contribute to money laundering, the numbers of studies specific to Kenya are rather scarce. It is against this background that this study hoped to fill this void in money laundering knowledge gap by answering the question; what is the effect of anti-money laundering regulation implementation on the financial performance of commercial banks in Kenya?

1.3 Objective of the Study

The objective of this study was to investigate the effects of anti-money laundering regulation implementation on the financial performance of commercial banks in Kenya.

1.4 Value of the Study

The findings of this study were of benefit to:

The Kenyan Government and the Central bank of Kenya; they would benefit from this study as it will bring insight into the understanding of the issue of Money Laundering and how to counter various cases of money laundering in the country. The study would also highlight the advantage of banks complying with the AML policies hence leading to reduction on in money laundering cases.

Commercial banks; they would benefit from the study as it intends to provide insight on compliance with AML policies by assessing the current level of industry compliance with the Regulations, and to identify financial activities and sectors that are most vulnerable to the risk of money laundering activity. This would facilitate informed decision making on compliance with AML policy.

Academic researchers; they would benefit from this study as it would serve as a point of reference and source of literature in their reviews while carrying out further studies on the topic under study.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are theoretical framework and the empirical review.

2.2 Theoretical review

2.2.1 Theory of "Crying Wolf"

Excessive reporting, called "crying wolf", can dilute the information value of reports. Excessive reporting is investigated by undertaking the first formal analysis of money laundering enforcement. Banks monitor transactions and report suspicious activity to government agencies, which use these reports to identify investigation targets. Banks face fines should they fail to report money laundering. However, excessive fines force banks to report transactions which are less suspicious, thereby diluting information. The empirical evidence is shown to be consistent with the model's predictions. The model is used to suggest implementable corrective policy measures, such as decreasing fines and introducing reporting fees.

Excessive reporting fails to identify what is truly important by diluting the information value of reports. The intuition can be best understood through an analogy with the tale: "The boy who cried wolf". In the tale, the boy rendered his cries useless by resorting to them too often, and failing to identify the wolf's presence. Similarly, excessive reporting, which will be referred to as

"crying wolf", fails to identify what is truly relevant. More generally, the crying wolf phenomenon shows that information is not only data, but also able and expert identification of truly important data (Becker, 1968).

The model explores the agency problem between the bank and government law enforcement agencies. The bank monitors transactions and reports suspicious activity to the government, which identifies targets for investigations based on these reports. The bank undertakes costly monitoring and reporting, because the government will find it in cases where money laundering is successfully prosecuted and the bank did not report such a transaction (Becker, 1968).

The formal model builds on five main economic building blocks. First, communication is between the bank and the government, though here the problem is not with verifying the information, but rather with telling it precisely. Second, the bank's incentives to report are coarse; the bank is fined only for concealing potential money laundering information, i.e. for not reporting transactions which are prosecuted later as money laundering. Third, the bank is always uncertain about the transaction's true nature, i.e. every transaction can be potential money laundering. Fourth, the bank faces dual tasks: it has to monitor all transactions in order to report the suspicious ones. Fifth, the bank's information, i.e. its signal on the transaction, is not verifiable ex-post, because the local information at the time of the judgment cannot be reproduced later. The model shows that harmful excessive reporting, called crying wolf, can arise in this setup. As the bank cannot share its signal with the government, the government must make decisions based on whether or not it observes the report (Becker, 1968).

2.2.2 Transparency-Stability Theory

Regulation has now gone beyond the dichotomous language of public authority versus private interests (Hancher and Moran 1989). It has become apparent that differences between national regulatory requirements have led to distorted consequences. This has prompted regulation across the globe using multi-level governance through a specialized discourse involving specialist epistemic communities, broad financial policy and advocacy networks. Indeed, regulatory action brings about discursive practices by building upon participants shared understandings of problems and solutions. Tadesse (2006) for example, suggests banking crises are less likely to occur in countries with greater regulated disclosures and transparency.

Tadesse (2006) puts forward a transparency-stability theory which holds that greater disclosure and thus greater transparency facilitates efficient resource allocation by reducing informational asymmetry. If accounting information is viewed as public good (Watts and Zimmerman, 1986) central banks are funded by the public's conscripted taxpayers (and thus conscripted investors) then it is not unreasonable for central banks to produce extensive disclosures to satisfy the information needs of that public. This, of course, flies in the face of transparency-fragility theory which avers that greater disclosure may indicate widespread problems in the banking system which in turn creates negative externalities such as runs on money and concern about the financial system's vulnerability. But as Smellie (2004) explains, that there is now a global acceptance that the struggle against organized crime cannot be won unless some kind of enforcement is put in place. Such enforcement should be found in the contribution of central banks' extensive disclosure practices.

2.2.3 Economic Theory

In classical economic theory two basic forces determine the behavior of an individual. First, every individual acts rationally and aims to maximize his personal utility. This principle is taken into account for most decisions an individual takes. For criminal ventures which are committed to acquire personal wealth in particular, the decisions are governed by this principle. Second, the personal utility of an economic venture is mainly determined by its expected costs and revenues, which in turn are governed by the fundamental laws of demand and supply (Smith, 1846).

In this classical world of Adam Smith, it is not the individual person or company who looks after the wellbeing of the nation. "He [the individual] generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. [Smith, 1846] he intends only his own security; [Smith, 1846] he intends only his own gain, and he is in this, as in other cases, led by an invisible hand to promote an end which was no part of his intention." The state should protect its citizens from "violence" and "injustice". Adam Smith proposed the "obvious and simple system of natural liberty", where "every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men." (Smith, 1846).

But these principles only work, if the legal framework, e.g. AML rules, does not lead to distortion of competition. Given the differences in economic law and implementation worldwide, and also the different impact of AML rules and other regulation on the participants of the economy, this is assumption is questionable. State regulation often actively sets competitive incentives and therefore promotes certain institutional structures. This is dangerous, as could it retard, "instead of accelerating, the progress of the society towards real wealth and greatness; and

diminishes, instead of increasing, the real value of the annual produce of its land and labour (Smith, 1846).

2.3 Empirical Review

In 1989, the Group of Seven Industrial Democracies (G-7) created a global money-laundering watchdog organization called the Financial Action Task Force (FATF), with an Organization of Economic Cooperation and Development (OECD) Secretariat in Paris. In 1990, the FATF issued its first annual report, containing its now-famous FATF 40 Recommendations on actions for governments to take to combat money laundering. These 40 recommendations fell into three categories: Legal: What law-making bodies need to do create an overall legal framework to combat money laundering. For example, the first legal recommendation was that governments criminalize money laundering in its own right, and not merely in connection with drug trafficking (FATF, 2001).

Financial Regulatory: How governments should regulate their financial systems. An important example is that governments should require financial institutions to report suspicious activity to authorities. To make this work, governments would need to enact safe harbors to indemnify businesses and employees. International Cooperation: How governments should work together. For example, they should collaborate and exchange information in criminal matters and enter into bilateral treaties to facilitate asset seizure and forfeiture and the sharing of proceeds (FATF, 2003).

The FATF 40 Recommendations are still the most important set of international AML standards and have been a substantial force in encouraging government AML initiatives. In June 2003, the FATF issued a report revising and augmenting the 1990 Recommendations.6 Today, FATF

membership includes 33 jurisdictions and several other IGOs, including the international lending agencies. The FATF conducts mutual evaluations of members' progress in implementing the FATF 40 every four years, and also assesses the cooperation of other nations in combating international money laundering. There are also regional FATFs, such as the Caribbean Financial Action Task Force (CFATF), which has similar goals and objectives. The FATF also publishes annually an update of Money Laundering Typologies, providing refreshed assessments of money laundering risks and techniques (FATF, 2003).

Financial Statement Effects: Money launderers tend to use business entities more as a conduit than as a means of directly expropriating assets. For this reason, money laundering is far less likely to affect financial statements than are frauds such as misappropriations. Consequently, money-laundering activities are unlikely to be detected in a financial statement audit. In addition, while most frauds result in the loss or disappearance of assets or revenue, money laundering involves the manipulation of large quantities of illicit funds to distance them from their source quickly and in as undetectable a manner as possible. Because money-laundering activities may, however, have indirect effects on an entity's financial statements, they are of concern to external auditors (FATF, 2003).

Know Your Customer, Suspicious Activity Reporting and Tipping Off: An important element and theme of the FATF model and a number of FATF members' AML regimes, the Wolfs berg AML Guidelines and the Basel Committee's Customer Due Diligence for Banks are the KYC principles (The Financial Action Task Force, 2003). The primary objective of KYC principles is to enable effective identification and reporting of suspicious activity (FATF, 2003). The underlying assumption is that, unless you truly know your customer, and well enough to understand and anticipate that customer's business behavior, you can neither reasonably nor

effectively distinguish unusual and possibly suspicious activity from usual and customary behavior (FATF, 2003).

Mbwayo (2004) wrote a paper on the strategies applied by commercial banks in Kenya in anti money laundering compliance programs. Mbwayo (2004) found out that “As anti-money laundering measures are implemented in financial institutions, the risk of detection becomes greater for those seeking to use the banking system for laundering criminal proceeds. Increasingly, money launderers seek out the advice or services of specialised professionals to help facilitate their financial operations. Solicitors [and] accountants…provide advice to individuals and businesses in such matters as investment, company formation, trusts and other legal arrangements, as well as optimism of tax situation. Additionally, legal professionals prepare and, as appropriate, file necessary paperwork for the setting up of corporate vehicles or other legal arrangements.

Mutheu (2008) examined the Perceived Effects of Money Laundering on International Business using a case study of banks in Kenya. In view of these risks and the global impact of money laundering, the Kenyan Government recently enacted new anti-money laundering and counter-terrorist financing legislation, which regulates the activities of the financial sector, the gambling sector and bullion dealers. Legislation regulating the legal profession and other classes of professionals has also been drafted but has not yet been enacted. Like their colleagues in the developed countries, lawyers and accountants in Kenya will now have to implement an effective program to ensure they are compliant.

2.3.1 Money Laundering

Money laundering is, at its core, a simple phenomenon: it is the conversion of assets generated from criminal activity into assets that cannot be traced back to the underlying crime. Money laundering is done so that criminals can use their illicit profits in the open economy. Money laundering is traditionally separated into three stages: Placement is the process of transferring the proceeds from illegal activities into the financial system in a way that financial institutions and government authorities are not able to detect (Lilley, 2000). Layering is the process of generating a series or layers of transactions to distance the proceeds from their illegal source and to obscure the audit trail. Common layering techniques include outbound electronic funds transfers, usually directly or subsequently into a "bank secrecy haven" or a jurisdiction with lax record-keeping and reporting requirements, and withdrawals of already placed deposits in the form of highly liquid monetary instruments, such as money orders or travelers checks van Duyne (2003) and Integration, the final money-laundering stage, is the unnoticed reinsertion of successfully laundered, untraceable funds into an economy. This is accomplished by spending; investing and lending, along with cross-border, legitimate-appearing transactions (Duyne, 2003).

2.3.2 Effects of Money Laundering on Financial Institutions in Developing Countries

According to Bartlett (2002) Money Laundering facilitates illicit capital flight from developing economies. In addition, financial institutions in the developing countries could be eroded through three main means: the possibility that individual customers could be defrauded by corrupt staff of the institutions; by increasing probability that the institution itself could be corrupted and controlled by criminal interest and thirdly the institution itself been defrauded. These give way to reputational consequences therefore eroding critical investors' interest in the financial sector and the economy as a whole. These are the operational risk that has the potential of eroding the

financial institutions. For instance; an unauthorized staff "rogue trader" who lost approximately $100 million bringing a huge loss to the third largest bank in Croatia, (Bartlett, 2002).

2.3.3 Anti-Money laundering in Kenya

Proceeds of Crime and Anti-Money Laundering (AML) law aims to enable the identification, tracing, freezing as well as seizure and confiscation of proceeds of crime. The AML Law seeks to establish a Financial Reporting Centre (FRC) and Assets Recovery Agency, to criminalize money laundering and further require reporting institutions to take measures to help combat money laundering. The Act has further ensured Kenya's compliance with anti-money laundering standards set by the Financial Action Task Force on Money Laundering (FATF, 2003) an intergovernmental body that promotes policies to combat money laundering and terrorist financing globally.

The law's enactment is being lauded as a positive move by players in the country's banking and financial services sector, who see it as a key step in the country's fight against money laundering in the country and region. As banks improved their controls for preventing, detecting and reporting money laundering, however, and as law enforcement has made similar strides, criminals have learned to diversify their operations and to expand into other financial institutions or conduits of financial activity (Mutheu, 2008).

2.4 Conclusion

This chapter reviewed literature on the work of past scholars in the area of anti money laundering and its effects on an economy. It reviewed the theories that the study is grounded including the agency theories. The study used theory of crying wolf, Transparency-Stable Theory and the Economic Theory. Bartlett (2002) argued that Money Laundering facilitates illicit capital flight

from developing economies and that financial institutions in the developing countries could be eroded through three main means: the possibility that individual customers could be defrauded by corrupt staff of the institutions; by increasing probability that the institution itself could be corrupted and controlled by criminal interest and thirdly the institution itself been defrauded. Mutheu (2008) observed that law's enactment is being lauded as a positive move by players in the country's banking and financial services sector, who see it as a key step in the country's fight against money laundering in the country and region.

Mbwayo (2004) did a study on the strategies applied by commercial banks in Kenya in anti money laundering compliance programs whereby he found out that as anti-money laundering measures are implemented in financial institutions, the risk of detection becomes greater for those seeking to use the banking system for laundering criminal proceeds. Increasingly, money launderers seek out the advice or services of specialised professionals to help facilitate their financial operations. No study has been done on of anti-money laundering regulation implementation on the financial performance of commercial banks in Kenya. Therefore, this study sought to fill the gap by investigating the effects of anti-money laundering regulation implementation on the financial performance of commercial banks in Kenya.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methodology that was used to carry out the study. The sections presented here include research design, population of the study, data collections and data analysis.

3.2 Research Design

The research was conducted through a descriptive survey which will be aimed at determining the extent of money-laundering policy compliance by commercial banks and whether it affects their performance. A descriptive survey study is concerned with finding out what, where and how of a phenomena Cooper and Schindler (2006). The main focus of this study was quantitative. However some qualitative approach was used in order to gain a better understanding and possibly enable a better and more insightful interpretation of the results from the quantitative study.

3.3 Population of the Study

The population of the study consisted of 42 commercial banks operating in Kenya as at 30th June 2013. (Appendix II). The Bank under statutory management was not considered because of its legal status, uncertainty in its continuity and the fact that it is not actively dealing with customers or transacting. Target population is the specific population about which information is desired (Touliatos & Compton, 1988).

3.4 Data Collection

The study relied on both primary and secondary sources of data. Primary data was collected using a semi-structured self administered questionnaire. (See appendix I). A questionnaire is more appropriate since the study is concerned with variables which cannot be directly observed such as views, opinions, perceptions and feeling of the respondents. Such information is collected through the use of questionnaires (Touliatos & Compton, 1988).

Secondary data was obtained from audited annual reports of the banks filed with Central Banks of Kenya for the last five years. The data collected was for both the Anti-Money Laundering Regulation Implementation variables and financial performance variables.

3.5 Data Analysis

The data collected will be coded and analyzed using both descriptive statistics and inferential statistics (using the Ordinary Least Squares-OLS-regression). The result was computed using SPSS version 17 for windows. Data was presented in figures and tables, summary statistics of the mean, and standard deviation. In addition, Multiple regression analysis was used in order to establish whether the set of independent variables (Regulation implementation variables, on one hand) explain a proportion of the variance in the dependent variable (financial performance variables, on the other hand) and also established the relative predictive importance of the independent variables (by comparing beta weights).

3.5.1 Research Model

A multiple regression model was employed to estimate the combined effects of anti-money laundering regulation implementation on the financial performance of the 42 commercial banks registered in Kenya. Along the line of Hassan (2011), the AML Regulation Implementation

(AMLRI) is estimated as a function of the firm's characteristics, which have been defined in this study as Banks Reporting (BR), Operational Cost (OC) and Cost of Monitoring Transactions (CMT). The significance of the research model was to show that there is a relationship between banks reporting, fine for concealing information and monitoring transactions and financial performance of commercial banks in Kenya. This was expressed as AMLRI= f (BR, OC, CMT,). On the other hand, financial performance (FP) was represented by Return on Asset (ROA).

Thus, FP= f (AMLRI), which by expansion becomes:

FP= f (BR, OC, CMT)

The Ordinary Least Squares (OLS) regression that is used to estimate the relationship is as follows:

$ROA = \beta_0 + \beta_1 BR + \beta_2 OC + \beta_3 CMT + \acute{\varepsilon}$………………. (i)

Where:

ROA is Return on Assets

BR= Bank Reporting

OC= Operational Costs

CMT= Cost of Monitoring Transactions

β_0 = Constant

β_1 to β_3 = Parameters to be estimated.

$\acute{\varepsilon}$ = error term.

Therefore,

$FP = \mathbb{C}_o + \beta_0 + \beta_1 BR + \beta_2 OC + \beta_3 CMT + \acute{\varepsilon}$

Where:

$\mathbb{C}_o$ is the intercept co-efficient

In order to test the significance of the model in measuring the relationship between banks reporting, fine for concealing information and monitoring transactions and financial performance of commercial banks in Kenya, this study conducted an Analysis of Variance (ANOVA). On extracting the ANOVA statistics, the researcher looked at the significance value. The study was tested at 95% confidence level and 5% significant level. If the significance number was found to less than the critical value (α) set, then the conclusion was that the model was significant in explaining the relationship.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This chapter presents data collected using questionnaires. The purpose of the study was to investigate the effects of anti-money laundering regulation implementation on the financial performance of commercial banks in Kenya.

The data was collected using a questionnaire as the data collection instruments. The study targeted 42 respondents. 31 questionnaires out of 42 were completed and returned giving a response rate of 73%. This response rate was good enough and conforms to that recommended by Mugenda and Mugenda (2003).

4.2 Bank Reporting

4.2.1 Effects of AML on bank reporting

The study sought to find out the effects of AML on bank reporting in Kenya

Table 4.1: Effects of AML on bank reporting

Description	Mean	Std. Deviation
It has increased transactional Screening	4.00	1.0010
It has increased the reporting frequency	3.18	1.5374
It has broadened the types of reports prepared	4.45	0.8202
It has broadened regulatory framework	4.18	0.8739

Asked if it has increased transactional Screening the respondents agreed as shown by a mean of 4.00.On if it has increased the reporting frequency the respondents moderately agreed as shown by a mean of 3.18.Asked if it has broadened the types of reports prepared the respondents agreed as shown by a mean of 4. 45. And on if it has broadened regulatory framework the respondents agreed as shown by a mean of 4. 18.

4.2.2 Extent to which the bank reporting affects AML in Kenya

The study sought to find out the extent to which the bank reporting affects AML in Kenya

Table 4.2: Extent to which the bank reporting affects AML in Kenya

	Frequency	Percent
To a very great extent	9	29
To a great extent	7	23
To a moderate extent	11	35
To a little extent	3	10
To no extent	1	3
Total	31	100

From the study findings, 29% the respondents indicated that the bank reporting affects AML in Kenya to a very great extent, 23% to a great extent, 35% of a moderate extent, 10% of a little extent and 3 % to no extent.

4.3 Operational Costs

4.3.1 Operational costs on money laundering

The study sought to find out the level of respondents' agreement with each statement as regards operational costs on AML.

Table 4.3: Operational costs on money laundering

Description	Mean	Std. Deviation
Increased/high transaction costs	3.55	0.6876
All application for employment are too stringent due diligence background checks	3.55	1.4397
All staff have been trained on identification of suspicious transactions	2.91	1.4460
All staff have being informed of the sanctioned countries	2.36	1.0269
Employees are encouraged to immediately report and fraudulent conduct of colleagues that is suspected, notices or actually observed or detected	2.64	1.2863
Currency fluctuation	2.00	1.0955

On increased/high transaction costs the respondents agreed as shown by a mean of 3.55. On whether all application for employment are too stringent due diligence background checks the respondents agreed as shown by a mean of 3.55.Asked if all staff have been trained on identification of suspicious transactions the respondents agreed to a little extend as shown by a mean of 2.91.On if all staff have being informed of the sanctioned countries the respondents agreed to a little extend as shown by a mean of 2.36. Asked whether the employees are encouraged to immediately report and fraudulent conduct of colleagues that is suspected, notices or actually observed or detected the respondents agreed to a little extend as shown by a mean of 2.64.On currency fluctuation the respondents agreed to a little extend as shown by a mean of 2.00.

4.3.2 Operational costs on AML

The study sought to find out the extent to which the operational costs affects AML in Kenya.

Table 4.4: Operational Costs on AML

	Frequency	Percent
To a very great extent	11	35
To a great extent	8	26
To a moderate extent	10	32
To a little extent	1	3
To no extent	1	3
Total	31	100

From the study findings, 35% the respondents indicated that the operational costs affects AML in Kenya to a very great extent, 26% to a great extent, 32% of a moderate extent, 3% of a little extent and 3 % to no extent.

4.4 Cost of Monitoring Transactions

4.4.1 Cost of monitoring transactions on AML

The study sought to find out the level of respondents' agreement with each statement as regards cost of monitoring transactions on AML.

Table 4.5: Cost of Monitoring Transactions on AML

Description	Mean	Std. Deviation
There are enough staff to monitor suspicious transaction in the Bank	3.14	1.2608
Monitoring cost have increased business operational cost	2.61	1.4079
Implementation of AML has consumed high capital	3.40	1.6039
AML has reduced business opportunities for the bank	2.41	1.2989
The expenses in AML has been done fully by the Bank	4.44	1.0654

Asked if there were enough staff to monitor suspicious transaction in the Bank the respondents agreed to a little extend as shown by a mean of 3.14. On if monitoring cost have increased business operational cost the respondents agreed to a little extend as shown by a mean of 2.61.On the implementation of AML has consumed high capital the respondents agreed to a little extend as shown by a mean of 3.40.Asked if AML has reduced business opportunities for the bank the respondents agreed to a little extend as shown by a mean of 2.41.On whether the expenses in AML has been done fully by the Bank the respondents agreed to a little extend as shown by a mean of 4.44.

4.4.2 Cost of monitoring transactions on AML in Kenya

The study sought to establish the extent to which the cost of monitoring transactions affects AML in Kenya.

Table 4.6: Cost of monitoring transactions on AML in Kenya

	Frequency	Percent
To a very great extent	17	55
To a great extent	9	29
To a moderate extent	5	16
Total	31	100

From the study findings, 55% the respondents indicated that the cost of monitoring transactions affects AML in Kenya to a very great extent, 29% to a great extent and 16% of a moderate extent.

4.5 AML Measures Taken by Commercial Banks

The study sought to establish the extent to which the following AML measures are applied by your bank. The findings are presented in the table below.

Table 4.7: AML Measures Taken By Commercial Banks

Items	Mean	Std. Deviation
Staff training on anti-money laundering issues	4.45	0.8202
A centralized customer account opening centre	4.00	0.8944
KYC or customer identification screening program	3.82	0.7508
A documented and approved AML policy and procedures	4.36	0.8090
Filling forms to report transactions on SAR	3.73	1.1037
Application of Customer Identification Program (CIP)	3.82	0.8739
Creating awareness on suspicious account reporting (SAR)	4.18	0.7508
Your bank's allocation of resources to fight money laundering.	3.82	0.7508
Application of an internal management information system that provides Money laundering information to management.	3.55	0.8202
A designated AML Compliance Officer where AML issues are reported	3.36	1.3618
An independent Audit function that comes out testing and review of the compliance programmes.	3.55	1.1282

On staff training on anti-money laundering issues the respondents indicated that the measure was largely applied as shown by a mean of 4.4545.On a centralized customer account opening centre the respondents indicated that the measure was largely applied as shown by a mean of 4.0000.On KYC or customer identification screening program the respondents indicated that the measure was moderately applied as shown by a mean of 3.8182. On documented and approved AML policy and procedures the respondents indicated that the measure was largely applied as shown

by a mean of 4.3636. On filling forms to report transactions on SAR the respondents indicated that the measure was moderately applied as shown by a mean of 3.7273. On application of Customer Identification Program (CIP) the respondents indicated that the measure was moderately applied as shown by a mean of 3.8182.

On creating awareness on suspicious account reporting (SAR) the respondents indicated that the measure was largely applied as shown by a mean of 4.1818. On your bank's allocation of resources to fight money laundering the respondents indicated that the measure was the measure was moderately applied as shown by a mean of 3.8182. On the application of an internal management information system that provides Money laundering information to management the respondents indicated that the measure was moderately applied as shown by a mean of 3.5455.On a designated AML Compliance Officer where AML issues are reported the respondents indicated that the measure was moderately applied as shown by a mean of 3.3636. On An independent Audit function that comes out testing and review of the compliance programmes the respondents indicated that the measure was moderately applied as shown by a mean of 3.5455.

4.5.1 Effectiveness of AML Policies in the Bank Today

The study sought to establish whether the AML policies in the bank are effective today than they were 5 years ago.

Table 4.8: Effectiveness of AML policies in the bank today

AML policies	Frequency	Percent
Yes	19	61
No	12	39
Total	31	100

From the study findings, majority 61% of the respondents indicated that the AML policies in the bank are effective today than they were 5 years ago while as 39% indicated that they were not effective.

4.6 Regression Analysis

In order to establish the relationship between return on assets and the independent variables which included banking reporting, operating costs, cost of monitoring transactions. The study conducted a multiple regression analysis.

Table 4.9: Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.920[a]	.890	.853	543.711
a. Predictors: (Constant), Bank Reporting, Operational Costs, Cost of Monitoring Transactions				

Coefficient of determination explains the percentage of variation in the dependent variable (Return on Asset) that is explained by the independent variables or extent to which changes in

the dependent variable can be explained by the change in the independent variables.

From the analysis, the independent variable studied here had a strong relationship with return on assets as explained by adjusted R^2 of 0.89. A deduction can therefore be made that the relationship between return on assets and the independent variables (Bank Reporting, Operational Costs and Cost of Monitoring Transactions) is strong.

The study further conducted an Analysis of Variance to check on the significance of the Model. The findings were as shown in table 4.2 below:

Table 4.10: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.0492	3	4.1363	11.421	.036[a]
	Residual	8.5136	2	2.8862		
	Total	2.6142	5			
a. Predictors: (Constant), Bank Reporting, Operational Costs, Cost of Monitoring Transactions.						
b. Dependent Variable: Return on Assets						

From the ANOVAs results, the probability value of 0.036 was obtained which indicates that the regression model was significant in predicting the relationship between Return on Assets and the predictor variables.

Table 4.11: Coefficients

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1344.313	1121.478		10.025	.043
	Bank Reporting	4.303	3.014	1.031	-1.305	.028
	Operational Costs	-20.944	4.023	-2.637	-3.631	.009
	Cost of Monitoring Transactions	-9.242	3.150	-.615	-2.552	.054
a. Dependent Variable: Return on Assets						

The researcher conducted a regression analysis so as to determine the relationship between independent variables and Return on Assets (dependent variable). The following regression equation was obtained:

ROA = 1344.313 + 4.303BR- 20.944OC - 9.242CMT

From the regression model obtained above, holding all the other factors constant, the Return on Assets would be 1344.313. A unit change in bank reporting holding the other factors constant will lead to change the Return on assets by 4.303; A unit change in Operational Costs holding the other factors constant will change Return on assets by - 20.944 while a unit change in Cost of Monitoring Transactions holding the other factors constant will change the Return on assets by -

9.242. This implied that bank reporting had the highest influence on Return on assets followed by Cost of Monitoring Transactions and finally Operational Costs.

The obtained regression equation further implied that there was a direct relationship between Return on assets and reporting on banks while there was an inverse relationship between return on assets and Cost of Monitoring Transactions as well as Operational Costs.

The analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the corresponding probability value obtained and α=0.05. If the probability value was less than α, then the predictor variable was significant otherwise it wasn't. Bank reporting and operational costs were significant in the model as their corresponding predictor variables were 0.028 and 0.009 respectively while cost of monitoring transactions was insignificant in the model as the probability value obtained was 0.054.

4.7 Discussions and Interpretation of Findings

The study findings established that bank reporting, operational costs and cost of monitoring transactions had high influence on the return on assets hence the relationship was found to be very strong. Operating costs and cost of monitoring transactions were found to inversely relate to return on assets while bank reporting was found to be directly related to the Return on Assets. Increase in operating cost led to increased expenditure by the banks and therefore lowering return. Also, increase in the cost of monitoring transactions led to increase in the expenditures incurred by the in turn reduced the returns obtained. The direct influence of bank reporting on the Return on assets could be attributed to the improvement in the operating and reduction in the money laundering incidences in banks.

The study found out that banks had increased transactional Screening as well as reporting frequency and that the banks had broadened the types of reports prepared as well as regulatory framework. These efforts could have been made to improve bank reporting so as to effectively fight money laundering in Kenya. With advancement in technology, chance of money laundering could occur more easily hence necessitating improvement of reporting. The study findings established that bank reporting had a great impact on AML in Kenya to a very great extent.

The AML is expected to trigger increase operational cost as banks have to put on mechanisms to fight money laundering. This can be as a result of acquiring modern technology as well as training of the staffs. The study findings established that AML Had led to increased/high transaction costs, subjection of application for employment to stringent due diligence background checks and training of the staff on identification of suspicious transactions. The study revealed that the operational costs affect AML in Kenya to a very great extent.

The study found out that there were enough staff to monitor suspicious transaction in the Bank, monitoring cost had increased business operational cost, implementation of AML has consumed high capital and that the cost of monitoring transactions affects AML in Kenya to a very great extent. The study also revealed that staff were trained on anti-money laundering issues, existence of centralized customer account opening centre, application of KYC or customer identification screening program and application of Customer Identification Program (CIP).

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the summary of the findings from chapter four and also the conclusions and recommendations of the study based on the objectives of the study. The general objective of this study was to investigate the effects of anti-money laundering regulation implementation on the financial performance of commercial banks in Kenya.

5.2 Summary

The study established that there is increased transactional Screening by the banks and the respondents agreed as shown by a mean of 4.0000. On if it has increased the reporting frequency the respondents moderately agreed as shown by a mean of 3.1818.Asked if it has broadened the types of reports prepared the respondents agreed as shown by a mean of 4. 4545. And on if it has broadened regulatory framework the respondents agreed as shown by a mean of 4. 1818. 29% the respondents indicated that the bank reporting affects AML in Kenya to a very great extent.

On increased/high transaction costs the respondents agreed as shown by a mean of 3.5455. On whether all application for employment are subjected to stringent due diligence background checks the respondents agreed as shown by a mean of 3.5455. Asked if all staff have been trained on identification of suspicious transactions the respondents agreed to a little extend as shown by a mean of 2.9091, 35% the respondents indicated that the operational costs affects AML in Kenya to a very great extent.

The study found out the level of respondents' agreement with each statement as regards cost of monitoring transactions on AML. Asked if there were enough staff to monitor suspicious transaction in the Bank the respondents agreed to a little extend as shown by a mean of 3.1397. On if monitoring cost have increased business operational cost the respondents agreed to a little extend as shown by a mean of 2.6069.On the implementation of AML has consumed high capital the respondents agreed to a little extend as shown by a mean of 3.4034.Asked if AML has reduced business opportunities for the bank the respondents agreed to a little extend as shown by a mean of 2.4057, 55% the respondents indicated that the cost of monitoring transactions affects AML in Kenya to a very great extent.

On staff training on anti-money laundering issues the respondents indicated that the measure was largely applied as shown by a mean of 4.4545.On a centralized customer account opening centre the respondents indicated that the measure was largely applied as shown by a mean of 4.0000.On KYC or customer identification screening program the respondents indicated that the measure was moderately applied as shown by a mean of 3.8182. On application of Customer Identification Program (CIP) the respondents indicated that the measure was moderately applied as shown by a mean of 3.8182.

5.3 Conclusion

From the findings, the study concludes that bank reporting affects AML these has lead to increased transactional costs due to screening and the reporting frequency that the bank has instituted as well broadened the types of reports prepared.

The study further concludes that operational costs affect the performance of commercial banks in Kenya to a very great extent due to increased/high transaction costs that the bank incur including training staff on identification of suspicious activities.

As regards to the cost of monitoring transactions on AML the study concludes that there are no enough staff to monitor suspicious transaction in the Bank and that the cost of monitoring transactions affects AML in Kenya to a very great extent.

5.4 Limitations of Study

The main limitation of the study was the unavailability of data or difficulty in obtaining data that is likely to have a strong direct effect on the analysis of financial performance. This is because financial performance is influenced by many other factors such as the decisions of the Board, quality of management staff, cost management and cost of banks funds among others.

The study was further limited by the fact that the researcher only administered the questionnaires to the top functional head and departmental heads of the commercial banks. Therefore only the managerial perspective informed the findings of the study while the perspective of junior employees was not factored.

Another limitation was in the explanatory power of the model. The model explains about four variables that affected the performance of commercial banks. This suggests that there are a number of variables that are left out in the model which would have improved the explanatory power of the model. Other similar financial institutions were not researched on.

It was also difficult to access data because some respondents failed to give adequate information for fear of victimization by management. However, the researcher assured them that the information was confidential and would be used only for academic purpose.

The study covered a period of five years. However studies of this nature spun for periods of several decades. This is because financial performance and implementation of the AML regulations cover a long period of time. Accordingly the results may not be conclusive.

The financial resources available to carry out the study were not adequate. The researcher however utilized the only available resources to facilitate the success of the study.

5.5 Policy Recommendations

The researcher makes the following recommendation to address the key findings of the study. The study recommends that bank management should offer staff training on anti-money laundering issues. The centralized customer account opening centre as well as customer identification screening program should be implemented to counter money laundering.

The study further recommends that to ensure the stability and integrity of the financial system the financial action task force (FATF) should continue to be implemented in addition to regulatory and institutional framework under the AML Act, in collaboration with the Central Bank of Kenya (CBK).

The study also recommends that the policymakers should enact legislation that can capacitate the commercial banks to and other relevant institutions to fight against money laundering issues.

5.6 Recommendations for Further Research

Further research is recommended with full disclosure of information and data on the effectiveness of the implementation of the Anti money laundering regulations in the performance of commercial banks in Kenya.

The researcher suggests that a study whose respondents include junior staff and officers posted in the branches can give feedback to provide great insight in their perspective of the effect of AML regulation implementation by commercial banks in Kenya.

Due to the shortcomings of the regression model used, further research using other models can be used to explain the various relationships between variables. This should be done using more independent variables in the model so as to improve the explanatory power of the model.
Further research is needed to establish if controls in AML regulations are effective in other financial institutions and how they influence the performance of the financial sector in Kenya.

The researcher used 5 years data. Further research can be conducted for a longer period of time to obtain more representative data.

More financial resources can be availed to carry out a comprehensive study since this research was carried out with financial strains. The researcher however utilized the only available resources to facilitate the success of the study.

REFERENCES

Agarwal, J. D. and Aman Agarwal (2002). Liberalization of Capital Flows, Banking System & Trade: Focus on Crisis Situations; Invited paper for International Review of Comparative Public Policy, titled *International Financial Systems and Stock Volatility* Volume 13,pages 151-212.

Alexander, K. (2001). The international anti-money laundering regime: the role of the financial action task forces, *Journal of Money Laundering Control*, Vol. 4 No.3, pp.213-32.

Angell, I.O. and Demetis, D.S. (2005). Systems thinking about anti-money laundering: considering the Greek case, Jo*urnal of Money Laundering Control*, Vol.8 No. 3, pp. 271

Barrett, R. (1997). Confronting tax havens, the offshore phenomenon, and money laundering. *International Tax Journal,* Vol. 23 No.2, pp.12-42.

Barve, J. (2010). COBIT for IT risk management in a bank – a case study, *COBIT Focus*.

Becker, G.S. (1968). Crime and Punishment: An Economic Approach, *Journal of Political Economy*, Vol 76, pp. 169-217

Berger, A. (2003). The economic effects of technological progress: evidence from the banking industry, *Journal of Money, Credit and Banking*,

Blum, J. A., Michael L. R., Naylor, T and Phil, W. (1998). Financial havens, banking secrecy and money laundering. A study prepared on behalf of the United Nations under the auspices of the Global Programme against Money Laundering, Office for Drug Control and Crime Prevention; Vienna, Austria. (Available at: http://www.cf.ac.uk/socsi/whoswho/levi-laundering.pdf

Camdessus, M. (1998). *Money Laundering: the importance of International Countermeasures*, Plenary meeting of the FATF, Paris.

Central Bank of Kenya (2007). Guidance notes on the detection and prevention and preventions of money laundering and Terrorism financing activities. Retrieved from http://www.centralbank.go.ke.

Cooper D.R and Pamela S.Schindler, (2003). Business Research Methods: New Delhi: Tata Mc Graw-Hill publishing Company ltd.

Cyber Laundering.(2002). The Risks to On-line Banking and E-Commerce Companies. Retrieved (2013, March 29) http://www.antimoneylaundering.ukf.net/papers/solicitor.htm

Dan, M. (2009). The Illegal Sector, Money Laundering and Legal Economy: A Macroeconomic Analysis, *Journal of Financial Crime, Vol.4, No.2, pp.103-112*

Duyne, P. C. Van (2003). Money Laundering, Fears and Facts. in Duyne, P.C. Van, Lampe, K. Von & Newell, J.L. (ed.), Criminal Finances and Organizing Crime in Europe, Nijmegen: Wolf Legal Publishers, p. 67-104

FATF, (2001) Review to Identify Non-Cooperative Countries or Territories. 22June.Paris:FATF.

FATF (2002-2006) Financial Action Task Force on Money Laundering, the Mutual Evaluation Reports on Anti-Money Laundering and Combating the Financing of Terrorism of Australia and United States of America (May 2006), *published on the FATF* website: www.fatf-gafi.org

George Kegoro, (2002, July and August). Profiling Money Laundering in Eastern and Southern

Africa. *Money laundering patterns in Kenya.5,* 1

Government of Kenya (2004). The Banking Act Cap 488 Nairobi, CBK.

Government of Kenya (2004). The Central Bank Act Cap 489 Nairobi, CBK

Government of Kenya (2006). Prudential Guidelines -Nairobi, CBK

Government of Kenya (2010). Proceeds of Crime and Anti-Money Laundering Act -Nairobi

Hancher, L., Moran, L. (1989). Organizing regulatory space, in Hancher, L., Moran, M. (Eds),*Capitalism, Culture and Economic Regulation*, OUP, Oxford, pp.271-4.

Hassan, S. U. (2011). Corporate Governance and Financial reporting Quality: A Case Study of Nigerian Money Deposit Bank, *International Journal of Research in Computer Application and Management*. 26: 12-19.

Hutter, B. (2005). The attractions of risk-based regulation: accounting for the emergence of risk ideas in regulation, London School of Economics and Political Science, Economic & Social Research Council Centre for Analysis of Risk and Regulation, London, *Discussion Paper* No. 33, .

Lilley, P (2003). Dirty dealing, the untold truth about Global money laundering international Crime and terrorism, *Stylus Pub 2003* pp51-52

Mbwayo, M., (2005). Strategies applied by commercial banks in Kenya in Anti-Money Laundering compliance programmes, *Unpublished MBA Project*, University of Nairobi

Mishkin, F., Strahan, P. (1999). What will technology do to financial structure? *Working Paper Series,* Working Paper No. 6892,

Mugenda, O & Mugenda, A. (2003): *Research Methods; Quantitative and Qualitative approaches;* Nairobi, African Center for Technology Studies

Mutheu, M. (2008). Perceived effects of money laundering on international business. A case study of banks in Kenya. *Unpublished MBA Project*, University of Nairobi

Njagi, L. (2009). Effectiveness of know your customer (KYC) policies adopted by commercial banks in Kenya in reducing laundering and fraud incidents. *Unpublished MBA Project,* University of Nairobi

Olasanmi, O. (2010). Computer crimes and counter measures in the Nigerian banking sector, *Journal of Internet Banking & Commerce*, *Vol. 15 No. 1, pp. 1-10.*

Philippsohn, S. (2001). The dangers of new technology – laundering on the internet, *Journal of Money Laundering Control*, Vol. 5 No.1,

Rebecca O.K (2008). The challenges of implementing Anti-Money Laundering regimes in the banking sector in Kenya. *Unpublished MBA Project,* University of Nairobi

Ross, S., Hannan, M. (2007). Money laundering regulation and risk-based decision-making, *Journal of Money Laundering Control*, Vol. 10 pp.106-15.

Smellie, A. (2004). Prosecutorial challenges in freezing and forfeiting proceeds of transnational crime and the use of international asset sharing to promote international cooperation, *Journal of Money Laundering Control*, Vol. 8 No.2, pp.104.

Tadesse, S. (2006). Economic value of regulated disclosure: evidence from the banking sector, *Journal of Accounting & Public Policy*, Vol. 25 pp.32-70.

Touliatos & Compton, (1988). Research methods in human ecology/home economics, *Published by Iowa State University Press* (Ames)

Toroitich, E. (2010). Challenges faced by the Central Bank of Kenya in Combating Money Laundering, *Unpublished MBA Project*, University of Nairobi

Watts, R., Zimmerman, J. (1986). *Positive Accounting Theory*, Prentice-Hall, Engle wood Cliffs,

Yeandle, M., Mainelli, M., Berendt, A., and Healy, B. (2005). Anti-Money Laundering Requirements: Costs, Benefits and Perceptions Institute of Chartered Accountants In England and Wales and the Corporation of London City Research Series No. 6.

APPENDIX I

Commercial Banks

1. African Banking Corporation Ltd.
2. Bank of Africa Kenya Ltd.
3. Bank of Baroda (K) Ltd.
4. Bank of India
5. Barclays Bank of Kenya Ltd.
6. CFC Stanbic Bank Ltd.
7. Charter house bank Ltd –Under Statutory Management
8. Chase Bank (K) Ltd.
9. Citibank N.A. Kenya
10. Commercial Bank of Africa Ltd.
11. Consolidated Bank of Kenya Ltd.
12. Co-operative Bank of Kenya Ltd.
13. Credit Bank Ltd.
14. Development Bank of Kenya Ltd.
15. Diamond Trust Bank of Kenya Ltd.
16. Dubai Bank Kenya Ltd.
17. Ecobank Kenya Ltd.
18. Equatorial Commercial Bank Ltd.
19. Equity Bank Ltd.

20. Family Bank Ltd.
21. Fidelity Commercial Bank Ltd.
22. Fina Bank Ltd.
23. First Community Bank Ltd.
24. Giro Commercial Bank Ltd.
25. Guardian Bank Ltd.
26. Gulf African Bank Ltd.
27. Habib Bank A.G. Zurich
28. Habib Bank Ltd.
29. Imperial Bank Ltd.
30. I & M Bank Ltd.
31. Jamii Bora Bank Ltd.
32. Kenya Commercial Bank Ltd.
33. K-Rep Bank Ltd.
34. Middle East Bank Kenya Ltd.
35. National Bank of Kenya Ltd.
36. NIC Bank Ltd.
37. Oriental Commercial Bank Ltd.
38. Paramount Universal Bank Ltd.
39. Prime Bank Ltd.
40. Standard Chartered Bank of Kenya Ltd.
41. Transnational Bank Ltd.

42. UBA Kenya Bank Ltd.

43. Victoria Commercial Bank Ltd

APPENDIX III: Questionnaire

SECTION A: Background Details

1. Name of the Bank: ______________________________ (Optional)

Section B. Bank Reporting

2. Below as some of the statements on the effects of AML on bank reporting in Kenya .Kindly indicate your level of agreement with each statement in your bank. On a scale of 1-5, please indicate the extent of your agreement with each statement as regards effects of Money laundering (Tick appropriately)

Description	1	2	3	4	5
It has increased transactional Screening					
It has increased the reporting frequency					
It has broadened the types of reports prepared					
It has broadened regulatory framework					

3. To what extent does the bank reporting affects AML in Kenya

   To a very great extent [ ]

   To a great extent [ ]

   To a moderate extent [ ]

   To a little extent [ ]

   To no extent [ ]

Section C. Operational Costs

4. Below as some of the statements on the effects of AML on operational costs in Kenya .Kindly indicate your level of agreement with each statement in your bank. On a scale of 1-5, please indicate the extent of your agreement with each statement as regards effects of Money laundering (Tick appropriately)

Items	1	2	3	4	5
Increased/high transaction costs					
All application for employment are to stringent due diligence background checks					
All staff have been trained on identification of suspicious transactions					
All staff have being informed of the sanctioned countries					
Employees are encouraged to immediately report and fraudulent conduct of colleagues that is suspected, notices or actually observed or detected					
Currency fluctuation					

5. To what extent does the operational costs affects AML in Kenya

   To a very great extent [ ]

   To a great extent [ ]

   To a moderate extent [ ]

   To a little extent [ ]

   To no extent [ ]

Section D. Cost of Monitoring Transactions

6. Below as some of the statements on the effects of AML on operational costs in Kenya .Kindly indicate your level of agreement with each statement in your bank. On a scale of 1-5, please indicate the extent of your agreement with each statement as regards effects of Money laundering (Tick appropriately).

Cost of Monitoring Transactions	**1**	**2**	**3**	**4**	**5**
There are enough staff to monitor suspicious transaction in the Bank					
Monitoring cost have increased business operational cost					
Implementation of AML has consumed high capital					
AML has reduced business opportunities for the bank					
The expenses in AML has been done fully by the Bank					

AML Measures Taken By Commercial Banks

7. Listed below are the AML measures taken by commercial banks, please indicate the extent to the measures are applied in the anti-money laundering compliance program in your bank. Use a five point measurement scale as follows 1=Not applied at all, 2= Least applied**,3**=Moderately applied**,4**=Largely applied**,5**=Applied to a great extent.

Items	**1**	**2**	**3**	**4**	**5**
Staff training on anti-money laundering issues					
A centralized customer account opening centre					
KYC or customer identification screening program					
A documented and approved AML policy and procedures					
Filling forms to report transactions on SAR					
Application of Customer Identification Program (CIP)					
Creating awareness on suspicious account reporting (SAR)					
Your bank's allocation of resources to fight money laundering.					
Application of an internal management information system that provides Money laundering information to management.					
A designated AML Compliance Officer where AML issues are reported					
An independent Audit function that comes out testing and review of the compliance programmes					

Thank you for your participation.