EFFECTIVENESS OF KNOW YOUR CUSTOMER (KYC) POLICIES ADOPTED BY COMMERCIAL BANKS IN KENYA IN REDUCING MONEY LAUNDERING AND FRAUD INCIDENCES

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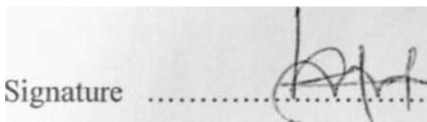
DECLARATION

This is my original work and has nol been presented for a degree in any other university.



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

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DEDICATION

Tliis research paper is dedicated to my family and friends. Thank you for the love, support and always being there. God bless you.

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ABBREVIATIONS AND ACRONYMS

AML	Anti Money Laundering
ATM i	Automatic teller machine
CBK	Central Bank of Keya
KYC	Know Your Customer
MNCs	Multinational Corporations
NGO	Non-governmental Organization
PIN	Personal Identification Number
SMEs	Sinai! and Medium Enterprises
USA	Unii ;d Stales of America

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ABSTRACT

Fraud and money laundering have bceome rampant crimes in commercial banks which unless controlled, will continue exposing the financial institutions to massive losses both in terms of financial costs and loss of customers' confidence leading into loss of business. Bank fraud includes all sorts of misappropriations, embezzlements, manipulation of negotiable instruments, misrepresentations, impersonation, cheating, thefts, undue favors and irregularities. Introduced under the Banking Act in the laws of Kenya in January 2006, prudential guidelines on proceeds of crime & money laundering, which emphasised on know your customer (KYC), aimed at reducing and finally eliminating altogether fraud and money laundering incidences. However, with the crime having entrenchcd itself over the years and its methods of execution evolving over time, it has become increasingly difficult to detect, prevent, investigate, and prosecute those involved.

The objective of this study was to establish the current KYC practice, the level of compliance and the general effectiveness of the policies in reducing fraud and money laundering cases in commercial banks in Kenya. The research design was a survey with a population of 43 licensed commercial banks targeted. Primary data was collected by use of a structured questionnaire which was administered to risk and compliance managers and account opening officers, while secondary data was obtained from the industry regulator's banking fraud prevention unit. The data collected was analysed, and presented by use of graphs, pie charts, bar charts and tables.

In conclusion, the KYC strategies are in themselves sufficient to curb cases of fraud and money laundering reported in commercial banks. However, the problem lies with compliance with banks choosing what policies and procedures to comply with, and what to give little importance if not ignore completely. The recommendations include putting in place mechanisms to ensure full compliance, with the industry regulator - CBK, required to play a more active supervisory role and imposing heavy penalties on non-cornpiiant banks. Establishment of a databank containing information on those involved in fraudulent and money laundering activities will help blacklist offenders, and prevent the fraudsters from opening fraudulent accounts with other banks.

CHAPTER ONE: INTRODUCTION

1.1 Background

Money Laundering is coined from the word launder, which means to wash, clean, filter de-contaminate, make legal. Money laundering is therefore the washing/cleaning/fillering of otherwise unclean or illegally obtained money to make it appear legal or legitimate. It is the process by which criminals attempt to hide and disguise identity, source or origin and ownership of the proceeds of their criminal activities, with aim of avoiding prosecution, conviction and confiscation of the criminally acquired funds (Hellman et al, 1995). It also includes knowingly assisting a criminal in moving money or other property that constitutes the proceeds of criminal activity.

Banking fraud involves obtaining moneys, funds, credits, assets, securities, or other properly owned by, or under the custody of or control of a financial institution, by means of false pretenses, representations, or promises (Glaessner, 1995). This chapter will define know your customer (KYC) policies adopted by commercial banks, stale the research problem being investigated and objeclives of the same, while outlining the importance of this study.

1.1.1 Know Your Customer (KYC) Policy

KYC is due diligence and bank regulations that financial institutions and other regulated companies must perform to identify their clients and ascertain relevant information before opening accounts or engaging in financial transactions with them. In order to prevent identity fraud, money laundering, terrorist financing among others, banks are required to put in place a policy framework to know their customers before opening any accounts or transacting.

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The purpose of this policj io provide guidance regarding the prevention, detection and the control of possible money laundering, fraud and terrorism financing. The policy applies to all institutions licensed to transact business under the banking act. It highlights methods and

processes for prudent customer identification, record keeping, identification of suspicious activities and the need to »eport such activities to the appropriate authority for further investigation.

Established under the Banking Act in the laws of Kenya, Prudential Guidelines on Proceeds of Crime & Money Laundering (Prevention) CBK/PG/08, bccame effective on 1st January 2006. The enacting of the guidelines was necessitated by the need to ensure effective prevention, detection and control of money laundering and fraudulent activities, whose incidcnces had steadily been on the rise in commercial banks and financial institutions. Under the guidelines, commercial banks and financial institutions are expccted to obtain and maintain proper identification of customers wishing to open accounts or make transactions whether directly or through proxy; they should also obtain and maintain adequate records regarding the sources of funds and details of transactions for at least 7 year) in order to enable the identification of unusual or suspicious transactions, and reconstruct individual transactions if need arises.

The efforts to combat money laundering and Financing of terrorist activities were enhanced following the September 11, 2001 bombing of the twin towers in America. The United States of America particularly look lead in legislation giving rise to the enactment of the USA PATRIOT (Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism) ACT. The Patriotic Act requires American banks and governments not to get into any business dealings with any bank in the world not embracing know your customer (KYC) and anti-money laundering (AML) policies. Scction 326 of the USA PATRIOT Act requires that Customer Identification Program (CIP) - locally known as know your customer (KYC) policy - must include procedures to identify and verify the identity of each customer "to the extent reasonable and practicable" to enable the financial institution to form a reasonable belief that it knows the true identity of the customer.

The Act gives the US Finance Secretary immense powers in U.S and over customers and Banks operating in or through US Banks. Section 319 of the Act permits Treasury & the Justice Dept to issue summons to any foreign bank that maintains a correspondent in the US, relating to deposit of funds into the foreign Bank. Section 319 section permits the closure of the Bank

account within 10 days of the notification to the US government of the foreign bank that does not comply with the summons relating to the correspondent account. A penalty of ten thousand dollars a day can also be imposed for the period of the bank's non-compliance. Section 319 of the Act allows US law enforcement officers to seize from the US based correspondent account of a foreign bank, the equivalent amount of money that a foreign bank is holding for the suspicious transaction, subject to the US issuing a restraining order, seizure and or arrest warrant.
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At the international level, FATF (Financial Action Task Force), an inter-governmental body comprising 31 Governments and Organizations was established by G-7 Summit in Paris in 1989 in response to increasing concern over money laundering. 'Hie Task Force was charged with the responsibility of examining money laundering techniques and trends, reviewing action already taken at national and international level, and setting out further measures required to be taken to combat the crime. In April 1990, FATF issued 40 recommendations and later issued a further 9 special recommendations (all of which arc now recognized as the standards for combating money laundering and financing of terrorism).

Kenya is a member of ESAAMLG (East & Southern Africa Anti-Money Laundering Group). It is a signatory to the UN Security Council Resolution 1373 on Combating Terrorism and 1267 Sanction Committee which designates & issues liaiS of individuals & entities suspected to be linked with terrorism and terrorism financing. Enforcement of the Prudential Guidelines is largely by central bank of Kenya and to some extent by Kenya anti-corruption commission (KACC) among other law enforcement agencies.

Kenya has also signed the twelve major protocols related to anti-money laundering, corruption, trans-national crime and combating terrorism. Among them is the united nations security council resolution 1373 on combating terrorism and 1267 sanction committee that designates and issues lists of individuals or entities suspected to be linked to terrorism. Failure to comply with the requirements of the concerned international organizations jeopardizes a country's safe and sound financial system and may also result in the country being blacklisted.

The know your customer process involves verifying a customer's identity and address by asking them to submit documents that are accepted as relevant proof. Mandatory details required under K.YC norms are proof of physical address, valid passport, voter's card, electricity or water bill, a letter from employer, personal identification number or driving licenses, and in some cases introduction or verification of details by an existing customer. It is however the responsibility of the management of banking institutions to establish appropriate policies and procedures, and train stall to ensure adequate identification of customers, their source of funds and the use of the said funds. Such policies should also ensure effective prevention, detection and control of possible money laundering activities and terrorism financing.

1.1.2 Commercial Banks

A commercial bank is a financial intermediary which collects credit from lenders in the form of
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deposits and lends in the form of loans. They offer a wide range of corporate financial services that address the specific needs of private enterprise. They provide deposit, loan and trading facilities but will not service investment activities in financial markets. Commercial banks can be described as a type of financial intermediary. In the United States, the term is used to refer to any banking organization or division that deals with the deposits and loans of business organizations. The term commercial bank is used to differentiate these banks from investment banks, which are primarily engaged in the financial markets. Commercial banks are also differentiated from retail banks that cater to individual clients only. In non English-speaking countries the term commercial bank is used interchangeably with the term trading bank.

Commercial banks play a number of roles in the financial stability and cash flow of a country's private sector. They process payments through a variety of means including telegraphic transfer, internet banking and electronic funds transfers, issue bank cheques and drafts, as well as accept money on term deposits. Commercial bajiks also act as moneylenders, by way of instalment loans and overdrafts. Loan options include secured loans, unsecured loans, and mortgage loans. A securcd loan is one where the borrower provides a certain property or asset as collateral against the loan. The main condition of these loan; is that if the loan remains unpaid, the bank

has the right to use the property in any way they like to realize the outstanding amount. Unsecured loans have no collateral and therefore command higher interest rates. There are a variety of unsecured loans available today and these include credit cards, credit facilities such as lines of credit, corporate bonds, and bank overdrafts.

Commercial banks also provide a number of import financial and trading documents such as letters of credit, performance bonds, standby letters of credit, security underwriting commitments and various other types of balance sheet guarantees. They also lake responsibility for safeguarding such documents and other valuables by providing safe deposit boxes. Currency exchange functions and the provision of unit trusts and commercial insurance are typically provided by the relevant departments in large commercial banks.

Locally, the Central Bank of Kenya was established in 1966 through an Act of Parliament - the Central Bank of Kenya Act of 1966, to regulate commercial banks. The establishment of the Bank was a direct result of the desire among the three East African states to have independent monetary and financial policies. This led to the collapse of the East Africa Currency Board (EACB) in mid 1960s. The Central Bank of Kenya's primary mission is to formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices, to foster the liquidity, solvency and proper functioning of a stable market-based financial system, to formulate and implement foreign exchange policy, to hold and manage foreign exchange reserves, to license and supervise authorized dealers, to formulate and implement such policies as best promote the establishment, regulation, and supervision of efficient and effective payment, clearing and settlement systems, to act as banker and adviser to, and as fiscal agent to the Government as well as issue currency notes and coins.

In a bid to serve its customers, commercial banks in Kenya are facing a number of challenges key among them fraud and money laundering. Banks frauds are on the increase and the amount of laundered money in the economy is on the rise. Although bank frauds and money laundering practices are a creation of professional criminals, bank's customers or errant bankers, the increase in crime rate has greatly been attributed to loopholes in the know your customer (KYC) policies. Apart form losing confidence from customers who are affectcd, banks, and by extension insurance companies are making big losses from fraudulent activities which impact negatively on

their profitability. The objective of this study therefore is to understand the KYC policies currently being applied by commercial banks in Kenya, investigate why they are not being effective while finding other more effective ways of identifying customers before banks enter into any financial dealings with them.

1.2 Statement of the Problem

Despite the adoption of anti-money laundering /anti banking fraud strategies, with emphasis on know your customer (KYC) policies, the level of fraud cases in the banking industry has been on the rise. The banking sector has been losing a lot of money through fraudulent activities, a situation which has had a negative impact on their profitability. The global economic meltdown occasioned by credit crunch has worsened the situation by limiting access to funds, and many unscrupulous people have resc.rtcd to money laundering and fraudulent activities to bridge the gap.

Despite the critical part played by KYC policies in preventing fraud and money laundering, the subject has not been given the attention it deserves by researchers locally. A study by Mbwayo (2005) focused on strategies applied by commercial banks in anti-money laundering compliance program, while Muia (2008) looked at perceived . >cts of money laundering on international business. Both researchers did not pay attention to the role played by KYC policies which are at the center of anti-banking fraud and anti-money laundering strategies

The question therefore is to determine whether the existing KYC policies are ineffective in reducing incidcnces of fraud and money laundering, or is non-compliance with KYC procedures to be blamed for the increase? There is therefore a need to re-examine the existing anti-moncy-laundcring and anti-fraud strategies especially those touching on KYC, so as to seal the existing loopholes while making it easier for banks to identify customers while opening accounts and authorising transactions.

1.3 The Research Objectives

i. To determine wha. .he banks are doing in implementing know your customer (KYC) policies.

ii. To determine the .ovel of compliance with know your customer policies among commercial banks

iii. To determine if the level of compliance is ulated to Ihe number of fraud and money laundering incidences.

1.4: Importance of the Study

Commercial banks are likely to benefit from the study by highlighting loopholes and new strategies which can be adopted to enhance existing KYC policies to make them effectively reduce cases of fraud and money laundering. Customers in commercial banks will also benefit since the study will be seeking to identify less cumbersome identification processes while transacting or opening bank accounts.

Researchers arc likely to benefit from the study by giving them an insight of KYC policies thus helping them appreciate its magnitude within the banking sector in Kenya. The study will also help investor identify areas tc be keen on before making a decision to invest in any financial institution. The industry regulator - cestrd l^ik, will also gain since the study will highlight areas in prudential guidelines .hich need enhancing or strict enforcement.

CHAPTER TWO: LITERATURE REVIEW

2.1 Concept of Policies

A policy is plan or coursc of action, guiding principle, or procedure intended to influence and determine decisions. It can be defined as a policy as a set of decisions which are oriented towards a long-term purpose or to a particular problem. Such decisions by governments or organizations are often embodied in legislation and usually apply to a country as a whole. In a broader view, policy can be defined as the translation of a government's political priorities and principles into programmes and actions to deliver desired changes within a given time frame. Gilu (2001) asserts that a policy is purposeful statement, written or spoken, aimed at solving a particular problem derived from a felt need by someone or a group of people, and that policies are meant to advise rulers and to promote good governance with the aim of achieving some predetermined objectives. He further noted that policies are made by policy makers, the persons bestowed with the power, either by society or by a group of people in a society to make decisions. Odhiambo-Mbai (1998) refers to policy as a broad government statement that outlines how a government intends to deal with specific social issues to achieve a developmental goal.

Policies often express the limits within which action should occur. These rules often take the form of contingent decisions for resolving conflict among specific objectives. Major policies which guide overall direction and posture or determine viability are called strategic policies. Policies often increase managerial effectiveness by standardizing routine decisions and empowering or expanding the discreiion of managers and subordinates in implementing business strategies (Pearce & Robinson, 2007).

The following central issues emerge from the various definitions of policy: a policy statement by an administrative organ intended to achieve a specific objective within a given time frame. The overall goal of policy formulation is to improve the welfare of people and institutions in a country. Policies may be written and formal or unwritten and informal. Informal, unwritten policies usually associated with a strategic need for competitive secrecy. Though informal, these

kinds of policies are however widely known by employees and sanctioned by the management. The latitude granted by such policies makes them popular with employees and managers, although they may in the long term hinder success of the policy. Policy formulation however needs to be followed by capacity building to facilitate implementation (Hayes et al 1996).

Formal written policies advantages in that managers will be required to think through the meaning, content and application of the policy. This is because once policies are written down, then those charged with implementation or operationalisation will need to read and think through the content so as to understand and apply the same. Issues arising from misunderstanding and misinterpretation are also avoided when policies are formally written down. This is because written policies leave no room for manipulation and provide a clear reference point incase of uncertain circumstances (Cline, 2000). Due to their consistency, written policies facilitate similar treatment of similar issues. This increases efficiency and effectiveness in that the personnel charged with the responsibility of implementation, operationalising and compliance are able to consistently deal with issues arising from day to day organizational activities.

Written policies provide a convenient and authoritative reference point for the organization, and communicate the authorization or sanction of policies more firmly and clearly. This means that the middle and lower level employees do not have to refer to their superiors every time they are faced by an uncertain situation, since they are able to refer to the formally presented policies and procedures (Mintsburg et al, 1999). This increases efficiency and facilitates quicker resolution of problems since their course of action is clearly set out. Formal written policies ensure unalterable transmission of policies within the organization from top to bottom. Once formally put down, policies ensure systematic indirect control and co-ordination of key policies within organizations.

Tlie strategic significance of policies can vary from simple work rules without an obvious link to strategy implementation to organization-wide policies which are virtually functional strategies (Mintsburg et al, 1999). Policies can be externally imposed or internally derived. External policies arc imposed by the government usually through the industry regulators, while internal policies arc developed by organizations for strategic purposes. Overall, the role of ideology in the development of strategy ::;i the public sector is probably greater than that in commercial organizations. The criterion of acceptability to stakeholders of strategic choices is probably of

greater significance in the public sector than in the commercial sector (Johnson & Scholes, 2004).

2.2 Development of Policies

Policies communicate guideli :s to decision. They are designed to control decisions while defining allowable discretions within which operational personnel can execute business activities. (Pearce & Robinson, 2007). Policies reduce uncertainty in repetitive and day to day decision making, thereby providing a necessary foundation for coordinated, efficient efforts and freeing operating personnel to act.

Development of a policy stalls with definition or ntification of the problem. In this context, the definition of the problem should be evaluative, the problem should be quantified, and possible solutions to the problem identified. Caution however needs to be taken at this stage so as not to capture contributors to the problem as the actual problem (Oyugi & Kibua, 2004). The next step involves gathering information or evidence and reliable information about the history and context of the problem. This includes analyzing similar problems and policies which were used to remedy the situation (Ngethe, 1998). This will give valuable pointers on what course of action should be taken and what pitfalls should be avoided. It is important at this point to collect stakeholders' views so that all factors are considered and included in the policy to be formulated.

Policies development process is viewed differently by various interest groups (Johnson & Scholes, 2004). Senior executives see it in tenns of design whereas middle management tend to see the process being as a result of cultural political processes. Managers who work for government organizations or agents cf government tend to see strategy as more imposed than those in the private sector. People who work in family businesses tend to see more evidence of the influence of powerful indiv iduais, who are basically die owners of the organization.

During the policy making process, it is important to develop a list of potential alternatives. This involves giving consideration to different policy options, alternate courses of action and strategies of intervention to s^lve or mitigate the problem in question. In developing alternatives, one can look at how similar p.oblems have been handled previously, brainstorm for fresh ideas

or be guided by the expectations of stakeholders (Odhiambo-Mbai, 1998). A choice of both policy and alternative however needs to be made considering the costs of implementation, feasibility of the same given resource and technological consUaints, who stands to gain or lose, but most importantly, if it will effectively solve the problem in question (Oyugi & Kibua, 2004). After policy choice has been made, it is important . project or predict possible outcomes. This step involves examining goals and alternatives to predict the value of outcomes and impact upon implementation. This is however complicated by the fact that it is difficult to make realistic decisions based on forecasts of an uncertain future.

Policies are developed to establish indirect control over independent action clearly stating how things are to be done. By defining discretion, policies in effect control decisions yet empower employees to conduct activities without direct intervention by top management (Johnson & Scholes, 2004). Employees therefore arc able to make decisions without necessarily having to refer to management since they are enabled to work within certain parameters. By providing predetermined answers to routine problems, policies make it easier for employees and the management to deal with both ordinary and extraordinary problems by providing a reference point (Pearce & Robinson, 2007) This then ensures quicker decision making by standardizing answers to previously answered questions, that otherwise would recur and be pushed up the management hierarchy for response or clarification.

Policies promote uniform handling of similar activities. This facilitates the co-ordination of work tasks and helps reduce friction arising from favoritism, discrimination and the disparate handling of common functions (Jeffrey, lv98). Since similiir activities arc handled in a similar manner, decision making process is enhanced. Policies afford managers a mechanism for avoiding hasty and ill-conceived decisions in day to day operations. Prevailing policy can always be used as a reason for not yielding to emotion-based, expedient or temporarily valid arguments for altering procedure and practices.

Policies institutionalize basic aspects of organization behavior (Pearce & Robinson, 2007). This minimizes conflicting practices and establishes consistent patterns of action in attempts to hannonise strategies within the organization. Policies in this case used as means to communicate direction and guide behaviors within an organization (Mintsburg, ct al 1999). The function in this

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case is not just control, but also to guide behaviors or actions at workplace. Harmonising workplace behaviors ensures that deviations from the set policies are noted on time and corrective action taken to prevent recurrence.

Policies counteract resistance to or rejection of chosen strategies by organization members. When major strategic change is undertaken, unambiguous operating policies clarify what is expcctcd and facilitate acceptance, particularly when operating or concerned managers participate in policy development (Bardach, 1996). When an organization is going through change, change in strategy will necessitate change in operating policies and procedures. Development of new policies will therefore be necessary so as to align policy with strategy, and eliminate room for manipula»ion by resistant forces (Ng'ethe, 1998). A policy is nccessary to provide guidance in most suitable way to handle various situations, to protect the company or institution legally, to ensure compliance, and to establish consistent work standards, rules, and regulations.

2.3 Functions of Policies

Functions refer to full range of duties and powers, statutory and non-statutory, internal and external associated with the policy. The term policy has a wide meaning and includes the full range of formal and informal decisions you make in carrying out your duties and use your powers (Mintzburg et al, 1999). In reality many policies are translated into everyday processes and procedures. Policies may also be described as strategies, plans, procedures and guidelines. To be effective, policies need to be relevant, that is, if is has, or could have, implications of any kind on the duty being performed.

Regardless of the negative connotation of the word "control", it is critical for the survival of an institution or organization. Whether an organization is highly bureaucratic or changing and self-organizing, the organization must exist for some reason, purpose, or mission either implicit or explicit (Hayes, Pisano & Upton, 1996). The organization must have some goals, and identifying this goal requires some form of planning, informal or formal. Reaching the goal means identifying some policies and strategies, formal or informal. Members of the organization are hence required to act in accordance with what has been set out in policies (Gitu, 2001).

Policies are used as means to communicate direction and guide behaviours in an organization. The function in this case is not to control, but rather to guide behaviours or actions at workplace. Policies help ensure that behaviours in the workplace conform to federal and state laws, and also to expectations of the organization (Stevenson, 2002). Often, policies are applied to specified situations in the form of procedures, which once followed minimize the likelihood of costly litigation. A procedure is a step-by-step list of activities required to conduct a certain task. Procedures ensure that routine tasks arc carried out in an effectively and efficiently (Jhingan, 2001).

Policies make the process of delegation easier as employees and managers are sufficiently guided on what is required of them in various situations. Delegation is often viewed as a major means of influence and therefore is categorized as an activity in leading rather than controlling and coordinating. Delegation generally includes assigning responsibility to an employee to complete a task, granting the employee sufficient authority to gain the resources to do the task and letting the employee decide how that task will be carried out (Stevenson, 2002). Typically, the person assigning the task shares accountability with the employee for ensuring the task is completed. Since policies guide behaviour, managers arc therefore able to comfortably delegate without fear of quality of work being compromised.

Policies play an important role in budget management .Once the organization has establish goals and associated policies, funds arc set aside for the resources and labour to the accomplish goals and tasks, statements is one of the more common methods to monitor the Financial audits are regularly conducted to ensure that financial management practices follow generally accepted standards, as well as well within the policies and procedures of the organization (Mintzburg et al, 1999). For example, some policies will require the board of directors to approve the budget before any spending can be done. Policies play a critical role in performance management in that they set standards which are used to evaluate individual employee and overall organization's performance (Nelson, 1998). Performance management focuscs on the performance of the total organization, including its processes, critical subsystems (departments, programs, or projects) and employees. Performance reviews provide an opportunity for supervisors and their employees

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to regularly communicate about goals, how well those goals should be met, how well the goals are being met and what must be done to continue to meet or change those goals.

Quality Control and Operations Management relies heavily on policies and procedures, with emphasis on aspects like "do it right the first time, "zero defects", "Total Quality Management", among others. Broadly put, quality control and management includes specifying a performance standard often by benchmarking, or comparing to a well-accepted standard, monitoring and measuring results, comparing the results to the standard and then making adjustments where necessary (Stevenson, 2002). Recently, the concept of quality management has expanded to include organization-wide programs, such as Total Quality Management, 1S09000, Balanced Scorecard, among others.

For a variety of reasons including the increasing number of lawsuits, organizations arc focusing a great deal of attention to policies that minimize risk, avoid liabilities and ensure safety of organization and employees. Once policies and procedures are strictly followed, the organization is able to protect itself from any arising operational issues, be they legal or otherwise and avoid incurring unnecessary costs (Dixit, 1991).

2.4 Implementation of Policies

There usually is exists an assumption that successful policy formulation will be followed by successful policy implementation. This is however not always the case as the implementation process is influenced by a number of internal and external factors. Juma and Clark (1995) note that the dominant approach to public policy management one that separates policy formulation to from its formulation by assuming that once policy decisions have been made, they are easily translated into implementation programmes. Ngethe (1998) argues that the linear view of the policy making process that portrays formulation and implementation as two discrete activities is too simplistic. The argument therefore is that policy formulation, implementation as well as evaluation are not mutually exclusive events. There exists a complex relationship between these processes, largely resulting from the fact that new policy issues do emerge out of evaluation of old or current policies, calling for adjustments which affcct each proccss.

The main thrust of research in the area of public-policy implementation has been to analyze the problems of implementing public policy, hi other words, what accounts for the differential success of public policies in the implementation process? Few researchers have sought to examine the impact of implementation problem definition on the analytic frameworks they use. This is important because how one defines the implementation problem shapes both the analysis of key issues in the process and the recommendations that result from the analysis (Oyugi & Kibua, 2004). If the implementation problem is incorrectly defined in a model, the results of any analysis that uses this model will be flawed.

The implementation problem can be defined in two basic ways (Stoker, 1983). The first and more traditional focus of implementation studies is on problems of organizational management. This approach concentrates on the ability of single authority structures to effectively manage the implementation process. According to this view, policy managers see goal specification and control of subordinates as the essential implementation problems (Kotter, 1990). Factors that inhibit effective management include such things as technical incompetence, bureaucratic procedures and agents, the structural characteristics of the implementing institutions, and communication failures between policy makers and the people charged with implementation (Hayes et al, 1996). Policy makers and implementation managers should therefore work together to ensure successful policy implementation. Ln many instances, there is little linkage between institutions dealing with policy formulation, implementation and evaluation (Ngethe, 1998).

Hie implementation problem also arises as a result of conflict of interest among the stakeholders. Given the existence of this conflict, such a process should focus on how to elicit cooperation from those who participate in the implementation process. Thus management of potential inter-organizational conflict would be an essential part of the policy making process (Stoker 1983,). Hius it is conflict over values that more often than not hinder the implementation of a policy. The solution therefore is to build institutions or mechanisms that create a cooperative context for those who participate in the implementation. The external environment in which an organization operates in can influence policy implementation (Johnson & Scholcs, 2004). Successful implementation will depend on the organisation's strategic capacity to perform at the level which

is required for success. Understanding of the strategic capability is important as it addresses how organizations strategy fits in the operating environment, takes advantage of opportunities and deals with threats.

While operationalising a strategy, various infrastructural elements such as human resource policies, planning, control systems, quality monitoring systems and feedback mechanisms need to be moulded and aligned with the strategy (Hayes et al, 1996). When infrastructural elements are not factored in during policy formulation, then implementation becomes problematic and the effectiveness or achievement of intended objectives is negatively affected. Strategy integration process maybe incremental, but not piecemeal. Effective management executives need to constantly re-asses the total organizational capabilities and its needs so as to re-align with the changing environmental needs (Mintzberg et al, 1999).

2.5 Compliance with Policies

Regardless of the origin, formality and nature of policies, it is important to note that policies play a key role in strategy implementation. The value of a policy will however depend on its relevance, timeliness, credibility and the costs of its output in terms of time, human and financial resources (Stevenson, 2002). Effective communication and empowering of relevant personnel is critical in order to overcome resistance to implementation and the resultant change (Bardach, 1996). This will ensure commitment and compliance to ensure successful policy implementation.

To ensure compliance, the following steps need to be taken: Set standards of performance which will serve as benchmarks during implementation and appraisal of the policies. Mechanisms to measure actual performance against set standards need to be put in place so as to facilitate the appraisal or evaluation process. During evaluation, deviations from set standards need to be identified and corrective action processes put in place so as to ensure effectiveness of the policies. Compliance starts at the top most level of the organizational structure, and should be viewed as an integral part of the core activities of the organization (Pearcc & Robinson, 2007). Compliance is usually most effective in a corporate culture that emphasizes standards of honesty and integrity. Compliance laws rules and standards have various sources, including primary

legislation, rules and standards issued by legislators and supervisors, market conventions, codes of practice promoted by industry associations, and internal codes of conduct applicable to members of an organization.

In the banking sector, complia.icc covers matters such as observing standards of sector conduct, managing conflicts of interest, treating customers fairly, prevention of money laundering and terrorist financing, adhering to tax laws and structuring of banking products. Compliance risk in this case as defined by the central bank's prudential guidelines is defined as the risk of legal or regulatory sanctions as well as material financial loss (CBK/PG/08). It is important for organization's management to realize that failures in compliance with policies and procedures compromise service and lead to loss of business (Stevenson, 2007). Business organizations benefit from enhanced compliance reputation by gaining increased market share, greater customer loyalty, fewer service problems and lower liability costs.

After deviations and their causes have been identified, the implications of the deviations for the ultimate success of the strategy musi be considered (Mackenzie & Shilling, 1998). Some of the problems which hinder compfance with policies and procedures arise from the fact that policy development is in many instances reactive to situations that have gone bad rather than being proactive giving suggestions on how emerging problems should be handled. The reactive nature of such policies therefore pose implementation and compliance problems since their credibility and objectivity becomes questionable.

In instances where policy formulation process does not involve stakeholders, resistance by stakeholders is likely to negatively impact on compliance (Oyugi & Kibua, 2004). The very existence of viable alternatives may also affect compliance as different options will affect diffqrent stakeholders differently due to varying priorities, benefits and costs associated with each policy alternative. When stakeholders are given room to choose or make exceptions, then compliance becomes problematic since there is no uniformity in implementation. Evaluation of policies also poses a compliance problem since the institutions and personnel charged with formulation, implementation, monitoring and evaluation do not collaborate (Ng'ethe, 1998). The result is a breakdown between the various steps thus hindering smooth flow of processes and procedures. Lack of a reliable and constant feedback mechanism means that the policy makers

are not able to review and or modify existing policies so as to deal with compliance issues on time (Bardach, 1996). Once policies are formulated and implemented, evaluation needs to be given due attention since it is critical to ensure compliance.

2.6 Money Laundering

The word laundering comet, from the word "launder", which means to wash, clean, filter, decontaminate, make legal. Money laundering is therefore the process of washing, cleaning, filtering of otherwise unclean or illegally obtained money to make it appear legal and legitimate. Money laundering can also be defined as the process by which criminals attempt to hide and disguise the true origin and o nership of the proceeds of their criminal activities, with aim of avoiding prosecution, conviction and confiscation of the criminal acquired funds (Hellman et al, 1995) During the laundering process, illegally obtained money is handled in such a way that it is disassociated or hidden from its true illegal source and identity.

According to Central Bank of Kenya, money laundering is the act of a person who:

> Engages directly or in.'.irectly in a transaction that involves proceeds of any unlawful activity; Acquires, receives, possesses, disguises, transfers, converts, exchanges or carries, disposes, uses, removes from or brings into Kenya proceeds of any unlawful activity; Conceals, disguises or impedes the establishment of the true nature, origin, location, movement, deposition, title of, rights with respect to, or ownership of proceeds of any unlawful activity in cases where as may be inferred from objective factual circumstances, the person knows or has reason to believe, that the property is proceeds from unlawful activity; o. in respect of the conduct of a natural person without reasonable excuse, fails to take reasonable steps to ascertain whether or not the property is proceeds from unlawful activity.

In the United States, money laundering is widely defined to include proceeds from many illicit activities which include the following: drug trafficking, official corruption, embezzlement (defined as the fraudulent appropriation of money or property by a person to whom it has been lawfully entrusted or to whom lawful possession was given), terrorist financing, illegal

gambling, racketeering (fraud, rip-offs, deception & similar schemes), smuggling or illegal importation, evasion of taxes an J violent crimes.

2.6.1 Money Laundering Process

The money laundering process » wolves the following three stages (Popiel, 1994):

Stage 1: Placement

This is the physical disposal of cash proceeds derived from illegal activities. The placement could be in financial system, Retail economy or smuggled out of the country. The objective is to change or transform the illegally acquired money into another form of financial or valuable asset like real estate, or simply move cash to another jurisdiction to avoid detection.

Stage 2: Layering

This is the attempt to conce '.l or disguise the source and ownership of funds through a complicated maze of transactions. This stage involves the actual separation of the criminal activity proceeds from their true origin, and the subsequent creation of a complex web or layers of financial transactions design :d to disguise the funds as legitimate and complicate an audit trail (Popiel, 1991). The layering process creates a trail so complcx that it becomes difficult to trace the original source or destination of ;>uch funds.

Stage 3: Integration

This stage involves using an apparent legitimate transaction to disguise illicit proceeds. This is usually done by mixing legitimate funds with illegitimate funds and re-introducing the illegitimate or illegally acquired funds back into the economy in such a way that they re-enter the financial system as otherwise legitimate. This is done through investing in legitimate ventures so that finally the illegal funds appear as normal business funds (Auguslo et al, 1995). Potential ventures or activities through which money can be laundered include banking, currency exchange houses, stock brokerage houses, gold dealers, casinos, automobile dealers, insurance companies, free trade zones, ai.d trade financing. The banking system is the favourite for money launderers becausc of rigid banking secrecy laws, integrated global financial system, removal of

barriers on capital flows in some countries, increased sophistication of financial products, branchless and electronic banki. g and cash based transactions.

There are two types of money laundering processes (Popiel, 1994). The first is whereby the funds involved arc proceeds of a crime. This is whereby regular transactions arc used to transform the proceeds from illicit activities into funds with an apparently legitimate source. The second type involves reverse money laundering whereby legal funds are used for illicit or illegal purposes like terrorist financing.

2.7 Fraud

Fraud is defined to be an intentional perversion of truth or a false misrepresentation of a matter of fact which induces another person to part with some valuable thing belonging to him or to surrender a legal right (Glaessn^r & Mas, 1995). In addition to the traditional criminal definition of fraud, there are many regula-ory laws that have very specific rules that must be complied with. If you do not follow these rules to the letter, you could be charged with and convicted of fraud.

Banking fraud is the use of fraudulent means to obtain money, assets, or other property owned or held by a financial institution. In many instances, bank fraud is a criminal offense. While the specific elements of a particular banking fraud law vary between jurisdictions, the term bank fraud applies to actions that employ a scheme or artifice, as opposed to bank robbery or theft. For this reason, bank fraud is sometimes considered a white-collar crime.

Under federal law in the United States banking fraud is defined, and made illegal, primarily by the Bank Fraud Statute in Title 18 of the U.S. Code. 18 U.S.C. 1344 (Bank Fraud Statute) states:

> Whoever knowingly executes, or attempts to execute, a scheme or artifice:-
>
> (1) To defraud a financial institution; or
>
> (2) to obtain any of the moneys, funds, crcdits, assets, securities, ur other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises;
>
> Shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

The Bank Fraud Statute criminalizes cheque-kiting, cheque forging, non-disclosure on loan applications, diversion of funds, unauthorized use of automated teller machines (ATMs), credit card fraud, and other similar offenses.

2.8 Types **of Bank Fraud**

2.81. Stolen Cheques

Some fraudsters obtain access to facilities handling large amounts of cheques such as a mailroom, post office or the offices of a tax authority which receives many cheques, or from a corporate payroll or a social V enefiis office which issues many cheques. The cheques are then stolen or substituted and ficii.ious accounts are opened under assumed names. Stolen blank cheque books are also of valuable to forgers who then sign and issue cheques as if they were the genuine account holders.

2.8.2 Cheque Kiting

i

Cheque kiting_cxploils a system in which, when a cheque is deposited to a bank account, the money is made available immediately to the payee, even though it is not yet debited from the account on which the cheque is drawn until the cheque actually clears (Augusto et al, 1995). In many instances, the customer collects the payment long before the funds are actually available, and by the time the cheque is unpaid, the funds have already been withdrawn.

2.83 Forgery and Altered Cheques

Thieves have altered cheques to change the name in order to deposit cheques intended for payment to someone else or the amount on the face of a cheque (augusto et al, 1995). Instead of tampering with a real cheque, some fraudsters will attempt to forge a depositor's signature on a blank cheque or even print thJr own cheques drawn on accounts owned by others, non-existent accounts or even alleged accounts owned by non-existent depositors. The cheque will then be deposited to another bank and the money withdrawn before the cheque can be returned as invalid or for non-sufficient funds. * 'sually, a cheque is cashed and before the bank receives any money by clearing the forged cheque, the money is deposited into soi..e other account or withdrawn by

writing more cheques. Some perpetrators have swapped cheques between various banks on a daily basis, using each to cover the shortfall for a previous cheque.

2.8.4 Uninsured Deposits

There are a number of cases each year where the bank itself turns out to be uninsured or not licensed to operate at all (Garcia, 1996). The objective is usually to solicit for deposits to this uninsured bank, and in extreme cases some will also stocks of the purported bank. The fraudsters in this case use names appearing very official or similar to those of legitimate established banks. For instance, the "Chase Trust Bank" of Washington D.C. traded in 2002 with no license and no affiliation to its seemingly apparent namesake - the real Chase Manhattan. Bank based in New York.

2.8.5 Demand Draft Fraud

Demand draft fraud is usually done by one or more dishonest bank employees. They usually remove few draft leaves or draft books from stocks in the bank and issue them like a regular legitimate draft. Since they are insiders, they know the coding, punching and clearing procedures of a demand draft. These demand drafts will be issued payable at distant town, city or country without debiting an account, and it is cashed at thj payable branch (Garcia, 1996). This kind of fraud will be discovered only when the head office does the branch-wise reconciliation, which normally will take 6 months and by that time the money is already utilised.

2.8.6 Rogue Traders

A rogue trader is a highly placed insider nominally authorised to invest sizeable funds on behalf of the bank (Hellman et al, 1995); this trader secretly makes progressively more aggressive and risky investments using the bank's money, when one investment goes bad, the rogue trader engages in further market speculation in tlie hope of a quick profit which would hide or cover the loss. Unfortunately, when one investment loss is piled onto another, the costs to the bank can result into huge losses, and in severe cases the bank is driven out of business due to unmanageable investment losses.

2.8.7 **Fraudulent Loans**

One way to remove money from a bank is to take out a loan, a practice bankers would be more than willing to encourage if they know that the money will be repaid in full with interest. A fraudulent loan, however, is one in which the borrower is a business entity controlled by a dishonest bank officer or an accomplice; the borrower then declares bankruptcy or vanishes and the money is gone. The borrower may even be a non-existent entity and the loan merely an artifice to conceal a theft of a large sum of money from the bank.

Fraudulent loans take a number of forms varying from individuals using false information to hide a credit history filled with financial problems, and unpaid loans given to corporations using accounting mis-reporting to overstate profits in order to make a risky loan appear to be a sound investment for the bank (Garcia, 1996). In order to hide serious financial problems, some businesses have been known to use fraudulent bookkeeping to overstate sales and income, inflate the worth of the company's assets or state a profit when the company is operating at a loss. These tampered records are then used to seek investment in the company's bond or security issues or to make fraudulent loan applications in a final attempt to obtain more money to delay the inevitable collapse of an unprofitable or mismanaged firm.

2.8.9 Wire Fraud

Wire transfer networks such as the international SWIFT inter-bank fund transfer system are tempting since once a transfer is made, is difficult or impossible to reverse. As these networks are used by banks to settle accounts with cach other, rapid or overnight wire transfer of large amounts of money are common. Although banks have put checks and balances in place, there is the risk that insiders may attempt to use fraudulent or forged documents which claim to request a bank depositor's money be wired to another bank, often an offshore account in some distant foreign country or geographical location (Glaessner & Mas). The risk is greatest when dealing with offshore or Internet banks as this allows selection of banks or countries with lax banking regulations.

2.8.11 Bill Discounting Fraud

Essentially a confidence trick, a fraudster uses a company at their disposal to gain confidence with a bank, by appearing as a genuine, profitable customer (Caprio et al, 1995). To give the illusion of being a desired customer, the company regularly and repeatedly uses the bank to get payment from one or more of its customers. These payments are always made, as the customers in question arc part of the fraud, actively paying any and all bills raised by the bank. After time, after the bank has gained confidence with the company, the company requests that the bank settles its balance with the company before billing the customer. Again, business continues as normal for the fraudulent company, its fraudulent customers, and the bank. After the outstanding balance between the bank and the company is sufficiently large the company and its customer disappears, leaving no-one to pay the bills issued by the bank2.8.12 Booster cheques

A booster cheque is a fraudulent or bad cheque used to make a payment to a credit card account in order to "bust out" or raise the amount of available credit on otherwise-legitimate credit cards (Garcia, 1996). The amount of the cheque is credited to the card account by the bank as soon as the payment is made, even though the cheque has not yet cleared. Before the bad or fraudulent cheque is discovered, the perpetrator goes on a spending spree or obtains cash advances until the newly raised available limit on the card is reached. The original cheque then consequently bounces, but by then it is already loo late as the funds have already been utilised.

2.8.13 Duplication or Skimming of Card Information

This takes a number of forms, ranging from a dishonest merchant copying clients' credit card numbers for later misuse, oi a thief using carbon copies from old mechanical card imprint machines to steal the information to the use of tailored credit or debit card readers to copy the magnetic stripe from a payment card while a hidden camera captures the numbers on the face of the card (Hellman et al, 1995). Some fraudsters have surreptitiously added equipment to publicly accessible automatic teller machines; a fraudulent card stripe reader is used to capture the contents of the magnetic stripe while a hidden camera sneaks a peek at the user's PIN. The fraudulent equipment would then be removed and the data used to produce duplicate cards that will then be used to make ATM withdrawals from the victims' accounts.

2.3.14 Impersonation

Impersonation or identity theft has become an increasing problem; the scam operates by obtaining information about an individual, then using the information to apply for identity cards, accounts and credit in that person's name. Often little more than name, parents' name, date and place of birth are sufficient to obtain a birth certificate; each document obtained then is used as identification in order to obiain more identity documents. Government-issued standard identification numbers such as social security numbers are also valuable to the fraudster. Information may be obtained from insiders such as dishonest bank or government employees, by fraudulent offers for employment or investments (Ilcllman et al, 1995). In this kind of fraud, the victim is asked for a long list of personal information. The fraudsters then use the information thus obtained to gain access to bank accounts, credit cards, and obtain loans from financial institutions.

2.3.15 Flushing and Internet Fraud

Phishing operates by sending forged e-mail, impersonating an online bank, auction or payment site(Popiel, 1991) The e-mail directs the user to a forged web site which is designed to look like the login to the legitimate site, but which claims that the user must update personal info. The information thus stolen is then used in other frauds, such as theft of identity or online auction fraud. A number of malicious programmes have also been used to snoop on Internet users while online, capturing keystrokes or confidential data in order to send it to outside sites.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The study sought to explore the extent to which know your customer policies adopted by commercial banks in Kenya have been effective in reducing money laundering and fraud cases, lhe study also seeks to establish alternative policies and procedures which would effectively be implemented so as to make it easier for banks to identify their customers and their transactions, while making it less cumbersome for customers to open accounts and transaction.

3.2 Research Design

lhe research design used was a survey. This is because a broad Range of information regarding KYC policies adopted by commercial banks in Kenya was required for this study. A survey provided the kind and nature of information that was useful for comparison and generalization across banks with different demographics.

3.3 Research Population

The research population consisted of all commercial banks licensed by the central bank of Kenya to carry out business in Kenya as at august, 2009. Banks under statutory management were not considered because of their legal status, uncertainty in their continuity and the fact that they are not actively dealing with customers or transacting. The banks which fit this category were 43.

3.4 Data Collection

l he research relied on both primary and secondary data. Primary data was collected by way of questionnaire containing both open and close ended questions. Section A of the questionnaire addressed the structure of the banks, section B addressed the know your customer processes and procedures currently practiced by banks. Section C sought to determine the level of compliance by banks while section D of the questionnaire sought to establish the number of fraudulent and money laundering eases reported in commercial banks over the last few years. The target respondents were risk and compliance managers. In their absence, account opening officers were

targeted. Drop and pick, which is a variation of the mail method, was used to administer the questionnaire.

Secondary data was obtained from the Kenya anti-banking fraud unit, which is a unit under the Central bank of Kenya charged with the responsibility of handling fraud and money laundering cases reported in commercial banks. Being an organ of the industry regulator, the statistics and other information obtained from the anti-banking fraud unit provided a clear indication of the direction taken over the years by the crimes the study is investigating.

3.5 Data Analysis

The data collected using the questionnaire was edited for accuracy, uniformity, consistency and completeness, and organized to facilitate coding and tabulation. Data was then coded and checked for any errors, commissions or omissions. Responses in the questionnaires were tabulated, coded and processed by use of a Statistical Package for Social Science (SPSS) programme to analyze the data. Frequency tables, percentages and means were used to present the findings. Factor analysis was used to classify the predetermined variables affecting know KYC policies and procedures.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter presents the results of the analysis of the data collected during the study survey. A total of 33 completed and useable questionnaires were obtained from the members for the survey. This represents 77% response rate. The chapter is divided into four sections: Section *4.2* gives a summary of the respoi.Jents' data, section 4.3 gives die response on know your customers process and procedures, section 4.4 gives analysis of level of compliance and section 4.5 presents the finding on cases of frauds and money laundering.

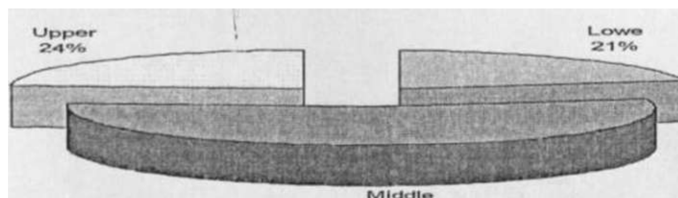
4.2 General Information

The general information considered in this study for the members included the tier group, number of operating years in Kenya, number of branches and customer focus group.

42.1 Tier Group

The respondents were to indicate their tier group. The findings in fig 1, shows that majority (55%) of the respondents we— in the middle group, 24% were in die upper group and the remaining 21% were from the lower group. The tier distribution shows that the respondents' information could be relied on.

Figure 1: Gender of the Management Respondents



4.2.2 Duration of Being a Member

The respondents were to indicate how long their respective banks have been operating in the Kenyan market. The results presented in table 4.2.1 shows that the number of years of operation varies from a period of less than 10 years to more than 25 years. 24% of the respondents banks have been in operation for less than 10 years, 33% have been operating for a period of between 10 to 25 years, 43% have operated for more than 25 years. Majority of the banks have been operating in the Kenyan market for more than 10 years, thus there is high level of understanding of Kenyan banking industry.

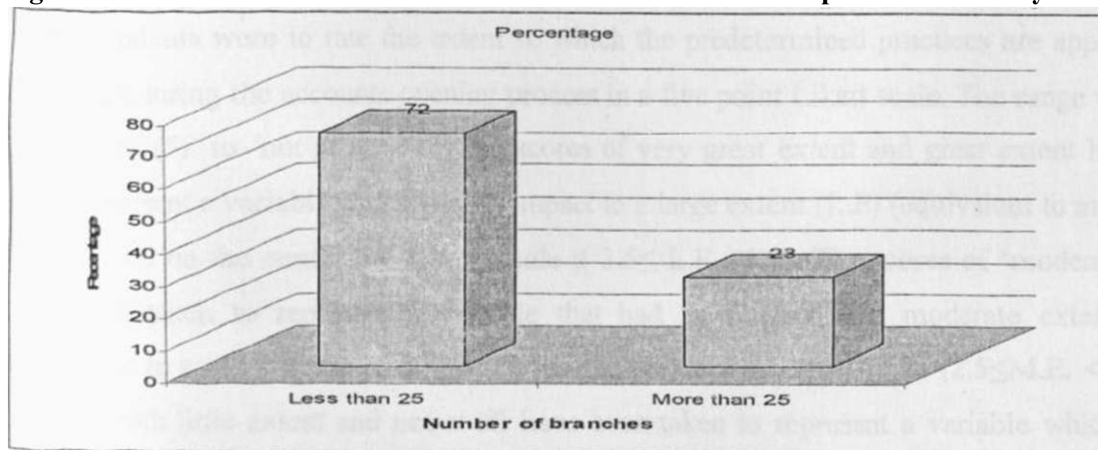
Table 4.2.2: Duration of being a member

, Years	frequency	Percentage	Cumulative frequency
Less than 10	8	24	24
10 to 25	11	33	57
More than 25	14	43	100
1 Total	33	100	

4.2.2: Number of Branches Operated by Banks

As can be observed, in Figure 2, 72% of the banks have less than 25 physical branches country wide while 28% of the banks had more than 25 physical branches country wide.

Figure 2: Number of branches operated by banks

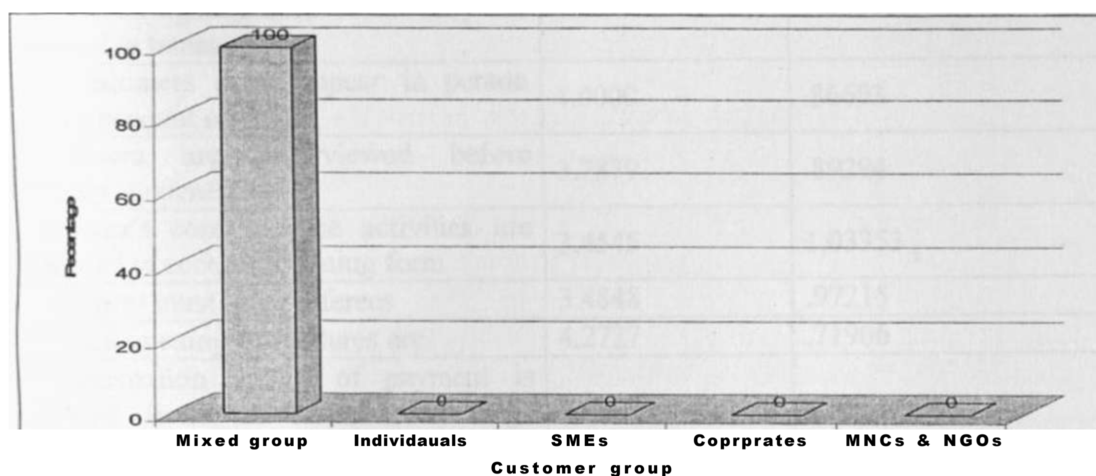


Source: research data

4.2.3: Customer Focus Group

The respondents were to indicate the customer group Uieir bank usually serves. The respondents unanimously stated that their banks served mixed group, that is, individuals, SME's, corporates and MNCs /NGOs.

Figure 3: Customer focus group



Source: research data

4.3 KYC Policies and Procedures

1 he respondents were to rate the extent to which the predetermined practices are applicable in their banks during the accounts opening process in a five point Likert scale. The range was 'very great extent (5)' to 'not at all' (1). The scores of very great extent and great extent have been taken to present a variable which had an impact to a large extent (L.E) (equivalent to mean score of 3.5 to 5.0 on the continuous Likert scale ;(3.5< L.E <5.0). The scores of 'moderate extent have been taken to represent a variable that had an impact to a moderate extent (M.E.) (equivalent to a mean score of 2.5 to 3.4 pm the continuous Likert scale (2.5<M.E. <3.4). The score of both little extent and not at all have been taken to represent a variable which had an impact to a small extent (S.E.) (equivalent to a mean score of 0 to 2.5 on a continuous Likert

scale; 0< L.E. <2.5). A standard deviation of >0.9 implies a significant difference on the impact of the variable among respondents.

Table **4.3.1: Practices applicable during accounts opening**

	Mean	Std. Deviation
All required documentation	4.5152	.75503
Original documents are sighted	4.4242	.79177
A search is conducted for registered companies/organizations before they are allowed to transact	3.7879	1.34065
All customers must appear in person during account opening	4.0000	.86603
Customers are interviewed before account is opened	3.7879	.89294
Customer's core income activities are specified in account opening form	3.4545	1.03353
Customers must have referees	3.4848	.97215
Account opening procedures are	4.2727	.71906
Documentation /proof of payment is required from customers with large I amount transactions	3.6364	1.36515

Source: research data

From the findings to a very great/great extent; all required documentation (mean of 4.5152), Original documents are sighted (mean of 4.4242), account opening procedures are written down and standardized (mean of 4.2727), all customers must appear in person during account opening (mean of 4.00), a search is conducted for registered companies/organizations before they are allowed to transact (mean of 3.7879), customers arc interviewed before account is opened (mean of 3.7879) and documentation /proof of payment is required from customers with large amount transactions (mean of 3.6364).To a moderate extent; Customers must have referees (mean of 3.4848) and Customer's core income activities are specified in account opening form (mean of 3.4545).

There is low variation on the respondents' opinion across the banks concerning the practice during accounts opening as indicated by the low values of the standard deviations. This could be

attributed to the fact that KYC policies and procedures are generic and are supposed to be applied across the banks without exemption. Notably, the banks seem to give different weights or importance to some of Uie practices, with 'acquiring all required documentation' receiving most importance at a rating of 4.5, while 'customers must have referees' receiving the least importance with the lowest rating of 3.4. This difference in attaching different importance to different KYC requirements might be the reason why erratic increases and decreases in reported cases of fraud are being reported as indicated in Figure 7.

4.3.2: Factor Analysis on Practiccs during Accounts Opening

Table 4.3.2: KMO and Bartlctt's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.459
Bartlett's Test of Sphericity	Approx. Chi-Square	301.396
	df	36
	P- value	.000

In order to use factor analysis for practices during account opening, it was important to lest the significance of the technique (factor analysis technique). This **P** value of 0.000 shows that the technique is significant at 5 percent

Tabic 4.3.3: Total Variance Explained

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	5.442	60.467	60.467	5.442	60.467	60.467
2	1.331	14.794	75.261	1.331	14.794	75.261
3	.994	11.049	86.310			
	.461	5.126	91.437			
5	.348	3.863	95.300			
6	.209	2.319	97.619			
7	.130	1.445	99.064			
8	.075	.829	99.893			
9	.010	.107	100.000			

Extraction Mcthod: Principal Component Analysis.

From the total variance explained table/Eigen values (a measures of the variance explained by factors); factor extraction has been done to determine the factors using Eigen values greater than 1. Factors with Eigen values less than 1.00 were not used because they account for less than the variation explained by a single variable.

The result indicates Uiat 9 variables were reduced into 2 factors. The two factors explain 75.261 % (Cumulative percentage) of the total variation, the remaining 7 factors together account for **24.739%** of the variance. The explained variation 75.261% is greater than 70% and therefore, Factor Analysis can be used for further analysis. The model with two factors may be adequate to represent the data.

Table 4.3.4: Rotated Component Matrix

Variables		Components	
		1	2
All required documentation	x_1	**.567**	.562
Original documents are sighted	x_2	**.902**	.298
A search is conducted for	x_3	**.955**	.064
All customers must appear	X_4	**.737**	.346
Customers are interviewed	x_5	**.869**	.380
Customer's core income activities	x_6	.369	**.814**
Customers must have	x_7	-.013	**.873**
Account opening procedures are	X_8	.363	**.691**
Documentation /proof of payment	X_9	.373	**.667**

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged in 3 iterations.

The rotated component matrix is to transform the complicated matrix (initial matrix into simpler one).The purpose of rotation is to achieve a simple structure, that is, we would like each factor to have non zero loading for only some of the variable so that we can easily interpret the factors.
A factor loading of 0.5 has been used to determine the variable belonging to each factor.

$$F_1 = 0.567X_1 + 0.902X_2 + 0.955X_3 + 0.737X_4 + 0.869X_5$$

$$F_2 = 0.814X_6 + 0.873X_7 + 0.691X_8 + 0.667X_9$$

4.4: Level of Compliance

This section covers findings from the specific questions posed to the respondent's to determine the extent to which some predetermined factors applies to compliance of KYC in their respective banks. Measure of central tendency (mean) and a measure of variation (standard deviation) was used to analyze the data.

Table 4.4.1: Extent to which the following variables applies to level of compliance

	Mean	Std. Dev
Authenticity of a/e opening	4.0909	1.01130
All staff are trained on KYC	3.6970	1.31065
All account referees details are verified	3.3939	1.34488
Transactions in new & existing accounts are regularly monitored	3.2121	1.49494
Irregular / unusual transactions are monitored and reported	3.3939	1.41287
Staff are not allowed to introduce accounts	2.4545	1.34840
1 Management gives exemptions for account opening	2.7879	.96039
Physical location of businesses individuals opening an account is confirmed	2.8485	1.17583
Accounts can be opened online	2.2727	1.32930
1 Customers can transact online	1.9091	.94748
[Customers are allowed to give instructions on phone	2.7273	1.09752

The findings in Table 4.4.1 above show that a very great/great extent (3.5< L.E <5.0), banks almost unanimously comply in two variables which are; all staff are trained on KYC (mean of 3.6970) and verifying authenticity of account opening documents (mean of 4.0909). To a moderate extent (2.5<M.E. <3.4), compliances is achieved in the following variables; All account referees details are verified (mean of 3.3939), irregular/unusual transactions are monitored and reported (mean of 3.3939), transactions in new and existing accounts are regularly monitored (mean of 3.2121), management gives exemptions for account opening (mean of 2.7879), physical location of businesses enterprises opening an account is confirmed (mean of 2.8485), customers are allowed to give instructions on phone (mean of 2.7273). To a small extent (0<S.E. <2.5); staff members are not allowed to introduce accounts (mean of 2.4545),

accounts can **be** opened online (mean of 2.2727) and customers can transact online (mean of 1.9091). From this analysis, it is evident that again, banks choose what to comply or give importance to, and what to give little attention to.

4.4.2: Factor Analysis on Compliance Level

Table 4.4.1: KMO and Bartk tt's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.424
Bartlett's Test of Sphericity	Approx. Chi-Square	405.010
	df	55
	Sig.	.000

ThisP value of 0.000 shows that the technique is significant at 5 percent.

Table 4.4.2: Total Variance Explained

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
1	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	4.492	40.835	40.835	4.492	40.835	40.835
2	2.915	26.500	67.335	2.915	26.500	67.335
3	1.270	11.547	78.882	1.270	11.547	78.882
4	.873	7.933	86.815			
5	.614	5.580	92.395			
6	.340	3.090	95.485			
7	.290	2.633	98.118			
8	.135	1.230	99.348			
9	.055	.407	99.844			
10	.012	.108	99.953			
11	.005	.047	100.000			

Extraction Method: Principal Component Analysis.

Source: research data

The result indicates that 11 variables were reduced into 3 factors. The three factors explain 78.882 % (Cumulative percentage) of the total variation, the remaining 8 factors together account for 21.118% of the variance. The explain. J variation 75.261% is greater than 70% and therefore, factor analysis can be used for further analysis. The model with three factors will therefore be adequate to represent the data.

Tabic 4.4.3: Rotated Component Matrix

Variables		Components		
		1	2	3
Authenticity of a/c opening documents are verified	x,	**.755**	.012	-.420
All staff arc trained on KYC policies and procedures	x_2	**.813**	-.069	-.258
All account referees details are verified	x_3	**.875**	-.210	.202
Transactions in new & existing account are regularly monitored	X4	**.938**	.088	.093
Irregular / unusual transactions are monitored	X_5	**.843**	.276	.117
Staff are not allowed to introduce accounts	X_6	.055	.109	**.882**
1 Management gives exemptions for a/c opening	X_7	-.203	**.868**	-.045
Physical location of businesses individuals opening an account is confirmed	Xg	**.755**	-.064	-.504
1 Accounts can be opened on line	x_9	.296	**.870**	.089
I Customers can transact online	X10	.076	**.823**	.148
Customers are allowed to give phone instruction on phone	X„	-.266	**.572**	.527

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged in 5 iterations.

Source: research data

A factor loading of 0.5 has been used to determine the variable belonging to each factor.

F r 0.755X) + $0.813X_2 + 0.875X_3 + 0.938X_4 + 0.843X_S + 0.755X_g$

Fi= O.868X7 + 0.870X9+ 0.823Xio + 0.572Xu

0.882X6

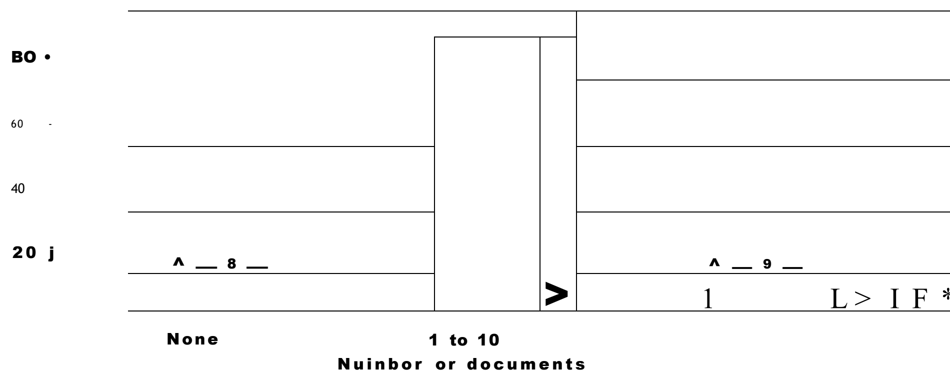
4.5: Cases of Fraud and Money Laundering

This section covers findings from the specific questions posed to the respondent's to determine the number of documents provided during account opening turned out to be forged/false/fraudulent during the year 2008, trend of the frauds, level of compliance with KYC policies and the role of central bank in the implementation of KYC.

4.5.1: Number of False Documents Provided During Accounts Opening

As indicated in Figure 4 of all reported fraudulent and money laundering cases during the year 2008, 1 to 10 documents presented during account opening process of accounts with fraudulent activities were falsified - this accounts for 82% of documents presented, 11 to 20 documents accounts for *9%* fraudulent documents while only 9% of the documents in reported cases happened to be non fraudulent. It means that banks need to intensify verification of the documents presented during accounts opening, or better still come up with other means of identifying and knowing their customers. Most importantly, banking institutions need to note that there is no bank among the respondents which reported zero number of fraudulent documents presented during account opening. This means that there is rampant use of fake documents during account opening especially by those who have criminal intent.

Figure 4: Number of false documents provided during accounts opening



Source: research data

45.2: Trend of Fraudulent Documents Presented during Accounts Opening

I lie findings show that 45% of the respondents were of the opinion that the number of fraudulent presentation of documents during account opening is on the increases, 39% felt that the trend is declining while 16% were of the opinion that the trend remained the same during the year 2008.

High variation in the opinion amongst the respondents between increase and decrease shows that either different banks have put place different mechanisms to deal with fraud and money laundering, or die variation is due to different compliance levels exhibited by the respective banks, or is an indication that banks do not freely share information with their staff regarding reported cases.

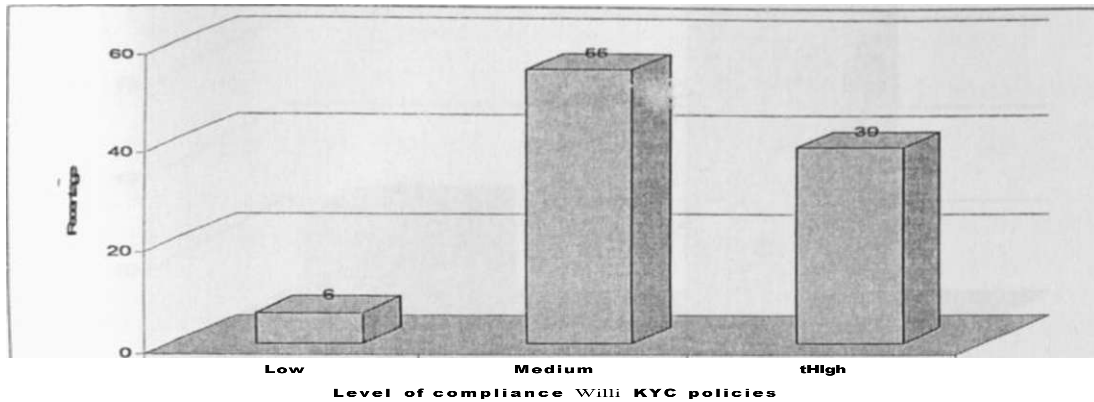
Table 4.5.1: Trend of fraudulent documents presented during accounts opening

	Frequency	Percentage	Cumulative frequency
Increase	15	45	45
Decrease	13	39	84
Remained the same	r	16	100
1 Total	33	100	

4.5J: Level of Compliance with KYC Policies by Banks

As indicated below, 55% of the respondents rated level of compliance with KYC policies in their banks as medium, 39% rated compliance rate as high and the remaining 6% rate compliance as low. These findings are extremely worrying since banks are expected to ensure 100% compliance with KYC policies and procedures. With only 39% indicating high compliance, it therefore means that majority of the banks in the industry are not complying as expected. The failure of KYC policies to eradicate fraud and money laundering then should be attributed to the low level of compliance among banks.

Figure 5: Rating of level of compliance with KYC policies by banks

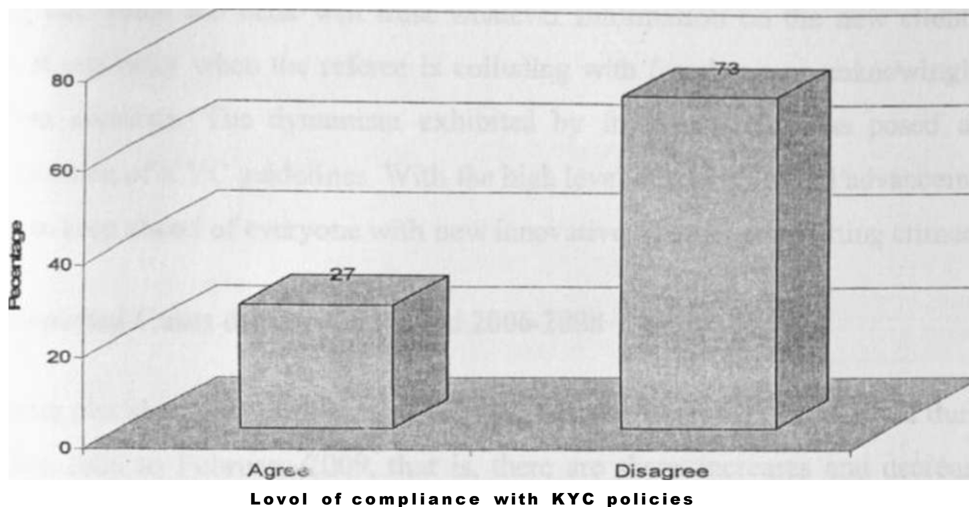


Source: research data

4.5.4: Opinion on Central Bank of Kenya KYC Guidelines

The role of central bank of Kenya is to formulate and ensure implementation of KYC guidelines. As evidence in figure 6 below indicates, 73% of the respondent's disagree with the statement that the industry regulators' KYC guidelines are unnecessarily stringent. This means that majority of the banks fully support and recognise the critical part played by KYC guidelines. On the other hand 27%of the respondents felt that the guidelines are unnecessarily stringent. This acknowledgement contradius .he findings obtained in Figure 5 above because it therefore means that although banks acknowledge that KYC guidelines are indeed necessary, they are still not billing to comply fully.

Figure 6: Opinion on Central bank of Kenya KYC guidelines



Source: research data

4.5.5: Factors influencing KYC and AML compliance levels in banks

Respondents identified the following as factors affecting/influencing KYC and AML compliance levels in banks; management laxity whereby the management is not keen on account opening procedures, documentation and monitoring transactions in old and new accounts, while at the same time giving exemptions while opening accounts without proper consultation. Limitation of resources to conduct KYC compliance requirements was cited as another hindrance to compliance since for example; verifying physical location of business enterprises would require additional staff and transport arrangements. The high targets given to those in sales, marketing and other departments make desperate staff bring in any accounts they come across, sometimes without carrying out any background checks.

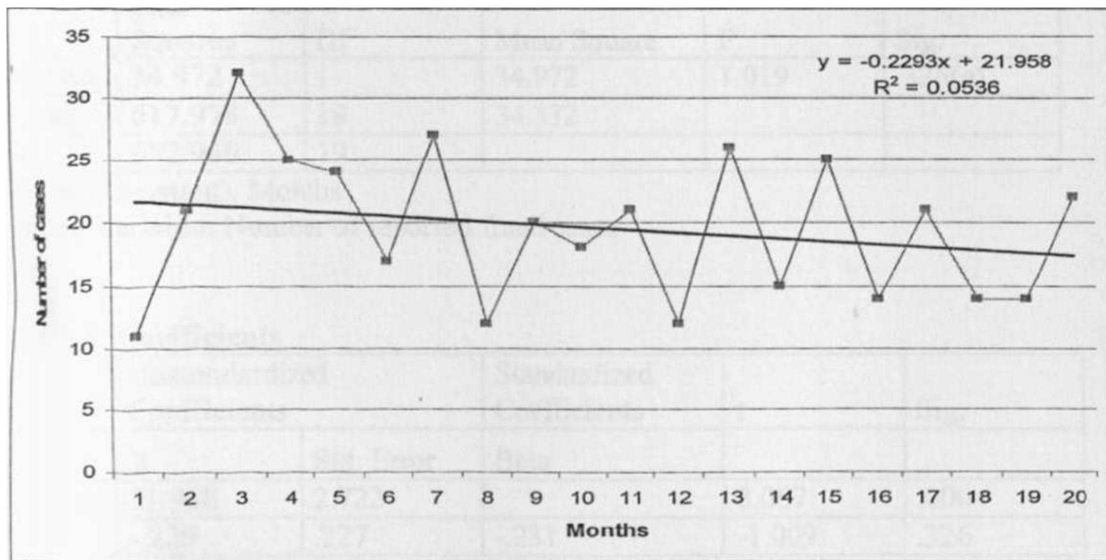
Some of the banks have extremely busy account opening desks and the staff handling the same are left with little time to interview customers before proceeding to open accounts for them. Illiteracy and client sensitivity also limit carrying out of KYC since some customers will be offended and suspicious when asked to disclose information, especially that pertaining to their source of income. Existing customers are also posing problems when carrying out KYC because in some instances, they have been known to give referrals to customers Uiey don't even know

properly, and therefore have no knowledge of the nature of business or transactions they are earning out. Since the bank will trust whatever information on the new client given by the referee, it gets risky when the referee is colluding with fraudsters or unknowingly to introduce fraudulent accounts. The dynamism exhibited by fraudsters also has posed a challenge to implementation of K.YC guidelines. With the high level of technological advancement, fraudsters are able to keep ahead of everyone with new innovative ways of committing crimes.

4.5.6: Reported Cases during the Period 2006-2008

The scatter plot shows an enatic trend for the number of fraud cases reported during the period December 2006 to February 2009, that is, there are sharp increases and decreases. The trend seems to be linear and as such a linear regression analysis can be used for analysis of reported fraud cases.

Figure 7: Scattcr plot



Source: banking fraud prevention unit

Table 4.5.2: Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
				R Square Change	F Change	df1	df2	Sig. F Change
.231(a)	.054	.001	5.85936	.054	1.019	1	18	.326

Predictors: (Constant), Months

The coefficient of determination (R^2) equals 0.054. This shows that months explain only 5.4 percent of the total number of reported fraud cases leaving 94.6 percent unexplained. The **P-**value of 0.326 (ANOVA table) implies that the model of reported fraud cases is not significant at the 5 percent significance.

Table 4.5.3: ANOVA

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	34.972	1	34.972	1.019	.326(a)
Residual	617.978	18	34.332		
Total	652.950	19			

Predictors: (Constant), Months

Dependent Variable: Number of reported fraud cases

Table 4.5.4: Coefficients

1	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	21.958	2.722		8.067	.000
Months	-.229	.227	-.231	-1.009	.326

Dependent Variable: Number of reported raud cases

The trend line multiple regression model using the regression coefficient gives the equation Number of fraud cases reported = 21.958 - 0.229 Months; Where 21.958 is a constant- meaning that at least number of fraud cases reported takes the value 21.958 (when months take the value

is 0). For every one unit increase in months, the number of fraud cases reported decreases by 0.229.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The objectives of this study were; to determine what the banks are doing in implementing know your customer (KYC) policies, to determine the level of compliance with know your customer policies among commercial banks, and to determine if the level of compliance is related to the number of fraud and money laundering incidences reported in commercial banks in Kenya.

From the findings, all banks were serving mixed g.oup, that is, individuals, SME's. corporates and MNCs /NGOs. This enables them to interact with the different customer groups which are represented in the Kenyan market. From the research findings, to a great extent, all banks required that original documents be sighted before accounts are opened, account opening procedures are written down and standardized and all customers must appear in person during account opening process. However, some banks did not require that a search is conducted for registered companies/organizations before they are allowed to transact, not all customers were interviewed before an account is opened to ascertain their nature of business and source of funds, and documentation or proof of payment was not necessarily requested from customers with large amount transactions in some banks. To a moderate extent, customers were required to have referees to be allowed to open accounts and customer's core income activities were not necessarily specified in account opening form. Physical location of businesses opening accounts were not ascertained by most banks.

5.2 Conclusions

The introduction of know your customer (KYC) procedures was meant to reduce or eliminate altogether cases of fraud and money laundering. However, although the number of reported cases seems to have reduced since the introduction of KYC, a significant number of cases are still being reported across the banking sector. Although a large percentage of the respondents agree that the C13K guidelines issued on KYC are not stringent, there seems to be laxity as far as compliance is concerned.

The erratic increase and decrease in reported cases exhibited over the period in review could be attributed to the inconsistencies exhibited by the respondent banks as far as compliance is concerned. For instance, while documentation or proof of payment for large transaction is a requirement of KYC, many banks did not comply with the same, and others did not monitor transactions in both new and existing accounts. This means that once fraudsters or those engaging in money laundering manage to go through the account opening procedure undetected, they are safe to transact since there is nobody monitoring their activities. While it is a requirement that customer's wishing to open accounts have a referee, this was not applicable to all the banks as some didn't necessarily require a new client to have one. However, even those who required that a referee be provided did not necessarily verify details of the same to ensure that the referees did not introduce fraudulent accounts. This therefore does not serve as a deterrent to fraudsters as all they need to do is get a colluding existing customer and they proceed to open and operate accounts.

Proof of location of businesses opening accounts is another KYC requirement which is not being given the attention it deserves by many banks. Although many respondent banks required those opening business account to provide proof of location of business (usually a lease, utility bill or trading licence), there was no follow up to physically confirm that the business actually exists and operates within the premises specified in the documents provided to the bank. This then exposes the banks to fraudsters since they will be able to use non-existent "briefcase" companies to commit fraud and use them as channels for moii^y laundering practices. On staff training and awareness, a large percentage of the respondents reported an impressive "to a great extent" the fact all their staff are trained on KYC. Some banks however only trained those they felt were relevant to the account opening and transacting processes. This then opens loopholes for fraudsters to exploit since they take advantage of the ignorance of the bank's staff to commit crimes.

I'rom the research finding, majority of fraudulent transactions involved use of forged or falsified documentation. It is therefore alarming that some banks responded "to a moderate extent" to the question if original documents were sighted during account opening. With falsified documents

being the leading means used by fraudsters, this procedure should be mandatory before any documents can be admitted to the bank and certified as a true copy of the original. The fact that some banks gave their employees the leeway to give exemptions during account opening worsens the situation as this gives room for manipulation of account opening requirements.

It is evident from the study tnat the problem lies not with the KYC policies and procedures, but with the implementation and compliance of the same. The banking institutions in the country in conjunction with the industry regulator therefore need to come up with more effective ways of ensuring compliance in the industry so as to reduce if not eliminate altogether incidences of fraud and money laundering.

53 Recommendations

The following recommendations were proposed as the way forward in enhancing KYC compliance and reducing cases of money laundering and fraud. Verification and sighting of original documents before opening an account sho.. J be made mandatory. This will ensure that forged documents don't find their way into the banking system and be used for committing fraud and money laundering. In the same light, search must be conducted for all registered business or corporate companies to confirm their existence and legal status before they are allowed to transact. This will keep off fraudsters who use 'briefcase' or dummy companies as conduit for feir illegal activities.

Banks needs to comply fully with KYC requirements and should not give its staff the leeway to give exemptions during account opening or as far as any other KYC requirement is concerned. From the study, some banks allowed their staff to give exemptions. This gives rise to discrepancies in the way account opening procedure is carried out as different staff members will give exemptions based on their individual and different judgement capacities. This opens up the account opening process to manipulation, especially when staff members arc colluding with criminal to defraud the bank. If and when an exemption has to be given, then this decision should not be left to one person, and a panel which must involve the risk and compliance department should be established to independently review the case and issue an exemption.

One of the aspects of KYC which many banks were unable to comply with had to do with verifying the physical location of businesses. With many of them citing resource constraints, lack of time and frequent change in location of many business enterprises, it is important to note that this is one exercise if duly carried out could save the banks a lot in terms of losses occasioned by non-existent companies which open account for money laundering or fraud purposes. Considering that this is a tedious exercise, banks could outsource this service to other service providers like security companies who would be charged with the responsibility of confirming the actual location of business enterprises among other details.

The responsibility given to account referees or introducers need to be enhanced. As it is, the referees have no responsibility beyond introducing a new account. This therefore means Uiat fraudsters will collude with existing customers to get a reference to open an account, and then proceed to misuse the account. Since there is no clause which makes the introducer or referee take responsibility for the accounts they introduce, then the reference given by the introducer becomes irrelevant since they can as well introduce total strangers to open accounts. If tlie terms and conditions for referees are changed to make them take full responsibility or become guarantors for the accounts they introduce, then they will be more careful and diligent with the people they introduce to the bank.

Considering that some of the frauds were committed by employees of the bank either solely or in collusion with the fraudsters, banks need to put in place more stringent staff recruitment policies. This should include establishing a potential employee's employment history, their personal and family history, as well as the kind of mipany they keep. While this is a time consuming exercise, it could save the bank a lot i.' terms of losses occasioncd by frauds involving its dishonest employees. From the data collected from the industry regulator, a number of cases reported every period involved rogue bank employees. Staff induction program also needs to include a mandatory KYC training session, regardless of what department one is joining in the bank. This will ensure that all the employees in the bank are well equipped to identify and report suspicious activities which they might eiv ountcr as they carry out their duties.

lhe central bank of Kenya which is the industry regulator needs to enhance its supervisory role to ensure compliance, and impose heavily punitive penalties to non-compliant banks. The effects

the supervisory unit are barely felt in the sector since they visit banks once or twice a year. To effective, the unit needs to make compliance checks a more regular and random exercise so as ensure that banks comply fully. The regulator should also ensure that all cases of attempted d actual fraud and money laundering incidences are reported so that a clear tend can be ablished and measures to deal with it put in place. Currently, many cases go unreported as **xcially** those which don't lead to actual loss of funds as many banks feel that reporting the ne will expose their non-compliance practices or highlight the loopholes in their internal ltrols.

nks in conjunction with the industry regulator and other stakeholders need to establish a abank which will contain information on all actual and suspected fraudsters. This will serve as alid reference point for many banks and will consequently prevent serial offenders from nupting to commit crimes in other banks as they will have already been blacklisted. In the ie light, those who will have been convicted with fraud and money laundering crimes should banned from opening accounts with other banks. This will serve as a strong deterrent for the udsters as they will be aware that once convicted, their details will be keyed into the databank I will he accessible to all banks and relevant stakeholders, making it impossible for them to rate accounts in any bank in Kenya.

Limitations of the Study

research data collection targeted the whole population of 43 banks and questionnaires were ributed to all of them accordingly. However, only 33 questionnaires were returned duly filled. • however represented about 77% of the population and considered adequate for the study. ʳe was also the issue of incomplete data especially as far as the question involving the sties of reported cases of fraud and money laundering. This was mainly due to the facts that «are conservative, and for the sake of their image and reputation, they would not want to be reporting high incidences of fraud and money laundering. This could also have been due to tioia and mistrust among the individual respondents within the banks that some of the "mation given could be used against them. This limitation was however overcome by ining relevant data from the central bank's banking fraud prevention unit.

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Banks in conjunction with the industry regulator and other stakeholders need to establish a databank which will contain information on all actual and suspected fraudsters. This will serve as a valid reference point for many banks and will consequently prevent serial offenders from attempting to commit crimes in other banks as they will have already been blacklisted. In the same light, those who will have been convicted with fraud and money laundering crimes should re banned from opening accounts with other banks. This will serve as a strong deterrent for the fraudsters as Uiey will be aware that once convicted, their details will be keyed into the databank 2nd will be accessible to all banks and relevant stakeholders, making it impossible for them to operate accounts in any bank in Kenya.

5.4 Limitations of the Study

The research data collection targeted the whole population of 43 banks and questionnaires were distributed to all of them accordingly. However, only 33 questionnaires were returned duly filled. This however represented about 77% of the population and considered adequate for the study. There was also the issue of incomplete data especially as far as the question involving the statistics of reported cases of fraud and money laundering. This was mainly due to the facts that banks are conservative, and for the sake of their image and reputation, they would not want to be seen reporting high incidences of fraud and money laundering. This could also have been due to paranoia and mistrust among the individual respondents within the banks that some of the infonnation given could be used against them. This limitation was however overcome by obtaining relevant data from the central bank's banking fraud prevention unit.

5.5 Suggestions for Further Itcsearch

This study has established that KYC policies and procedures in themselves are not stringent and if strictly adhered to can drastically reduce fraud and money laundering incidences. However, their effectiveness is being hampered by poor compliance practices. Although the banking sector acknowledges that the CBK guidelines are in fact necessary with an approval rating of 73% from the data collected, there is no corresponding effort to ensure compliance of the same. A study therefore needs to be carried out to establish why banks arc not complying, and what can be done to ensure total compliance.

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APPENDICES

Appendix 1: Sampling Frame

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. Charterhouse Bank Ltd - Under Statutory Management
8. Citibank N.A Kenya
9. City Finance Bank Ltd.
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 (K) 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 Limited
24. Giro Commercial Bank Ltd.
25. Guardian Bank Ltd
26. Gulf African Bank Limited
27. Habib Bank A.G Zurich

28. Habib Bank Ltd.
29. Housing Finance Ltd
30. Imperial Bank Ltd
31. InvesUnent & Mortgages Bank Ltd
32. Kenya Commercial Bank Ltd
33. K-Rcp Bank Ltd
34. Middle East Bank (K) Ltd
35. National Bank of Kenya Ltd
36. Oriental Commercial Bank Ltd
37. Paramount Universal Bank Ltd
38. Prime Bank Ltd
39. Savings & Loan (k) Ltd
40. Southern Credit Banking Corporation Ltd.
41. Standard Chartered Bank (K) Ltd
42. Trans-National Bank Ltd
43. United Bank of Africa
44. Victoria Commercial Bank Ltd

Source: Central Bank Of Kenya (Licensed Banks 2009)

i

Appendix II: Kcscarch Questionnaire

Please answer the following questions as accurately as possible.

SECTION A: BANK'S STRUCTURE AND TARGET MARKET

1. Name of Bank (Optional)

2. Tier group (please tick) (a) Upper (b) Middle (c) Lower

3. How long has the bank been in the (Kenyan) market

4. How many branches docs the bank have in Kenya

5. What is your focus customer group? (Please tick)

(Individuals)	(SMEs)	(Corporates)	(MNCs & NGO's)	(Mixed groups)
( )	( )	( )	( )	( )

SECTION B: KYC PROCESSES AND PROCEDURES

Please indicate by ticking appropriately the extent to which the following practices are applied in your bank during the account opening process.

	Not at All	Little Extent	Moderate Extent	Great Extent	Very Great Extent
All required documentation Is obtained	( )	( )	( )	( )	( )
Original documents are sighted And certified as true copies	( )	( )	( )	( )	( )
A search is conducted for Registered companies/Orgs Before they are allowed to Transact	( )	( )	( )	( )	( )

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All customers must appear
In person during a/c opening ( ) ( ) ( ) ( ) ( )

Customers are interviewed
Before account is opened ( ) :) ( ) ( ) ( )

Customer's core income activities
Are specified in a/c opening ( ) ( ) ( ) ( ) ( )
Form

Customers must have ( ) ( ) ( ) ( ) ( )
Referees

Account opening procedures are
Written down and standardized ( ) ( ) ( ) ( ) ( )

Documentation /proof of payment
Is required from customers witfi
Large amount transactions ( ) ( ) ( ) ( ) ( )

SECTION C: LEVEL OF COMPLIANCE

Please indicate by ticking the extent to which the following apply.

	Not at All	Little Extent	Moderate Extent	Great Extent	Very Great Extent
Authenticity of a/c opening Documents are verified	( )	( )	( )	( )	( )
All staff are trained on KYC Policies & procedures	( )	( )	( )	( )	( )
All account referees details arc verified	( )	( )	( )	( )	( )
Transactions in new & existing A/cs are regularly monitored	( )	( )	( )	( )	( )
Irregular / unusual transactions Are monitored & reported	( )	( )	( )	( )	( )
Staff are not allowed to Introduce accounts	( )	( )	( )	( )	( )

Management gives
Exemptions for a/c opening ( ) ( ) ( ) ( ) ( )

Physical location of businesses
Individuals opening an account
Is confirmed ( ) ( ) ( ) ( ) ( )

Accounts can be opened
Online ( ) ( ) ( ) ( ) ( )

Customers can transact
Online ( ) ( ) ( ) ( ) ( )

Customers are allowed to
Give instructions on phone ( ) (( ) ( ) ( )

SECTION D: CASES OF FRAUD AN1) MONEY LAUNDERING

1. From your experience in thj bank, approximately what number of Documents provided during account opening turned out to be forged/false/ Fraudulent during the year 2008? (Please tick)

(None) (1 - 10) (11 -20) (21 -30) (>30)
( ) ( ) ( ) ' ( ) ( )

2. From your experience, what is the direction taken by the statistics in question 1 above? (Please tick)

(Increase) (Decrease) tRemained the same)
( ) ( ) ( )

3. In your opinion, what is the level of compliance with KYC policies in your Bank? (Please tick)

(Low) (Medium) (High)
( ) ( ) ( )

4. Do you agree or disagree with the following statement: Central bank of Kenya's KYC guidelines arc rinccessarily stringent. (Please tick)

(Agree) ( )

(Disagree) ( )

5. What factors influence /affect KYC & AMI. compliance levels in your bank

6. Give recommendations o : hat can be done to enhance KYC :ompliance and reduce cases of money 'sundering and fraud

7. Please indicate in the table below the number of reported fraudulent and money laundering cases in each period.

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Year	**2006**	**2007**	**2008**
Number of reported cases			

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Appendix III: Letter of introduction

Date

University of Nairobi,
School of business,
P.O. Box 30197,
Nairobi - Kenya

Dear sir/Madam,

RE: REQUEST FOR RESEARCH DATA

I am a postgraduate student undertaking a Master of Business Administration (MBA) degree at the University of Nairobi. I am currently carrying out research on effectiveness of Know Your Customer (KYC) policies adopted by commercial banks in Kenya in reducing money laundering and fraud incidences.

Your bank is among those selected for the study. I kindly request you to fill the attached questionnaire to the best of your knowledge. Your response and or contribution will be treated with utmost confidentiality, and the information provided will be used purely for academic purposes, and specifically for this study.

Your assistance and cooperation is highly appreciated.

Yours faithfully,

Lucy Njagi
MBA Student

Dr. Martin Ogutu
Supervisor & Senior Lecturer,
School of Business - Univ. of Nairobi