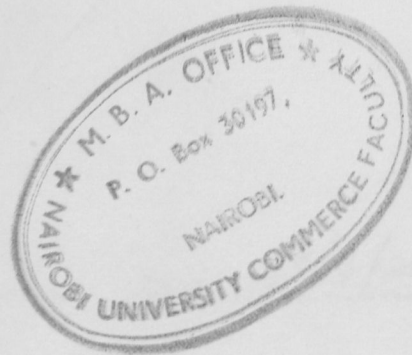


DECLARATION

**STRATEGIES APPLIED BY COMMERCIAL BANKS IN KENYA IN
ANTI-MONEY LAUNDERING COMPLIANCE PROGRAMS**



BY

MBWAYO MARK M.

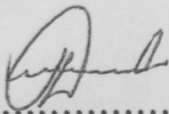
A MANAGEMENT RESEARCH PROJECT SUBMITTED IN PARTIAL
FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF MASTERS OF
BUSINESS ADMINISTRATION DEGREE OF THE UNIVERSITY OF NAIROBI

September 2005

DEDICATION

DECLARATION

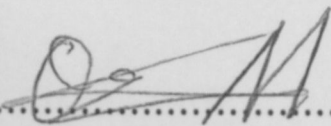
This Project is dedicated to my wife Anne Wanjiru Mbwayo who gave me the
This Research is my original work and has not been submitted for a degree in any other
University
period of study, and to my Children, Anthony, Christine and Elizabeth for
being understanding and supportive during the entire period of study.

Signed  Date 23/9/2005

Mbwayo Mark M.

D61/P/7525/02

This Research Project has been submitted for examination with my approval as the
University Supervisor

Signed  Date 24/9/2005

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DEDICATION

My special thanks go to all the Academic Staff of the MBA Program at the University of

This Project is dedicated to my wife Anne Wanjiru Mbwayo who gave me the encouragement to enroll for the MBA studies and the encouragement she provided throughout the period of study, and to my Children, Anthony, Christine and Elizabeth for being understanding and supportive during the entire period of study.

I also thank my colleague, Laban Omangi for the encouragement he gave me to continue to this end.

Last but not least, I thank greatly all the Chief Executives of the banks and all the staff who assisted in the completion of the questionnaires that made this work possible.

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My special thanks go to all the Academic Staff of the MBA Program at the University of Nairobi for their dedication and support they have given me all the way.

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I also thank my colleague, Laban Omangi for the encouragement he gave me to continue to this end.

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ABSTRACT

INTRODUCTION

Money Laundering has become a global problem and is generally associated with criminal activities, which include the financing of terrorism, drug trafficking and other related crimes. Money laundering may also result to instabilities to economies if experienced on a large scale. It is in the light of these negative consequences of money laundering that there has been pressure for the implementation of Anti -Money laundering regulation globally with the aim of managing its effects.

Kenya, being part of the global village faces similar threats from Money laundering activities and is therefore required to comply with global efforts of combating and preventing money laundering. As response, central Bank of Kenya has put in place Money Laundering regulation to govern the activities of Commercial banks in an effort to comply with global Anti Money Laundering Regulations.

This project sought to find out the strategies applied by Kenyan banks in such Anti Money Laundering Compliance programs and also to determine the extent to which the Programs are effective.

Results from the study indicate that Kenyan Banks apply the different strategies at different levels and also that the programs are effective to some extent. However, this level of effectiveness requires improvement bearing in mind the seriousness of the threats posed by money laundering activities.

Recommendations from this study include a further research to determine the level of Money Laundering activities in Kenya as well as the need to speed up an effective Anti - Money Laundering Legislation.

CHAPTER ONE

INTRODUCTION

1.1. Background

Anti-money laundering is the process by which efforts are made to prevent and detect money laundering activities, while compliance is the process of complying with laws, regulations, and guidelines (KPMG, 2004). The Department of Treasury, Internal Revenue Service defines money laundering as the activities and financial transactions that are undertaken specifically to hide the true source of the income.

Money Laundering has become a global issue because it supports a number of criminal activities. The common activities include the financing of terrorism, drug trafficking and other related crimes. Further, money laundering activities can cause severe negative macro economic consequences and instabilities to economies.

A report by the United States Department of State (Narcotics Control Strategy, 2001) noted that modern financial systems, in addition to facilitating legitimate commerce, permit criminals to transfer millions of dollars instantly using modern technology. The report notes that unchecked money laundering can erode the integrity of a nation's institutions and ultimately undermine national economies and currencies. In a similar report by the Asian Development Bank (Regional Technical Assistance Project, No. 5967), it is stated that money laundering impairs the development of financial institutions by eroding them through fraudulent activities and loss of trust by customers. These negative effects may ultimately lead to damaged reputation and the eventual collapse of the affected institutions.

Additional pressure is being exerted on Commercial banks through regulatory agencies who now require banks to put in place anti-money laundering compliance programs. Banks now face potential disciplinary measures and penalties for facilitating money laundering activities. Cases of banks which have fallen victim to money laundering

1.2. Statement of the Research Problem

activities have been highlighted in a report by the Department of Treasury, Internal Revenue Service (2003) and include the collapse of Best bank, a prominent American bank.

Leading the fight against money laundering are international bodies which include the Financial Action Task Force (FATF) on money laundering (Forty Recommendations); the International Monetary Fund, the World Bank and the United Nations. The Financial Action Task Force is the leading agency in these efforts and part of its mandates include promoting the creation of regional and sub-regional bodies responsible for formulating and promoting anti-money laundering efforts in their respective jurisdictions. An example of such a regional body is the Eastern and Southern Africa Anti-money laundering Group (ESAAMLG), responsible for promoting anti-money laundering efforts in the Eastern and Southern Africa region.

Nationally, individual country regulators have been charged with the responsibility of enacting and enforcing the laws that manage money laundering. In the Kenyan case, the banking industry is expected to comply with the Central Bank of Kenya regulation of money laundering guidelines (CBK.RG/12). The Kenyan banking sector is affected by globalization as well as the development in technology, leading to increased innovation of more risky products and services. As a result, the sector faces threats from potential money laundering activities and hence the need for anti-money laundering compliance programs to ensure that Central bank of Kenya regulation of money laundering guidelines is met.

The Central Bank of Kenya Regulation of money laundering (CBK.RG/12) is a comprehensive document that spells out specific measures the banks must implement in meeting the regulatory requirements. These requirements are also in line with the international requirements on anti-money laundering especially as spelt out by the Financial Action Task force on money laundering. The Central bank of Kenya regulation of money laundering became effective on 1st October, 2000.

1.2. Statement of the Research Problem

Given the seriousness of the threats from money laundering activities to the Kenyan banking sector, especially the negative impact they may have on the economy and the financial system, there are a number of compelling reasons to re-evaluate the effectiveness of the Anti-money laundering programs in the industry.

The research will highlight strategies that the banking industry in Kenya has applied in their anti-money laundering compliance programs. These programs will enable banks to pursue strategies with long term value to the banks. Firstly, there will be opportunities for globalization of business. However, while globalization opens new lines of business for strategically focused banks, it also exposes the banks to high incidences of criminal activities, including money laundering. Banks with global focus should therefore ensure that their Anti-money laundering programs are effective and receive global acceptance. This is especially true with banks that are subsidiaries of major international banks.

Secondly, there will be opportunity for the unrestricted application of electronic banking systems. These systems enable the introduction of speed and efficiency in the banking services. Unfortunately, the advances in technology that allow customers constant access to accounts and provide personalized service also facilitate the promotion of money laundering activities.

Thirdly, banks will benefit from reduced reputational risk. Regulatory and law enforcement agencies have warned that a financial institution's reputation could be at risk if it did not take obligations towards detecting and preventing money laundering seriously. This may have devastating consequences for the institution, and this may include loss of shareholder value or in the extreme, collapse of the institution.

Fourthly, institutions will benefit from corresponding banking relationships. Following the enactment of the US PATRIOT (the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism) Act, it has now been a requirement that financial firms a round the globe conducting business transactions with US banks have effective Anti-money laundering programs in place, otherwise their

correspondent banking relationships are placed at risk. This threat is supported by cases highlighted in such reports as the International Narcotics Control Strategy report (2001) and the Russian Money laundering update. The reports document cases of banks that have been negatively affected by incidences of money laundering and related prosecutions and asset forfeiture. The reports highlight the extent of the money laundering problem globally and reinforce the need for more stringent strategies to combat it.

A review of the Kenyan literature reveals extensive research coverage of the Kenyan banking industry. Most of the research has focused on topics dealing with financial performance (e.g. Kathanje, 2000, Thuku, 2002, and Muthungu, 2003), interest rates (e.g. Kimutai, 2003, and Kilonzo; 2003) and other performance related areas (e.g., Njagi; 2003, Kiyai, 2003, Goro, 2003 Gathoga, 2001 and Kibe, 2003). Elsewhere, a research entitled, Profiling Money Laundering in Eastern and Southern Africa (Kegoro, 2002), highlights the various crimes associated with money laundering such as corruption, fraud and drug trafficking and consumption in Kenya. The report, however, does not cover issues touching on anti-money laundering strategies and the effectiveness of the anti-money laundering compliance programs. Given its negative impact and the seriousness with which key international organizations are viewing the money laundering subject, there is need to research on the strategies applied by Kenyan Banks in the Anti-Money Laundering Compliance programs.

1.3. The Research Objectives

- i). To find out the strategies applied by Kenyan banks in the anti-money laundering compliance programs.
- ii). To determine the extent to which the anti-money laundering compliance programs in the Kenyan banking industry are effective.

1.4. Beneficiaries of the Study

- i). Central Bank of Kenya as a regulatory body to determine the extent of compliance.
- ii). The crime prevention agencies, fighting drug trafficking and related crimes, Terrorism and corruption. (ESAAMLG, C.I.D).
- iii). The Student Community/Academic Scholars as an added body of knowledge.

CHAPTER TWO

LITERATURE REVIEW

This section covers the literature relating to the subject of study and is derived from texts, internet material and from presentations by key experts especially on the subject of money laundering and the anti-money laundering compliance programs.

2.1. The Concept of Strategy

Various authors have defined strategy differently. George Steiner (1979), points out that strategy is that which top management does that is of great importance to an enterprise. He however notes that this concept is broad and includes, purposes, missions, planning objectives, program strategies and key methods to implement the strategies. Further, Steiner concedes that there is no consensus in the definition of strategy, noting that while some writers still define business strategies in the older military sense, other writers define strategies to include directional decisions, important actions to achieve specific decisions, or answers to the questions: "what should the organization be doing" or "what are the ends we seek and how are we going to achieve them?".

James Quinn (1991) defines strategy as the pattern or plan that integrates an organization's major goals, policies, and action sequences into a cohesive whole. He goes on to add that a well-formulated strategy helps to marshal and allocate an organization's resources into a unique and viable posture based on its relative internal competencies and shortcomings, anticipated changes in the environment and contingent moves by intelligent opponents.

Thompson and Stickland (2003) notes that a company's strategy consists of the combination of competitive moves and business approaches that manager's employ to please customers, compete successfully and achieve organizational goals. In crafting a strategy, management is saying in effect that among all the paths and actions it could have chosen, a decision has been made to move in the direction, focus on the markets and customer needs, compete in the fashion, allocate resources and energies in the ways it has

done and rely on the particular approaches to doing business. A strategy thus entails managerial commitment to specific markets, competitive approaches and ways of operating.

Pearce and Robinson (1997), notes that by strategy, managers mean their large-scale, future oriented plans for interacting with the competitive environment to achieve company objectives. A strategy is a company's "game plan". According to the authors, strategy provides a framework for managerial decisions and it reflects a company's awareness of how, when, and where it should compete, against whom it should compete and for what purposes it should compete.

Hitt (1997) defines strategy as an integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage. The authors state that an effectively formulated strategy marshals, integrates and allocates a firm's resources, capabilities and competencies so as to cope successfully with its external environment. Such a strategy also rationalizes a firm's strategic intent and strategic mission and what will be done to achieve them.

Henry Mintzberg in the book "The Strategy Process" outlines what is commonly called "The Five Ps" of strategy. He defines strategy as a plan, a ploy, a pattern, a position or a perspective. As a plan, Mintzberg views strategy as a consciously intended course of action, or a guideline to deal with a situation. By this definition, it is implied that the strategy is made in advance of the actions to which they apply, and that it is developed consciously and purposefully. Strategy as a ploy is regarded as a specific maneuver intended to outwit an opponent or competitor. Strategy as a pattern implies a pattern in a stream of actions that are realized whether or not they were intended. Strategy as a position refers to a means of locating an organization in an environment. It is the match between organization and the environment. While strategy as a perspective refers to not just a chosen position, but of an ingrained way of seeing the world.

Michael Porter (1996) defines strategy as the creation of a unique and valuable position, involving a different set of activities. He argues that if there were only one ideal position, then there would be no need for strategy. According to Porter, strategy is about being

competitive or about being different. This means deliberately choosing a different set of activities to deliver a unique mix of value. In short, Porter argues that strategy is about competitive position, about differentiating yourself in the eyes of the customer and about adding value through a mix of activities different from those used by competitors.

Kenneth Andrews (1976) introduces the concept of corporate strategy, which he refers to as the pattern of decisions in a company that determines and reveals its objectives, purposes, or goals. It also produces the principal policies and plans for achieving those goals and defines the range of business the company is to pursue, the kind of economic and human organization it is or intends to be and the nature of the economic and non-economic contribution it intends to make to its shareholders, employees, customers and communities. Andrews recognizes two different levels of strategy: Corporate strategy, which determines the businesses in which a company will compete in and business strategy, referring to the basis of competition for a given business.

2.2.1 Role of Senior Management in Anti-Money Laundering Strategies

Other notable writers on strategy include, Johnson and Scholes, Fred David and Igor Ansoff. Johnson and Scholes (2002) define strategy as the direction and scope of an organization over the long term, which achieves advantages for the organization through its configuration of resources within a changing environment and to fulfill stakeholder expectations. David (1997) defines strategy as the means by which long-term objectives will be achieved, while Igor Ansoff (1990) refers to it as a set of decision-making rules for guidance of organizational behaviour. The rules encompass objectives and goals, the product-market scope, the organizational concept and the operating policies.

2.2.2 Key Business Functions that are critical in the compliance process

Following from the above views, especially as noted by Mintzberg, strategy may be a perspective, a position, a plan or a pattern or even a ploy. Nickols (2000) summarises the word strategy as a term that refers to a complex web of thoughts, ideas, insights, experiences, goals, expertise, memories, perceptions and expectations that provide general guidance for specific actions in pursuit of particular ends. He notes that strategy then, has no existence apart from the ends sought. It is a general framework that provides guidance for actions to be taken and at the same time, is shaped by the actions taken. This means that the necessary pre-condition for formulating strategy is clear and widespread understanding of the ends to be obtained. With reference to anti-money laundering

compliance programs, therefore, without a clear understanding of what constitutes an effective anti-money laundering compliance program, banks will not formulate effective and suitable strategies to implement them. The strategies in this respect constitute all the important steps and actions taken to implement anti-money laundering compliance programs.

2.2. Anti-Money Laundering Compliance Strategies

Strategies are required in ensuring that a sound compliance program is in place to prevent and detect money laundering activities. A comprehensive Anti-Money laundering compliance program requires sound strategies covering the following areas (Everhardt, 2003, and KPMG Survey, 2004):

2.2.1. Role of Senior Management in Anti-Money Laundering Strategies

Senior management plays a key role in setting the tone and focus of an anti-money laundering compliance programs (KPMG Survey, 2004). These include, setting the bank's policies and procedures, delegating responsibilities through clear and logical structure and formal monitoring of the operation of processes and controls and ensuring that senior management receives appropriate management information on the business and controls. This means that senior management must set up an appropriate organization structure that adequately supports the processes and allows clear lines of responsibility for processing controls and reporting. Management is also responsible for setting up the Audit and Compliance functions that are critical in the compliance process.

2.2.2. Policies and Procedures

An effective anti-money laundering compliance program must be supported by a well formulated and documented corporate policy and procedures. Such policy and procedures clearly outline the compliance principles and should receive support and commitment from top management of the organization (Everhardt, 2003). Procedures customized by lines of business and operating activities that support the corporate policy should be in

place across the institution. It is critical that procedures be comprehensive and be sustainable.

Policies and procedures derive from organization culture, represent the core values of the organization and require a formal framework, supported by senior management to help ensure their efficient implementation and acceptance (KPMG Survey, 2004). The policies set the tone for the institution's approach to anti-money laundering compliance, while procedures document the detail of the systems and controls on which the institutions rely.

2.2.3. Due Diligence and Customer Identification

Financial institutions are required to perform due diligence and have a customer Identification program or Know Your Customer (KYC) in place. An effective anti-money laundering compliance program includes due diligence a round the account opening process that meets requirements identified in the Know Your Customer process (Everhardt, 2003).

Customer files should include documentation that clearly indicates the steps taken to know the true identity of the customer and include the beneficial owner, if different from the account holder (Everhardt, 2003). The nature and purpose of the relationship should be determined and should include expected activity, frequency of cash deposits and withdrawals, funds transfer activity and international activity for example.

In essence, a customer account profile should be established for anticipated account activity. This profile should make sense when compared to the customer's business and the geographic markets where the customer transacts business. The account opening process should be customized to fit individual lines of business and reflected in the daily operating procedures, which should be clear and unambiguous to guide staff on how to deal with specific cases. The decision as to the appropriate level of due diligence to be performed on each customer should be based as far as possible on such procedures, not on a bank officer's subjective view (KPMG Survey, 2004).

2.2.4. Assessment of Risk

A sound compliance program should include a process to evaluate the risk associated with money laundering (Everhardt, 2003). Risks are divided into three main categories; customer, product and transactional risks. Customer risk tells us characteristics about each individual (who the customer is and who the customer tells us that he is or she is), which is then verified by the financial institution as part of its due diligence process. Product risk refers to products and services that the customer purchases, while transactional risk represents the daily transaction activity that takes place on the various products and services.

An effective assessment and evaluation of these risks require the deployment of an intelligent system as it monitors information across these three risks. The system should be capable of constantly monitoring daily transaction activity to establish what the customer is actually doing while taking into consideration customer characteristics and the products that the customer uses.

2.2.5. Transaction Monitoring for Suspicious Activity and Reporting

Given the sheer volume and increased complexity of transactions, suspicious activity monitoring requires an automated, technology-driven approach (Everhardt, 2003). The need to profile and monitor the behaviour of every customer and every transaction is a necessary compliance requirement.

New anti-money laundering regulations require more effective systems with true analytics capabilities to find unusual transactions and determine organizational risk. These include software that incorporates sophisticated Pattern Detection and Adaptive Profiling technology which enables a financial institution to detect any behaviour within the organization that is unusual and analyze it for risk. Adaptive profiling provides further analysis and allows a financial institution to discover previously unknown patterns of behaviour through a complete knowledge of customer activity. This enables continuous analysis and has the ability to learn and understand each individual customer profile.

Everhardt also adds that an efficient workflow and case management is critical in achieving a total compliance solution. This process must be flexible, auditable and have the ability to maintain, retrieve and report case management activities. The presentation of unusual or suspicious activity in an organized and easy-to-use format is crucial. There is a strong need to maintain centralized information, yet have the ability to have open and free routing capabilities across financial operating units and unilateral business lines. Finally, the KPMG Survey, 2004 has also added that improved training for staff and investment in electronic monitoring and reporting systems as well as staff awareness can lead to improved reporting and hence increased compliance.

2.2.6. Monitoring of Anti-Money Laundering Systems and Controls

Banks should be able to assess the effectiveness of their systems and controls. Regulators expect that new or existing procedures are tested for adequacy and appropriateness on regular basis and doing so is good corporate governance and business practice (KPMG Survey, 2004). Monitoring can be performed by both internal and external auditors. The key is to help ensure that the monitoring process is independent of the areas of the business responsible for operation of the procedures, and so help ensure that there is a channel of communication to report any deficiencies to senior management.

2.2.7. Anti-Money Laundering Training

According to Everhardt, a successful anti-money laundering staff-training program is a key component that must be in place to ensure compliance. Training should cover all of the compliance policies and procedures, account opening due diligence, the risk assessment process, and suspicious activity monitoring and reporting.

However, effective training should be tailored to the particular needs of the institution and reflect the specific risks it runs, particularly for those staff that work closely with clients or might be in the best position to identify actual money laundering.

A successful training program has a highly positive impact on the promotion of an anti-money laundering culture within an organization, particularly if senior management demonstrates its commitment to the process.

2.3. Central Bank of Kenya: Regulation of Money Laundering (CBK.RG/12)

The regulation of money laundering is a comprehensive document that spells out specific measures that banks must implement in meeting the regulatory requirements. These regulations fall under the following specific categories:

2.3.1. Specific Measures

Banks should take specific measures to obtain and maintain proper identification of customers wishing to open accounts or make transactions whether directly or through proxy. Banks should also obtain and maintain adequate records regarding the sources of funds and details of transactions in order to enable the identification of unusual or suspicious transactions and reconstruct individual transactions. Additionally, banks should submit to the Central bank, a report of any suspicious transactions or activities, which may indicate money laundering or other attempts to conceal the true identity of customers or ownership of assets.

2.3.2. Customer Identification

Under this requirement, the regulation spells out what is to be considered the minimum acceptable for determining the true identity of customers wishing to open accounts or make transactions whether directly or through a proxy.

These requirements are for personal accounts or transactions, for Corporate, Partnership or Sole traders' accounts or transactions, and as well as for minors' accounts.

2.3.3. Legitimacy of Funds and Transactions

This section covers information that will be considered the minimum acceptable for determining the legitimacy of funds and transactions. The most common are large or unusual cash deposits or withdrawals, large, frequent or unusual currency exchanges and large, frequent or unusual transfers or payments of funds.

The regulations require that for large or unusual transactions in any of the above, written confirmation from the customer regarding the nature of such transaction be given.

2.3.4. Suspicious Activities

Under this section the regulations specifies the type of activities or transactions that may indicate possible money laundering activities and requires institutions to be vigilant and put in place adequate monitoring tools to identify them.

2.3. 5. Reporting of Suspicious Activities or Transactions

This section requires institutions that becomes aware of suspicious activities or transactions that may indicate possible money laundering activities to ensure that it is reported to the Central bank of Kenya immediately. The report should provide sufficient details as prescribed regarding the activities or transactions so that regulatory authorities can properly investigate and take any necessary action.

2.3.6. Confidentiality of Information

Banking institutions that obtain or become aware of information that is suspicious or indicates possible money laundering activities shall not disclose such information except to report it to the Central bank as required.

The above constitute the minimum requirements under the Central Bank of Kenya regulations. However, branches of foreign multinational banks may find themselves subjected to more elaborate compliance requirements in line with parent organization's international demands. In this regard, a Draft Proceeds of Crime and Money laundering (Prevention) Bill, 2004 has been enacted by Kenyan Parliament that will deal with the wider issues of Money laundering and the connected purposes.

2.4. Money Laundering Process and Anti- Money Laundering Effects

2.4.1. Money Laundering: Definition

The IMF (a fact Sheet 2003), has additionally defined money laundering as a process in which assets obtained or generated by criminal activity are moved or concealed to obscure the link between the crime and the assets. Examples of such activity are the

terrorist activities which are sometimes funded from proceeds of illegal activities, and perpetrators must find ways to launder the funds in order to use them without drawing the attention of authorities. Office of the Comptroller of Currency (the Banker's Guide to avoiding problems, 2002), defines money laundering as the criminal practice of filtering ill-gotten gains or dirty money through a series of transactions, so that the funds are cleaned to look like proceeds from legal activities and conceal the true source, ownership, or use of the funds. While, the Department of the Treasury (Internal Revenue Service, 2003) refers to money laundering as the activities and financial transactions that are undertaken specifically to hide the true source of the income.

2.4.2 Money Laundering Process

The Office of the Comptroller of currency (2002) identifies three independent steps that money laundering may take place and these may occur simultaneously. These are; placement, layering and integration. Placement involves placing, through deposits or other means unlawful proceeds into the financial system. Layering is the second step and involves separating proceeds of criminal activity from their origin through the use of layers of complex financial transactions. The final step, integration, involves using additional transactions to create the appearance of legality through the purchase of assets.

2.4.3. Money Laundering Effects

The Monograph (2001), notes that money-laundering activities have assumed significant proportions in recent times. According to one estimate, the annual worldwide value of laundered funds in 1997 was in the range of US\$300 to \$500billion. The US Senate Foreign Relations Committee's Sub Committee on Narcotics and Terrorism (1990) estimated that US \$300 billion is generated annually through international drug trafficking. In 1989, the United Kingdom Parliamentary Home Affairs committee estimated that a round £1800 million of drug-related money was flowing through the United Kingdom at the time.

The IMF (a fact sheet: April 2003) has also noted that if countries fail to address money laundering issues quickly, organized crime can become more entrenched. Among the other negative effects of money laundering on countries are a full range of severe

macroeconomic consequences, such as, unpredictable changes in money demand, prudential risks to the soundness of financial institutions and financial systems and a contamination effect on international capital flows and exchange rates due to unanticipated cross-border transfers. Furthermore, money laundering can have a dampening effect on foreign direct investment if a country's commercial and financial sectors are perceived to be under the control and influence of organized crime.

The negative effects of money laundering have also been felt in the Kenyan environment. Jackson Kitili (2003) notes that Kenya has had first hand terrorism experience, having suffered the bomb blast on 8th August, 1998 during which two hundred and fifty four lives were lost and thousands were seriously injured or maimed. Further, on 28th November 2002, Kenya was once again an unfortunate target of yet another terrorist attack in Mombasa. Currently, a travel ban has been issued against Kenya by jurisdictions on which Kenya relies greatly on to support two of her major sectors – Tourism and Agriculture. The said negative advisories are a direct result of the threat of terrorism, which can be funded by money laundering and have resulted in severe socio-economic ramifications to the country. Thus, combating the twin problems of money laundering and terrorist financing is therefore a natural reaction for Kenya. If the control over access to the financial system is weak, it will make the system more attractive to the money launderers.

The integrity of institutions in the financial system is dependent upon among others, the perception that they function within a framework of high legal, professional and ethical standards. Involvement of such institutions with money laundering activities will damage the attitudes of other institutions, regulatory authorities and customers towards such institutions. The involvement of banks in criminal activities erodes public confidence and undermines the stability of the banking system. Thus one answer to the question as to why money laundering should be combated is therefore that it serves to protect society and in particular, the commercial and financial spheres and the institutions that function within these spheres.

The questionnaire was administered by "drop and pick later" method and targeted Managing Directors, Finance Directors and where applicable, Compliance Officers of the Commercial banks as the main

CHAPTER THREE

RESEARCH METHODOLOGY

3.3 Data Analysis

This part describes the research methodology that was adopted so that the objectives of the study are met. The study was cross-sectional and descriptive in nature and it highlights aspects of the population of interest, the data collection methods and instruments of the data collection and data analysis techniques. This was a census survey.

Programs as well as the extent to which the Compliance programs were effective.

The data collected was then coded to facilitate statistical analysis using MS Excel

summarized further using frequency tables from which

3.1 Population of Interest

The population of interest consisted of all Commercial banks that were licensed under the banking act and which were participating in the Clearing House as at October 2004 (see Appendix I). There were 42 such banks registered and fully operational in Kenya at the commencement of the study. This number was composed of five foreign owned and not locally incorporated, seven foreign owned but locally incorporated, five banks with government participation and twenty-five banks which were locally owned.

The target population was all the 42 commercial banks registered under the banking Act and which participated in the Clearing House in Kenya. This number was considered manageable for a census survey.

3.2 Data Collection

Primary data was collected by use of a semi-structured, self-administered questionnaire (see Appendix II). The questionnaire was divided into the following sections: Part A, which covered demographic data, Part B, Strategies applied in the anti-money laundering compliance programs, while Part C covered the effectiveness of the anti-money laundering compliance programs.

The questionnaire was administered by "drop and pick later" method and targeted Managing Directors, Finance Directors and where applicable, Compliance Officers of the Commercial banks as the main respondents.

The data was collected by the use of a questionnaire. The data was then analyzed and presented using Mean Score and Standard deviation tables. The Mean and Standard deviation scores represented the extent to which the subject strategies were

3.3 Data Analysis

Completed questionnaires were edited for completeness and accuracy before processing. A five-point measurement scale was used to collect data from respondents to determine the extent the various strategies are applied in the Anti Money Laundering Compliance Programs as well as the extent to which the Compliance programs were effective.

The data collected was then coded to facilitate statistical analysis using MS Excel Worksheet. The results were summarized further using frequency tables from which a final summary of the Mean and Standard deviation scores for the results were tabulated.

March 2004 and responses received between March 2005 and June 2005. All the questionnaires received back from the 30 banks were usable. Table 1, which is shown below shows the distribution of these respondents as well as the percentage of response per category.

Table 1: Respondents by Category of Banks

Category of Bank	Number of Responses	Number Registered	Percentage Response by Category
Foreign Owned and not Locally Incorporated	3	5	60%
Foreign Owned and Locally Incorporated	7	7	100%
Banks with Government Participation	3	4	75%
Banks Wholly Locally Owned	17	26	65.4%
Total	30	42	71.4%

CHAPTER FOUR RESEARCH FINDINGS

The data was collected by the use of a questionnaire. The data was then analyzed and summarized and presented using Mean Score and Standard deviation tables. The Mean and Standard deviation scores represented the extent to which the subject strategies were applied in the Anti – Money Laundering compliance programs as well as the extent to which the programs were effective.

4.1. RESPONSES BY CATEGORY OF BANKS

Questionnaires were sent out to all 42 banks registered in the Clearing house as at October 2004, and 30 of these banks responded. Questionnaires were administered in March 2004 and responses received between March 2005 and June 2005. All the questions received back from the 30 banks were usable. Table 1, which is shown below shows the distribution of these respondents as well as the percentage of response per category.

Table 1: Respondents by Category of Banks

Category of Bank	Number of Responses	Number Registered	Percentage Response by Category
Foreign Owned and not Locally Incorporated	3	5	60%
Foreign Owned and Locally Incorporated	7	7	100%
Banks with Government Participation	3	4	75%
Banks Wholly Locally Owned	17	26	65.4%
Total	30	42	71.4%

4.2. STRATEGIES APPLIED IN ANTI - MONEY LAUNDERING COMPLIANCE PROGRAMS

The study sought to establish the strategies that are applied by banks in the Anti Money Laundering compliance programs. Respondents were asked to indicate from a list of strategies the extent to which these strategies are applied measured on a scale ranging from not applied at all (1) to Applied to a great extent (5). The results of the survey for all the strategies are summarized in Table 2, depicting Mean score and Standard deviation of each strategy

Table 2: Mean and Standard Deviation Scores on the Application of Strategies in Anti - Money Laundering Compliance Programs

	Type of Strategy	Mean Score	Standard deviation
1	Documented Anti Money Laundering Corporate Policy & Procedures.	3.90	1.25
2	Designated Anti Money Laundering Compliance Officer	3.63	1.49
3	Centralized Customer Account Opening Centre	2.40	1.70
4	Know Your Customer Screening Program	4.20	0.98
5	Decentralized Customer Account Opening Centres	3.60	1.70
6	Documented Anti Money Laundering Corporate Culture	3.60	1.28
7	Application of Technology Systems in Suspicious Activity Monitoring.	2.90	1.45
8	Application of Technology Systems in Suspicious Activity Reporting	2.77	1.38
9	Application of Technology Systems in evaluating: - Customer Risks - Product Risks - Transactional Risks	2.97 3.07 3.37	1.45 1.26 1.30
10	Independent Audit Review Function	4.40	0.66
11	Employee Training Programs	3.50	1.18
12	Internal Management Information Reporting System	3.50	1.50

4.3. EFFECTIVENESS OF THE ANTI MONEY LAUNDERING COMPLIANCE PROGRAMS

The results in Table 2 show that Independent Audit function and Know Your Customer Screening are the two strategies applied to a higher extent than others with mean scores of 4.40 and 4.20 respectively. The standard deviation scores of 0.66 and 0.98 for the Independent Audit Function and Know Your Customer Screening respectively are also lower than those recorded on other strategies.

Documented Anti Money Laundering Corporate Policy and Designated Anti - Money Laundering Compliance Officer come next in the extent of application. Corporate policy on Anti Money Laundering has 3.90 Mean score while Compliance Officer has 3.63 Mean score indicating that a good number of the respondents have documented their policies and also utilize the services of a compliance officer in managing their Compliance programs.

At the lower end, Centralized Account Opening Centre has the lowest mean score of 2.40, indicating that most banks do not utilize this as common strategy to manage the compliance programs. Strategies requiring the application of Technology systems also scored lower means than average. Suspicious Activity reporting and suspicious Activity monitoring have 2.77 and 2.90 Mean Scores respectively.

Strategies in the middle of the upper and lower scales include Decentralized Account opening (3.60), Anti Money Laundering Corporate Culture (3.60), Internal Management Information Reporting systems (3.50) and Employee Training (3.50) However, although Decentralized account opening and Internal Management information reporting systems have medium mean scores, they also have higher standard deviations of 1.70 and 1.50 respectively.

The results of the responses on the evaluation of Customer, Product and Transactional risks also fall in the medium range category

4.3. EFFECTIVENESS OF THE ANTI MONEY LAUNDERING COMPLIANCE PROGRAMS

The second objective of the study was to determine the extent to which the Anti Money Laundering Compliance programs were effective

Respondents were asked to indicate the extent to which their programs were effective in meeting some specific objectives and also indicate the extent to which they consider their programs effective overall. The effectiveness was measured on a scale ranging from not at all effective (1) to very high degree of effectiveness (5). The results of the survey were analyzed and presented in terms of mean and standard deviation scores as shown in Table 3. below.

Table 3: Effectiveness of Anti Money Laundering Compliance Programs

	Compliance of Objective	Mean Score	Standard Deviation
1	Carrying out Customer Due Diligence.	3.83	0.90
2	Identifying Transactional Risks	3.83	0.97
3	Suspicious Activity Monitoring	3.77	1.09
4	Identifying Product Risks	3.50	1.12
5	Suspicious Activity Reporting	3.73	1.06
6	Identifying Customer Risks	3.63	1.05
	Overall Effectiveness of the Anti - Money Laundering Compliance Programs	3.70	0.86

The results above indicate that the Compliance programs have scores above moderate on carrying out Customer due diligence and also on identifying transactional risks with mean

scores of 3.83 each. However, with a Standard deviation of 0.90, the programs are more effective in meeting customer due diligence than in identifying transactional risks which has 0.97 Standard deviation.

5.1. Introduction

The lowest Mean and Standard deviation scores are on Suspicious Activity reporting, with 3.50 and 1.12 scores on mean and standard deviation respectively.

In terms of the overall assessment of the Compliance Programs, the results indicate a Mean Score of 3.70 and a standard deviation of 0.86. The measure for the mean indicates an assessment of between moderately effective and largely effective. The rest of the scores are as shown in Table 3 above.

5.2. Summary, Discussions and Conclusion

Regarding the application of strategies, the results of the study indicate that banks apply the various strategies with different levels of extent. The application of independent Audit function in reviewing compliance programs, Know Your Customer Screening and Documented Anti-Money laundering Corporate policy and procedures ranked as the most commonly applied strategies with mean scores of 4.40, 4.20 and 3.96 respectively. The three strategies are important if effective compliance programs are to be put in place and these findings indicate that banks are focusing on the right strategies but require further effort to improve the score.

Designated Anti-Money Laundering compliance officer, Internal Management information reporting and Documented Anti-Money laundering corporate culture are also scored fairly. This indicated some effort on the part of banks to internalize the compliance process and thus improve compliance.

CHAPTER FIVE

SUMMARY AND CONCLUSION

5.1. Introduction

The study's first objective was to find out the strategies applied by Kenyan banks in the Anti-Money Laundering compliance programs while the second was to determine the extent to which the Anti-Money Laundering Compliance Programs in the Kenyan banking industry are effective.

The study covered banks registered at the clearing house of Central Bank of Kenya and on register as at November 2004. Data from the respondent banks was collected between March 2005 and June 2005. The results of the study are tabulated in Table 1 to Table 3 in the data analysis section of this report.

5.2. Summary, Discussions and Conclusion

Regarding the application of strategies, the results of the study indicate that banks apply the various strategies with different levels of extent. The application of independent Audit function in reviewing compliance programs, Know Your Customer Screening and Documented Anti-Money laundering Corporate policy and procedures ranked as the most commonly applied strategies with mean scores of 4.40, 4.20, and 3.90 respectively. The three strategies are important if effective compliance programs are to be put in place and these findings indicate that banks are focusing on the right strategies but require further effort to improve the score.

Designated Anti-Money Laundering compliance officer, Internal Management Information reporting and Documented Anti-Money laundering corporate culture are also scored fairly. This indicated some effort on the part of banks to internalize the compliance process and thus improve compliance.

At the lower end, Centralized Account opening Centre ranked last with a mean of 2.40 indicating that banks do not consider this to be a key strategy. Further strategies requiring the application of technology in Suspicious Activity Reporting and Monitoring are not commonly used with their mean scores being 2.77 and 2.90 respectively. These results may be attributed to the low investment in technology as well as the lower level of development in technology.

The scores for Application of Technology in Customer, Product and Transactional risks evaluation were also generally medium, an indication of low investment in technology by the banks.

This study covered strategies applied by banks in Kenya in Anti-Money Laundering

On the effectiveness of Anti Money Laundering programs, the results indicated that the programs were more effective in carrying out Customer due diligence than in the other areas with a mean score of 3.83 and a standard deviation of 0.90. This was followed by identifying transactional risks with a mean score of 3.83 and a standard deviation of 0.97

The results for the other compliance objectives indicate a slightly higher than moderate scores. However, these results still leave a significant portion of the scores that are not effective. This is a situation than requires attention especially considering that Money laundering is a potential global issue that requires urgent addressing by all banks.

seek to determine the level of money laundering in the banking industry in Kenya for

In overall terms, the respondents recorded a mean score of 3.70 and a standard deviation of 0.86 on effectiveness of the programs. This leaves a mean score gap of 1.30 that requires bridging through additional efforts on the part of banks to ensure improvement in effectiveness of the programs.

Although the study did not cover the extent to which current legislation and supervision

5.3. **Limitations of the study**
 based on the results recorded, respondents pointed out the
 failure to implement an effective Anti- Money laundering legislation as contributing to

The first limitation of the study involves the high percentage of non response. Responses were not received from 12 banks or 29.6% of the population. This is a significant number whose responses could potentially change the findings of the study.

Secondly, the time available for the study was short and it was not possible to carry out personal interviews to clarify on any unclear areas and thus ensure that clear results are achieved from respondents.

REFERENCES

The third limitation is that it may not be possible to conclude that the respondents have provided honest disclosure of the strategies as well as the level of effectiveness of the programs on suspicion that the information could be made available to competitors or the regulator.

5.4. Recommendations for further Research

This study covered strategies applied by banks in Kenya in Anti-Money Laundering Compliance Programs and also the extent to which the programs are effective. The study did not cover the relationship between the specific strategies and the level of effectiveness. It is therefore recommended that future studies are carried out to determine the extent to which the specific strategies influence the level of effectiveness of the compliance programs.

Secondly, the study did not seek to determine the level of incidences recorded if any, of Money Laundering in the banking industry in Kenya. Future research should therefore seek to determine the level of money laundering in the banking industry in Kenya for which purpose the compliance programs are designed.

5.5. Recommendations for Policy Implementation

Although the study did not cover the extent to which current legislation and supervision by Central bank of Kenya contributes to the results recorded, respondents pointed out the failure to implement an effective Anti – Money laundering legislation as contributing to lower levels of compliance. It is recommended that the proposed legislation on Money laundering (currently in Draft form) be hastened and that more strict supervision by central bank be put in place to increase the level of compliance.

Results also indicated lower scores on areas requiring the application of technology.

It is therefore recommended that banks increase the level of investment in areas of compliance requiring the application of technology to improve effectiveness.

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Appendix I: List of Commercial Banks Registered in Kenya

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6. Barclays Bank of Kenya Ltd
7. Standard Chartered Bank Ltd
8. Development bank of Kenya Ltd
9. Stanbic Bank Ltd
10. Bank of Baroda Ltd
11. Diamond Trust Bank of Kenya Ltd
12. K-Rep Bank Ltd

Institutions with Government Participation

13. Kenya Commercial bank Ltd
14. Industrial Development Bank Ltd
15. National Bank of Kenya Ltd
16. Consolidated bank of Kenya Ltd

APPENDICES

Appendix I : List of Commercial Banks Registered in Kenya

(October 2004)

Foreign Owned not Locally Incorporated

1. Citibank N.A
2. Credit Agricole Indosuez
3. Habib Bank A.G. Zurich
4. Bank of India
5. Habib Bank

Foreign Owned but Locally Incorporated (partly owned by Locals)

6. Barclays Bank of Kenya Ltd
7. Standard Chartered Bank Ltd.
8. Development bank of Kenya Ltd.
9. Stanbic Bank Ltd.
10. Bank of Baroda Ltd.
11. Diamond Trust Bank of Kenya Ltd.
12. K-Rep Bank Ltd.

Institutions with Government Participation

13. Kenya Commercial bank Ltd.
14. Industrial Development Bank Ltd.
15. National Bank of Kenya Ltd.
16. Consolidated bank of Kenya Ltd.

Appendix II: Research Questionnaire

Institutions Locally Owned

- QUESTIONNAIRE NO. _____
- PART I
- PERSO
- RESPONDENT
1. NAME
2. POSITION
3. NATURE OF ORGANIZATION
4. YEAR OF ESTABLISHMENT
5. PLEASE STATE THE CURRENT NUMBER OF BRANCHES OF YOUR ORGANIZATION
17. CFC Bank Ltd.
 18. Commercial bank of Africa Ltd.
 19. Transnational bank Ltd.
 20. Credit Bank Ltd.
 21. Guardian Bank Ltd.
 22. First American Bank Ltd.
 23. Investments and Mortgages Bank Ltd.
 24. Middle East Bank Ltd.
 25. Akiba Bank Ltd.
 26. FINA Bank Ltd.
 27. Imperial Bank Ltd.
 28. Victoria Commercial Bank Ltd.
 29. Prime Bank Ltd.
 30. Equatorial Commercial Bank Ltd
 31. Giro Commercial Bank Ltd.
 32. Biashara Bank Ltd.
 33. African Banking Corporation Ltd.
 34. Chase Bank Ltd.
 35. City Finance Bank Ltd.
 36. CharterHouse Bank Ltd.
 37. Paramount Universal Bank Ltd.
 38. Southern Credit Banking Corporation Ltd.
 39. Fidelity Commercial Bank Ltd.
 40. Delphis Bank Ltd
 41. Cooperative Bank Ltd.
 42. National Industrial Credit Bank Ltd.

Appendix II: Research Questionnaire

QUESTIONNAIRE NO-----

PART A: DEMOGRAPHIC DATA

PERSONAL DETAILS OF RESPONDENT

1. Name (optional) -----

2. Position in the organization-----

COMPANY INFORMATION.

3. Name of the Organization -----

4. Year of incorporation -----

5. Please tick the Category that best describes your organization.

Foreign owned and not locally incorporated []

Foreign owned but locally incorporated []

With Government participation []

Wholly locally owned []

6. Please state the current number of employees in your organization-----

7. Please state the current number of branches of your organization-----

PART B: STRATEGIES

For each of the questions numbered 8 to 19, please indicate the extent to which the following strategies are applied in the anti-money Laundering compliance program in your institution.

Use a five-point measurement scale as follows:

- 1 – Not applied at all, 2 – Least applied, 3 – Moderately applied
- 4 – Largely applied, 5 – Applied to a great extent.

8. A documented anti-money laundering corporate policy and procedures outlining compliance principles.

1	2	3	4	5
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

16. Application of technology systems that evaluate the following:

9. A designated anti-money laundering compliance officer responsible for compliance issues/matters.

1	2	3	4	5
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

10. A centralized customer account opening centre

1	2	3	4	5
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

11. Know Your Customer (KYC) or Customer Identification Screening program.

1	2	3	4	5
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

12. Decentralized customer account opening centres.

1	2	3	4	5
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

19. An external Management information reporting system

1	2	3	4	5
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

13. A documented anti-money laundering corporate culture spelling out required behaviour from all staff in support of anti-money laundering initiatives.

1 2 3 4 5

14. Application of technology-driven systems in Suspicious Activity Monitoring.

1 2 3 4 5

15. Application of technology-driven systems in Suspicious Activity Reporting.

1 2 3 4 5

16. Application of technology systems that evaluate the following:

b) Identifying transactional risks

1 2 3 4 5

i. Customer risks

ii. Product risks

iii. Transactional risks.

17. Having an independent audit function that carries out testing and review of the compliance programs.

1 2 3 4 5

18. Having an employee training program covering the anti-money laundering compliance programs.

1 2 3 4 5

19. An internal Management information reporting system that provides money laundering information to management.

1 2 3 4 5

PART C: EFFECTIVENESS OF ANTI-MONEY LAUNDERING COMPLIANCE PROGRAMS

20. To what extent do you consider the anti-money laundering compliance program in your organization effective in respect of the following:

Use the five-point measurement scale, where 1 = Not at all effective, 2 = low degree of effectiveness, 3 = Moderate degree of effectiveness, 4 = High degree of effectiveness and 5 = Very high degree of effectiveness.

	1	2	3	4	5
a) Carrying out a Customer due diligence	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b) Identifying transactional risks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c) Suspicious Activity Monitoring	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d) Identifying Product risks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e) Suspicious Activity Reporting.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f) Identifying Customer risks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

21. What would you consider to be your overall assessment of your organization's anti-money laundering compliance program in tackling the money laundering issues in the Kenyan banking industry ?.

Not at all effective	<input type="checkbox"/>
Low degree of effectiveness	<input type="checkbox"/>
Moderate degree of effectiveness	<input type="checkbox"/>
High degree of effectiveness	<input type="checkbox"/>
Very high degree of effectiveness.	<input type="checkbox"/>

22. What additional views would you like to give that may contribute to the improvement in the fight against money laundering in the banking Sector in Kenya.

23 Please give any other comments that you deem useful for this exercise

A. -----

B. -----

I thank you very much for your co-operation and time spared to complete this Questionnaire.

Mark Mbwayo.