

**CHALLENGES FACED BY CENTRAL BANK
OF KENYA IN COMBATING MONEY
LAUNDERING**


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DECLARATION

This management research Project is my original work and has not been presented for a degree in any other University.

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SUPERVISOR'S DECLARATION

This management research project has been submitted for examination with my approval as the candidate's University Supervisor.

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DEDICATION

First to God almighty for his grace and everlasting love. To my dear wife Lynne Kiplagat for her love and moral support. My son Emmanuel Kiprop and daughter Charlyne Jematia who gave me peace and understanding, especially when they required my presence to be with them. To my dear parents Mr. and Mrs. Musa Toroitich Kipyegen , my siblings and the entire Kipyegen family for their prayers, encouragement and moral support.

“Education is an ornament in prosperity and a refuge in adversity”.

ABSTRACT

One of the economic crimes that have adversely affected the level of economic development in Africa today is money laundering. Money laundering has the notorious tendency to discourage or frustrate legitimate business enterprise, corrupt the financial system and ultimately, the socio-political system. Money laundering diminishes government tax revenue and weakens government control over the economy and thus undermining the function and integrity of financial systems. Modern financial systems, in addition to facilitating legitimate commerce, permit criminals to order the transfer of millions of shillings instantly. Criminals have always endeavored to conceal the origin of illegally generated funds in order to erase all trace of their wrongdoings.

This study sought to establish the challenges faced by the Central Bank of Kenya in combating money laundering in the country and determine how the bank is dealing with these challenges. The significance of the study will help the bank as the regulator in financial industry realize the areas of attention and where it needs to improve in order succeed on its objective in combating money laundering in Kenya.

The researcher carried out a case study of Central Bank of Kenya to find out the challenges it faces in combating money laundering the respondents were senior bank managers and officers of Bank Supervision Department and Bank Fraud Investigation Unit who were required to respond to questions in an interview guide. Each section of the interview guide was aimed at answering each of the 2 objectives of the study.

The study established that Kenya is faced with the challenge of the porous borders especially the war torn neighboring States which aid in human and drug trafficking and piracy combined with the extensive unsecured borders along these states. The findings indicated this as the sole agent through which money launders have taken advantage. Porous borders are also the source of terrorism financing through unreported foreign cash inflows not ascertained if related to money laundering. It is difficult for the regulator to trace or detect the proceeds of crimes either through aliens, hard cash smuggled in and

out of the country. The AML act empowers the Financial Reporting Centre to ensure compliance.

The study identified the money laundering challenges as; lack of adequate laws, delay in implementation of the recently enacted AML Act, lack of laws to deal with money laundering in neighbouring countries, difficulty in monitoring the movements of people including terrorists, presence of cash couriers, ease of smuggling, corruption at the porous borders , unreported cash flows and legal and regulatory challenges. The study further found out that the big challenge for reporting institutions is to strike a proper balance between implementing the Act and maintaining client confidentiality for the case of the commercial banks and this will affect how CBK can effectively monitor and supervise them in combating the vice.

The study concludes that that money laundering is a threat to both the integrity and stability of the banking sector and even the forex bureaus themselves. Further, with increased globalization, the Kenyan banking systems are increasingly under close scrutiny by its international trading partners particularly with regard to anti money laundering legal and regulatory frameworks. The study concludes that Kenya is vulnerable to money laundering particularly given it's mainly cash based economy. This is further aggravated by porous borders and weak institutions for enforcements of law.

The study recommends that CBK should establish appropriate policies and procedures to ensure the effective prevention, detection and control of possible money laundering activities and terrorism financing and that the regulator institute strict measures on its Prudential Guidelines to all commercial Banks pursuant to the Banking Act on "Know Your Customer" and "Customer Due Diligence" procedures ensure adequate identification of customers, their source of funds and the use of the said funds. This is through strengthening of customer due diligence procedures. The study further recommends that the Proceeds of Crime and Anti-Money Laundering law, be implemented. This would place institutions, including casinos, real estate agencies, precious metals and stones dealers, and legal professionals and accountants under the scrutiny of CBK.

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LIST OF ABBREVIATION AND ACRONYMS

AML - Anti Money Laundering - Measures used to combat money laundering.

CBK - Central Bank of Kenya

GOK - Government of Kenya

IMF - International Monetary Fund

KYC - Know Your Customers – Thorough knowledge of own customer.

FRC - Financial Reporting Centre

SMURFING - Placement techniques used in money laundering scams

HAWALA – Organized crime in India involved in money laundering activities.

KBA - Kenya Bankers Association

SIMBA PROJECT – System for Information Management for Banking and Accounting Project

KACA - Kenya Anti-Corruption Commission

KEPSS - Kenya Electronic Payment and Settlement System

DoS REPORT -The 2009 U.S. Department of State report on Kenya money laundering

AU - African Union – Union of African states to foster its interest in both Africa and the international arena.

FATF – Financial Action Task Force – An inter-governmental body whose purpose is the development and promotion of policies to combat money laundering.

2000 UN CONVENTION- 2000 United Nations Convention against Transnational Organized Crime- This is a UN body set in the year 2000 to ensure that banking transactions conform to the convention.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

One of the economic crimes that have adversely affected the level of economic development in Africa today is money laundering. Not only has it negatively impacted on the economies of African countries, but it has also seriously dented the image of the continent at the international arena. Indeed, it is the international aspect and adverse effect on international business and commerce that has galvanized national and international action to regulate it, (McClean, 1990). Money laundering has the notorious tendency to discourage or frustrate legitimate business enterprise, corrupt the financial system and ultimately, the socio-political system. It is the consequence of such activities that has negatively affected the level of direct foreign investment in a number of African countries, Kenya included. The effect of this crime is so devastating that certain business transactions are now on a gradual decline particularly in those areas where local businessmen do not have the necessary resources to meet the required investment profile. Money laundering diminishes government tax revenue and weakens government control over the economy and thus undermining the function and integrity of financial systems, (Bartlett and Ballantine, 2002).

The Daily Nation newspaper of 10th August, 2010, in an article written by Prof. Njuguna Ndungu (CBK Governor) and Mr. Richard Etemesi (Chairman -KBA) responding to reports that the financial sector was experiencing rampant fraud and dirty money, the Governor said the government and the CBK in close liaison with the KBA and other stakeholders have undertaken to minimize the prevalence of fraud and money laundering in the country's financial sector. He admitted that despite this concerted

efforts by the stakeholders in the industry, money laundering continues to be a big challenge in the financial sector in Kenya. The marked increase in money laundering activities in third world countries, Kenya inclusive, has been attributed to a number of factors, all bordering on the dependent nature of their economies, (Osinbajo and Ajayi, 1999). The challenges to combating money laundering are; regional instability, cash-based economies and the growth of the informal remittance sector, law enforcement and judicial personnel with inadequate expertise and training, increased criminal use of technological innovations, liberalization of the financial infrastructure, corruption barriers and lack of funds and technical expertise. Money laundering has devastating social consequences and poses a threat to the security of any country, large or small. It provides the fuel for drug dealers, terrorists, illegal arms dealers, corrupt public officials and all types of criminals to operate and expand their criminal activities. Unhindered money laundering can quickly erode the integrity of a small nation's financial institutions creating unfair competition between legitimate and illegitimate business. International Monetary Fund suggests that smaller countries like Kenya are more susceptible to large scale money laundering operations causing severe macroeconomic instability, (Bartlett and Ballantine, 2002).

Money laundering is not a new phenomenon, it's as old as crime itself. Criminals have always endeavored to conceal the origin of illegally generated funds in order to erase all trace of their wrongdoings. The globalization process and the communications revolution have made crime increasingly international in scope, and the financial aspects of crime have become more complex. The spread of international banks all over the world has facilitated the transmission and disguising of the origin of funds. This has also been assisted by the "hijacking" of financial institutions by wealthy criminals who use

their institutions to introduce their illicitly earned funds into the financial world, (McDonnell, 2006). Money laundering is generally associated with criminal activity or corruption, with the intention of disguising the money's origin of income so that the money generated can be used "legitimately".

Modern financial systems, in addition to facilitating legitimate commerce, permit criminals to order the transfer of millions of dollars instantly, using personal computers and state of the art communications systems. For money laundering activities to be carried out, a medium to launder the illicit funds is required. The preferred medium chosen by money launderers is the financial institutions, (Masciandaro, 1999) due to its efficiency and its low cost in carrying out financial transactions. These activities taint the integrity of financial institutions which has a negative impact on the soundness and stability of these financial institutions. When the integrity of the financial institutions is weak, it has a discouraging effect on foreign direct investment due to lack of investor confidence. This in turn can distort the long-term growth of the economy. According to Masciandaro and Portolano, (2003) money laundering threatens economic and financial systems in countries. Money is laundered through currency exchange agencies, stockbrokers, jewelers, casinos, expensive car dealers, insurance companies, and trading companies. Private banking facilities, offshore banking havens, shell corporations, free trade zones, money transfer systems (like SWIFT), and trade financing can all be used to cover-up illegal activities. Money launderers do not necessarily seek the best rate of return but the easiest way to clean their dirty money, (Porteous, 2000).

Daily Nation Newspaper of 9th August, 2010, in the business news section, the article highlighted that in addition to the rising need for surveillance due to increased incidents of money laundering and the threat of terrorism in the country. Players in the banking

industry say there is need for creative ways to enable institutions adhere to prudential benchmarks set by the CBK.

1.1.1 Money Laundering

According to the United Nations Conventions (1988) and (2000) money laundering is defined as “the conversion or transfer of property, knowing that such property is derived from any offence or offences or from an act of participation in such offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such offence or offences to evade the legal consequences of his actions”. The "International Guide to money laundering: Law and Practice" defined it as the criminal process whereby, the proceeds from crime are hidden and transferred by attempts to integrate them into the financial system in order to give them the appearance of legitimate funds". It can also be defined as the various processes or methods by which profits from criminal activities are disguised as legitimate funds, by concealing their true origin and ownership, to give the picture that they emanate from legitimate source so as to permit the criminals further use of the money.

According to Imala, (2004) money laundering is the process criminals use to hide, control invest, and benefit from the proceeds of their criminal activities. Crimes committed for financial gain tend to produce cash. These crimes include illegal arms sales, smuggling and the activities of organized crime. Others are drug trafficking, prostitution rings, embezzlement, insider trading, bribery, tax related economic crimes and cyber crime. This poses real problems for criminals because spending large amount of cash arouses suspicion. Therefore criminals attempt to create a legitimate background

for their money. Consequently, money laundering is a derivative or second-order financial crime. By this, is meant that for money laundering to take place, there must be an underlying criminal activity that will generate proceeds which, when laundered, results in the offence of money laundering. Money laundering is also often a trans-border crime. Unchecked money laundering has a high potency to corrupt and sabotage the economic policies of governments as well as threaten national and international security leading to unpleasant consequences such as, undermining initiatives and efforts to establish and strengthen market-based economies, discouraging foreign private investments, contaminating the financial system and making it vulnerable to failure, facilitating tax evasion and denying governments of substantial revenues, exposing governments and financial institutions reputation risks, threatening national and international security and free movement of persons and creating unhealthy volatility in banks' deposits.

1.1.2 Central Bank of Kenya

The Central Bank of Kenya was established in 1966 under the CBK Act (CAP 481), 1966. The Act assigned to the CBK the statutory objectives “to assist in the development and maintenance of a sound monetary and credit, and banking system in Kenya, conducive to the orderly and balanced economic development of the country and the external stability of the currency”. The Bank is also required to maintain a desirable level of foreign exchange computed as equal to at least four months of imports cover averaged over the last three years, (www.centralbank.go.ke). The objectives of the bank are enumerated under Section 4A of the Act, and empower the bank to, formulate and implement foreign exchange policy, hold and manage its foreign exchange reserves,

license and supervise authorized dealers, formulate and implement such policies as best promote the establishment regulation and supervision of efficient and effective payment, clearing and settlement systems, act as banker and adviser to, and as fiscal agent of the government and issue currency notes and coins.

Under the CBK Act, the responsibility for determining the policy of the bank, other than the formulation of monetary policy, is given to the Board of Directors. The Monetary policy committee of the bank is responsible for formulating monetary policy. All members are appointed by the President to hold office for a term of four years and are eligible for reappointment once, provided that a board member shall hold office for not more than two terms, this policy is bound to change with the enactment of the new Kenyan constitution which was promulgated on 27th August, 2010. The executive management team comprises the Governor, the Deputy Governor and fifteen heads of department who report to the Governor. The Bank operates from its head office in Nairobi and has branch offices in Mombasa, Kisumu and Eldoret, (CBK, 2010). The Bank also owns the Kenya School of Monetary Studies (KSMS) which is headed by an Executive Director answerable to the Governor. The Bank has recently opened a currency centre in Nyeri while plans are underway to open others in Nakuru, Kisii, and Meru regions in a new strategy by CBK to address the collection of old currencies and introduction of clean currencies in the rural economy.

The vision of the CBK is to offer world class banking service and delivery. The CBK principal objective is formulation and implementation of monetary policy directed to achieving and maintaining stability in the general level of prices. The aim is to achieve stable prices – that is low inflation – and to sustain the value of the Kenya shilling. The second objective is to foster the liquidity, solvency and proper functioning of a stable

market based financial system. (Monthly Economic Review, Oct. 2009). The secondary objectives are to formulate and implement foreign exchange policy, hold and manage its foreign exchange reserves, license and supervise authorized dealers in the money market, among other objectives. (Monthly Economic Review, Oct. 2009)

The mandate of compliance to AML guidelines is under the Bank Supervision department (BSD) whose main objective is to foster liquidity, solvency and proper functioning of a stable market-based financial system as stipulated under Section 4 (2) of the CBK Act. This mandate is aimed at promoting and maintaining the safety, soundness and integrity of the banking system. This is undertaken through the implementation of policies and standards that are in line with international best practice for Bank supervision and regulation. BSD has two divisions, Surveillance and Policy.

1.2 Statement of the Problem

According to the IMF (2010), money laundering averages between \$725 billion (Ksh 56.5 trillion) and \$ 1.8 trillion (Ksh140.4 trillion) worldwide. This is the case because only a limited number of countries have set up anti money laundering regimes that are up and running and therefore able to provide appropriate statistics. Despite the enactment of AML laws designed to curb crime and acts of crime, these evils still take place and are in most cases on the increase. In order for the government to protect their respective financial systems from the destabilizing effects of money laundering, it is imperative that they act and respond to this scourge with unprecedented resolve and commitment to combating it. CBK and the government have been looking for ways of stemming the crime by coming up with legislation- the AML Act 2009, which become effective on June this year. Through the enactment of the Act, the government has

established a framework through which it can monitor, report, and manage money laundering.

The U.S (DoS) report, shows that Kenya does not have an effective AML regime and refers to a major money laundering case in Kenya between 2007 and 2009 where Charterhouse Bank Management committed account irregularities, and evaded taxes, import duties and audit to launder funds to the tune of \$500 million (Ksh.40 billion) from 1999 to 2006. The Charterhouse managers were also suspected of violating the CBK's basic Know Your Customer guidelines and the CBK Prudential Guidelines. The license was revoked and Bank placed under liquidation to date, but investigations revealed a pervasive abuse of the country's inadequate money laundering regime. The same report stated that in Kenya \$100 million (Ksh.8 billion) are laundered every year. The combating of money laundering has assumed an urgent impetus at both national and international levels as a result of the scale that money laundering has begun to assume, especially with respect to the financing of terrorist acts. No one wants to be left behind mainly due to the consequences of such a situation – those lagging behind might find it difficult to transact and do business with the rest of the complying world. Kenya has also continued to enhance the investigative capacity of the KACA and the Office of the Attorney General. However, the reform process appears to have suffered a setback with a challenge on the CBK's AML related to supervisory and legal authority by court rulings. The Daily Business Newspaper of 29th July, 2010, highlighted how local financial institutions have embraced technology to curb illegal deals. The article looks at how Transnational Bank has installed a new an anti-money laundering system to ensure clean transactions. This came after a transaction the Bank had instructed an international Bank to process payment for a sugar consignment from Sudan, the global institution

raised the red flag effectively stopping the payment on the grounds that party to receive the money had been blacklisted for being involved in money laundering.

This research highlights some of the underlining challenges that CBK as a regulator is facing as it looks for ways of stemming the crime. There are local research studies and literature that have been done in Kenya on money laundering, Kegoro, (2002) did a study on money laundering patterns in Kenya to find out the nature and extent of money laundering in Kenya. His studies found out that Kenya's strategic location was relatively well developed sea and air transport infrastructure aided with informal economy and lax law enforcement environment made Kenya excellent money laundering destination. He associated money laundering with crimes as corruption, fraud, and drug trafficking. Unpublished academic research studies done in University of Nairobi by 3 MBA students on money laundering includes; Mbwayo, (2005) researched on ,The Strategies applied by commercial Banks in Kenya in anti-money laundering compliance programs. He observed various measures have been put in place by Kenyan Banks in joint forces with the regulator to fight against money laundering this includes passing of laws and enacting of various prudential guidelines to try and control and possible avoid the country from being a centre of money laundering. His studies did not cover the role that CBK plays and the challenges it faces as a regulator in the industry. Further Muia, (2008) researched on Perceived effects of money laundering on international business a case study of Banks in Kenya and found out that the most significant perceived effect of money laundering on international business was assets seizure leading to loss of wealth. The study also found out that the main source of laundered funds in Kenya was corruption. Njagi. (2009) did a study on the effectiveness of Know Your Customer (KYC) policies adopted by commercial Banks in Kenya in reducing money laundering

and fraud incidences. In the study, he found out that due to the high level of competition in the banking industry, Banks have relaxed the extent of trying to know more information of their clients so as not to discourage customers from transacting with them.

Despite the measures adopted by CBK, the government and other stakeholders, the country has continued being a centre of money laundering and claims of unexplained money in the economy. As can be observed from the studies already done above, there has been no study done to evaluate the challenges faced by the CBK in combating the money laundering problem and this creates research gap in knowledge. This study therefore seeks to answer the following question; ‘what are the challenges faced by the Central Bank of Kenya in combating money laundering in the country?’

1.3 Research Objectives of the Study

- (i) To establish the challenges faced by the CBK in combating money laundering in the country.
- (ii) To determine how CBK is dealing with the challenges.

1.4 Significance of the study

The study will be important to:

- The Central Bank as a regulator, it will help them realize the areas of attention and where it needs to improve in order succeed on its objective.
- To other Commercial Banks as they implement measures to combat money laundering, they will be able to know in advance the possible challenges to encounter and thus be able to seal the loopholes in advance.

- The parliament, this study will offer them a deeper understanding on money laundering challenges from Central Bank perspective.
- The government and especially the Ministry of Finance in making policy decisions whose overall objectives are to accelerate the rate of combating money laundering within the borders of the country.

This study is expected to increase body of knowledge to the scholars on money laundering and the challenges various governments and especially Central Banks encounter in combating money laundering. However in order to determine appropriate policy response to take against the fight against money laundering further research work needs to be done on the impact of money laundering and the channels through which money laundering takes place in Kenya. The findings and recommendations of the study can be used by researchers and other scholars in the world of academics.

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CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers with the review of literature related to the study. An overview of money laundering, stages of money laundering, challenges faced in combating money laundering, causes of money laundering and ways of dealing with money laundering is given.

2.2 Money Laundering

Taken at its simplest, money laundering is a process by which the origins and ownership of money, generated as a result of criminal activity, can be concealed. In effect, the money is 'cleaned' or 'laundered' through legitimate means and, as a result, the proceeds lose their existing criminal identity and appear to have originated from a legitimate source. This process is usually completed several times. It is common for this process to occur in respect of the proceeds of drugs/human trafficking, prostitution, corruption, racketeering, securities, jewels and illegal arms smuggling, (Uribe, 2003).

The process allows the money to be controlled, without the fear that the transaction will lead back to the originator(s) of the proceeds. Criminal organisations utilise this process to enable them to exploit further criminal opportunities in a systematic and large scale manner. Although countries have come up with different money laundering definitions in their statutes, it is important that any useful definition should recognize that crime of any nature is an act against society and as such, to launder any proceeds from unlawful

activity or the contravention of any law followed by laundering should be encompassed in the definition, (Shaping, 2003).

Money laundering is the process used by criminals to move, conceal and legitimise their proceeds of crime. The purpose of money laundering is “to render it almost impossible for evidence to be obtained which allow a court to establish the derivation of the money” (Rider, 1992). “Dirty” money is put through a cycle of transactions or washed, and is turned into legal and “clean” money when it comes out at the other end. The money launderer can then use the proceeds for future legal or illegal activities without fear of criminal or civil sanction. The processes involved in money laundering are not necessarily harmful or abusive per se, simply keeping wealth secret may not be intolerable in either a legal or moral sense, and it might even be prudent and beneficial in certain circumstances (Rider, 2006). However, the money laundering process “will inevitably involve resort to transactions, real or imagined, which will be designed to confuse the onlooker and confound the inquirer”, (Rider, 2006).

Money laundering is every kind of technique directed to the transformation of unfairly and illegally acquired proceeds in order to make it appear legitimate (Hersak, 1992:741). Money laundering includes activities directed toward covering the value of proceeds acquired by criminal activities and the inclusion, lodgement and disposition of objects such as money, securities and jewels in order to make them appear legal, (Giunio, 1998:40). Money laundering as an illicit money transfer has two main kinds of illicit money transfers traditional money laundering which entails transferring illegally obtained funds to conceal their origins and make them appear legal. For example, drug dealers deposit cash revenues in banks and later transfer them until the funds appear to

originate from legitimate sources and terrorism financing which entails transferring mostly legal funds for illegal purposes. For instance, legal charity donations are transferred to fund terrorist attacks, (Wei, 2008).

Money laundering can happen through various intermediaries. Bank transfers, both wire transfers and checks, are the most common channels for illicit money transfers as described in, (Reuter and Truman, 2004). Money transmitting businesses, such as Western Union are also used by money launderers. These businesses are typically franchised or owned by individuals, who might have stronger incentives to turn a blind eye to money laundering than bank branch-managers. In the gray area of finance, informal value transfer systems provide money transmitting services usually without proper paper trail. The hawala or hindi systems used by different ethnic communities are described, for instance, in (El-Qorchi, 2002).

Money laundering is a process the aim of which is to cover traces leading to the real source of illegally acquired money, in which, more and more often, the non-financial sector and the professions become involved. Money laundering is process which includes covering up the real nature, the source of money, its transformation and transmission in order to conceal its illegal origin. This may involve purchasing, possessing or using property derived from illegal activities or participation in, connection with, abetting, stimulating and facilitating any of the aforementioned activities, (Amoah, 1992). Money laundering is a complex system which is still developing; new techniques have been used and money launderers are becoming more and more sophisticated. Criminals hide themselves behind complex transactions, which include international transfers, dispersion into smaller amounts or transfers made to the

accounts of different persons, changing the shape of money and advice received from banking experts, brokers, investment bankers, accountants, consultants, public notaries and lawyers.

2.3 Stages of Money Laundering

The following paragraphs discuss the main stages in money laundering.

2.3.1 Placement

This is the initial entry point into the financial system of funds derived from criminal activities. The proceeds generated from criminal activities are placed into the financial system, or invested into real estate and movables. This may include the use of 'front' businesses such as hotels, cinemas or casinos that may reasonably claim to do business in cash. It may also involve the use of 'smurfing' techniques, through which launderers make numerous deposits of amounts of money that are small enough to avoid raising suspicion or triggering reporting mechanisms. The main goal is the lodgement of such proceeds into legal financial flows or their transfer outside the country. In this phase, the launderers must expose their earnings, which is crucial for the easier detection of dirty money (Maros, 1999). This is the most dangerous phase for criminals regardless of whether their money appears in cash or not. Here there is a direct link between the money and the criminals. After that moment, the money is not cash anymore; it becomes a number on paper or on the computer display, (Lilley, 2000).

2.3.2 Layering

This is the creation of complex networks of transactions to obscure the link between the initial entry point and the end of the laundering cycle. Layering often uses complex corporate structures and trusts, perhaps involving a number of jurisdictions, and is, therefore, a stage of the process which requires particular vigilance. It is more difficult to detect layering as the inter-company transfers may be disguised to lend the transactions an air of commercial reality and probity. The final goal of such money transfers is the dispersal of money and earnings and the laying of as many paper-trails as possible to confuse ongoing supervision or future investigations and finally, the making of an artificial origin or source of money,(Lilley,2000). To consolidate this conversion, the funds might be channeled to the purchase and sale of investment instruments or represented as payments for goods or services. The funds could also be scattered through the use of different accounts at various banks in several countries, most of which could be passed through those jurisdictions that do not have effective mechanisms against money laundering activities, (Osinbajo and Ajayi, 1991).

2.3.3 Integration

After layering, integration schemes place the illicit proceeds back into the economy, making them appear to be genuine and bona fide business funds. The money laundering process never stops. Yet regardless how many phases dirty money passed through and how many forms it takes, such proceeds will never be legal in the sense of the law, (Claessens, 2000). Corruption plays a potential role at every stage of the money laundering cycle, but has its greatest opportunity at the placement stage. As the placement stage usually involves face-to-face contact with financial institutions (who are

required to verify the identity of the customer and carry out a certain measure of due diligence of the customer), there is increased risk of detection of criminality. Since money launderers are more vulnerable to detection at the placement stage, they have a greater incentive to bribe private sector actors. Employees in financial institutions may be corrupted so as to facilitate the opening or operating of accounts in false names, ignore reporting requirements or tip-off customers who may be the subject, (Chaikin, 2008).

2.4 Challenges Faced in Combating Money Laundering

The following paragraphs discuss the main challenges in combating money laundering.

2.4.1 Extradition of suspects from other countries

Where suspects externalized (exported) foreign currency and defrauded investors of large volumes of money and fled to other countries, those countries are not receiving any assistance regarding extradition of the suspects as these countries take the word of the suspects that they are political refugees, (DeGabielle, 2006).

2.4.2 Lack of mutual assistance

Each country should afford one another the widest measure of mutual legal assistance in investigations, prosecutions and judicial proceedings in relation to economic crime including money laundering, (Lilley, 2000).

2.4.3 Non-commensurate sentences

The sentences for economic crimes including money laundering are not proportionate to the gravity of these crimes; therefore, they do not sufficiently serve as a deterrent for these crimes, (Cassella, 2004).

2.4.4 No global uniformity in combating the crime

There is no global uniformity in combating economic crime including money laundering, since in developing countries they lack the resources like computers and camcorders for surveillance, they also lack training in learning effective methods for combating economic crime including money laundering. Thus, the developing countries need technological assistance to upgrade their systems, (Holder 2007).

2.4.5 Banks' confidentiality requirements

According to (Aufhauser, 2003), bank operations are governed by confidentiality rules and thus they are exposed to the risk of lawsuits and of loss of trust if they breach confidentiality by reporting customers, whose identity is then revealed. Bankers argue that banking is first and foremost a business and that anti-money laundering measures sometimes scare off potential or existing customers. This is a short-term problem for the banks, though reputable banks are willing to take this risk as they believe there will be long-term benefits for their efforts. According to (Ali, 2003) some banks have trained their staff in how to use anti money laundering policies and rules but without revealing what they are aimed at because they fear the staff may not use them or that they may scare off customers. In sum, in some instances banks are suspicious of certain kinds of activities but may fail to enforce appropriate measures because they fear to lose their

customers. There is a need to review confidentiality laws in Kenya with a view to removing any confidentiality impediments or giving legal protection to banks who breach confidentiality as part of implementing anti- money laundering policy.

2.4.6 Failure to Know Your Customers - KYC

Some financial institutions, especially those that are not commercial bank, cannot know their customers because they operate without accounts. In most cases they conduct once-off transactions. The financial institutions most affected by this include forex bureaus, where transactions take place at the counter and no record or identity of the customer is kept. Cash receipts are issued, which are used by the officers in the Research Department to assess foreign exchange flow. The postal and courier services also have a similar problem.

2.5 Causes of Money Laundering

The implementation of anti-money laundering policies requires participation and cooperation by all stakeholders. Clients are made happy when businesses go the extra mile to please them. Fearing the loss of their customers to other institutions, banks and other financial institutions sometimes do not carry out some of the activities that they are meant to in order to detect money laundering. Co-ordination and co-operation from all stakeholders, such as businesses and professions dealing with cash (casinos, lawyers, accountants), as well as banks and forex bureau, is thus needed. However, corruption and competition mean this has not been achieved yet, (Madinger and Zalopany, 1999).

Some financial institutions, especially those that are not banks, cannot know their customers because they operate without accounts. In most cases they conduct once-off

transactions. The financial institutions most affected by this include forex bureaus, where transactions take place at the counter and no record or identity of the customer is kept, (World Bank, 2005).

According (Imala, 2004) most Africans prefer using cash for all forms of transactions including the purchase of high-value items such as real estate and motor vehicles because of a lack of trust and a fear that cheques will bounce. This makes detecting the source of money difficult.

The widespread use of cash rather than other means of exchange are perhaps the biggest handicap to many banks in detecting and controlling money laundering, (Imala, 2004). Central banks and other stakeholders find it impossible to trace the origin of cash because people refuse other mode of payments, even when transactions involve millions of shillings. Buyers simply go to their banks, withdraw cash and pay for all kinds of transactions in this way. The problem of a cash economy has curtailed banks' ability to distinguish between 'clean' and 'dirty' money thus affecting the work of central banks. Banks rely on the information customers provide, which may or may not be accurate as customers fear that such information may be given to KRA, who can use it for tax evaluation, (Imala, 2004).

At a more sophisticated level, corrupt senior managers of financial institutions may assist money launderers to avoid detection compliance systems. Corruption of senior management in the private sector is more likely in countries where there is systemic corruption. Individuals with political power that wish to conceal their illicit income may bribe management of financial institutions so as to prevent the discovery of their bank accounts. Senior public officials (often described as politically exposed persons) may use their contacts with management in financial institutions to block AML

investigations, impede the suspicious transacting reporting system, and undermine good governance standards. It is not only financial institutions that are vulnerable to corruption. Lawyers, accountants, and trust and company service providers, have specialised knowledge and skills to create and organise money laundering schemes assistance may include the layering or integration of financial transactions, by using a complex maze of corporate entities in offshore havens, and the concealment or destruction of records to avoid detection. A key element of these money laundering services is anonymity in the ownership or management of private sector entities.

2.6 Ways of Dealing with Money Laundering

Since most serious forms of economic crime often involves transnational organized criminal groups and international transactions, international standards prescribed in the 2000 UN TOC convention should be the fundamental basis on which governments explore effective measures to combat economic crime including money laundering. All countries should be strongly encouraged to ratify or accede to this convention as soon as possible. In order to do so, they should enact or amend their domestic laws and regulations in accordance with the articles of the TOC convention. State parties to the TOC convention should properly and effectively implement their obligations under the Convention, (Douglas, 2006). Paragraph 14 of Article 16 of the TOC convention provides the safeguard against the extradition of a person for the purpose of prosecuting or punishing the person on account of his/her “political opinions”. However, such safeguard should be applicable only when the requested State has “substantial grounds” for believing that, that is the case, and should not be misappropriated, taking into account the gravity of economic crime which causes or risks causing substantial loss,

(Haynes,2004). Each country should afford one another the widest measure of mutual legal assistance in investigations, prosecutions and judicial proceedings in relation to economic crime including money laundering in accordance with Paragraph 1 of Article 18 of the TOC convention. Each state should also consider the possibility of concluding bilateral or multilateral agreements or arrangements as provided in Paragraph 30 of this Article, (FSA 2006). In case where a country does not have such agreements or arrangements, the law enforcement authorities of that country should endeavor to explore all possible measures, including using diplomatic channels, to request and obtain assistance from a foreign country, (Gill ,2004).

Countries must have anti- money laundering laws in place. In criminalizing money laundering, countries should seek to apply such laws to the widest range of predicate offences and should include as predicate offences all serious crimes as in conformity with the TOC Convention Article 6 and Article 2(b), (Blunden, 2006).

In Africa, a number of regional anti-money laundering bodies have been created and it is comforting to see the support these regional groupings are receiving from their respective authorities, (Ali, 2003). The creation of necessary anti-money laundering institutions such as the Financial Intelligence Centers is an issue that each of the African authorities is busy working on. Financial Intelligence Centers are important for the detection of money launderers by linking the money flows to the perpetration of specific crimes. The pressures that the African banking sector is being subjected to for compliance with national and international anti-money laundering requirements, makes me to want to compliment our banking sector in Africa for living up to those requirements despite the costs involved in some instances. In one way or another banks in Africa have been working to ensure compliance with the important aspect of customer

due diligence and have been improving on their institutional capacity to ensure that their systems and personnel are geared for their discharge of their responsibilities as reporting institutions, (Alba, 2003).

According to (Chatain, 2004) each state should enact laws to institute a comprehensive domestic regulatory and supervisory regime for financial institutions, including banks, in accordance with Article 7 of the TOC Convention. Financial regulatory authorities in each country should play a pivotal role in the supervision of banks and non-bank financial institutions. A regulatory and supervisory regime should ensure that these institutions are complying with customer identification procedures, record-keeping, reporting of suspicious transactions and making efforts to prevent criminal's use of their channels for the purpose of money laundering and other unlawful transactions. Financial regulatory authorities should be encouraged to have their own administrative regulations in line with the government laws. These regulations must be able to safeguard loopholes against economic crime including money laundering.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1: Introduction

This chapter presents the methodology used to carry out the study. It describes the type of research design, the data collection method and data analysis.

3.2 Research Design

The proposed research design for the study was primarily a case study method. The case study method provides much more detailed information on the subject under study. This study is descriptive in its very nature this is because it allows for in-depth exploration of issues in a phenomenon. Kothari, (1990) defines a case study as a powerful form of qualitative analysis and involves careful and complete observation of a social unit be it a person, family, cultural group or an entire community and/or institution – (CBK). The study is focused on challenges faced by CBK in combating money laundering through careful and complete observation. A case study also has the advantage of being free from material bias in addition to affording the researcher an opportunity to undertake intensive investigation of the particular study unit or population in CBK.

3.3: Data Collection

Primary data was collected through face to face interview. An interview guide was appropriate in this study for purposes of getting detailed information on area under investigation. Cooper, (2003) argues that open ended questions used in intensive interviews help measure sensitivity or disapproval behaviour, discovers salience, or encourages natural modes of expression. Also Mugenda and Mugenda (2003), note that

interview obtain in-depth data through the use of probing questions and allow collection of data relevant to the research objectives through clarifications of intended choices. An interview guide was used to collect data on the challenges faced by the bank in combating money laundering. The researcher held in-depth interviews with Director Banking Fraud Investigation department and four middle level managers of Central Bank who are tasked with the challenge of monitoring the laundered money and five senior bank officers who are charged with implementation of the strategies used by the Bank in combating the challenge. Secondary data was collected from organization's documents such as annual reports, monthly economic review booklets, CBK library journals and banking reports.

3.4: Data Analysis

The data collected was qualitatively analyzed by use of content analysis techniques; this is because the data collected was qualitative in nature. The responses were detailed in nature giving the challenges faced in combating the vice and the strategies to cope with the same challenges. The information was analyzed and evaluated to determine their usefulness, consistency, credibility and adequacy. The content analysis technique was used because it assists in making inferences by systematically and objectively identifying specific messages and then relating them with their occurrence trends. Content analysis is the effort to develop an "objective, systematic and quantitative description of the manifest content of communication", Hoslti, (1974). Similar studies in the past like those done by Njagi, (2009) and Koskei, (2003) used this technique of content analysis to analyse data collected from a case study.

CHAPTER FOUR: FINDINGS AND DISCUSSION

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research in the methodology. The results are presented in order of objectives i.e. to establish the challenges faced by the CBK in combating money laundering in the country and to determine how CBK is dealing with the challenges. The data was gathered exclusively from an interview guide as the research instrument.

4.2 Study respondents

The study targeted 12 top executives the researcher held in-depth interviews with Director Banking Fraud Investigation department and four middle level managers of Central Bank who are tasked with the challenge of monitoring the laundered money and five senior bank officers who are charged with implementation of the strategies used by the Bank in combating the challenge. Out of the total 12 interviews the study sought to carry out the researcher administered 10 of the interviews. This commendable response rate was made a reality after the researcher made personal calls and visits to request the interviewee to fill-in the interview guide as well as insisting the importance of participating in the study.

Accordingly 6 of the respondents were male, while 4 the respondents were female. These findings imply that the Bank employs both male and female staff where the male staffs in the management level are more than the female staff.

4.2.1 Number of Years Worked

The respondents were required to indicate the number of years they had worked with the Central Bank. 4 of the respondents said they had worked between 1 – 10 years, 5 of the respondents had worked between 11- 20 years, while 1 had worked for 21 years and above. This implies therefore that the employees had a lot of service experience in the Central Bank.

4.2.2 Academic Qualifications

The study sought to establish the academic qualifications of the staff. The aim of this challenge question was to find out if they had the necessary qualifications to handle fraud related issues in the bank. According to the respondents 7 respondents are qualified MBA holders, 2 of the respondents holds Masters in Arts, and while 1 of the respondent holds a degree in Finance

4.3 Challenges Faced by CBK in Combating Money Laundering

The study found that there are several challenges faced by CBK in dealing with money laundering these are discussed below.

4.3.1 Challenges Posed by the Porous Kenyan Borders

The study sought to investigate the challenges of combating money laundering. The study sought to determine challenges posed by the porous Kenyan borders in combating money laundering. The respondents identified the following challenges; lack of adequate laws, lack of enforcement, lack of laws in neighbouring countries, difficulty in monitoring the movements of people including terrorists, presence of cash couriers, ease

of smuggling, corruption at the borders, unreported cash flows. Subsequently the researcher ranked the importance of each according to importance. From the findings corruption was ranked first challenge with a frequency of 10 followed by free movement of people at 2 with a frequency of 9. Other notable challenges included unreported cash flows at 3 with a frequency of 8, with presence of cash couriers and ease of smuggling tying at rank 4.5 with a frequency of 6. This aid in Human and drug trafficking, cattle rustling combined with the extensive unsecured borders along this states, most respondents saw this as the sole agent through which money launders have taken advantage. Those countries that have not developed AML laws may prove a challenge in the implementations of AML laws by CBK and thus enabling launders escape the prosecution process. The AML act empowers the Financial Reporting Centre to ensure compliance with international standards and best practices in anti money laundering measures. The interviewees responded that CBK will only support the financial role through supervision of banking industry by ensuring that commercial banks observe international best practice in anti-money laundering including customer due diligence (CDD) procedures, filing of suspicious reports, CBK will also offer support to FRC to establish its offices.

The study sought to determine the effectiveness of the AML law in helping the Kenyan Government to look into and prosecute law-breakings committed in the state or abroad by or against its citizens. Consequently the respondents were required to indicate incidences where some countries without such AML laws are a barrier to CBK prosecution process. From the findings 6 of the respondents indicated that the situation in war torn countries mitigated the lack of AML legislations because of lawlessness, 3

thought that this challenge came from countries which financed terrorism while I was not aware of any incidence.

The study noted that the AML bill empowers the Financial Reporting Centre to ensure compliance with international standards and best practices in anti-money laundering measures. Consequently the respondents were required to indicate the role CBK plays to support FRC. The respondents indicated that the CBK carried out the following functions; it acts as secretariat plays, a supervisory role, leads in fraud investigations, enforces monitoring of monetary activities and also enforces AML compliance. These sentiments were echoed by 7 the respondents.

4.3.1 Legal and Regulatory challenges CBK faces

The study set to determine the legal and regulatory challenges CBK faces in the cause of its duty in trying to prosecute the offenders of money laundering in Kenya. Based on the challenge question, respondents gave the following responses; lack of willingness to prosecute by the law enforcers, lack of information on offences relating to money laundering, ignorance of legal procedures by the judicial officers and slow judicial process in the country.

According the researcher on legal and regulatory challenges a slow judicial process in the country which was ranked 1st among the respondents with a frequency of 10. It was followed by lack of willingness to prosecute money laundering related cases, so many judges' and prosecutors are not familiar with the offence and may not be ignorant of the procedures in dealing or prosecuting money laundering cases followed by 3 with a frequency of 7. Since the legislation was recently enacted. Some commercial Banks may still be ignorant in regards to the procedure for filing suspicious transactions which

will provide the basis for further investigations and prosecution of money laundering offences. Secondly there is the lack of information that CBK will use to facilitate the prosecution process. Institutions may not be willing to disclose information of their customer suspected to be launders be the fear of legal action. The other challenge is that CBK is not mandated by law to undertake such prosecution process of the suspected money laundering offenders.

The respondents were required to offer their opinion on CBK representation at the anti-money laundering advisory committee board. The following responses were elicited.

8 of the respondents indicated that the CBK was fairly represented at the anti-money laundering advisory board. While 2 thought that the CBK was not fairly represented.

The respondents were required to indicate some of the obstacles faced by the CBK officers when collecting evidence to prosecute money laundering suspect for the offence. The study established the following; there is fear of legal action against the reporting institution, there is lack of active investigation by the investigators and also lack of trained investigators. The study posed that the Muslim community in Kenya had expressed strong concerns about the AML bill before it was enacted, saying it would sanction human rights violations by the state. The respondents were required to indicate if the act protected the sanctity of human rights provisions for all Kenyans. 9 of the respondents indicated that the act protected the sanctity of human rights provisions for all Kenyans 1 on the other hand thought that the Muslim concerns related to the anti terrorism act.

The study set to establish the challenges CBK is facing through its Bank Fraud Investigations Unit in enhancing judicial consequences of financial fraud. The following responses were recorded. That in the CBK there were; legislative handicaps in execution

of successful court process, lack of knowledge, lack of cooperation, cases take long to prosecute and also there is a lot of political interference in case of grand fraud.

The study posed that some customers' due diligence requirements have been difficult to implement particularly in rural and even urban areas. For instance, the requirement to verify the physical address of a customer has been a challenge in some instances. Respondents were required to react to the statement. Below are the responses on the customer's identification. It is not possible to verify due to nomadic lifestyle, however the identity card has solved some issues on the government administration the chiefs play a central role in verification however the overall challenge is general lack of physical address.

The respondents were also required to indicate in their own opinion some of the difficulties that banks have faced in the enforcement of know your customer requirements. Respondents gave out the following responses; difficulty in obtaining personal data, lack of utility bills for verification, fake documentation, lack of thorough customer verification, insider support for fraud, lack of credit reference bureaus and Lack of legislation to provide bio-data. The study findings were subsequently ranked and the leading opinion was that there was lack of utility bills for verification which was ranked 1st with a frequency of 9. It was followed by an opinion on difficulty of obtaining personal data ranked 2nd followed by presence of fake documentation ranked 3rd with a frequency of 6. Most of the study interviewees were of the opinion that the difficulty in verifying physical address, fake documentations e.g. identification card, pin number and certificate of identification and issues with registration of dummy companies, with these challenge of incorrect or inaccurate information banks and for so

CBK will face difficulties in monitoring and knowing their customers as the law requires.

The respondents were required to indicate if CBK also face the challenge of not having sufficient resources to carry out their new responsibilities 7 of the respondents indicated that the bank did not face the challenge of not having sufficient resources to carry out their new responsibilities while only 3 thought that the CBK faced the challenge. 3 on the other hand thought that the act did not. The lack of sufficiency of resources has been a big challenge on part of Central Bank because fighting the vice requires unlimited resources and assistance from other important stakeholders.

The study sought to find out the types of financial and non-financial businesses are considered to be vulnerable to money laundering. The following financial providers were recorded; forex bureaus, banks, stock market players, real estate firms, money transit companies, precious stones dealers, motor vehicle dealers, law firms, insurance companies and casinos.

The study sought to find out if the CBK Bank Fraud Investigations Unit has the required investigative capacity to perform its duties in fraud and money laundering investigation. Most the interviewees who were interviewed were in agreement that the unit needs to be strengthened and beefed up to enable the staff who are all CID officers seconded from the CID headquarters to the CBK affiliate bank fraud department. The officers also lacked the required necessary training to enable them perform investigation professionally and conclusively in investigation of cases and prosecution duties.

The respondents were asked to indicate some of the challenges that have come with the growth of technology and more particularly the internet and telephone banking in Kenya

relative to the CBK. The following responses were recorded, the interviewees indicated that technology has opened up operations in the banks to global connectivity and that banks are now branchless as all of them are wired together therefore a customer can go to any branch to carry out a transaction. This makes customer identification more difficult. Transaction processing times now take shorter times leaving little time for more keen checks. While technology increased turn around times, it has also been used by fraudsters to commit frauds. Bank operations such as online transactions, swifts, transfers and other payments operate on technology platforms and customer data is also stored electronically. Therefore unauthorized access to sensitive bank information may cause great losses. It's more challenging because changes in technology are also unpredictable and technology levels also change. Being able to conduct non-face to face transactions where one may not be able to verify the identity of the customer. Technology has enable the transfer or movement of large amounts of money in a very short time, the threat of hackers who may be able to penetrate money laundering through telephone and internet banking and defeating the audit trails controls established by banks fraudsters have become more complex, inadequate regulation and the movement of large sums hence greater risk.

4.4 How CBK is dealing with the same challenges

The study sought to establish the measures taken by CBK to address the issue of vulnerability of Kenya to money laundering. The respondents indicated that CBK had instituted the following measures; financial institutions must report transactions above US\$10000, introduction of value capping techniques and also encouraged the use of debt and credit cards.

The study sought to find out how the CBK Sh1 million caps on written and transacted cheques helped in combating fraud and money laundering. The respondents indicated that it has minimized possible fraud and the real value of fraud cases had reduced. Respondents were also required to indicate how effective are some of the guidelines and policies issued by CBK to banking industry like the source of funds, the use of the said funds and the strengthening of the due diligence procedures in combating money laundering in the sector. The study sought to find out if CBK has invested in the training of staff in the Bank Supervision department who responsible for prevention, detection and control of possible money laundering activities and terrorism financing in Kenya. 9 respondents said CBK invested in the training of staff in the Bank Supervision while only one thought they did not.

The respondents were also required to indicate the guidelines and policies through which CBK monitors surveillance mechanisms and adopting them to the changing environment. According to the findings the CBK has emphasized on, monitoring terrorist and criminal suspects to minimize their transactions, the CBK had sent a circular to financial institutions on the correct procedures and guidelines as well as CBK procedural guidelines.

The respondents were asked to indicate the strategies CBK will employ ready to counter corruption and political goodwill challenges and ensure that the AML attains its objective. 9 of the respondents indicated that the CBK had embarked on, sensitization on international best practices, the provision of a revised legal and regulatory framework and an intended increase investigative capacity.

The study posed that the CBK established the Credit Reference Bureaus (CRB) to reinforce commercial banks' commitment to minimizing fraud as they will share

information on irregular transactions. The respondents were required to indicate their opinions. The respondents gave their opinions as; banks should be able to distinguish the good from bad loaners, banking will be able to assess the credibility of borrowers by exposing serial defaulters, credit information sharing does not amount to blacklisting but information sharing among banks. CRB is also an avenue to make people law abiding and not a basis for loan decisions instead on information shared is on non-performing loans.

The study set to find out what steps has been taken to address the issue with porous borders to ensure that it does not facilitate the money laundering avenues in this country. According to the findings the following have been instituted; the government is reinforcing border controls, PISCES software to identify people wanted by interpol, the issuance of new generation passports, the requirement to declare US\$10000 or Kshs. equivalent and the cooperation with regional groupings e.g. IGAD, COMESA, EAC to fight money laundering and fraud.

4.5 Discussion

The findings of the study found that CBK has put in place a regulatory and legal framework particularly requiring reporting institutions to report transactions that are “complex, unusual, suspicious, and large. But globalization has created new opportunities for legitimate business as well as new risks for fraudsters to reign on the loopholes in our systems. These findings are related with what other findings done by other scholars in the empirical literature discussed in chapter two. This findings therefore answers the two objectives of this study.

CHAPTER FIVE: SUMMARY OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The main objectives of this study were to determine the challenges faced by the CBK in combating money laundering in the country and to establish how CBK is dealing with the challenges. This chapter provides the summary of the findings from chapter four, and also it gives the conclusions and recommendations of the study based on the objectives of the study.

5.2 Summary of the Findings

The study found out that although the CBK had a gender imbalance in the employment of its staff in relation to money laundering, most of the staff were professionally qualified in the fields of finance and Business. From the study findings it was established that money laundering is a serious crime, which threatens the integrity of the financial sector by distorting markets through misallocation of investment. Globalization has created new opportunities for legitimate business as well as new risks for fraudsters to reign on the loopholes in our systems.

According to the study findings the money laundering is a major challenge and although the AML Act was enacted in June 30, 2010 the various agencies under the Act still require for its proper implementation are yet to be set up. These include the Reporting Centre, the Assets Recovery Agency, the Anti-Money Laundering Advisory Board and the Criminal Assets Recovery Fund. The AML Act also refers to regulations to be made

under the new law. The study found that the act is yet to be implemented and it is not clear how this is to be achieved.

According to the study the CBK has put in place a regulatory and legal framework particularly requiring reporting institutions to report transactions that are “complex, unusual, suspicious, and large. But what is complex, unusual, suspicious or large is subjective and guidance is required on this point. The Act requires reporting institutions to report all “cash” transactions of more than \$10, 000. Various banks, particularly the large ones have argued that this is relatively small amount depending on the size of the reporting institution and this would result in numerous transactions being reported. It is difficult to imagine how, for instance, a small real-estate agent or accountant operating a small outfit with limited resources and structures will be in a position to marshal the resources required to ensure compliance with the Act.

The study established that Kenya is faced with the challenge of the porous borders especially the neighbor countries without the stable governments like the war torn neighboring States which aid in human and drug trafficking and piracy combined with the extensive unsecured borders along these states, most respondents saw this as the sole agent through which money launders have taken advantage. Porous borders could be the source of terrorism financing through unreported foreign cash inflows not ascertained if related to money laundering. It is difficult for the regulator to trace or detect the proceeds of crimes either through aliens, hard cash smuggled in and out of the country. The AML act empowers the Financial Reporting Centre to ensure compliance.

According to the respondents CBK will only support the financial role through supervision of banking industry by ensuring that commercial banks observe international best practice in anti-money laundering including Customer Due Diligence (CDD) procedures, filing of suspicious reports, CBK will also offer support to FRC to establish its offices. Under the Proceeds of Crime and AML Act 2009, (POCA), CBK is both a financial institution and a regulator. CBK is a member of the AML Advisory board and also required to cooperate with the FRC in the investigation of suspicious activities in the institutions it regulates. The major challenge cited by the respondents is on the legal and regulatory challenges that CBK faces in the cause of its duty in trying to prosecute the offenders of money laundering in Kenya. Since the legislation was recently enacted, so many judge's prosecutors are not familiar with the offence and may be ignorant of the procedures in dealing or prosecuting money laundering cases. Because of this reason many cases relating to money laundering are thrown out and offenders released for lack of evidence. CBK also lacks the adequate information from commercial banks on the offenders to facilitate successful prosecution.

The study also established that ensuring compliance with money laundering requirements can be a tedious and time-consuming for financial institutions and non financial institutions. It is difficult to imagine how, for instance, a small real-estate agent or accountant operating a small outfit with limited resources and structures will be in a position to marshal the resources required to ensure compliance with the Act. The study further found out that the big challenge for reporting institutions is to strike a proper balance between implementing the Act and maintaining client relationships for the case of the commercial banks and this will affect how CBK can effectively monitor and

supervise them in combating the vice. In Kenya, there is only one threshold of \$10,000 regardless of the nature of the institution.

5.3 Conclusion

The study concludes that the amended Banking Act, the CBK, and the Kenya Bankers Association Guidelines have provisions for customer identification, record keeping, especially for foreign currency transactions, suspicious transactions reporting, and disclosure of information by the CBK to domestic or foreign financial regulatory authorities. However, enforcement mechanisms do not exist, and there have been no money laundering prosecutions, convictions, or arrests, encouraging serious and recurrent violations. The study concludes that that money laundering is a threat to both the integrity and stability of the banking sector and even the forex bureaus themselves. Further, with increased globalization, the Kenyan banking systems are increasingly under close scrutiny by our international trading partners particularly with regard to anti money laundering legal and regulatory frameworks. The study concludes that for CBK to play its role effectively some of the underlying challenges revealed above must be addressed. The responses from the interviewees clearly indicated that money laundering has the notorious tendency to discourage or frustrate legitimate business enterprise, corrupt the financial system and ultimately, the socio-political system. It is the consequence of such activities that has negatively affected the level of direct foreign investment in a Kenya. The study concludes that the Kenya is vulnerable to money laundering particularly given it's mainly cash based economies. This is further

aggravated by porous borders and weak institutions for enforcements for the case of CBK as a regulator.

The study concludes that the measures put in place by CBK to deter money laundering will only be effective if enacted legislation AML is fully implemented. The Central Bank, as both regulator and supervisor of banking institutions, is faced by challenges on both legal and judicial in prosecution of money laundering cases. The study also concludes that both CBK staff at the supervision and surveillance department, BFID officers and those entrusted to monitor money laundering in both financial and non-financial institution are trained in the prevention, detection and control of possible money laundering activities and terrorism financing. The study further concludes that CBK in as regulator as faced challenges in its role to ensure adequate identification of customers, their source of funds and the use of the said funds is monitor in the sector. According to the study findings, like foreign exchange bureaus and mortgage companies, are supervised by the CBK, whereas casinos are supervised by the Minister of Home Affairs. The study notes that there are 95 foreign exchange bureaus under supervision of CBK in Kenya. However, the study finds the supervision of this sector to be ineffective. The CBK has however enforced new guidelines under the Central Bank of Kenya Act in 2007 to regulate foreign exchange bureaus. Further, the study notes that the Proceeds of Crime and Anti-Money Laundering Act, if implemented, would place these institutions, including casinos, real estate agencies, precious metals and stones dealers, and legal professionals and accountants.

5.4 Recommendations

The study recommends that government of Kenya should bring into force the Proceeds of Crime and Anti-Money Laundering Law, 2009, as soon as possible. The GOK should implement the AML Law. The GOK should criminalize terrorist financing and pass a law authorizing the government to seize the financial assets of terrorists. Kenyan authorities should take steps to ensure that non-governmental organizations (NGOs), suspect charities and nonprofit organizations follow internationally recognized transparency standards and file complete and accurate annual reports. The Central Bank of Kenya (CBK), law enforcement agencies, and the Ministry of Finance should improve coordination to enforce existing laws and regulations to combat money laundering, tax evasion, corruption, and smuggling. The Minister of Finance should revoke or refuse to renew the license of any bank found to have knowingly laundered money, and the CBK should tighten its examinations and audits of banks. Kenyan law enforcement should be more proactive in investigating money laundering and related crimes, and its customs authorities should exert control over Kenya's borders.

The study recommends that CBK should establish appropriate policies and procedures to ensure the effective prevention, detection and control of possible money laundering activities and terrorism financing. Important attention should be given to train staff in both key division mandated with supervision and monitoring in CBK, CID officers attached to BFID unit of CBK and those Bank Officers responsible for the prevention, detection and control of possible money laundering activities and terrorism financing. Institutions should ensure that their staff's are trained on regular basis on the prevention, detection and control of money laundering and the identification of suspicious transactions. The study recommends that CBK calls upon institutions to ensure they comply with this requirement and that the regulator should also advise institutions to ensure that they conduct enhanced customer due diligence when dealing with High risk customers. The study recommends that CBK should enforce strict measures on its

Prudential Guidelines to all commercial Banks pursuant to the Banking Act on "Know Your Customer" and "Customer Due Diligence" procedures ensure adequate identification of customers, their source of funds and the use of the said funds, this is through strengthening of customer due diligence procedures.

The study further recommends that CBK should provide additional guidance on identification of suspicious transactions by commercial Banks. Introduction of guidance on customer Due Diligence Procedures for non face to face transactions that have gained increased prominence with the growth in internet and telephone banking. The rapidly changing technologies and the introduction of new financial products remains a major challenge which requires financial institutions and regulatory bodies to constantly remain vigilant of possible abuse of new products by criminals. Other recommendation is that CBK continues to monitor adherence to the existing guidelines through its surveillance mechanisms and adopting them to the changing environment. This study further recommends that a simplified customer due diligence that takes into account the existing circumstances without necessarily compromising the "Know Your Customer" obligations as required under the Financial Action Task Force (FATF) recommendations should be adopted. The study recommends that reporting persons must "obtain detailed information from all customers, maintain specific identification procedures, and report suspicious and unusual transactions to the FRC within 24 hours of the transaction.

5.5 Recommendations for Further Study

This study has explored the challenges faced by CBK in combating money laundering and established that money laundering is a threat to both the integrity and stability of the banking sector and even the Forex bureaus themselves. Further research is

recommended on the perceived effects of money laundering on other industries such as real estate, precious metals trade; the stock market and the tourism sector. These are some of the industries commonly targeted by money launders. There is need to also carry out research to determine how well the country is prepared on the fight to eradicate money laundering. Research is also required to determine the effect that developments in the information technology is having on the money laundering. This is because information technological advancement may help increase the ease of money laundering training as enhance measure to address the same.

5.6 Limitation of the study

This research project was carried out at time when CBK was in the process of implementing new system software dubbed SIMBA PROJECT and other change management in the Bank. Therefore as a result some of the targeted respondents for the interview were busy involved in this process and thus unavailable because they were busy in workshops, seminars and meetings. This did not only made data collection difficult but also made the project take longer time than expected. However, the limitation did not have any adverse effects on the findings of the study. The study was also limited to CBK as a regulator although they are other keys stakeholders in the fight against money laundering like Treasury, Capital Markets Authority, Commercial Banks, Kenya Bankers Associations and Retirement Benefits Authority.

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DATE..... 3rd SEPTEMBER 2010.

TO WHOM IT MAY CONCERN

The bearer of this letter EDWIN KIPLAGAT TOROTICH

Registration No: D61 | 70931 | 2008.

is a Master of Business Administration (MBA) student of the University of Nairobi.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate if you assist him/her by allowing him/her to collect data in your organization for the research.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

DR. W.N. IRAKI

CO-ORDINATOR, MBA PROGRAM

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APPENDIX: II INTERVIEW GUIDE

CHALLENGES FACED BY CENTRAL BANK OF KENYA IN COMBATING MONEY LAUNDERING

SECTION A: Background Details

1. Which position do you hold in the Central Bank of Kenya?
2. Your gender (To be filled by the researcher)
3. What are your academic qualifications?
4. For how many years have you worked in Central Bank of Kenya?

SECTION B: Challenges in Combating Money Laundering

(i) Challenges in Combating Money Laundering

1. What are some of the challenges posed by the porous Kenyan borders in combating money laundering?

2. The AML law will enable Kenyan Government to look into and prosecute law-breakings committed in the state or abroad by or against its citizens. Are there incidences where some countries without such AML laws are a barrier to CBK prosecution process?
3. The AML bill empowers the Financial Reporting Centre to ensure compliance with international standards and best practices in anti-money laundering measures. What role does CBK play to support FRC and are the two in conflict in their roles?
4. What are some of the legal and regulatory challenges CBK faces in the cause of its duty in trying to prosecute the offenders of money laundering in Kenya? .
5. In your own opinion, is CBK well represented at the Anti-money laundering advisory committee board?
6. What are some of the obstacles faced by the CBK officers when collecting evidence to prosecute money laundering suspect for the offence?
7. The Muslim community in Kenya had expressed strong concerns about the AML bill, saying it would sanction human rights violations by the state. Has the act protected the sanctity of human rights provisions for all Kenyans?

8. What are the challenges CBK is facing through its Bank Fraud Investigations Unit in enhancing judicial consequences of financial fraud?

9. Some customers' due diligence requirements have been difficult to implement particularly in rural and even urban areas. For instance, the requirement to verify the physical address of a customer has been a challenge in some instances. Briefly explain?

10. "Know Your Customer" obligation is a requirement under the Financial Action Task Force (FATF) recommendations. What are some of the difficulties that banks have faced in the enforcement of KYC requirements?

11. Combating Money Laundering requires sufficient resources. As a regulator, does CBK also face the challenge of not having sufficient resources to carry out their new responsibilities?

12. What types of financial and non-financial businesses are considered to be vulnerable to money laundering?

13. Does CBK's Bank Fraud Investigations Unit, have the required investigative capacity to perform its duties in fraud and money laundering investigation?

14. The growth of technology and more particularly the internet and telephone banking in Kenya, what are some of the challenges that have come with it, looking at it from CBK point of view?

(ii) How CBK is dealing with the same challenges

1. Kenya is in a region classified as cash based economy, which is attributed to vulnerability to money laundering. What are the measures taken by CBK to address this issue?
2. CBK moved to enforce a Sh1 million cap on written and transacted cheques through the (KEPSS) system, how has it helped in combating fraud and money laundering?
3. How effective are some of the guidelines and policies issued by CBK to banking industry like the source of funds, the use of the said funds and the strengthening of the due diligence procedures in combating money laundering in the sector?
4. Has CBK invested in the training of staff in the Bank Supervision officers responsible for prevention, detection and control of possible money laundering activities and terrorism financing in Kenya?

5. Rapidly changing technologies and innovations has introduced new financial products causing a major challenge which requires financial institutions and CBK to constantly remain vigilant of possible abuse of new products by criminals. What are some of the guidelines and policies through which CBK monitors surveillance mechanisms and adopting them to the changing environment?

6. From Kenya's past challenges on corruption and political goodwill, what are some of the strategies CBK will employ ready to counter these challenges and ensure that the AML attains its objective?

7. CBK established the Credit Reference Bureaus (CRB) to reinforce Commercial Banks' commitment to minimizing fraud as they will share information on irregular transactions, how will this help? Comment

8. What steps has been taken to address the issue with porous borders to ensure that it does not facilitate the money laundering avenues in this country?

Thank you for taking time to answer the interview questions, yours views and opinions are highly valued. God bless you