
FOREWORD

Ensuring the liquidity, solvency and proper functioning of a stable market based financial system is one of the two principal objectives of the Central Bank of Kenya. The Financial Institutions Supervision Department carries out the Central Bank's responsibility for the soundness and stability of the financial system by undertaking the supervision of banks, non-bank financial institutions, building societies and foreign exchange bureaus.

In line with its core responsibility, the Department, during the year proposed various amendments to the Banking Act and revised a number of Prudential Regulations as a cogent basis for ensuring and sustaining the stability and soundness of the Kenyan financial sector. Similarly, in tandem with global supervisory focus, the Department's effort was directed towards the implementation of Risk Based Supervision (RBS). The RBS approach emphasises on the understanding and assessing of the adequacy of each institution's risk management system. It is a proactive supervisory approach that focuses on risk mitigation, rather than risk avoidance. As a prelude to the implementation of Risk Based Supervision, the Department conducted a survey to establish the Risk Management practices and processes in the Kenyan Banking sector.

In pursuit of its role, the Department will continue to place emphasis on compliance with the requirements of the Banking Act and Prudential Regulations. In particular, attention will be directed towards strengthening corporate governance practices in the banking sector, both at the board of directors and shareholders level, as well as improvement in Risk Management practices of the financial institutions. Also, in conjunction with other government agencies, the Department will endeavour to formulate relevant legislations and regulations to combat money laundering and terrorist financing such that the Kenyan financial system shall not serve as a conduit for these international criminal vices.

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Chapter One

Developments in the Banking Industry

1.1 Overview

The number of banking institutions increased marginally from 43 as at December 2003 to 44 as at December 2004 following the conversion of one building society into a commercial bank. Following the lifting of the moratorium placed on the licensing of foreign exchange bureaus, the number of bureaus increased to 89 as at December 2004 from 80 as at December 2003. Financial institutions continue to embrace latest Information and Communication Technology (ICT) as integral to the sector's capacity and ability to enhance institutional productivity and operational efficiency through branch interconnectivity and improved service delivery.

There was marked improvement in the level of compliance as a result of supervisory enforcement actions

As a result of enhanced supervisory enforcement actions, and introduction of penalties as deterrence measure, there was a marked improvement in the level of compliance with the requirements of the Banking Act and the Central Bank Prudential Regulations. During 2004, the Central Bank proposed various amendments to the Banking Act aimed at promoting stability and soundness of the banking sector. The Central Bank will continue to improve its supervisory process in line with the best international practices and where necessary propose amendments to the Banking Act and review the existing Prudential Regulations, to further enhance efficiency and competitiveness of the banking sector.

1.2 Structure of the Banking Sector

The banking sector comprised 51 financial institutions with 44 commercial banks, two non-bank financial institutions, two mortgage finance companies and three building societies, with a total of 532 branches across the country. The number of commercial banks increased to 44 in December 2004 from 43 in December 2003 following the conversion of Equity Building Society into a fully fledged commercial bank. The sector comprised six locally incorporated foreign banks and four branches of foreign owned institutions. Devna finance, a non-bank financial institution is in the process of self-liquidation, and Daima Bank Limited is still under statutory management. The decline in the number of building societies to 3 in 2004 from 4 in 2003 was attributed to conversion of Equity Building Society to a commercial bank.

The banking sector comprised 51 financial institutions

Following the lifting of the moratorium on licensing of foreign exchange bureaus, the number of foreign exchange bureaus increased by nine to 89 in December 2004 from 80 in December 2003.

As indicated in Table 1.1 below, overall, the number of branches increased by 20 from 512 in 2003 to 532 in 2004. The increase was mainly attributed to opening of new branches by a number of institutions namely, K-REP Bank Limited, Kenya Commercial Bank Limited, Equity Bank Limited and Family Finance Building Society. The increase in branch network was however, unevenly distributed with Eastern Province recording highest increase of 8%, whereas there were no branch increases in North Eastern, Nyanza and Western Provinces.

Table 1.1: Regional Distribution of Financial Institutions Branch Network

Province	2003	2004	%Change 2003/4	2002	2001
Central	69	71	2.9	69	69
Coast	69	72	4.3	70	69
Eastern	36	39	8.3	34	35
Nairobi	204	212	3.9	166	192
N.Eastern	4	4	0.0	4	4
Nyanza	40	40	0.0	38	40
Rift Valley	71	75	5.6	67	67
Western	19	19	0.0	18	18
Total	512	532	3.9	466	494

1.3 Foreign Exchange Bureaus

The number of forex bureaus increased from 80 in 2003 to 89 in 2004

The introduction of the foreign exchange bureaus following the liberalisation of the Kenyan economy was aimed at providing increased competition in the foreign exchange market thereby reducing the margin between the buying and selling exchange rates. Foreign exchange bureaus are authorized to buy and sell currency in cash, but are not authorized to buy or sell travellers cheques, bank drafts or engage in money transfers services unless specifically approved by Central Bank of Kenya.

As at end of 2004, there were 89 licensed and operational bureaus as shown in the Table 1.2 below, with total assets of Ksh. 1.2 bn. Inspection of most bureaus was conducted for the year ended December 2004. Out of 89 operating foreign exchange bureaus 70 or 79% are located in Nairobi and 12 in Mombasa.

Table 1.2: Distribution of Foreign Exchange Bureaus

Location	December 2004	December 2003
Nairobi	70	64
Mombasa	12	11
Nakuru	2	1
Kisumu	1	1
Eldoret	2	1
Malindi	1	1
Namanga	1	1
Narok	1	1
Total	89	80

1.4 Information Communications Technology (ICT)

Information and Communications Technology (ICT) has become an integral part of banking operations. Developments in ICT are, however accompanied by various inherent risks that affect confidentiality, integrity and availability of information, as well as complexity of banking products and services. In order to minimise such risks, financial institutions have formulated security policies to uphold confidentiality and integrity of information. This is critical given the enormous resources committed to ICT and the potential risk of ICT systems failing to meet the needs of bank business.

A major concern among financial institutions is the possibility of business disruptions due to increased dependence on ICT, which may ultimately impact adversely on banks' operations. Thus, to minimise this risk, by 2004, most institutions had developed detailed disaster recovery and business continuity plans, which outline well defined strategy for quick resumption of critical business systems after disruptions.

ICT is integral to banking sector's capacity to enhance operational efficiency and quality of customer service

In addition, financial institutions continue to utilise ICT as a tool to enhance operational efficiency, support newly developed products and improve the quality of customer service. For example, some financial institutions are focusing on branch interconnectivity to facilitate branchless banking. Similarly, with the growth in the out-of-city centre supermarkets and retail parks, and emerging widespread convenience culture, there has been substantial growth in off-site ATMs particularly in Nairobi, installed in places other than bank premises. As a security measure, banks have put in place cameras in most new ATMs to deter criminals.

1.5 Customer Service Trends

In today's competitive banking environment, exemplary customer service is one of the distinguishing characteristics that banks can exploit to establish a competitive edge. Since most banks offer comparable products and services, they continually search for a competitive advantage that will attract new customers and help them retain existing ones. Banks therefore, must endeavour to develop innovative programs and initiatives to maintain superior customer service levels while remaining profitable.

In order to address customer concerns and remain competitive, institutions are increasingly turning to ICT solutions to enhance service delivery, as a tool to maintain and expand clientele. Financial Institutions are increasingly embracing E-banking and provision of ATMs to reduce long queues in banking hall. In addition, some of the banks with the large customer base have launched mobile phone banking services. Mobile phone banking services provides several account enquiry tools, including account balances, thereby, minimising the need for customers to visit banking halls.

Over the years, customers have expressed concerns regarding the high charges imposed by banks for the provision of services. In response to the concerns, the Central Bank publishes on weekly basis, selected bank charges levied by all financial institutions so as to foster transparency and enhance competitiveness in the industry.

Central Bank introduced weekly publication of selected bank charges to foster transparency and enhance competitiveness in the industry

1.6 Employment and Training in the Banking Industry

The general employment levels in the banking industry increased marginally by 5.4% during year 2004. While most institutions over the past years experienced a reduction in employment levels due to restructuring and staff rationalisation, over the last two years, the employment levels in the banking industry have stabilised.

The increase in the employment levels, registered in all categories of staff, was mainly as a result of the increase in branch network that was mainly driven by competition and business growth. As shown in Table 1.3, the increase is mainly concentrated in the middle and lower level categories while the upper grades registered minimal increases.

Table 1.3: Employment in the Banking Industry

Category	2003	2004	% Change 2003/04
Management	3,097	3,165	2.2
Supervisory & Sec. Heads	2,564	2,743	7.0
Clerks & Secretarial Staff	4,861	5,130	5.5
Other Categories	809	903	11.6
Total	11,331	11,941	

Training remains an important component of staff development process in the banking industry. While each bank trains its own staff, the Kenya School of Monetary Studies remains the premier training centre on banking and other related courses. The large banks however, mainly utilize their local training schools to train their staff while the small and medium sized banks mainly utilize the training facilities offered at the Kenya School of Monetary Studies.

Training remains an important component of staff development process

Emerging challenges and changes in the regulatory environment has necessitated the Financial Institutions Supervision Department (FISD) to develop a comprehensive and continuous training programme that is necessary in improving supervisory capacity of the department. The Department has included in its training program joint inspections with other

East African Central Banks, as well as in-house and external training opportunities thereby strengthening the Department's regulatory capacity.

1.7 Supervisory Enforcement Action

The Central Bank's enforcement of compliance requirements particularly through introduction of penalties resulted in reduced incidences of non-compliance. As shown in Table 1.4, the incidence of non-compliance reduced from 31 in December 2003 to 19 in December 2004. Similarly, the number of institutions that were non-compliant declined from 12 in December 2003 to 8 as at end of December 2004.

Positive progress noted in the level of compliance

In addition to the penalties, enforcement action also included withholding of corporate approvals for institutions that did not comply with the requirements of the Banking Act and Central Bank Prudential Regulations. Consequently, the Department reviewed banking licence applications for year 2005 from all institutions and forwarded recommendations to the Minister for Finance to grant approval only to those institutions that were fully compliant. Conditional licences were however, granted to the institutions that were non-compliant. Some of these institutions are undergoing restructuring in order to address structural problems associated with non-compliance. The Central Bank will continue to monitor the level of compliance in the banking sector on a daily basis with a view to ensuring that all institutions are fully compliant.

Table 1.4: Progress on compliance

	December 2003	December 2004
<i>No. of institutions not in compliance</i>	12	8
<i>Incidence of non-compliance</i>	31	16

In terms of specific non-compliance issues, the most frequently violated section of the Banking Act was **section 10(1)** on single borrowing, which limits exposure to not more than 25% of institution's core capital. As indicated in the Table 1.5 below, the number of institutions that were non-compliant with regard to single borrowing limits however declined by 25% to 6 institutions in December 2004 from 8 in December 2003. Similarly, the frequency of non-compliance, that is, the total number of violations of the Banking Act and prudential regulations in all institutions decreased to 16 in December 2004 from 31 in December 2003, an improvement of 48% in compliance rate.

Table 1.5: Trend of Non-compliance

No	Item	December 2004	December 2003
1	Single Borrowing (25% of core capital)	6	8
2	Single Insider (20% of core capital)	0	4
3	Insider Borrowing Not Secured	0	2
4	Liquidity Ratio	2	1
5	Min. Core Capital	1	2
6	Foreign Exchange Exposure	2	3
7	Invest. In non-banking Activities	0	2
8	Min. Total Capital/TRWA	1	1
9	Core Capital/TRWA	1	3
10	Core Capital/Deposit	0	1
11	Institutional Ownership	1	2
12	Adequate Provisions	2	1
	Total Frequency of Non-compliance	16	31

Section 10(1) on single borrower limit is the most frequently violated section

Source: Central Bank of Kenya: Daily returns on compliance from Institutions

1.8 Highlights of Amendments to Banking Legislation

A number of amendments to banking legislation were proposed in 2004, in order to harmonise the bank supervisory process with the international standards, strengthen banking supervision and ensure compliance with the

Regulatory amendments proposed to transfer supervisory and Regulatory powers to the Central Bank

Basle Core Principles for Effective Banking Supervision and other corporate governance requirements. Highlights of the proposed amendments to the Banking Act and Central Bank of Kenya Act were:

- Transfer of Supervisory and Regulatory powers to the Central Bank. The proposed amendments aim at ceding from the Minister for Finance most of the powers related to supervision and regulation of financial institutions.*
- Repeal of Section 39 of the Central Bank of Kenya Act, which regulate interest rates.*
- Repeal of section 44 of the Banking Act, which requires financial institutions to obtain approval of the Minister for Finance before increasing their rates of banking or other charges.*
- Introduction of a new section 44 A of the Banking Act on the in-duplum rule, which limits the total interest an institution can recover on a non-performing loan to a maximum of the amount of outstanding at the time the loan became non-performing.*
- Introduction of vetting of significant shareholders, who are defined as persons, other than the Government or a public entity, who hold, directly or indirectly, or otherwise have beneficial interest in, more than five percent of the share capital of an institution.*

1.9 Outlook

The Department continues to improve supervisory measures to enhance stability and soundness of the banking sector. In summary, some of these measures are:

Stringent supervisory and regulatory enforcement measures pursued to enhance stability and soundness of the banking sector

- Enforcement of compliance with the banking laws and prudential regulations. Penalties shall continue to be imposed as a deterrence mechanism.*
- Full implementation of Risk Based Supervision by the end of 2005. This is being done with the technical assistance from IMF - East Afritac. The department will issue risk management guidelines to the sector in the*

second quarter of 2005, and conduct pilot Risk Based Examinations in July 2005.

- *Introduction of more advanced inspection techniques. The Central Bank Supervisors are currently embracing the use of Computer Assisted Audit Techniques – CAATs. The bank examiners use Audit Command Language – ACL to interrogate computer files in the banking institutions and produce exception reports.*
- *The parallel run of the Banking Supervision Application (BSA) system currently in progress is expected to be completed in year 2005. With full implementation of the system, it is expected that data processing will be timelier.*
- *Implementation of the remaining Basle Core Principles for Effective Banking Supervision in order to enhance supervisory oversight and ensure compliance with international best practice.*
- *Strengthening the inspection follow up process to ensure that financial institutions rectify deficiencies observed during on-site examination promptly.*
- *Continued publication of bank charges to increase customer awareness of products and services available and their associated costs with a view to increasing competition in the sector.*
- *Working closely with other Governmental agencies in addressing the problem of Non-Performing Loans (NPL) affecting five public sector institutions, which also constitute the largest proportion of the sector's NPL.*

Pilot Risk Based Supervision (RBS) conducted in July 2005, and full implementation of RBS expected by end of the year

Chapter Two

Banking sector performance and macro economic developments

2.1 Overview

The Banking system remained sound and stable

The Kenya economy exhibited improved growth and stability in the banking sector attributed mainly to the favourable macroeconomic environment. The banking system remained sound with positive developments recorded in all key financial indicators. With net non-performing loans maintaining a downward trend and profitability improving, capital adequacy ratios were sustained at high levels throughout the year, thus providing the banking system with sufficient buffer to absorb any unexpected shocks. The continued enforcement of prudential and legislative supervisory requirements also supported the stability of the sector. While the reduction in net non-performing loans impacted favourably on earnings, thus contributing positively to the overall financial performance, the strengthened balance sheet enabled the banking system to expand credit thereby supporting the country's economic activities.

2.2 Macro-economic Conditions during 2004

Gross Domestic Product (GDP) expanded by 4.3%

The economic recovery process that began in 2003 continued into 2004 with Gross Domestic Product (GDP) expanding by 4.3% during the year, the fastest growth since 1994 compared with 2.7% in 2003 and 0.4% in 2002. The improvement in the economy was reflected in positive growth across all sectors complemented by strong macro economic fundamentals.

The Debt Restructuring Strategy pursued by the Central Bank since 2002, which substituted short term domestic instrument with long term instruments resulted in the reduction in general interest rates. The debt restructuring strategy together with ample liquidity in the system, led to a decline of the average interest rate on loans and advances from 13.47% in December 2003 to 11.25% by the end of 2004.

Similarly, the monetary policy stance remained supportive of domestic economic activity. The monetary policy pursued in 2004 ensured that

inflationary pressures were contained while monetary expansion at 9.5% facilitated, the availability of credit. Total domestic credit therefore increased by 14.2% of which private sector credit increased by 14.7% while credit to the public sector declined by 6%. The monetary policy stance was complemented by a process of fiscal consolidation as the Government strengthened its fiscal position by efficiently utilizing the existing resources and enhanced revenue collection. Moreover, public policy continued to be pursued with the objective of allocating increased resources to private sector activity and restating the private sector as the engine of economic growth.

2.3 Balance sheet analysis

2.3.1 Analysis of Assets and Liabilities

In response to improved economic environment, the banking sector expanded in terms of asset size by 12% or Ksh. 61.8 bn from Ksh. 515.8 bn as at December 2003 to Ksh. 577.6 bn as at December 2004. As a proportion of GDP, total assets remained at 45% of GDP which was the same as at the end of 2003. The assets growth was mainly funded by increases in local currency and foreign currency deposits, fresh capital injection and retained profits.

The banking sector expanded due to improved economic environment

Total deposits increased by Ksh. 49.7 bn during the year out of which local currency deposits expanded by Ksh. 29.1 bn from Ksh. 356 bn in 2003 to Ksh. 385.1 bn in 2004. Foreign currency deposits also rose by Ksh. 20.5 bn from Ksh. 58.9 bn to Ksh. 79.4 bn over the same period.

Total shareholders funds, over the year increased by Ksh. 7.8 bn from Ksh. 61 bn in 2003 to Ksh 68.8 bn in December 2004. Paid up capital in the sector rose by Ksh. 3.5 bn while reserves rose by Ksh. 4.3 bn during the year, reflecting strengthened capital position of the institutions. The improved capital position has enhanced the institutions' capacity to absorb losses, expand their operations and therefore the scope of financial intermediation.

While loans at 52% and government securities at 20% continue to constitute a major portion of their investments, the financial institutions substantially reduced investments in Government securities during the year as a result of declining interest rates. Investments in Government securities declined by Ksh. 27 bn from Ksh. 143 bn in December 2003 to Ksh. 116 bn in December

*Investment in
Government
securities declined*

2004. Changes in the composition of other assets and liabilities remained relatively stable during the year.

Total credit to the private sector increased by Ksh. 64 bn from Ksh. 266 bn in 2003 to Ksh. 330 bn in 2004. The highest credit growth was registered in the private households sector, in which credit increased by Ksh. 13.4 bn over the year, followed by the manufacturing sector that registered a growth of Ksh. 10.6 bn. This upward trend in credit to these sectors was in response to financial institutions' efforts to increase personal lendings, and in particular the upgrading of factories and manufacturing firms to take advantage of the improved business environment.

In terms of sectoral credit, most of the private sector credit was directed to finance, insurance and business services sector, which accounted for 22% of the total private sector credit. This was followed by the Manufacturing and Tourism (Trade and Hotels) sectors with 19% and 14.5% respectively.

*Substantial growth of
off balance sheet
items*

During the year, the off balance sheet items increased substantially by Ksh. 23.5 bn or 36%, mainly comprising of letters of credit, guarantees and acceptances. This increase reflected a deliberate strategy by most institutions to increase their share of non-fund based business in order to diversify sources of their income.

The movements in selected assets and liabilities is summarised in the Table 2.1 below:

Table 2.1 Global Balance Sheet Analysis

	Ksh million		% Change
	2004	2003	
Assets			
<i>Cash</i>	10,298	9,688	6
<i>Balances at Central Bank of Kenya</i>	32,767	24,408	34
<i>Placements</i>	13,582	12,330	10
<i>Government Securities</i>	115,994	143,049	(19)
<i>Investments</i>	5,056	4,555	11
<i>Loans & Advances (net)</i>	301,891	240,701	25
<i>Other Assets</i>	98,061	81,068	21
Total Assets	577,649	515,799	12
Liabilities & Shareholders' funds			
<i>Deposits</i>	465,572	415,972	12
<i>Other Liabilities</i>	43,245	38,834	11
<i>Capital & Reserves</i>	68,829	60,993	13
Total Liabilities & Shareholders' Funds	577,649	515,799	12

The 34% increase in balances with the Central Bank was mainly attributed to the rise in institutions' cash ratio reserve holdings at the bank reflecting increased level of deposits.

Chart 1

Balance Sheet Movements (Assets)

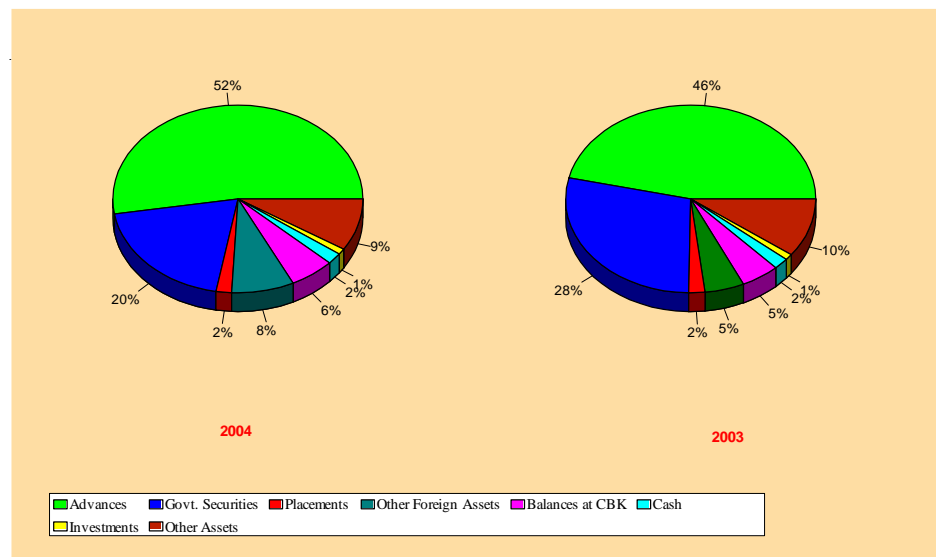
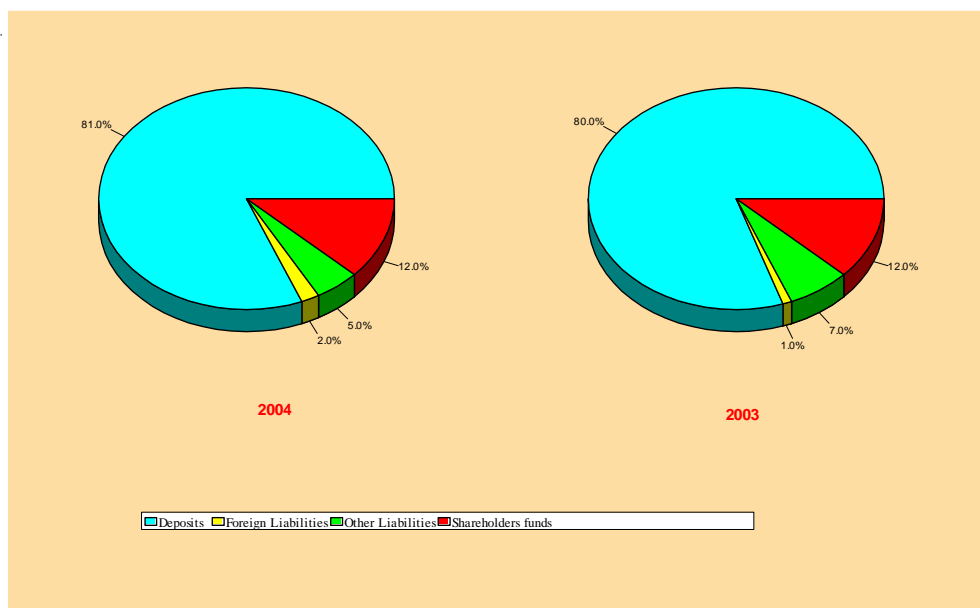


Chart 2

Balance Sheet Movements (Liabilities)



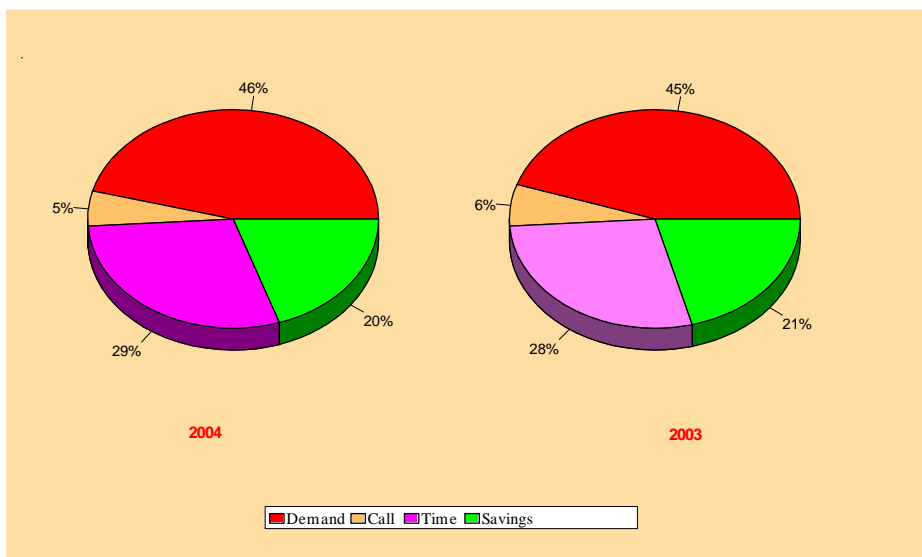
Increased lending and decreased investments in government securities led to rise in total risk assets thus, the risk weighted assets grew during the year by Ksh. 62.4bn or 19%. This is as a result of loans and other credit facilities carrying a much higher risk weight than government securities. However, the ratio of total capital to total risk weighted assets remained at 16.6% as a result of an increase in shareholders's funds.

The structure of deposits remained unchanged in terms of type and sources. Demand and call deposits continue to be the dominant type of deposits accounting for 51% of total deposits. The Non-Profit Institutions and individuals were the largest source of deposits, with 63% of total deposits. The percentage of demand deposits to total deposits however, increased from 45% in 2003 to 46% in 2004.

Non-profit institutions and individuals account for 63% of total deposits

Chart 3

Structure of Deposits



The government and parastatals continued to have significant deposits in the sector. Government and parastatal deposits amount to Ksh 40bn or 10% of total deposits, an increase of Ksh. 2 bn from Ksh 38bn in 2003.

2.3.2 Asset Quality

Arising from the improved economic performance, net non-performing loans of the banking system declined in 2004 to Ksh. 70.8 bn from Ksh. 73.9 bn in 2003. Similarly, as shown in Table 2.2, the gross non-performing loans as a ratio of total loans declined to 29.0% in 2004 from 35.0% in 2003. Recoveries and improved provisioning supported by reduced levels of new non-performing loans during the year contributed to the decline in net non-performing loans.

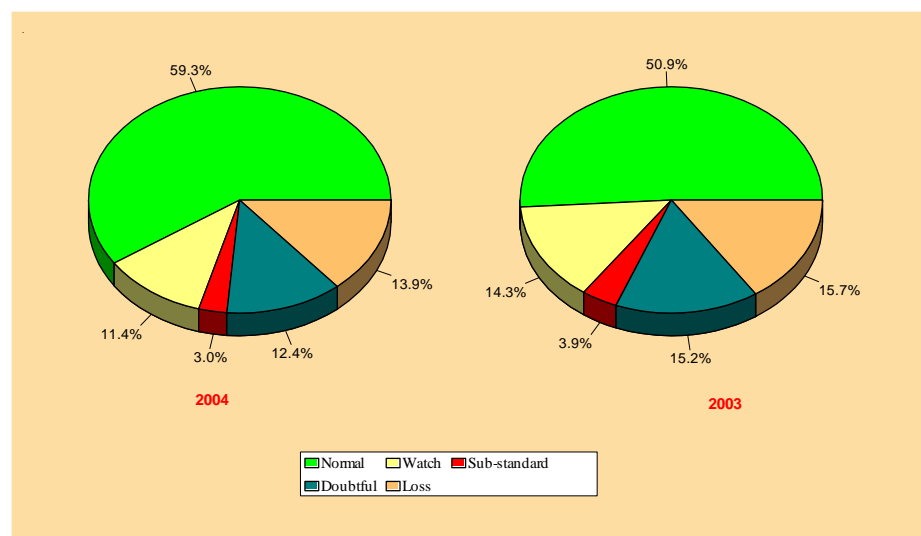
Table 2.2: Asset Quality

Asset Quality		
Ksh. Million	2004	2003
Total Assets	577,648	515,799
Gross Loans	382,290	315,321
Gross Non-Performing Loans	111,889	109,898
Interest in suspense	39,309	38,588
Net Non-Performing Loans	72,580	71,310
Specific provisions	37,940	33,435
Net Non-Performing Loans	34,640	37,875
Gross Loan over total assets (%)	66	61
Gross NPLs/Gross Loans (%)	29	35
Total NPLs/Total Loans (%)	21	26

* Total Loans = Gross Loans net of interest in suspense

Chart 4:

Risk Classification of loans



2.3.4 Capital Adequacy

The banking system remained adequately capitalised at Ksh. 69 bn

The banking system remained well capitalised with the capital base increasing by Ksh. 8 billion from Ksh. 61 bn as at the end of 2003 to Ksh. 69bn as at the end of 2004. The overall rating of the banking sector’s capital strength was satisfactory same rating as in the previous year. The improved capital base

was attributed to retention of current year's profit and additional injection of capital by institutions. As shown in Table 2.3 below, the risk weighted assets to core-capital ratio of the banking system was 16.2% the same level as at the end of 2003 since the rate of increase in risk weighted assets was matched by expansion in the capital base.

Table 2.3: Capital Adequacy Ratios

	2004	2003	2002
Core Capital/TRWA*	16.2	16.2	14.1
Total Capital/TRWA*	16.6	16.6	17.0
Core Capital/Total Deposits	13.8	13.1	12.2

* Total Risk Weighted Assets

2.3.5 Liquidity

The liquidity of the banking sector measured by the ratio of net liquid assets to total deposits, which is a reflection of an institution's ability to meet its maturing obligations as they fall due, remained strong as in the previous year. The high liquidity in the sector was attributed to the sector's preference for liquid assets notably investments in government securities. Out of the liquid assets amounting to Ksh. 190 bn, Ksh. 80 bn or 42% comprised investments in government securities while balances with foreign banks and at the Central Bank constituted 20% and 15% respectively. The liquidity position of 42 financial institutions with a combined market share of 90.2% was rated strong and satisfactory while liquidity status for 7 financial institutions was rated fair.

2.4 Profitability

2.4.1 Overview

Supported by favourable economic and financial conditions, gross operating profit of the banking system increased by Ksh. 1.0 bn to Ksh. 15.1 bn in 2004 from Ksh. 14.1 bn in 2003. The increase in profits reflected reduction in costs of operations by Ksh. 2.3 bn particularly interest expenses and bad debt charge as total income decreased by Ksh. 1.2 bn. Bad debt charge decreased by Ksh. 801m from Ksh 8.4 bn in 2003 to Ksh. 7.6 bn in 2004 while interest

Gross operating profit of the banking sector increased by Ksh. 1.0bn

expenses decreased by Ksh. 3.1bn from Ksh9.6bn in 2003 to Ksh. 6.5bn in 2004. The decline in bad debt charge was partly attributable to the improved credit administration by banks.

Commercial banks profits constituted 97.3% of the sector's total profits while non-bank financial institutions and building societies combined contributed 2.7%. Out of 49 financial institutions that were operating, 41 made an aggregate profit of Ksh. 15.9bn while the remaining 8 made an aggregate loss of Ksh. 0.8bn. Although the general performance of the banking sector has continued to improve over the years, the distribution of profits was still skewed with two major banks contributing 53.5% of the total pre-tax profits.

2.4.2 Income

Total income of the banking system declined marginally by 1.9% from Ksh 63.9bn in 2003 to Ksh. 62.7bn in 2004. The fall in income was mainly attributed to reduction in interest income from Ksh. 39.2bn in 2003 to Ksh. 38.0bn in 2004 following the general decline in interest rates during the year. Interest income however remained the major source of income at Ksh. 38.0bn or 61% of total income out of which income from advances was Ksh. 25.5bn while income from government securities was Ksh. 7.6bn.

In tandem with efforts by institutions to diversify sources of income, income from fees, commissions and foreign exchange transaction increased marginally from Ksh 24.7bn in 2003 to Ksh 24.8bn in 2004. Thus, the contribution of non-interest income to total income increased from 39% in 2003 to 40% in 2004 reflecting the strategy by banking institutions to shift away from traditional sources of income to non funded income as general interest rates remained low.

2.4.3 Expenses

Total expenses decreased by 4.5% from Ksh. 49.8bn in 2003 to Ksh. 47.5bn in 2004. The decrease in expenses was attributable to the decline in interest expenses and bad debt charge, which declined by Ksh. 3.1bn and Ksh. 0.8bn respectively.

Contribution of non-interest income increased from 37% to 38% in 2004.

Interest expense on deposits declined

Interest expense on deposits accounted for 14% of the total expenses having declined from 17% in the year 2003. The decline in interest expenses on deposits was due to lower interest rates offered by banking institutions following relatively high liquidity of the banking system. As a percentage of total income, interest expense fell from 13.3% in 2003 to 10.4% in 2004. Staff related expenses such as salaries and wages increased marginally by 0.6% from Ksh. 14.8 bn in 2003 to Ksh. 14.9 bn in 2004 mainly owing to increase in the number of employees from 11,331 in 2003 to 11,941 in 2004

Table 2.4 Income and expenditure items as percentage of total income.

	Ksh. billion					
	2004		2003		2002	
	Ksh.	%	Ksh.	%	Ksh.	%
Income						
<i>Interest on advances</i>	25.5	41	27.9	44	28.7	45
<i>Interest on government securities</i>	7.6	12	10.3	16	11.8	19
<i>Interest on placement</i>	4.9	8	1.0	2	1.3	2
<i>Other income</i>	24.8	39	24.7	38	21.7	34
Total income	62.7	100	63.9	100	63.5	100
Expenses						
<i>Interest expenses</i>	6.5	10.4	8.5	13.3	13.0	20.5
<i>Bad debts charge</i>	7.6	12.2	8.4	13.2	11.1	17.5
<i>Salaries & wages</i>	14.9	23.8	14.8	23.2	15.9	25.0
<i>Other expenses</i>	18.5	29.5	18.1	28.3	17.5	27.6
Total expenses	47.5	75.9	49.8	78.0	57.5	90.6
Profit before tax	15.1	24.1	14.1	22.0	6.0	9.4

Chart 5

Income as a Percentage of Total Income

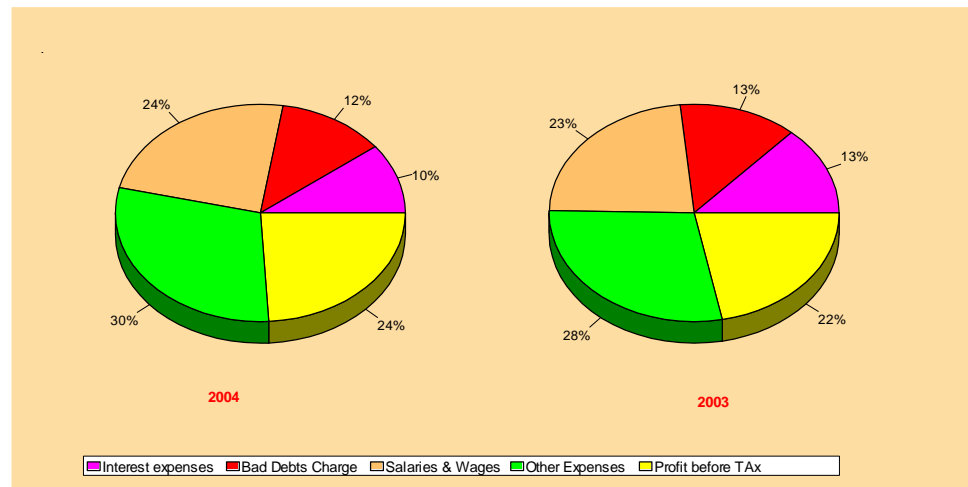
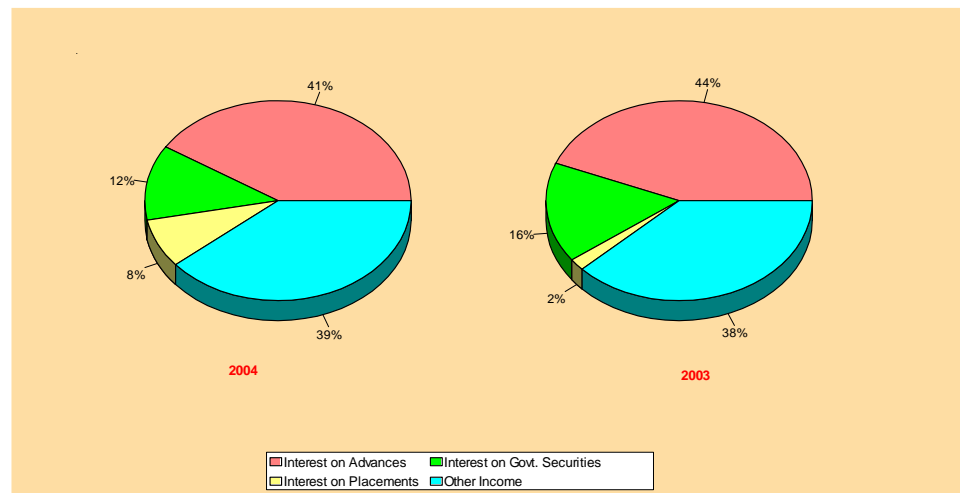


Chart 6

Expenses as a Percentage of Total Income



2.5 Market Share

Banking sector was dominated by a few banks, 13 banks accounted for 77% of total net assets

The banking sector continued to be dominated by a few banks as shown in Table 2.5 below with 13 largest institutions out of the 49 institutions accounting for 77% of total net assets and 78% of the total deposits. Similarly, the 13 institutions contributed 82.8% of the total pre-tax profits compared with 94% in the previous year.

Table 2.5: Ranking by Assets and Deposits as at December, 2004

Peer Group	Asset Range shs' billion	No. of Inst.	Net Assets		Deposits		Pre-Tax	
			Shs'	Market	Shs'	Market	Shs'	Shs'
			Billion	Share	billion	share	million	Share
1	Over 10	13	445.0	77.1%	361.8	77.9%	12.5	82.8%
2	5-10	11	67.1	11.6%	54.8	11.8%	0.9	6.0%
3	3-5	11	40.5	7.0%	32.6	7.0%	0.7	4.6%
4	0-3	14	25.0	4.3%	15.3	3.3%	1.0	6.6%
TOTAL		49	577.6	100.0%	464.5	100.0%	15.1	100.0%

2.6 Year End Performance Rating

The overall performance of the banking sector based on CAMEL rating framework of Capital Adequacy (C) Asset Quality (A) Management (M) Earnings (E) and Liquidity (L) was satisfactory, the same composite rating as in the previous year

As shown in Table 2.6 below, four institutions with a combined market share of Ksh. 12.6bn or 2.2% were rated strong compared to nine institutions in the previous year while twenty-three institutions were rated satisfactory. Seventeen institutions were rated fair compared to 13 in year 2003 while no institution was rated unsatisfactory. Five institutions were rated marginal.

Table 2.6: Year end overall Performance rating

CATEGORY	2004				2003		
	No. of INST.	Net Asset		No. of INST.	Net Assts		
		Shs. Billion	%		Shs. Billion	%	
STRONG	4	126	22	9	44.5	86	
SATISFACTORY	23	357.8	620	23	298.8	57.9	
FAIR	17	186.0	322	13	124.9	24.2	
MARGINAL	5	21.1	3.7	5	47.5	9.2	
UNSATISFACTORY	0	0	0.0	0	0	0.0	
TOTALS	49	577.6	100.0	50	515.8	100.0	
OVERALL	SATISFACTORY			SATISFACTORY			

Overall the banking sector was rated satisfactory.

Chapter Three

Developments in Regulatory Framework

3.1 Overview

One of the principal objectives of the Central Bank of Kenya is to foster the liquidity, solvency and proper functioning of a stable market-based financial system as spelt out in Section 4 (2) of the Central Bank of Kenya Act. In addition, section 33B of the Act specifies the legal basis for licensing of foreign exchange bureaus. The Banking Act, which provides the legislative framework for regulating banking business, empowers the Central Bank to issue guidelines to be followed by institutions in order to maintain a stable and efficient financial system.

The Central Bank continued to review legislations and regulators

The Central Bank continued to review the relevant legislations and regulations in 2004 in order to put in place up-to-date regulatory framework that meets international standards. These measures include: amendments to the Central Bank of Kenya Act and Banking Act, reviewing the Prudential Guidelines, and introduction of Risk Management Guidelines. The Central Bank also participated in the preparation of the micro-finance and anti money laundering bills.

3.2. Amendments to legislation

3.2.1 Overview

The Central Bank continued to enhance and develop the current regulatory framework in order to strengthen and ensure the stability and soundness of the banking system. Thus, in 2004 various amendments to the Banking Act, and Central Bank of Kenya Act were introduced. In addition, the ongoing process of the revision of current prudential guidelines is expected to be completed by end of 2005.

3.2.2 Amendments to the Central Bank of Kenya Act

In 2004, The Central Bank of Kenya Act was amended on three specific areas. These included introduction of: a new section 4D that provided for creation of a Monetary Policy Advisory Committee, section 36 (4) dealing with the Central bank rate, and deletion of sections 39 and 39A on the regulation of interest rates.

3.2.3 Amendments to the Banking Act

- *Ceding of Supervisory and Regulatory Powers to the Central Bank*

Numerous sections of the Banking Act grant the Minister for Finance powers to make decisions related to supervision and regulation of financial institutions. This is not in tandem with the Basle core principles for Effective Banking Supervision which requires that supervisory authorities be fully independent in discharging their functions. The Banking (Amendment) Bill, 2004 proposed various amendments aimed at transferring most of these powers from the Minister to the Central Bank. These include powers to;

- *Restrict institutions undertaking banking business.*
- *Authorise licenses;*
- *Revoke licenses;*
- *Approve location of places of business;*
- *Approve mergers and acquisitions;*
- *Determine minimum capital requirements*
- *Certify as fit and proper persons appointed to manage and control institutions;*
- *Place loan limitations by mortgage finance companies;*
- *Restrict trading and investments of institutions*
- *Interven in management of troubled institutions; and*
- *Approve voluntary liquidations.*

- **Section 44**

*The Banking (Amendment) Bill, 2004 contained a proposal to delete section 44 of the Banking Act which requires financial institutions to obtain approval of the Minister for Finance before increasing their rates of banking or other charges. To replace Section 44 a new Section 44 (A) was introduced in order to provide for the introduction of the *induplum* rule. This is a common*

Various amendments to the Banking Act proposed.

law principle that limits the total interest an institution can recover on a non-performing loan. The total interest charged cannot exceed the amount of outstanding principal at the time the loan becomes non-performing. The limitation does not apply to interest accruing under a court order after the order is made. The section also clarified that, for loans that became non-performing before the new section comes into operation, the principal applied is the total principal and interest owing at the time the section comes into operation.

- **Subjecting significant shareholders and senior officers to the fit and proper criteria**

Currently, vetting by the Central Bank is limited to directors and chief executives of institutions. It has been established however, that significant shareholders can influence management decision and exercise control on institutions. Unsuitable shareholders may therefore, exert adverse influence, thus exposing depositors and undermine stability of financial institutions. Accordingly, the following amendments to the Banking Act were proposed in the Banking (Amendment) Bill, 2004 in order to introduce vetting of significant shareholders and senior officers:

- **Section 2**

A definition of significant shareholder was introduced, to mean a person, other than the Government or a public entity, who holds, directly or indirectly, or otherwise has beneficial interest in, more than five percent of the share capital of an institution.

- **Section 4**

This section was amended to categorise significant shareholders among persons who manage and control institutions, and who therefore must be vetted.

- **Section 11**

Significant shareholders were included in the definition of 'insiders'. This means that the existing limitations on advances to insiders would also apply to shareholders with more than 5% shareholding.

Vetting of significant shareholders and senior managers of financial institution proposed.

- **First Schedule of the Banking Act**

The First Schedule, which provides the criteria for vetting persons proposed to manage or control institutions, was expanded to provide criteria for vetting a significant shareholder that is a corporation.

The amendments were part of the Banking (Amendment) Bill, 2004 that were referred back to Parliament in December 2004 for further review.

3.3 Revision of Prudential Regulations

The Financial Institutions Supervision Department (FISD) is in the process of revising the current Prudential Regulations in order to incorporate various amendments made to the Banking Act, and new developments in the international supervisory standards and practices. Details of the proposed changes are contained in Appendix 9.

The revised Prudential Regulations are to be submitted to the Kenya Bankers Association (KBA) and the Institute of Certified Public Accountants of Kenya (ICPAK) for comments. The comments received from these stakeholders will be taken into account in the revised Prudential Regulations.

Among the proposals is to revise the Guidelines on Risk Classification and Provisioning which is scheduled to be issued to the industry in the course of 2005/06. The key changes in the revised guidelines are: -

- 1. Besides the credit risk classification, the other assets other than loans will be evaluated and provisioned accordingly.*
- 2. Discounting of collaterals for non-performing advances over a 5 year period.*
- 3. Allocate specific rates in providing for the advances portfolio.*
- 4. Enhanced provisioning for non-performing assets.*

*Revision of
Prudential
Regulations.*

Risk Management Guideline is being developed for the banking sector.

3.3.1 Introduction of Risk Management Guidelines

As a prerequisite for the adoption of the Risk Based Supervisory framework, the Financial Institutions Supervision Department is developing Risk Management Guidelines for the banking sector. These guidelines are intended to provide minimum requirements for sound risk management. While the types and degree of risks an organization may be exposed to depends upon a number of factors such as its size, complexity of business activities, volume etc, the guidelines cover the most common risks in financial institutions, namely;

- *Strategic Risk,*
- *Credit Risk,*
- *Liquidity Risk,*
- *Interest Rate Risk,*
- *Foreign Exchange Risk,*
- *Price Risk,*
- *Operational Risk,*
- *Reputational Risk and Compliance/Regulatory Risks.*

In order to effectively manage these risks, banks will be required to put in place risk management processes that cover the four critical aspects of management oversight, policies and procedures, measurement and internal controls. The guideline details the pre-requisites for an institution's risk management system. The financial institutions will therefore put up the necessary structures that place strong emphasis on understanding and assessing the adequacy of each institution's risk management systems to identify, measure, monitor and control risk in an appropriate and timely manner.

3.4 Legal framework for Anti-Money Laundering and Combating Financing of Terrorism

National Task Force established to draft a comprehensive anti-Money Laundering legislation.

The Kenya Government continues to develop the national Anti-Money Laundering and Combating the Financing of Terrorism regime by strengthening the legislative framework, improving the domestic and international cooperation and upgrading the capacity of regulatory and enforcement personnel.

One of the measures taken by the Government to deter money laundering and terrorism financing was the formation of a National Task Force on Anti-Money Laundering whose main mandate was to draft specific and comprehensive Anti-Money Laundering Legislation. Once enacted by Parliament, the Anti-Money Laundering law will criminalize all forms of money laundering, and establish the necessary institutional arrangements to ensure the enforcement of the act and regulation therein. The National Task Force has drafted The Proceeds of Crime and Money Laundering (Prevention) Bill, 2005, which will soon be presented to National Assembly of Kenya for enactment.

The Objective of the draft legislation is to develop a legal framework on anti-money laundering and provide for institutional arrangements, and policy strategy on anti-money laundering. The draft Bill criminalises money laundering and establishes a Financial Intelligence Unit (FIU), whose main mandate will be to collect and collate information on suspicious transactions reports (STR), and to analyze and transfer such information to the law enforcement agencies for action. However, the FIU will not be a law enforcement agency itself as it's role will be restricted to providing the necessary information.

The draft Bill meets the Financial Action Task Force's (FATF)¹ 40 Recommendations. The draft Bill further extends the definition of money laundering beyond the realm of drug trafficking to include all indictable offences. It contains extensive forfeiture and seizure provisions. The Bill also seeks to establish a special fund where proceeds obtained from money launders shall be kept and may be applied to support the operations of the Financial Intelligence Unit and the anti-money laundering law enforcement agencies.

In addition, the draft Bill places a duty on financial institutions or persons engaged in relevant business activities to report suspicious unusual transactions to the FIU. It also provides for money laundering to be included as one of the offences extraditable under the Extradition Act and it enables the

The Draft Anti-Money Laundering bill criminalises money laundering

¹ FATF is an Inter governmental, multi disciplinary body whose task is to develop and promote policies both at national and internal levels, to combat money laundering. FATF has issued forty recommendations on money laundering and nine on combating financing of Terrorism (CFT). These recommendations are designed as minimum standard/best practices in creating effective AML/CFT regime. Their domestication should be subject to local risk, vulnerabilities and local circumstances and constitution.

extradition of fugitives to countries even, with which Kenya does not have Extradition Treaties.

The following provisions are included in the draft bill:

- *Synchronized modalities of tracing, seizing and freezing suspected money laundering accounts.*
- *Confiscation of the proceeds of crime, including proceeds of money laundering once the crime has been established.*
- *Introduction of mandatory Know Your Customer (KYC) policies for the financial sector in the following areas:*
 - *Identification*
 - *Financial status*
 - *Nature of Business*
 - *Penalise institutions for non-compliance with the KYC requirements.*
 - *Declaration of the source of funds.*
- *Outlaw the maintenance of anonymous bank accounts.*
- *Require banks to store financial records for a minimum of 5 years.*
- *Introduce mandatory reporting for any suspicious transactions, after amending the banks secrecy laws to protect the reporting banks from liability.*
- *Strengthen the declaration procedure for cash transactions across borders.*
- *Require banks to co-operate with the law enforcement and the prosecuting authorities in money laundering cases.*

3.5 Micro Finance Bill

During the year, the development of a legal and regulatory framework for the microfinance institutions, especially deposit-taking remained the central focus. As a result, the refinement of the proposed Deposit-Taking Microfinance Bill continued, in close consultation with stakeholders.

A bill drafted to regulate the micro finance sector.

A Bill has therefore been drafted for debate by Parliament for enactment of legislation to regulate the micro finance sector. Once enacted by Parliament, the Act shall be cited as the Deposit-taking Microfinance Act 2005. It shall apply to deposit-taking microfinance business, as well as empower the Minister

for Finance to issue regulations for the conduct of credit by microfinance institutions.

The Bill shall, among others;

- Define qualifications for carrying out deposit taking microfinance business.
- Provide procedures for applying for licensing to carry out deposit-taking microfinance business.
- Set out requirements for licensing of deposit-taking microfinance institutions.
- Grant the Minister for Finance the powers to regulate and set out categories of deposit-taking microfinance businesses.
- Grant the Governor of the Central Bank of Kenya powers, to revoke a license of a licensee.
- Specify the minimum capital requirements to operate a microfinance business.
- Specify the minimum liquid assets an institution shall maintain to be allowed to carry out a deposit-taking microfinance business.
- Determine prohibited activities for the licensed microfinance institutions.
- Specify limits on loans and advances in aggregate to core capital.
- Provide for ownership and corporate governance, including 'fit and proper' test for the owners and directors of the microfinance institutions.
- Provide for inspection and control of the deposit-taking microfinance institutions.
- Provide for deposit protection for customers of microfinance institutions.

It is anticipated that, when the Bill becomes law, a number of credit-only micro finance institutions (few initially) will be licensed under the new legislation.

In addition to the microfinance issues, during the year, the Central Bank was part of the Task Force formed to develop regulatory framework for savings and credit cooperatives, which culminated in the draft SACCO Regulatory Bill. The proposed Bill is aimed at establishing an authority to regulate SACCO societies, and especially to establish prudential regulation for SACCO societies with Front Office Services (FOSA).

A task force formed to develop regulatory framework for Saving and Credit Cooperatives (SACCOs)

Chapter 4

Current Supervisory Issues

4.1 Overview

The supervisory activities in 2004 continued to be directed at the promotion of a sound and stable banking system. These activities included on-site examination, off-site surveillance and enforcement of the requirements of the Banking Act and Central Bank Prudential Regulations. Significant progress was also achieved in implementing a number of initiatives to further promote the stability of the banking system. These included the implementation of the Bank Supervision Application (BSA), the Risk Based Supervision (RBS) and developing the framework for the implementation of Basel II Capital Accord. In addition, another important area of supervisory focus has been the monitoring of anti-money laundering measures taken by banking institutions.

Efforts have been undertaken to intensify reforms in the banking sector in order to promote competition and improve efficiency. These reforms are aimed at restructuring and privatizing the state owned bank, reforming the judiciary and the resolution of the non performing loans in the banking sector. In addition, recognizing the increasing challenges of banking supervision, the Central Bank is engaged in a number of international and regional cooperation initiatives to facilitate information exchange and closer cooperation with other regulatory and supervisory organizations and international bodies.

4.2 Risk Based Supervision (RBS)

Risk Based Supervision (RBS) is an approach that places strong emphasis on understanding and assessing the adequacy of each banks' risk management systems. RBS is a proactive supervisory approach as opposed to the traditional supervisory approach, which focuses on banks' historical financial performance. Most regulators across the world have embraced RBS. The global move towards adoption of RBS has been motivated by: -

Central Bank is in the process of implementing Risk Based Supervision (RBS)

- *Competition in the Banking industry that has led to the development of new products by banks.*
- *Expansion by banks across borders.*
- *Banks have embraced technological developments, which have increased their reliance on Information, and Communication Technology (ICT) leading to an increase in the attendant risk from technological failure.*
- *The need for Supervisory Authorities to focus their resources on banks that pose higher risk to the stability of the financial system.*

As a prerequisite to the implementation of RBS, the Central Bank conducted a survey in 2004 through a questionnaire sent to 48 financial institutions. The survey sought to establish the Risk Management practices and processes in the Kenyan Banking Sector. The Key findings of the survey were the followings:

*Central Bank
conducted Risk
Management survey*

1. *Ninety-four percent (94%) of institutions reported having clearly defined Risk management guidelines.*
2. *Institutions place their greatest emphasis on credit risk, with 97% of the respondents indicating credit risk as a principal risk covered in their risk management policies and procedures.*
3. *A number of other risks are considered relatively important by many institutions, such as Liquidity, Market and Operational Risks.*

The major gaps identified by the survey were: -

1. *Inadequate risk management policies and procedures, particularly for non-credit risks.*
2. *Not all institutions have functions and personnel dedicated for risk management*
3. *Several institutions have not developed their own risk management reports and are relying only on Central Bank of Kenya prudential returns to monitor risks.*
4. *Not all institutions utilize independent review of their risk management function.*
5. *A number of institutions have not set aside specific budgetary allocations to fund risk management activities.*

In cognisance of these gaps, the Central Bank is developing Risk Management Guidelines for the Banking Sector. The guidelines will stipulate the minimum standards for risk management frameworks to be established by banks. Based on the guidelines, banks will be required to develop Risk Management Programs (RMP) that will address the principal risks that they face. In addition, the Central Bank is reviewing its supervisory procedures and processes with the aim of aligning them to the RBS approach.

4.3 International Financial Reporting Standards (IFRS)

Kenya adopted International Financial Reporting Standards (IFRS) in 1998. The current Prudential Guidelines are being reviewed partially in response to changes in IFRS. The major changes proposed in the guidelines are the following:

1. *IFRS 40 on Investment Property which requires that investment property be revalued every year and that the gains or losses be passed through the profit and loss account. It has been proposed that these gains and losses be excluded from the computation of core capital. This is intended to shield core capital from the fluctuations inherent in periodic revaluation of property.*
2. *New disclosure requirements are to be incorporated in the Regulation on Publication of Accounts to take account of: -*
 - (a) *IFRS 17 on leases, which requires that leasehold land be disclosed separately from fixed assets.*
 - (b) *IFRS 32 on Financial Instruments, which requires that investments in commercial paper and corporate bonds be reported under loans and advances.*

In the financial year ending 31st December 2003, banks in Kenya started implementing IFRS 39, which deals with recognition, measurement and disclosure of financial instruments. With regard to provisioning, IFRS 39 requires that financial assets such as loans to be impaired (provided for) when

Prudential Guidelines being reviewed in line with changes in IFRS

their realizable value is less than their carrying (book value). The realizable value is derived by discounting the expected future cash flows from the financial assets. The estimation of the future cashflows and the discount rate are subjective and may lead to fluctuations in the amount of impairment losses/provisions. This may lead to fluctuations in the levels of capital. Banks are using both IFRS 39 and the Central Bank provisioning guideline, which largely follows objective criteria for the determining of loan loss provisioning.

4.4 Corporate Governance in the Banking Sector

As part of its supervisory activities the Central Bank evaluates the performance of directors and various board committees in banking institutions and continues to place emphasis on the importance of embedding strong corporate governance culture in all aspects of banking operations. The roles and functions performed by board members either individually or collectively are assessed during the inspection process. The Central Bank's approach to corporate governance in the banking sector is primarily designed to achieve public confidence through enhanced levels of transparency and accountability in board action.

To further strengthen corporate governance practices in the banking sector, the Department continues to review and propose amendments to the Banking Act and the Prudential Regulations. In this regard, some aspects of the Banking Act (Amendments) Bill 2004 were primarily aimed at enhancing the governance culture in the Banking sector. These include vetting and certification of significant shareholders as 'fit and proper'.

4.4.1 The Board of Directors and Management

The role of the Board of directors in each banking institution remains in focus as the financial sector embraces the Risk Based Supervision framework. The boards mandate is to ensure the implementation of policies and systems which strike a good prudential balance between risks and returns. These involve identification, measurement, monitoring and control of risks posed by its lending, investing, trading and other significant activities by institutions.

Banking Act (Amendment) Bill, 2004, extended the net of 'senior officers' to be certified as 'fit and proper'. The Chief Executive Officer, Deputy Chief Executive Officer, Chief Operations Officer, Chief Financial Officer, Secretary

Corporate governance geared towards enhanced transparency and accountability in board actions.

to the Board of Directors, Treasurer, Chief Internal Auditor or Manager of a significant unit of an institution or a person with a similar level of position or responsibilities as persons described shall be required to be vetted as 'fit and proper'.

Sustained progress has been observed in corporate governance practices and the Central Bank will continue to foster good corporate governance in the financial sector in line with international best governance practices.

4.5 International Convergence of Capital Measurement and Capital Standards

The Basel Committee on Banking Supervision released the International Convergence of Capital Measurement and Capital Standards (also referred to as Basel II Capital Accord) in June 2004. The framework provides a more risk sensitive approach to the measurement of capital adequacy in financial institutions, and for supervisors to review such assessments to ensure banks have adequate capital to support their risk. It also seeks to strengthen market discipline by enhancing transparency in financial reporting. It is anticipated that, subject to specific country circumstances, various supervisory and regulatory jurisdictions across the world will adopt the framework.

The Central Bank has, since the release of the final version of the Basle II Capital Accord, participated in various forums organized to consider the most appropriate implementation plan for the East African Region. Following resolutions arising from those deliberations, the Financial Institutions Supervision Department undertook an internal diagnosis of Pillar 1 of the Capital Accord. It sought to identify possible implementation challenges and determine corresponding strategies that may be necessary for each of the approaches available for computing capital charges for credit risk, operational risk and market risk.

Due to complexity of Basle II Capital Accord, banks and supervisors alike will have to re-engineer their processes and tailor their organizations to meet the Basel II standards. Consequently, the Central Bank has examined the pre-requisites of effective implementation of Basel II and decided that the following be put in place:

- *Implementation of Basel I by adopting the Market Risk component*

- *Compliance with the Basel Core Principles for Effective Banking Supervision*
- *Implementation of Risk Based Supervision*
- *Sensitization of stakeholders*
- *Liaison of regional regulatory agencies to keep abreast of developments in Basel II.*

4.6 Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT) initiatives in Kenya

Kenya is committed to the fight against money laundering and terrorism. In line with the government commitment to combating financing of terrorism, Kenya under the auspices of Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) hosted a regional workshop on counter terrorism in November 2004.

Kenya hosted a regional workshop on counter terrorism in November 2004.

As part of efforts to ensure the implementation of a comprehensive anti-money laundering system, a National Task Force (NTF) on Anti-money laundering was established in 2003. The Task Force which is chaired by the Ministry of Finance comprises of fourteen government agencies with the Central Bank as the Secretariat. The NTF has three distinct working sub-groups that correspond to the ESAAMLG working groups, namely Finance, Legal, and Law Enforcement. Kenya in collaboration with ESAAMLG hosted a regional workshop on counter terrorism in November 2004.

The NTF has prepared draft legislation on anti-money laundering based on the United Nations (UN) model. The draft Proceeds of Crime and Money Laundering (Prevention) Bill will be the focal point of Kenya's AML regulatory regime and has the following broad objectives:

- *Enable institutions and law enforcement agencies to identify, trace, seize, freeze, confiscate, forfeit, proceeds of crime following criminal or civil recovery proceedings.*
- *Establishing criminal assets recovery account and unit to deal with the process.*
- *Establishing mechanism for international assistance on investigations and mutual legal assistance.*

The Kenya government has initiated additional measures to combat money laundering and terrorism financing

Like most developing countries, Kenya has characteristics which may accommodate money laundering and financing of terrorism. These include prevalent of cash based transactions, lack of requisite legal framework, existence of alternative remittance avenues, illegal migration and most importantly inadequate capacity to deter criminals and other fraudsters. The overall broad objective of the National Task Force is therefore to work on the remaining weaknesses that render Kenya and the region vulnerable to money laundering and financing of terrorist activities. Some of the major challenges include:

- *Lack of policy and legislative framework to fight AML.*
- *Existence of predominantly cash based economy.*
- *Existence of porous borders and political instability in neighbouring countries*
- *Lack of training, technical and institutional capacity to deal with the new issues of AML.*

Additional measures initiated by the government to combating money laundering and terrorism financing include:

- *Signing and ratifying all the United Nations conventions on combating money laundering and the financing of terrorism.*
- *Criminalising money laundering in relation to drug trafficking;*
- *Establishment of an independent Anti-Corruption Commission;*
- *Enactment of Public Officers' Service Code of Ethics to minimize corruption among the public servants;*
- *Enactment of Anti-Corruption and Economic Crimes Act;*
- *Strengthening the Anti-Terrorism units within the Police Force;*
- *Issuing of Prudential Regulation on money laundering by the Central Bank;*
- *Amendments to the Banking Act and removal of Secrecy laws;*
- *Drafting of Witness Protection Bill 2005; and*
- *Strengthening the revenue collection system.*

Similarly, the Central Bank during its on-site inspection process ensures that banking institutions abide by prudential requirements and implement adequate controls that allows them to 'know' their customers. The main requirements of the Know Your Customer (KYC) principles are geared towards designing and implementation of appropriate policies and procedures for customer identification and for effective transactions monitoring particularly of high risk accounts by financial institutions.

4.7 Banking Sector Reforms: Financial and Legal Sector Technical Assistance Project (FLSTAP) and Financial Sector Reform Credit (FSRC)

Kenya's banking sector is currently stable and sound, with banks maintaining adequate levels of capital and liquidity. However, the following weaknesses require to be addressed in order to enhance the stability of the banking sector:

- *The resolution and privatization of state owned banks.*
- *Resolution of non-performing loans in the banking sector.*
- *Legal and judicial reforms.*

Following discussions with the World Bank and other development partners, it was proposed that these reforms be addressed within the framework of the two programs namely; Financial Sector Reform Credit (FSRC) covering key policy and institutional reforms and Financial and Legal Sector Technical Assistance Project (FLSTAP) to provide technical support for the implementation of required reforms.

The salient features of the FLSTAP and the FSRC are summarized in Table 4.2 below:

Table 4.1: Salient features of FLSTAP & FSRC

Feature	FLSTAP	FSRC
1. Objective:	<i>Create a sound financial system and a strengthened legal framework that will ensure broad access to financial and legal services.</i>	<i>Create a sound financial system that is fully supportive of private sector activities.</i>
2. Type of funding:	<i>Technical assistance through provision of consultancies, training software and hardware to strengthen the Financial and Legal Sectors.</i>	<i>Provision of direct credit to the Government for Financial Sector Reforms.</i>
3. Status	<i>Agreement for the FLSTAP was signed between the World Bank and the Government of Kenya (GOK) in November 2004.</i>	<i>Project proposal to be presented to the World Bank Board of Directors for approval in 2005.</i>

4.8 International and Regional Supervisory Initiatives

The Central Bank continued to participate in international and regional supervisory initiatives that impact on supervisory policies and practices.

4.8.1 World Bank and IMF

The report of the joint IMF/World Bank Financial Sector Assessment Program (FSAP) carried out in October 2003 was formally released in early 2004 and the Central Bank continued to address issues highlighted in the report. The issues included the following:

- *Amendments to the Banking Act to allow for independence of the Central Bank and vetting of significant shareholders;*
- *Introduction of Risk Based Supervision;*
- *Revision of prudential guidelines on asset classification;*
- *Capacity building for staff involved in supervision of financial institution;*
- *Enhancing enforcement actions on banks that fail to comply with legal and prudential guidelines*
- *Continuation of efforts to introduce Anti Money Laundering legislative framework*

4.8.2 The Basel Committee on Banking Supervision

- **International Convergence of Capital Measurement and Capital Standards (Basel II)**

In June 2004, the Governor attended, under observer status, the G10 Central Bank Governors' forum under the auspices of the Bank for International Settlements (BIS). The forum endorsed the revised framework on International Convergence of Capital Measurement and Capital Standards, leading to its issuance on June 26, 2004.

- **FSI Connect**

The Financial Stability Institute, which operates under the auspices of the BIS, launched an e-learning tool referred to as FSI Connect. The tool has been designed to provide bank supervisors with effective skills development

Report on Financial Sector Assessment Program released

Central Bank subscribes for five pilot users for e-learning tool, FSI (Financial Stability Institute)E-connect

on the Basel II framework. During the year the bank implemented a pilot subscription for five users.

4.8.3 The Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI)

MEFMI is a regionally owned institute with 12 member countries currently: Angola, Botswana, Kenya, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe. Its main objectives include:

- Building sustainable capacity in identified key areas in Central Banks, Ministries of Finance and Economic Planning
- Fostering best practices
- Bringing emerging risks and opportunities to the fore among executive level officials.

MEFMI has since its formation in 1997 dedicated itself to its mandate of capacity building in debt management, macroeconomic management, and financial management. Kenya joined MEFMI in 2003 and first participated in its training programmes in 2004. Four members of staff are pursuing the MEFMI fellowship program.

4.8.4 The Common Market for East and Southern Africa (COMESA)

In November 2004, Committee of COMESA Central Bank Governors meeting in Lusaka, Zambia, resolved to fast-track the process to have a Monetary Union in place by 2018. Among the convergence criteria adopted was the implementation of the 25 Basel Core Principles for Effective Banking Supervision.

4.8.5 The Monetary Affairs Committee (MAC) of the East African Community

The Governors of the three East African Central Banks met in Tanzania, Arusha in March 2004 within the framework of the Monetary Affairs Committee (MAC), and made the following decisions relating to the harmonization of banking supervision within the three East African countries:

- Monitoring progress in performance of commercial courts;
- Speeding up of the development of anti-money laundering legislation;
- Draft legislation on regulation of microfinance institutions;

Central Bank
participated in
MEFMI in 2004

Harmonisation of
banking supervision
discussed within the
framework of
Monetary Affairs
Committee (MAC)

- *Promotion of Credit Reference Bureaus;*
- *Reviewing the proposal for a policy towards a consolidated financial services regulatory framework*
- *Defining the role of Central Bank in licensing and revocation of licences of financial institutions*
- *Reviewing best practices in recovery of NPLs*
- *Revising the best approach towards implementation of the New Basle Capital Accord.*

Efforts were made during the year to promote harmonisation in these areas. This included a regional workshop on implementation of Basel II held in Bagamoyo, Tanzania in July 2004.

4.9 Deployment of the Bank Supervision Application (BSA)

*Central Bank
deployed BSA in
November 2004*

The Banking Supervision Application (BSA) System, is an Information and Communication Technology (ICT) solution developed to automate banking supervision workflows and risk analysis within the East and Southern African Central banks. The system was deployed by the Central Bank of Kenya between November 2004 and January 2005 and was the 9th central bank within the region to deploy the solution.

The benefits of the BSA solution are as follows:

- *The BSA is an intergrated ICT solution that automates all supervisory processes and risk analysis and thus greatly reduces the time taken to conduct analysis and produce management reports. The system does not require collecting of information from individual computers.*
- *The BSA has a facility for automated data capturing and validation from financial institutions that ensures timely and accurate data.*
- *The BSA provides powerful analysis tools for reports and graphs that enable supervisors to spend more time on data analysis rather than data preparation.*
- *The BSA is based on a powerful database management system that is unlikely to become unstable with data growth.*

- *The system is built on a workflow concept that provides a mechanism for tracking tasks and is therefore a useful management tool.*
- *The shared cost of the BSA enabled all participating central banks to acquire the solution at a minimal cost.*
- *Above all, the BSA provides the basis for the implementation of harmonised banking supervision in the East Africa and SADC region that is a powerful tool in minimising systemic risks within the central banks in the region.*

The BSA deployment process kicked off on November 1, 2004 with a Stakeholders Meeting and the User Requirements Definition Workshop which was attended by delegates from Uganda. During the User Requirements Workshop, staff from the Financial Institutions Supervision Department defined supervision workflows and identified the relevant approval levels and processes to facilitate mapping of the workflows in the system. This was followed by the installation of servers, setting up of client machines, configuration of returns and reports, benchmarks and training of both system users and administrators. A test environment was set up and the system was rolled out to users in January 2005. Currently the system is under testing and operated on a parallel-run basis in preparation for going live once users are fully conversant with it and other operational handcups have been resolved.

Bank staff have been trained to provide first level support under the general guidance of the BSA Support Office in South Africa.

Future enhancements to the system will be discussed by users and system administrators drawn from member central banks that have deployed the solution. The BSA User Group has been mandated to oversee and co-ordinate all BSA user activities to effectively apply and upgrade the solution at the central banks that have deployed the solution. The BSA User Group is scheduled to meet bi-annually and advise on the new change requests and enhancements for the application.

Appendix I

Audited Banking Sector Balance Sheet
As at December 2003 & December 2004

Ksh. mn

	Dec-04								Dec-03				
	Banks	NBFIS	Sub Total	%	BLD Society	Total	%	Growth	Banks	NBFIS	Sub Total	BLD Society	Total
A. ASSETS													
1. Cash	10,164	70	10,234	2%	64	10,298	2%	6%	9,373	65	9,438	250	9,688
2. Balances at CBK	32,653	114	32,767	6%	-	32,767	6%	34%	24,292	116	24,408	0	24,408
3. Placements	10,932	1,427	12,359	2%	1,223	13,582	2%	10%	7,334	2,431	9,765	2,565	12,330
4. Government Securities	110,617	3,371	113,988	20%	2,006	115,994	20%	-19%	137,030	3,497	140,527	2,522	143,049
5. Investments	4,480	124	4,604	1%	452	5,056	1%	11%	3,948	94	4,042	513	4,555
6. Advances(net)	242,714	9,879	252,593	44%	2,120	254,713	44%	29%	184,111	10,118	194,229	3,285	197,514
7. Foreign Loans	47,144	34	47,178	8%	-	47,178	8%	9%	43,187	-	43,187	0	43,187
7.(b) Other foreign Assets	42,679	63	42,742	8%	-	42,742	7%	59%	26,692	63	26,755	120	26,875
8. Fixed Assets	16,483	336	16,819	3%	1,142	17,961	3%	5%	15,395	335	15,730	1,403	17,133
9. Other Assets	35,842	635	36,477	6%	881	37,358	6%	1%	35,662	734	36,396	664	37,060
10. Total Assets	553,708	16,053	569,761	100%	7,888	577,649	100%	12%	487,024	17,453	504,477	11,322	515,799
B. LIABILITIES													
11. Local Currency Deposits	365,804	12,947	378,751	66%	6,353	385,104	67%	8%	332,146	14,452	346,598	9,359	355,957
12. Foreign Currency Deposits	79,429	-	79,429	14%	-	79,429	14%	35%	58,884	-	58,884	0	58,884
13. Accrued Interest	929	57	986	0%	53	1,039	0%	-8%	983	83	1,066	65	1,131
14. Foreign Liabilities	11,225	-	11,225	2%	-	11,225	2%	135%	4,772	-	4,772	0	4,772
15. Other Liabilities	30,928	732	31,660	6%	363	32,023	6%	-6%	32,951	711	33,662	400	34,062
16. Total Liabilities	488,315	13,736	502,051	88%	6,769	508,820	88%	12%	429,736	15,246	444,982	9,824	454,806
17. Net Assets/(Liabilities)	65,393	2,317	67,710	12%	1,119	68,829	12%	13%	57,288	2,207	59,495	1,498	60,993
C. CAPITAL & RESERVES													
18. Paid up/Assigned Capital	40,472	1,475	41,947	7%	350	42,297	7%	9%	36,859	1,531	38,390	413	38,803
19. Shareholders Loans/Grants	746	-	746	0%	-	746	0%	-34%	1,127	-	1,127	0	1,127
20. Reserves	20,497	463	20,960	4%	680	21,640	4%	51%	13,035	383	13,418	950	14,368
21. P & L Account	3,678	379	4,057	1%	89	4,146	1%	-38%	6,267	293	6,560	135	6,695
22. Total Shareholders' Funds	65,393	2,317	67,710	12%	1,119	68,829	12%	13%	57,288	2,207	59,495	1,498	60,993
23. Contingent Liabilities	89,413	3	89,416	-	-	89,416	-	36%	65,898	7	65,905	2	65,907
24. Gross Loans	364,405	14,758	379,163	-	3,127	382,290	-	21%	295,830	15,302	311,132	4,189	315,321
25. Total Loans	329,521	10,723	340,244	-	2,737	342,981	-	24%	261,949	10,903	272,852	3,881	276,733
26. Gross Non-Performing Loans	101,971	8,416	110,387	-	1,502	111,889	-	2%	98,887	9,283	108,170	1,728	109,898
27. Total Non-performing loans	67,087	4,381	71,468	-	1,112	72,580	-	2%	65,006	4,884	69,890	1,420	71,310
28. Interest in suspense	34,884	4,035	38,919	-	390	39,309	-	2%	33,881	4,399	38,280	308	38,588
29. Specific Provisions	36,593	749	37,342	-	598	37,940	-	13%	32,145	725	32,870	565	33,435
30. General Provisions	3,070	61	3,131	-	19	3,150	-	21%	2,506	60	2,566	31	2,597
31. Total Provisions	39,663	810	40,473	-	617	41,090	-	14%	34,651	785	35,436	596	36,032
32. Gross Provisions	74,547	4,845	79,392	-	1,007	80,399	-	8%	68,532	5,184	73,716	904	74,620
33. Accum. Depreciation	16,087	336	16,423	-	218	16,641	-	14%	13,991	423	14,414	218	14,632
35. Total Capital	65,077	2,316	67,393	-	705	68,098	-	19%	54,549	2,186	56,735	937	57,672
36. Total Risk Weighted Assets	380,639	11,538	392,177	-	4,679	396,857	-	19%	316,290	11,784	328,074	6,405	334,480
D. PERFORMANCE INDICATORS													
37. Capital/Deposits Ratio	14.7%	17.8%	14.7%	-	17.5%	14.8%	-	-	14.6%	15.2%	14.6%	15.9%	14.7%
38. Capital/Assets Ratio (Unweighted)	10.2%	14.4%	10.3%	-	14.2%	10.3%	-	-	10.4%	12.6%	10.4%	13.2%	10.5%
39. Core Capital/TRWA	16.2%	18.7%	16.2%	-	13.2%	16.2%	-	-	16.2%	17.2%	16.3%	13.5%	16.2%
40. Total Capital/TRWA	17.1%	20.1%	17.2%	-	15.1%	16.6%	-	-	17.2%	18.6%	17.3%	14.6%	16.6%
41. Core Capital/Total Deposits	13.8%	16.7%	13.9%	-	9.7%	13.8%	-	-	13.1%	14.0%	13.2%	9.2%	13.1%
42. Liquidity Ratio	42.4%	36.3%	50.6%	-	47.8%	48.2%	-	-	49.2%	39.4%	48.8%	47.8%	48.2%
43. Gross Prov/Gross Non-perf Loans	73.1%	57.6%	71.9%	-	67.0%	71.9%	-	-	69.3%	55.8%	68.1%	52.3%	67.9%
44. Gross Non-perf Adv/Gross Loans	28.0%	57.0%	29.1%	-	48.0%	29.3%	-	-	33.4%	60.7%	34.8%	41.3%	34.9%
45. Total NPLs/Total Loans(27/25)	20.4%	40.9%	21.0%	-	40.6%	21.2%	-	-	24.8%	44.8%	25.6%	36.6%	25.8%
46. (Total NPLs-S/Prov)/Net Loans	7.5%	24.2%	8.2%	-	15.8%	8.2%	-	-	10.3%	26.8%	11.1%	19.7%	11.2%
47. Gross Loans/Deposits Ratio	81.7%	113.5%	82.6%	-	48.8%	82.1%	-	-	75.5%	105.3%	76.5%	44.5%	75.8%
48. Gross Provisions/Gross Loans	20.5%	32.8%	20.9%	-	32.2%	21.0%	-	-	23.2%	33.9%	23.7%	21.6%	23.7%
49. Total Provisions/Total Loans	12.0%	7.6%	11.9%	-	22.5%	12.0%	-	-	13.2%	7.2%	13.0%	15.4%	13.0%
50. Total NPLs/Total Assets	12.1%	27.3%	12.5%	-	14.1%	12.6%	-	-	13.3%	28.0%	13.9%	12.5%	13.8%

Appendix 2

Audited Banking Sector Profit & Loss
As at December 2003 & December 2004

Ksh. mn

	December 2004							December 2003			
	Banks	NBFIs	Sub Total	%	BLD Societies	Total	%	Growth	Banks	NBFIs	Sub Total
A. INCOME											
1. Interest on Advances	23,752	1,383	25,135	41%	322	25,457	41%	-9%	25,044	2,282	27,326
2. Interest on Placement	4,763	48	4,811	8%	57	4,868	8%	383%	853	69	922
3. Interest on Govt. Securities	7,239	183	7,422	12%	154	7,576	12%	-27%	9,844	204	10,048
4. Foreign Exc. Gain/(Loss)	4,523	1	4,524	7%	6	4,530	7%	-4%	4,675	30	4,705
5. Other Interest Income	753	8	761	1%	4	765	1%	-3%	758	12	770
6. Other Income	18,822	282	19,104	31%	380	19,484	31%	2%	18,359	282	18,641
7. Total	59,852	1,905	61,757	100%	923	62,680	100%	-2%	59,532	2,880	62,412
B. EXPENSES											
8. Interest on Deposits	5,661	398	6,059	13%	152	6,211	13%	-27%	7,516	646	8,162
9. Other Interest Expenses	299	4	303	1%	2	305	1%	-74%	1,186	5	1,191
10. Occupancy Costs	1,610	72	1,682	4%	118	1,800	4%	-5%	1,708	65	1,773
11. Director's Emoluments	372	9	381	1%	42	423	1%	2%	370	9	379
12. Bad Debts Charge	7,183	335	7,518	16%	97	7,615	16%	-10%	7,272	1,042	8,313
13. Salaries & Wages	14,266	484	14,750	32%	184	14,934	31%	1%	14,036	483	14,519
14. Other Expenses	15,724	319	16,043	34%	210	16,253	34%	11%	13,895	350	14,245
15. Total	45,114	1,621	46,735	100%	805	47,540	100%	-5%	45,983	2,599	48,582
16. Profit Before Tax	14,738	284	15,022		118	15,140		7%	13,549	281	13,830
17. No. of Employees	11,941	355	12,296		398	12,694			11,139	390	11,529
C. PERFORMANCE INDICATORS											
18. Yield on Earning Assets	9.1%	8.6%	9.1%		8.8%	9.1%			10.1%	12.6%	10.2%
19. Cost of Funding Earning Assets	1.3%	2.1%	7.3%		2.5%	7.4%			2.1%	3.2%	2.2%
20. Interest Margin on Earning Assets	7.8%	6.5%	8.7%		6.3%	8.7%			7.9%	9.5%	8.0%
21. Yield on Advances	7.3%	9.9%	5.6%		12.8%	5.6%			9.6%	15.7%	9.9%
22. Cost of Deposits	1.6%	3.1%	1.6%		2.4%	1.6%			2.6%	4.5%	2.7%
23. Return on Assets(Including Contingencies)	2.1%	1.4%	2.1%		1.4%	2.1%			2.3%	1.3%	2.2%
24. Return on Shareholders Funds	22.5%	12.3%	9.0%		10.5%	9.0%			23.7%	12.7%	23.2%
25. Overhead to Earnings	65.4%	64.0%	65.4%		70.5%	65.4%			62.6%	67.7%	62.9%
D. RATINGS											
Capital Adequacy	2.00	1.00	2.00		3.00	2.00			2.00	2.00	2.00
Asset Quality	2.00	5.00	2.00		4.00	2.00			3.00	5.00	3.00
Earnings	2.00	3.00	2.00		3.00	2.00			2.00	3.00	2.00
Liquidity	1.00	1.00	1.00		1.00	1.00			1.00	1.00	1.00
Composite Score	1.75	2.50	1.75		2.75	1.75			2.00	2.75	2.00
Performance Category	Satisfactory	Fair	Satisfactory		Fair	Satisfactory			Satisfactory	Fair	Satisfactory

Key: 1=Strong 2=Satisfactory 3=Fair 4=Marginal 5=Unsatisfactory

Source: Central Bank of Kenya

Appendix 3

Market Share: (Net Assets, Net Advances, Deposits, Capital & Profits). Dec. 2004

Ksh.Mn.											
No	Name of Institution	Total Net Assets	Market Share	Net Advances	Market Share	Total Deposits	Market Share	Capital & Reserves	Market Share	Pre-Tax Pre-Tax	Market Share
1	Barclays Bank of Kenya Ltd	107,530	19.4	63,187	21.8	82,583	18.6	12,485	19.1	5,413	36.7
2	Standard Chartered Bank Ltd	67,306	12.2	26,557	9.2	56,971	12.8	5,419	8.3	2,691	18.3
3	Kenya Commercial Bank Ltd	66,536	12.0	33,644	11.6	54,560	12.3	7,978	12.2	1,076	7.3
4	Co-operative Bank of Kenya	46,476	8.4	27,009	9.3	39,486	8.9	3,299	5.0	354	2.4
5	National Bank of Kenya Ltd	30,594	5.5	22,302	7.7	25,470	5.7	2,625	4.0	743	5.0
6	Citibank, N.A.	25,129	4.5	9,595	3.3	20,001	4.5	3,510	5.4	356	2.4
7	Commercial Bank of Africa	20,176	3.6	5,305	1.8	17,774	4.0	1,812	2.8	416	2.8
8	CFC Bank Limited	17,727	3.2	10,940	3.8	14,268	3.2	1,702	2.6	354	2.4
9	National Industrial Credit Bank	16,636	3.0	11,307	3.9	12,788	2.9	2,644	4.0	373	2.5
10	Investment & Mortgages Bank	14,912	2.7	8,198	2.8	12,554	2.8	1,721	2.6	372	2.5
11	Stanbic Bank Kenya Limited	11,479	2.1	6,991	2.4	8,092	1.8	1,771	2.7	154	1.0
12	Diamond Trust Bank Kenya	11,037	2.0	7,137	2.5	9,203	2.1	1,223	1.9	193	1.3
13	First American Bank Limited	8,928	1.6	5,088	1.8	7,500	1.7	1,325	2.0	214	1.5
14	Bank of Baroda	8,355	1.5	2,692	0.9	7,130	1.6	969	1.5	65	0.4
15	Equity Bank Limited	6,707	1.2	2,874	1.0	5,074	1.1	1,271	1.9	218	1.5
16	Bank of India	6,138	1.1	1,522	0.5	4,935	1.1	959	1.5	123	0.8
17	Fina Bank Limited	5,948	1.1	2,718	0.9	5,021	1.1	786	1.2	-51	-0.3
18	Imperial Bank Limited	5,814	1.1	3,870	1.3	4,662	1.1	876	1.3	268	1.8
19	Prime Bank Limited	5,709	1.0	2,612	0.9	4,737	1.1	670	1.0	103	0.7
20	Bank of Africa	4,945	0.9	3,053	1.1	3,964	0.9	649	1.0	-32	-0.2
21	Giro Commercial Bank	4,744	0.9	3,027	1.0	4,137	0.9	431	0.7	14	0.1
22	Habib AG Zurich	4,453	0.8	1,039	0.4	3,763	0.9	448	0.7	56	0.4
23	Akiba Bank Ltd	4,210	0.8	2,541	0.9	3,169	0.7	604	0.9	-62	-0.4
24	African Banking Corporation	4,188	0.8	2,065	0.7	3,446	0.8	504	0.8	114	0.8
25	Guardian Bank	4,112	0.7	2,876	1.0	3,261	0.7	715	1.1	119	0.8
26	Middle East Bank of Kenya	3,983	0.7	1,608	0.6	3,146	0.7	713	1.1	36	0.2
27	Southern Credit Banking Corp.	3,848	0.7	1,972	0.7	3,203	0.7	504	0.8	61	0.4
28	Victoria Commercial Bank Ltd	3,620	0.7	1,877	0.7	3,049	0.7	507	0.8	45	0.3
29	Charterhouse Bank Limited	3,407	0.6	1,751	0.6	2,820	0.6	503	0.8	43	0.3
30	Habib Bank Limited	3,368	0.6	872	0.3	2,767	0.6	413	0.6	92	0.6
31	Equatorial Commercial Bank	2,873	0.5	1,750	0.6	2,294	0.5	508	0.8	103	0.7
32	Consolidated Bank of Kenya	2,767	0.5	1,129	0.4	1,907	0.4	565	0.9	-71	-0.5
33	K-REP BANK	2,710	0.5	2,044	0.7	1,602	0.4	757	1.2	110	0.7
34	Credit Bank Limited	2,708	0.5	1,352	0.5	2,252	0.5	419	0.6	47	0.3
35	Development Bank of Kenya	2,391	0.4	647	0.2	620	0.1	934	1.4	94	0.6

Cont...

36	Transnational Bank Limited	2,342	0.4	867	0.3	1,229	0.3	1,009	1.5	1,035	7.0
37	Chase Bank Limited	2,086	0.4	1,280	0.4	1,452	0.3	526	0.8	-92	-0.6
38	Oriental Commercial Bank	1,630	0.3	544	0.2	638	0.1	388	0.6	-369	-2.5
39	Fidelity Commercial Bank	1,587	0.3	1,087	0.4	1,277	0.3	262	0.4	2	0.0
40	Industrial Development Bank	1,398	0.3	1,092	0.4	212	0.1	184	0.3	-90	-0.6
41	Paramount-Universal Bank	1,328	0.2	758	0.3	997	0.2	292	0.5	12	0.1
42	Dubai Bank Limited	926	0.2	550	0.2	475	0.1	373	0.6	31	0.2
43	City Finance Bank	543	0.1	308	0.1	74	0.0	417	0.6	11	0.1
44	Daima Bank Limited	403	0.1	218	0.1	669	0.2	-276	-0.4	-3	0.0
	TOTAL	553,707	100.0	289,855	100.0	445,232	100.0	65,394	100.0	14,739	100.0
	NBFI's										
1	Housing Finance Co. of Kenya	9,489	59.1	6,617	66.8	8,012	61.9	1,080	46.6	99	40.7
2	Savings & Loan (K) Ltd	3,858	24.0	1,982	20.0	2,984	23.1	533	23.0	19	7.7
3	Prime Capital and Credit Ltd.	2,704	16.9	1,313	13.3	1,950	15.1	704	30.4	125	51.6
	TOTAL	16,051	100.0	9,912	100.0	12,946	100.0	2,317	100.0	242	100.0
	BUILDING SOCIETIES										
1	East African Building Society	5,610	72.2	1,142	53.9	4,514	71.1	751	74.6	18.0	16.5
2	Family Finance Building Society	2,193	27.6	978	46.1	1,839	28.9	285	25.4	90.9	83.5
	TOTAL	7,803	99.8	2,120	100.0	6,353	100.0	1,036	100.0	109.0	100.0

Appendix 4							
Non-Performing Loans & Provisions - December 2004							
Ksh. "000"							
Name of Institution	1	2	3	4		5	
	Total Non-Perf. Loans	Specific Provisions	Total Loans	NPLS / Total Loans (1/3)	%	Specic Prov./ NPLS (2/1)	%
1 National Bank of Kenya Ltd	17,233,725	12,109,447	34,627,555		49.8		70.3
2 Kenya Commercial Bank Ltd	15,777,723	8,433,969	42,348,284		37.3		53.5
3 Barclays Bank of Kenya Ltd	9,081,239	3,844,032	69,768,719		13.0		42.3
4 Co-operative Bank of Kenya	8,663,321	5,496,106	33,023,932		26.2		63.4
5 Standard Chartered Bank Ltd	1,631,842	255,499	26,960,203		6.1		15.7
6 Oriental Comm. Bank	1,127,826	802,789	1,354,982		83.2		71.2
7 Akiba Bank Ltd	1,042,648	390,332	2,714,538		38.4		37.4
8 Guardian Bank	910,632	281,028	3,222,462		28.3		30.9
9 Consolidated Bank of Kenya	780,662	443,881	1,579,270		49.4		56.9
10 Giro Commercial Bank	774,013	221,655	3,273,717		23.6		28.6
11 Investment & Mortgages Bank	766,030	188,916	8,468,385		9.0		24.7
12 Southern Credit Banking Corp.	651,574	171,748	2,158,701		30.2		26.4
13 National Industrial Credit Bank	589,512	547,716	11,854,340		5.0		92.9
14 First American Bank Limited	577,183	170,370	5,306,264		10.9		29.5
15 Fina Bank Limited	548,473	342,722	3,086,639		17.8		62.5
16 Charterhouse Bank Limited	534,023	213,401	1,983,136		26.9		40.0
17 Daima Bank Limited	500,893	331,443	552,233		90.7		66.2
18 Commercial Bank of Africa	485,196	289,024	5,648,091		8.6		59.6
19 Industrial Development Bank	453,724	126,996	1,226,232		37.0		28.0
20 Paramount-Universal Bank	433,384	100,339	890,197		48.7		23.2
21 Middle East Bank of Kenya	399,801	78,613	1,702,419		23.5		19.7
22 Prime Bank Limited	394,462	146,772	2,782,770		14.2		37.2
23 CFC Bank Limited	393,952	151,836	11,199,634		3.5		38.5
24 Citibank, N.A.	386,237	116,046	9,814,650		3.9		30.0
25 Imperial Bank Limited	373,296	289,956	4,198,043		8.9		77.7
26 Development Bank of Kenya	263,213	111,771	770,357		34.2		42.5
27 Bank of Baroda	234,485	79,498	2,797,686		8.4		33.9
28 Transnational Bank Limited	217,794	157,615	1,044,065		20.9		72.4
29 Fidelity Commercial Bank	196,257	98,583	1,195,961		16.4		50.2
30 Dubai Bank Limited	187,332	61,614	616,771		30.4		32.9
31 Credit Bank Limited	166,572	30,131	1,396,296		11.9		18.1
32 Equity Bank Limited	166,572	99,717	1,396,296		11.9		59.9
33 African Banking Corporation	130,467	45,293	2,130,829		6.1		34.7
34 Chase Bank Limited	118,277	532	1,293,593		9.1		0.4
35 City Finance Bank	115,139	22,966	333,574		34.5		19.9

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36	National Industrial Credit Bank	589,512	547,716	11,854,340	5.0	92.9
37	Oriental Comm. Bank	1,127,826	802,789	1,354,982	83.2	71.2
38	Paramount-Universal Bank	433,384	100,339	890,197	48.7	23.2
39	Prime Bank Limited	394,462	146,772	2,782,770	14.2	37.2
40	Southern Credit Banking Corp.	651,574	171,748	2,158,701	30.2	26.4
41	Stanbic Bank Kenya Limited	100,410	14,204	7,077,673	1.4	14.1
42	Standard Chartered Bank Ltd	1,631,842	255,499	26,960,203	6.1	15.7
43	Transnational Bank Limited	217,794	157,615	1,044,065	20.9	72.4
44	Victoria Commercial Bank Ltd	50,631	30,231	1,926,490	2.6	59.7
	TOTAL	66,978,933	36,622,805	329,672,894	20.3	54.7
	NBFI's					
1	Housing Finance Co. of Kenya	3,924	444	7,092	55.3	11.3
2	Prime Capital and Credit Ltd.	42	36	1,360	3.1	85.2
3	Savings & Loan (K) Ltd	416	270	2,271	18.3	64.9
	TOTAL	4,381	749	10,723	40.9	17.1
	BUILDING SOCIETIES					
1	East African Building Society	886	382	1,531	57.9	43.1
2	Family Finance Building Society	226	216	1,206	18.7	95.6
	TOTAL	1,112	598	2,737	40.6	53.8

Appendix 5

PROFITABILITY OF BANKING INSTITUTIONS FOR THE YEAR 2004

Ksh.Mn.

NO	BANKS	1	2	3	4	5
		PROFIT BEFORE TAX	RETURN ON ASSETS		RETURN ON EQUITY	
			TOTAL ASSETS	RETURN ON ASSETS (1/2) %	SHAREHOLDERS EQUITY	RETURN ON EQUITY (1/4) %
1	Barclays Bank of Kenya Ltd	5,413	115,800	4.67%	12,485	43.36
2	Standard Chartered Bank Ltd	2,691	70,310	3.83%	5,419	49.66
3	Kenya Commercial Bank Ltd	1,076	81,797	1.32%	7,978	13.49
4	Transnational Bank Ltd.	1,035	2,832	36.54%	1,009	102.57
5	National Bank of Kenya Ltd	743	59,727	1.24%	2,625	28.32
6	Commercial Bank of Africa Ltd.	416	21,394	1.94%	1,812	22.95
7	National Industrial Credit Bank Ltd.	373	17,549	2.12%	2,644	14.09
8	Investment & Mortgages Bank Ltd.	372	15,664	2.37%	1,721	21.61
9	Citibank, N.A.	356	26,043	1.37%	3,510	10.14
10	CFC Bank Ltd.	354	18,474	1.91%	1,702	20.77
11	Co-operative Bank of Kenya Ltd.	354	62,088	0.57%	3,299	10.72
12	Bank of Baroda	274	8,654	3.17%	969	28.28
13	Imperial Bank Ltd.	268	6,286	4.26%	876	30.56
14	Equity Bank Ltd.	218	7,161	3.05%	1,271	17.17
15	First American Bank Ltd.	214	9,630	2.23%	1,325	16.18
16	Diamond Trust Bank Kenya Ltd.	193	11,691	1.65%	1,223	15.77
17	Stanbic Bank Kenya Ltd.	154	11,959	1.29%	1,771	8.70
18	Bank of India	123	6,342	1.94%	959	12.82
19	Guardian Bank Ltd.	119	4,851	2.44%	715	16.58
20	African Banking Corporation Ltd.	114	4,321	2.64%	504	22.60
21	K-Rep Bank Ltd.	110	2,851	3.87%	757	14.57
22	Equatorial Commercial Bank Ltd.	103	3,023	3.42%	508	20.34
23	Prime Bank Ltd.	103	6,006	1.71%	670	15.33
24	Development Bank of Kenya Ltd.	94	2,780	3.36%	934	10.02
25	Habib Bank Ltd.	92	3,453	2.65%	413	22.17
26	Southern Credit Banking Corp. Ltd	61	4,453	1.37%	504	12.07
27	Habib AG Zurich	56	4,596	1.22%	448	12.50
28	Credit Bank Ltd.	47	2,708	1.74%	419	11.24
29	Victoria Commercial Bank Ltd	45	3,750	1.21%	507	8.92
30	Charterhouse Bank Ltd.	43	3,773	1.14%	503	8.57
31	Middle East Bank of Kenya Ltd.	36	4,366	0.81%	713	4.98
32	Dubai Bank Ltd.	31	1,146	2.70%	373	8.28
33	Giro Commercial Bank Ltd.	14	5,166	0.27%	431	3.25
34	Paramount-Universal Bank Ltd.	12	2,048	0.58%	292	4.06

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35	City Finance Bank Ltd.	11	624	1.77%	417	2.64
36	Fidelity Commercial Bank Ltd.	2	1,776	0.10%	262	0.65
37	Daima Bank Ltd.	-3	1,060	-0.24%	-276	0.91
38	Bank of Africa	-32	5,188	-0.62%	649	(4.95)
39	Fina Bank Ltd.	-51	6,564	-0.78%	786	(6.49)
40	Akiba Bank Ltd	-62	5,009	-1.24%	604	(10.30)
41	Consolidated Bank of Kenya Ltd.	-71	4,579	-1.55%	565	(12.57)
42	Industrial Development Bank Ltd.	-90	1,844	-4.86%	184	(48.74)
43	Chase Bank Ltd.	-92	2,128	-4.31%	526	(17.42)
44	Oriental Commercial Bank	-369	2,874	-12.83%	388	(95.07)
	SUB-TOTAL	14,948	644,338	2.32%	65,394	22.86
	NBFI'S					
1	Prime Capital & Credit Ltd.	122	2,810	4.33%	704	17.27%
2	Housing Fin. Co. of Kenya Ltd.	99	14,084	0.70%	1,080	9.13%
3	Savings and Loan (K) Ltd.	63	4,429	1.43%	533	11.85%
	SUB-TOTAL	283	21,323	1.33%	2,317	12.23%
	BUILDING SOCIETIES					
1	Family Finace Building Society	91	2,531	3.58%	285	31.81%
2	East African Building Society	27	6,582	0.42%	835	3.29%
	SUB-TOTAL	118	9,113	1.30%	1,120	10.55%
	GRAND TOTAL	15,350	674,774	2.27%	68,831	22.30%

Appendix 6						
Capital and Risk Weighted Assets - December 2004						
Ksh."000"						
	Institution	Core Capital	Total Capital	Overall risk Weighted Assets	Core Capital To Risk Weighted Assets Ratio	Total Capital Risk Weighted Assets Ratio
1	Barclays Bank of Kenya Ltd	10,862,884	10,924,378	83,325,832	13.1%	13.0%
2	Kenya Commercial Bank Ltd	7,716,691	7,986,691	48,406,027	16.5%	15.9%
3	Standard Chartered Bank Ltd	5,191,373	5,327,161	41,250,021	12.9%	12.6%
4	Citibank, N.A.	3,369,871	3,369,871	21,815,532	15.4%	15.4%
5	Co-operative Bank of Kenya	2,973,363	5,205,993	29,906,603	17.4%	9.9%
6	National Industrial Credit Bank	2,349,601	2,556,878	14,529,796	17.6%	16.2%
7	CFC Bank Limited	2,192,587	2,300,644	13,650,298	16.9%	16.1%
8	National Bank of Kenya Ltd	2,077,745	2,201,239	16,069,134	13.7%	12.9%
9	Stanbic Bank Kenya Limited	1,716,399	1,716,399	8,772,909	19.6%	19.6%
10	Investment & Mortgages Bank	1,709,983	1,709,983	11,895,284	14.4%	14.4%
11	Commercial Bank of Africa	1,700,442	1,768,773	9,671,643	18.3%	17.6%
12	First American Bank Limited	1,324,836	1,324,836	7,352,665	18.0%	18.0%
13	Equity Bank Limited	1,282,954	1,310,616	3,942,219	33.2%	32.5%
14	Diamond Trust Bank Kenya	1,146,525	1,153,175	8,274,799	13.9%	13.9%
15	Bank of Baroda	968,842	968,842	2,964,492	32.7%	32.7%
16	Transnational Bank Limited	950,775	969,803	1,225,545	79.1%	77.6%
17	Development Bank of Kenya	933,952	933,952	1,019,788	91.6%	91.6%
18	Imperial Bank Limited	876,474	914,721	4,500,603	20.3%	19.5%
19	K-REP BANK	757,237	779,815	2,242,549	34.8%	33.8%
20	Middle East Bank of Kenya	721,814	736,331	2,595,484	28.4%	27.8%
21	Guardian Bank	715,158	715,158	2,903,540	24.6%	24.6%
22	Prime Bank Limited	670,011	693,971	3,543,063	19.6%	18.9%
23	Bank of Africa	648,545	682,045	4,199,662	16.2%	15.4%
24	Fina Bank Limited	622,960	622,960	3,603,523	17.3%	17.3%
25	Bank of India	622,667	666,236	1,834,398	36.3%	33.9%
26	Akiba Bank Ltd	603,543	620,847	3,265,081	19.0%	18.5%
27	Chase Bank Limited	526,121	526,121	1,488,791	35.3%	35.3%
28	Equatorial Commercial Bank	507,697	507,697	2,104,841	24.1%	24.1%
29	Victoria Commercial Bank Ltd	507,396	507,396	1,882,323	27.0%	27.0%
30	Charterhouse Bank Limited	503,459	503,459	2,346,364	21.5%	21.5%
31	African Banking Corporation	503,221	524,221	2,478,296	21.2%	20.3%
32	Southern Credit Banking Corp.	492,568	495,374	2,383,807	20.8%	20.7%
33	Consolidated Bank of Kenya	461,891	500,680	2,165,653	23.1%	21.3%
34	Habib AG Zurich	444,902	444,902	1,620,526	27.5%	27.5%

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35	Giro Commercial Bank	426,101	426,101	2,734,507	15.6%	15.6%
36	Credit Bank Limited	419,041	432,541	1,439,587	30.0%	29.1%
37	City Finance Bank	416,605	416,605	498,410	83.6%	83.6%
38	Habib Bank Limited	413,139	413,139	891,241	46.4%	46.4%
39	Oriental comm bank	375,677	384,098	1,226,593	31.3%	30.6%
40	Dubai Bank Limited	372,674	372,674	873,194	42.7%	42.7%
41	Paramount-Universal Bank	281,919	288,174	837,757	34.4%	33.7%
42	Fidelity Commercial Bank	263,077	263,077	1,241,442	21.2%	21.2%
43	Industrial Development Bank	185,360	185,360	1,428,202	13.0%	13.0%
44	Daima Bank Limited	(276,057)	(276,057)	237,150	-116.4%	-116.4%
	TOTAL	61,532,023	65,076,880	380,639,174	16.2	17.1
	NBFI's					
1	Housing Finance Co. of Kenya	979,455	1,055,312	7,618,720	12.9	13.9
2	Prime Capital and Credit Ltd.	702,416	713,739	1,638,164	42.9	43.6
3	Savings & Loan (K) Ltd	474,715	546,670	2,281,303	20.8	24.0
	TOTAL	2,156,586	2,315,721	11,538,187	18.7	20.1
	BUILDING SOCIETIES					
	East African Building Society	265,415	349,207	3,278,325	8.1	10.7
	Family Finance Building Society	253,325	265,438	1,450,109	17.5	18.3
	TOTAL	518,740	614,645	4,728,434	11.0	13.0

Appendix 7				
Classification of Loans				
Ksh.Mn.				
No.	Item	2004	2003	% change
1	Normal	227,041	160,905	41%
2	Watch	43,620	45,074	-3%
3	Substandard Accounts	11,307	12,386	-9%
4	Doubtful Accounts	47,450	47,981	-1%
5	Loss Accounts	53,132	49,532	7%
6	Gross Loans (1+ 2+ 3+ 4+ 5)	382,550	315,878	21%
7	Gross NPLs (3+ 4+ 5)	111,889	109,899	2%
8	Total Loans (6-9)	343,133	276,732	24%
9	Interest Suspended	39,417	39,146	1%
10	Specific Provisions Held	37,763	33,390	13%
11	General Provisions	3,403	2,706	26%
12	Net Loans (8-10-11)	301,967	240,636	25%
13	Total NPLs (7 - 9)	72,472	70,753	2%
14	Net NPLs (13-10)	34,709	37,363	-7%
15	Value of Securities (estimated)	32,266	34,302	-6%
16	Net Exposure (14-15)	2,443	3,061	-20%
17	Gross Provisions (9+ 10+ 11)	80,583	75,242	7%
18	Total Provisions (10+ 11)	41,166	36,096	14%
19	Total NPLs/ Total Loans (13/8)	21%	26%	
20	Net NPLs/Net Loans (14/12)	11%	16%	
21	Total Provisions/Total Loans (18/8)	12%	13%	
22	Net Exposure/Total Loans(16/8)	0.7%	1.1%	

Appendix 8

PROPOSED CHANGES TO THE PRUDENTIAL REGULATIONS

	Regulation	Key Proposed Change(s)	Rationale for the Change
1.	CBK/RG/01-Capital Adequacy	<ul style="list-style-type: none"> • Exclusion of fair value gains and losses on investment property from core capital computation. • Inclusion of foreign treasury bills and bonds in definition of risk-weighted assets. • Adopt the original exposure method recommended by the Basel Committee to compute the credit equivalent amount of forward exchange contracts. 	<ul style="list-style-type: none"> • Take into account International Financial Reporting Standard (IFRS) 40 on investment property. The standard requires that investment property be revalued each year and the gains or losses passed through the profit and loss account. • To take note of increased investment in government securities by banks outside Kenya. • Adoption of international best practice.
2.	CBK/RG/02-Foreign Currency Exposure	<ul style="list-style-type: none"> • Incorporation of intercompany balances denominated in foreign currency in the computation of foreign exchange exposure. 	<ul style="list-style-type: none"> • Intercompany balances denominated in foreign currency are increasingly prevalent especially in multinational banks.
3.	CBK/RG/03-Enforcement of Banking Laws and Regulations	<ul style="list-style-type: none"> • Deletion of reference to formal and informal enforcement action and their replacement with the phrase "enforcement actions" 	<ul style="list-style-type: none"> • The enforcement actions contained in the regulation are all formal in nature.

4.	CBK/RG/04-Licensing of New Institutions	<p>The following additional requirements for licensing of new institutions are proposed:</p> <ul style="list-style-type: none"> - • Confirmation from the home country supervisor that the promoters of a foreign incorporated bank do not operate a shell bank. • The home country supervisor shall exchange supervisory information with the Central Bank of Kenya. 	<ul style="list-style-type: none"> • Prevent the use of shell banks for money laundering. • Facilitate the monitoring of the performance of foreign incorporated banks.
5.	CBK/RG/05-Liquidity Management	<ul style="list-style-type: none"> • Separation of leasehold land from fixed assets in the maturity analysis return, which falls under this regulation. 	<ul style="list-style-type: none"> • Take into account IFRS 17 which requires that leasehold land be separated from fixed assets.
6.	CBK/RG/06-Prohibited Business	<ul style="list-style-type: none"> • Incorporation of a definition of large exposures as all credit facilities granted to a person and his associates above 10% of an institution's core capital. • Deletion of restrictions on mortgage finance companies. 	<ul style="list-style-type: none"> • The current regulation makes reference to "large exposures", which are not defined in the definition section of the regulation. • The restrictions on mortgage finance companies are no longer applicable following amendments to the Banking Act.
7.	CBK/RG/07-Conduct, Duties and Responsibilities of Directors, Chief Executive Officers, Managers, Other Employees and Shareholders.	<ul style="list-style-type: none"> • Combination of the current CBK/RG/07 on the code of conduct for Directors, Managers and other employees with the current CBK/RG/08. CBK/RG/08 covers the duties and responsibilities 	<ul style="list-style-type: none"> • Both regulations relate to corporate governance in banks.

8.	CBK/RG/09- Regulation on Appointment of External Auditors	<ul style="list-style-type: none"> • An Auditor or any partner should not be a member of the board of that institution or any other institution or the Central Bank. 	<ul style="list-style-type: none"> • To avoid conflict of interest.
9.	CBK/RG/11- Mergers, amalgamations, transfers of assets and liabilities.	<ul style="list-style-type: none"> • Incorporation of the definitions of the terms: - <ul style="list-style-type: none"> ❖ Acquisition. ❖ Amalgamation. ❖ Merger. ❖ Take-over. ❖ Consolidation. ❖ Transfer of assets and liabilities. ❖ Partial transfer of assets and liabilities. 	<ul style="list-style-type: none"> • The current regulation does not define some crucial terms to which it refers.
10.	CBK/RG/12-Money Laundering	<ul style="list-style-type: none"> • Board of Directors of an institution should ensure that management: - <ul style="list-style-type: none"> ❖ Maintain adequate records for a minimum of 6 years regarding the sources of funds. ❖ Train staff on a regular basis on the prevention, detection and control of money laundering and the identification of the proceeds of crime. • Institutions should formulate policies on the maximum cash transaction amounts non-customers can undertake with them. 	<ul style="list-style-type: none"> • Incorporate best practice as stipulated by the Financial Action Task Force (FATF).
11.	CBK/RG/13- Licensing New Place of Business and Closures	<ul style="list-style-type: none"> • An additional requirement was added that institutions should comply with the statutory minimum capital requirements and be rated at least fair by the Central Bank before approval can be granted for new places of business. 	<ul style="list-style-type: none"> • To prevent weak banks from further erosion of their capital base through the opening of new branches.

12.	CBK/RG/13- Publication of Accounts.	<ul style="list-style-type: none"> • Reporting of assets and liabilities gross of interest. • Separate disclosure of leasehold land from fixed assets. • Disclosures of investments in commercial paper and corporate bonds under loans and advances. 	<ul style="list-style-type: none"> • Incorporate new disclosure requirements stipulated by various International Financial Reporting Standards (IFRS).
13.	Proposed CBK/RG/14- Dormant Accounts	<ul style="list-style-type: none"> • Segregation of dormant accounts from active accounts. • Submission to the Central Bank of a dormant accounts return on an annual basis. 	<ul style="list-style-type: none"> • Protection of the interests of dormant account holders.

Appendix 9

Financial Institutions Supervision Circulars Issued in 2004

Circular No.	Date of issue	Title	Subject
1	05.02.2004	Daily compliance returns	Revise the schedule of the daily compliance report to reflect changes introduced by the finance Act.
2	11.02.2004	Bank charges as at 31 st January 2004	Commercial banks and Nonbank financial institutions to forward their tariff of charges as at 31 st January 2004 to enable Central Bank update its records.
3	26.02.2004	Revised Table of the CBK BS(M) Return	The institutions were advised of the revision of Table F of the BSM.
4	01.03.2004	Submission of monthly returns	The circular brought forward the reporting date for all monthly returns specifically PR7 and PR8 to not later than 10 th day of the following month.
5	29.04.2004	Public sector Deposits and Borrowings in the banking sector	All institutions licensed under the banking Act are required to submit to the minister through central bank, quarterly information on public sector deposits and borrowings in the banking system beginning 31 st December 2002.
6	02.07.2004	Submission of returns on Bank charges and Tariffs	All institutions licensed under the banking Act are required to submit to Central Bank all bank charges/tariffs.
7	20.09.2004	<ul style="list-style-type: none"> i) Default on cash ratio Account ii) Overdrawn clearing and settlement Account 	To remind commercial banks that accounts maintained at Central Bank must remain in credit at all times and all banks' returns must be submitted within the stipulated period.

Appendix-10

INSTITUTIONS OPERATING IN KENYA AS AT DECEMBER 2004

A). COMMERCIAL BANKS

NAME	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED	BRANCHES		AGENCIES AND OTHERS
			FULL	SUB	
1. AFRICAN BANKING CORP. LTD	ABC Bank Mezzanine Floor Koinange Street	1.5.1984	8	-	-
2. AKIBA BANK LTD.	Fedha Towers Muindi Mbingu St. Nairobi	1972	5		
3. BANK OF AFRICA KENYA LTD	Plaza Taifa Road				
4. BANK OF BARODA (K) LTD.	Bank of Baroda Building Baroda house Koinange Street	1.7.1953	6	-	-
5. BANK OF INDIA	Kenyatta Avenue	5.6.1953	2	-	-
6. BARCLAYS BANK OF KENYA LTD.	Barclays Plaza Loita Street	1966	46	3	8
7. CFC BANK LIMITED	CFC Centre Chiromo road Westlands	14.05.55	5		
8. CHASE BANK (KENYA) LTD.	Prudential Ass. Building 6th Floor. Wabera Street	1.4.1991	1	-	1

NAME	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED	FULL	SUB	AGENCIES AND OTHERS
9. CHARTERHOUSE BANK LTD.	Longonot Place	11.11.96	2		
9. CHARTERHOUSE BANK LTD.	Longonot Place 6th. Floor Kijabe Street				
10. CITIBANK N.A.	Citibank House	1.7.1974	3		1
11. CITY FINANCE BANK LTD.	Unity House Koinange St.	10.09.1984	1		
12. COMMERCIAL BANK OF AFRICA LTD.	Wabera Street	01.01.1967	6		8
13. CONSOLIDATED BANK OF KENYA LTD.	Consolidated Bank Hse. Koinange Street New Location-(H.Q)	18.12.1989	12	-	-
14. CO-OPERATIVE BANK OF KENYA LTD.	CO-OPERATIVE HOUSE	1965	30	0	15
15. CREDIT BANK LIMITED	Ground Floor Mercantile Hse Koinange st.	14.5.1986	3	-	-
16. DAIMA BANK LTD. (Currently in liquidation)	Utalii House Off Uhuru Highway	1.9.1992	2	-	-
17. DEVELOPMENT BANK OF KENYA LTD.	Finance House Loita Street	1973	1	-	-

NAME	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED	FULL	SUB	AGENCIES AND OTHERS
18. DIAMOND TRUST BANK KENYA LTD.	Nation Centre- 8th Floor Kimathi Street	1946	5		
19. DUBAI BANK KENYA LIMITED	I.C.E.A Building Kenyatta avenue	1982	3	-	-
20. EQUATORIAL COMMERCIAL BANK LTD	Sasini House Loita street	20.12.95	3		
21. EQUITY BANK	Fouways Towers Muindi Mbingu Street				
22. FIDELITY COMMERCIAL BANK LTD.	I.P.SBldg. 7th Floor Kimathi St.	1.6.1992	2		
23. FINA BANK LIMITED.	Fina House Kimathi Street	1986	2		2
24. FIRST AMERICAN BANK OF KENYA LTD.	I.C.E.A Building Kenyatta Ave. 6TH&7TH FLOORS	1987	3	-	-
25. GUARDIAN BANK LIMITED.	Baba Dogo & Main branch Moi Avenue Nairobi	17.12.1992	6		

NAME	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED	FULL		SUB
26. GIRO COMMERCIAL BANK LIMITED	Giro House Kimathi Street	17.12.1993	6		-
27. HABIB BANK A.G. ZURICH	National House Koinange Street	1.7.1978	5		-
28. HABIB BANK LTD.	Exchange Building Koinange Street	2.3.1956	7		-
29. IMPERIAL BANK LTD.	Bunyala Road Upper Hill	1.11.1992	4		
30. INDUSTRIAL DEVELOPMENT BANK LTD.	National Bank Building Harambee Avenue	1973	1		
31. INVESTMENTS & MORTGAGES BANK LTD.	I & M Bank Tower 2nd Ngong Avenue	1974	7		
32. KENYA COMMERCIAL BANK LTD.	Moi Avenue		87		26
33. K-REP BANK LIMITED	Naivasha Road Riruta	25.03.99		3	

NAME OF INSTITUTION	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED	FULL	SUB	AGENCIES AND OTHERS
34. MIDDLE EAST BANK KENYA LTD.	Mebank Tower Milimani Road Nairobi	Oct.1980	3	-	-
35. NATIONAL BANK OF KENYA LTD	National Bank Building Harambee Avenue	1.1.1968	24		6
36. NATIONAL INDUSTRIAL CREDIT BANK LTD.	N.I.C. House Masaba Road	17.9.1959	4		
37. ORIENTAL COMMERCIAL BANK	Finance Hse.	02.08.91	5	-	-
38. PARAMOUNT UNIVERSAL BANK LTD.	Koinange St. Sound Plaza Building Westlands	1.10.93	3		
39. PRIME BANK LTD.	Kenindia Hse. Loita Street	1.3.92	7	-	-
40. SOUTHERN CREDIT BANKING CORP. LTD.	Off Muranga Road	1.10.80	6		
41. STANBIC BANK KENYA LIMITED.	Stanbic Bank Building Kenyatta Ave.	9.5.1970	3	-	
42. STANDARD CHARTERED BANK (K) LTD.	Stanbank House Moi Avenue	1.10.1910	28	2	0
43. TRANS - NATIONAL BANK LTD.	Transnational Plaza Mama Ngina Street	1.8.1985	6	-	-
44. VICTORIA COMMERCIAL BANK LTD.	Victoria Towers Kilimanjaro Ave. Upper Hill	1.6.1987	1		

B). FINANCIAL INSTITUTIONS						
NAME OF INSTITUTION	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED	FULL	SUB	AGENCIES AND OTHERS	
2. PRIME CAPITAL AND CREDIT LTD.	Kenindia House Loita Street 4th Floor	1.11.1987	1			
C). MORTGAGE FINANCE COMPANIES						
NAME OF INSTITUTION	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED	FULL	SUB	AGENCIES AND OTHERS	
1. HOUSING FINANCE CO. (K) LTD.	Rehani House, Kenyatta Avenue	7.5.1965	10			
2. SAVINGS AND LOAN (K) LTD.	Salama House Mama Ngina Street	1995	8			

D). BUILDING SOCIETIES						
NAME OF BUILDING SOCIETY	PHYSICAL ADDRESS OF HEAD OFFICE	DATE LICENSED	FULL	SUB	AGENCIES AND OTHERS	
1. EAST AFRICAN BUILDING SOCIETY	Fedha Towers Muirindi Mbingu Street	16.10.1958	9			
2. FAMILY FINANCE BUILDING SOCIETY	Fourways Towers Muirindi Mbingu Street	1984.00	13			
3. PRUDENTIAL BUILDING SOCIETY (Currently in liquidation)	Protection House Haile Selassie Avenue Parliament Road	1984.00	1			
E) REPRESENTATIVE & REGIONAL OFFICES						
NAME OF REPRESENTATIVE OFFICE	PHYSICAL ADDRESS	YEAR ESTABLISHED				
1. ABN-AMRO BANK N.V	Triad House, 83 Muthaiga Road	13.5.1951				
NAME OF REGIONAL OFFICE	PHYSICAL ADDRESS	YEAR ESTABLISHED				
1. P.T.A. BANK	NSSF Building 22nd & 23rd Floors Bishops Road	1991				

OVERSEAS AFFILIATIONS		
NAME	PHYSICAL ADDRESS	YEAR ESTABLISHED
1. PRIME CAPITAL AND CREDIT LIMITED	Delamere Hse. Victoria Ave. Blantyre, MALAWI.	1994
2. DIAMOND TRUST BANK LIMITED	Diamond Trust 17/19 Kampala Road	1965
	Diamond Jubilee Bld. 2nd Floor	1965
3. KENYA COMMERCIAL BANK LIMITED	Peugeot House 38 Upanga Road	1997
BANKING REGULATOR		
NAME OF BANKING REGULATOR	PHYSICAL ADDRESS	YEAR ESTABLISHED
CENTRAL BANK OF KENYA	Central Bank Building Haile Selassie Avenue Nairobi	1966

Appendix 11

Directory of Foreign Exchange Bureaus as at December 2004

	NAME	PHYSICAL ADDRESS
1	AMEX FOREX BUREAU LTD P.O. Box 45448 Nairobi	IPSBUILDING Standard Street
2	COSMOS FOREX BUREAU LTD P.O. Box 10284-00100 Nairobi	Rehema House Standard Street
3	ARISTOCRATS FOREX BUREAU LTD P.O. Box 10884 Nairobi	Kenindia House
4	BAY FOREX BUREAU (NRB) LTD P.O. Box 42909-00200 Nairobi	The Stanley Bld Kenyatta Avenue
5	BLUE NILE FOREX BUREAU LTD P.O. Box 47740 Nairobi	I & M Towers
6	BLUE SEAS FOREX BUREAU LTD P.O. Box 66012 Nairobi	Clyde House Kimathi Street
7	CAPITAL FOREX BUREAU LTD P.O. Box 54210 Nairobi	Jubilee Insurance House
8	CENTRAL FOREX BUREAU LTD P.O. Box 43966 Nairobi	Posta Sacco Plaza
9	CHASE BUREAU DE CHANGE LTD P.O. Box 45746 Nairobi	Gillfillan House

Cont...

10	CONTINENTAL FOREX BUREAU LTD P.O. Box 49580 Nairobi	Old Mutual Building Kimathi Street
11	CRATER FOREX BUREAU LTD P.O. Box 7357 Nakuru	Menengai Motors George Morara Avenue
12	CROWN BUREAU DE CHANGE (K) LTD P.O. Box 22515 Nairobi	Corner House
13	DIANI FOREX BUREAU LTD P.O. Box 90775 Mombasa	Paradise Cottages Diani
14	DOLLAR FOREX BUREAU LTD P O Box 1722 Malindi	FN Centre Lamu Road Malindi
15	DOWNTOWN CAMBIO LTD P.O. Box 42444 Nairobi	Wilson Airport
16	FINERATE FOREX BUREAU LTD P.O. Box 10733-00100 Nairobi	Bruce House
17	FOREX BUREAU AFRO LTD P.O. Box 14353 Nairobi	Jamia Plaza Kigali Street
18	FORT JESUS FOREX BUREAU LTD P.O. Box 89991 Mombasa	Old Town Mombasa
19	GIANT FOREX BUREAU DE CHANGE LTD P.O. Box 56947 Nairobi 00200	Unit 1 - Departure KIA
20	GLORY FOREX BUREAU LTD P.O. Box 42909 Nairobi	Norwich Union House, Kimathi Street

Cont...

21	GOLDFIELD FOREX BUREAU LTD P.O. Box 46371 - 00100 Nairobi	Fedha Towers Nairobi
22	LINK FOREX BUREAU (K) LTD P.O. Box 11659-00400 Nairobi	Uganda House, Kenyatta Avenue
23	JODECI BUREAU DE CHANGE LTD P.O. Box 21819 Nairobi	Unit 1, KIA
24	KAREN BUREAU DE CHANGE P.O. Box 24763 Nairobi	Karen Provision Stores Corner Langata Rd/Ngong Road
25	LEO FOREX BUREAU LTD P.O. Box 82304 Mombasa	T.SS Towers Nkrumah Road Mombasa
26	MAX FAIR FOREX BUREAU LTD P.O. Box 10334 GPO Nairobi	Standard Building Wabera Street
27	METROPOLITAN BUREAU DE CHANGE LTD P.O. Box 7080 Nairobi	Unit 2 - Departure KIA
28	MIDDLETOWN FOREX BUREAU LTD P.O. Box 41830 Nairobi	Westminister House(Kaunda Street)
29	MUTHAIGA FOREX BUREAU LTD P.O. Box 63533 Nairobi	Muthaiga Shopping Centre Nairobi
30	NAIROBI BUREAU DE CHANGE LTD P.O. Box 54210 Nairobi	Unit 2 KIA

Cont...

31	NAIROBI FOREX BUREAU LTD P.O. Box 73194 Nairobi	Gujarat House, Muindi Mbingu St.
32	LANGATA FOREX BUREAU LTD P.O. Box 13580 Nairobi	Mercantile House Loita Street
33	OVERSEAS FOREX BUREAU LTD P.O. Box 66864 00800 Nairobi	View Park Towers Monrovia/Utalii St.
34	PEARL FOREX BUREAU LTD P.O. Box 58059 00200 Nairobi	Hurlingham Shopping Centre
35	PEL FOREX BUREAU LTD Kisumu P O Box 957	Allmran Plaza, Oginga Odinga Road, Kisumu
36	PINNACLE FOREX BUREAU LTD P.O. Box 10020 Nairobi	Corner House, Kimathi Street
37	PWANI FOREX BUREAU LTD P.O. Box 87200 Mombasa	Mombasa Block 404 XVII/MI Abdel Nasseiz
38	ABC PlaceFOREX BUREAU LTD P.O. Box 63533 - 00619 Muthaiga Nairobi	ABC, PLACE, Wayiaki Way
39	SOLID EX CHANGE BUREAU LTD P.O. Box 19257 Nairobi	JIA
40	SPEEDY FOREX BUREAU LTD P.O. Box 45888 Nairobi	Jubilee Insurance Exchange Kaunda Street
41	STERLING FOREX BUREAU LTD P.O. Box 43673 Nairobi	Laxmi Plaza Biashara Street
42	TAIPAN FOREX BUREAU LTD* P. O. Box 42909 Nairobi	Stanley Hotel Building
43	TRADE BUREAU DE CHANGE LTD P.O. Box 7080 Nairobi	Cotts House City Hall Way Transnational Bank Nairobi

44	TRAVELLERS FOREX BUREAU LTD P.O. Box 13580 Nairobi	The Mall Westlands
45	UNION FOREX BUREAU LTD P.O. Box 43847 Nairobi	Sarit Centre, Westlands
46	VILLAGE MARKET FOREX BUREAU LTD P.O. Box 625 Village Market Nairobi	Village Market Complex, Limuru Road
47	WALLSTREET FOREX BUREAU LTD P.O. Box 6841 Eldoret	Bargetuny Plaza, Uganda Road Eldoret
48	YAYA CENTRE EXCHANGE BUREAU LTD P.O. Box 76302 Nairobi	Yaya Centre
49	ALPHA FOREX BUREAU LTD P.O. Box 1272 NAIROBI	Westlands
50	AMAL EXPRESS FOREX BUREAU LTD P.O. Box 3165-00100 Nairobi	Baraka Plaza Eastleigh, Nairobi
51	AMANA FOREX BUREAU LTD P.O. Box 70207 NAIROBI	Eastleigh, Sect VIII, 1st Ave. Nairobi
52	ARCADE FOREX BUREAU LTD P.O. Box 58059 NAIROBI	Adams Arcade Nairobi
53	BAMBURI FOREX BUREAU LTD P.O. Box 97803 MOMBASA	Nyali, Mombasa
54	COAST FOREX BUREAU LTD P.O. Box 86517 MOMBASA	Fontanella Mombasa
55	DAHAB SHILL FOREX BUREAU LTD P.O. Box 68991-0622 Nairobi	Lorhno House NAIROBI

56	DALMAR EX CHANGE BUREAU LTD	Eastleigh Nairobi
57	DALSAN FOREX BUREAU LTD P.O. Box 50418 NAIROBI	Dalsan House Eastleigh 2nd Ave
58	EURO DOLLAR BUREAU DE CHANGE LTD P.O. Box 82434 MOMBASA	Mpaka House Westlands Nairobi
59	FULUS BUREAU DE CHANGE LTD	Nkrumah Rd Mombasa
60	GATEWAY FOREX BUREAU LTD P.O. Box 68975 Nairobi	Eastleigh Sec II
61	GIVE AND TAKE FOREX BUREAU LTD P.O.Box 51463-002000 Nairobi	Gigiri Nairobi
62	GIGIRI FOREX BUREAU LTD P.O.Box 45448 Nairobi	Gigiri Shopping Centre
63	GNK FOREX BUREAU LTD P.O.Box 61300-002000 Nairobi	Jubilee Centre Karen, Nairobi
64	HILL FOREX BUREAU LTD P.O.Box 21819-00400, Nairobi	Upper Hill
65	HURLINGHAM FOREX BUREAU LTD P.O. Box 111, Nairobi	Hurlingham
66	INDUSTRIAL AREA FOREX BUREAU DE CHANGE LTD P.O.Box 45746, Nairobi	Industrial Area Nairobi,
67	ISLAND FOREX BUREAU LTD P.O.Box 84300 Mombasa	Moi Avenue MOMBASA
68	KA AH FOREX P.O.Box 22422, Nairobi	Eastleigh, Sec. II, NAIROBI
69	KENZA EX CHANGE BUREAU LTD P.O.Box 21819-00400, Nairobi	JKIA, Arrival NAIROBI
70	LACHE FOREX BUREAU P.O Box 16152-00100 Nairobi	NHIF Building Upper Hill

71	MANDEEQ FOREX BUREAU LTD P.O.Box 85670, Mombasa	Nasir Road MOMBASA
72	MANO FOREX BUREAU LTD P.O.Box 46240-00100, Nairobi	Hurlingham Nairobi
73	MARITIME FOREX BUREAU LTD P.O.Box 43296, Mombasa	Diani Mombasa
74	MASAI MARA FOREX BUREAU LTD	Maa Towers Narok
75	NAAMAGA FOREX BUREAU LTD P.O.Box 74093 Nairobi	Namanga
76	NAWAL FOREX BUREAU LTD P.O.Box 43888, Nairobi	Chaka Road Chaka Place
77	NORWOOD FOREX BUREAU LTD P.O.Box 17967, Nairobi	Eastleigh Nairobi
78	PENGUIN FOREX BUREAU LTD P.O. Box 3438, Mombasa	Nkrumah Rd Mombasa
79	PEAKTOP FOREX BUREAU P.O Box 13074-00100 Nairobi	Twiga Towers Nairobi
80	RIFT VALLEY FOREX BUREAU LTD P.O. Box 12165	Nakuru
81	SHEPHERDS FOREX BUREAU LTD P.O.Box 63533, Nairobi	Muthaiga Nairobi
82	SUNSHINE FOREX BUREAU LTD P.O. Box 68991 Nairobi	Eastleigh, 2nd Avenue NAIROBI
83	SATELLITE FOREX BUREAU P.O Box 43617-00100, Nairobi	Eastleigh, 2nd Avenue, Nairobi
84	TAWAKAL FOREX BUREAU LTD P.O.Box 71623 Nairobi	Eastleigh Nairobi
85	TAWFIQ FOREX BUREAU LTD P.O. Box 12338 Nairobi	Eastleigh Al- Amin Complex, 1st Ave Nairobi

86	UBANSTAR FOREX BUREAU LTD P.O. Box 78001, Nairobi	Gigiri, NAIROBI
87	WARWICK FOREX BUREAU LTD P.O. Box 30687 00100 Nairobi	The Warwick Center, GIGIRI, NBI
88	WESTERN FOREX BUREAU LTD P.O.Box 18572 Nairobi	Cabana Complex, Mombasa Rd NAIROBI
89	WESTLANDS FOREX BUREAU LTD P.O. Box 45746, Nairobi	Westlands Nairobi

*Financial Institutions Supervision Annual Report, prepared by the
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<http://www.centralbank.go.ke>

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CENTRAL BANK OF KENYA

