

**TALKING POINTS FOR THE PRESENTATION ON SECTION 33C OF THE BANKING ACT**  
*National Assembly Departmental Committee*  
*on Finance and National Planning*

*Dr. Patrick Njoroge, Governor, Central Bank of Kenya*  
*February 26, 2019*

Hon. Members, I am delighted to appear today before this Departmental Committee on Finance and National Planning. I am grateful to you for the flexibility you allowed in arranging this meeting. At the outset, I want to make three points.

First, I acknowledge the letters I received in the recent past requesting me to appear before this Committee. I want to state our desire to meet with you, only that the scheduling did not allow this to happen sooner as I indicated in my replies. In replying to the letter of February 5, 2018, I indicated our desire to appear before the committee as soon as we could, and I also answered some of the questions. Hon. Members, I am prepared to address the remaining concerns. *Kulingana na methali “Mgeni njoo, mwenyeji apone”*.

Second, I want to assure Hon. Members that the Central Bank of Kenya (CBK) serves the public interest. Everything we do is according to its mandate, ultimately for the prosperity of all Kenyans. On the specific questions, we are responding to the current challenges which are not only national but global—terrorism, money laundering, and corruption—and whose consequences are dire.

Third, we serve always and everywhere in accordance with the Constitution and all applicable laws. Nevertheless, a collaborative effort with all bodies is called for. In particular, we appreciate the National Assembly’s role and welcome its support.

If you will allow me, Hon. Members, I will now explain the recent Amendment to the Banking Act, (Section 33C) how CBK has acted to implement it, the difficulties in implementing this Amendment, and what is at stake. I will also explain the background to CBK’s circular on large cash transactions. You will see that, as never before, we are looking over the edge of an abyss. The economy has taken many blows over the years and proved resilient. This one though would be self-inflicted.

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On October 1, 2018, following the coming into force of Section 65 of the Finance Act (2018) the Banking Act was amended to include a new Section 33C. In one stroke, Kenya was on the brink of rolling back key instruments in the fight against corruption, money laundering, and financing of terrorism, bringing to nought the hard-fought gains. The amendment refers directly to cash transactions but has far-reaching implications.

## Section 33C of the Banking Act - Summary

Section 33 of the Banking Act became effective on October 1, 2018 requiring:

- CBK to develop regulations prescribing conditions on deposits and withdrawals
- The regulations should be developed within thirty days from the date of coming into force of Section 65 of the Finance Act (i.e., by October 31, 2018)
- No other persons other than CBK can issue regulations on deposits and withdrawals
- All existing guidelines or regulations on deposits and withdrawals by customers would become null and void within fourteen days of the coming into force of the regulations made under Section 33C
- Preparing the regulations should comply with the requirements of the Statutory Instruments Act, 2013

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Has CBK acted to implement the Amendment? Yes, CBK first saw the amendment after it had become effective, but embarked on understanding and implementing it. To be clear, CBK had not been made aware or otherwise consulted in formulating the amendments, so we had no lead time.

## Section 33C of the Banking Act - Current Status

- Amendment became effective on October 1, 2018. The stipulated 30-day period to make regulations ended on October 31, 2018
- CBK was not consulted in formulation of this amendment
- CBK commenced developing the indicated regulations and encountered significant difficulties
- CBK sought guidance from the Attorney General (AG) on October 26, 2018
- On November 30, 2018, a civil rights group sued the National Assembly and the AG on the amendment through High Court Constitutional Petition No. 426 of 2018
- CBK was enjoined in the suit as an interested party
- The case is scheduled for hearing on March 29, 2019
- CBK Governor was invited by the National Assembly Departmental Committee on Finance and National Planning to discuss implementation of the amendment on February 12, 2019

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- The initial objective was to gather in one place all regulations concerning cash deposits and withdrawals. Significant difficulties emerged right away, one of which is that the stipulated timelines were impossible – the existing regulations just could not be brought together, reviewed by the public, reviewed by the Attorney General, then brought to Parliament and then made effective all within 30 days. In fact, theoretically it takes a minimum of 90 days but in practice recent legislations have taken 1<sup>1/2</sup> years and more.
- In the circumstances we sought guidance from the Attorney General.
- There have been further developments that I will come back to later in my presentation.

Why is it impossible to implement the Amendment? What difficulties arise?

## Some Difficulties Implementing Section 33C of the Banking Act

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| <ul style="list-style-type: none"> <li>• There are a variety of requirements in the Banking Act and other laws on deposits and withdrawals which need to be wrapped into the proposed regulations</li> <li>• The amendment attempts to override other requirements on deposits and withdrawals that may be set by banks for their customers in terms and conditions</li> <li>• The amendment will conflict with POCAMLA</li> </ul> | <ul style="list-style-type: none"> <li>• The amendment attempts to annul the United Nations Security Council Resolutions that relate to AML/CFT. Kenya is a signatory of the UN Treaty and is therefore bound by these resolutions</li> <li>• The amendment does not ensure the safety and soundness of bank transactions. Current processes were intended to strengthen safety and soundness of bank transactions benefitting from experiences in other countries</li> </ul> |
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- The Amendment requires bringing together a variety of requirements in the Banking Act and other laws on deposits and withdrawals. Requirements set by banks for their customers, their terms and conditions, would also need to be wrapped in (including ATM limits, hours for accessing the bank).
- POCAMLA also has requirements on cash transactions, and these will conflict with the Amendment.
- Similarly by treaty, Kenya is subject to the resolutions of the UN Security Council, including on aspects of cash transactions. The amendment would conflict with that.

- The Amendment does not ensure the safety and soundness of bank transactions. In addition, it does not allow the needed flexibility even in cases of “clear and present” danger.

Can I describe Kenya’s AML/CFT framework? Yes, I will, but we must first acknowledge that Kenya remains vulnerable to risks from money laundering and the financing of terrorism, by virtue of its location, advanced financial sector, cash-based economy, and instances of the underlying crimes. To set the stage, I will first describe the tenets of an effective AML/CFT framework.

## Effective AML/CFT Framework

The tenets of an effective AML/CFT framework are:-

 <p><b>Know Your Customer/ Customer Due Diligence measures</b></p> <p>identity of customer, beneficial owner, nature of business and source of funds</p>	 <p><b>Monitoring of transactions</b></p> <p>monitoring of all complex, unusual, suspicious, large transactions and reporting of suspicious transactions</p>	 <p><b>Cash Reporting</b></p> <p>reporting of large cash transactions</p>	 <p><b>Record keeping</b></p> <p>obtaining and keeping records of all transactions and customers</p>	 <p><b>Internal controls</b></p> <p>obligation to establish robust governance structures and internal reporting procedures</p>	 <p><b>Criminalization</b></p> <p>criminalizing money laundering and terrorism financing</p>
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- Global AML/CFT standards are set by the FATF
- Kenya committed to adhering to global AML/CFT standards in 1999

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- The framework is intended to protect the financial sector from abuse. An effective framework strengthens the sector’s integrity, and that illicit funds do not flow through the financial sector.
- The tenets of effective AML/CFT include: KYC/customer due diligence measures; monitoring of transactions; report of large cash transactions; record keeping; and criminalizing money laundering and terrorism. Kenya has sought to apply this according to international best practices.

As mentioned, Kenya’s AML/CFT framework is aligned to international best practices and it is embedded in several complementary elements.

## Kenya's AML/CFT Framework

The framework is aligned to international best practices as formulated by FATF, comprising of:-

- Proceeds of Crime and Anti Money Laundering Act (POCAMLA) (2010) and Regulations (POCAMR) (2013)
- Prevention of Terrorism Act (POTA)(2012) and Regulations (2013)
- Banking Act
- CBK's Prudential Guideline on Proceeds of Crime and Money Laundering (Prevention) and Combatting the Financing of Terrorism (2013)
- Banking Circular Number 1 of 2016 (Additional Guidelines on Large Cash Transactions)
- Periodic United Nations Security Council Resolutions

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Cash monitoring is essential, as criminals performing illicit activities prefer using cash.

## Requirements for Large Cash Transactions

- Section 44(3) POCAMLA provides for the reporting of all cash transactions above a specified threshold to the Financial Reporting Centre (FRC)
- POCAMR requires reporting of all cash transactions of USD 10,000 and above to the FRC whether they are suspicious or not
- CBK's Banking Circular Number 1 of 2016 (Additional Guidelines on Large Cash Transactions):-
  - Reminded banks of the requirements in POCAMLA and POCAMR on legitimacy of funds and keeping track of large cash transactions
  - Informed by findings from target inspections that revealed that corruption proceeds had been transacted through large cash transactions
  - Sought compliance with international best practice on large cash transactions

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- Majority of suspicious transactions are triggered by unusually large cash transactions.
- CBK Circular No 1 of 2016 reminded banks of the requirements under POCAMLA on large cash transactions e.g. to determine the legitimacy of funds. The Circular was informed by:
  - Findings from target inspections had revealed that corruption proceeds had been transacted through large cash transactions.
  - Failure by institutions to obtain information to determine legitimacy of customer transactions.
  - Comply with international best practice on large cash transactions.
  - Comparative studies on how other jurisdictions treat large cash transaction.

What is the impact of Circular No.1 of 2016? The circular is part of measures to enhance the effectiveness of monitoring cash transactions. As explained, monitoring each cash transaction is an essential pillar of an effective AML/CFT framework.

What fraction of our population are affected by this requirement? First, only 0.68 percent of all bank accounts in Kenya have a balance of more than 1 million, and therefore only they are capable of transacting above that threshold. Secondly, most customers can immediately answer the necessary questions. Nevertheless, innovations by banks can simplify the process further.

What would happen if we removed this pillar? Would it not lead to all the money in mattresses and in foreign safe havens coming back to our banking system? “*Governor, hakuna pesa mashinani*”. This is a false hope. What is certain is the AML/CFT framework would collapse. The consequences would be severe and immediate.

## Adverse Impact on the Banking Sector

The adverse effects of the Amendment on the banking sector, would be immediate:-

- Termination of relationships by foreign correspondent banks and closure of accounts of Kenyan banks (derisking). Regional linkages of Kenyan banks will be adversely impacted
- Kenya's banking sector will be blacklisted internationally and the country will most likely be blacklisted by the Financial Action Task Force (FATF)
- Kenya's banking sector will be perceived as risky and less attractive to investors. Risk of some banks collapsing after these changes, threatening financial stability
- The war against corruption will be lost resoundingly. Kenya will become a safe haven for money laundering, terrorist financing, and other illicit flows

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The consequences would also be felt in every corner of our country, by every citizen.

## Adverse Impact on the Wider Economy

The effects of the Amendment on the economy will be devastating:-



Impaired ability to detect terrorism financing



Inability to transact with the rest of the world



Collapse of the economy (e.g., as followed the Goldenberg Scandal)

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- The Dusit Hotel attack: Certain cash transactions in December 2018 allowed the terrorists to finance their operations. As a consequence, 21 innocent lives were lost on January 15. Every Kenyan, was affected. If we could only turn back time...
- External transactions would be inhibited: You will not be able to send or receive money from outside Kenya, except under very stringent conditions; You will no longer be able to use your credit card for international transactions, including when you travel; International payments, including school and university fees for children, as well as medical fees, will become near-impossible.
- Impact on the economy would be severe: The Goldenberg scandal is a cautionary tale. Despite the pronounced good intentions of the architects, the Goldenberg scandal devastated the economy to the weakest it has ever been. As much as 25 percent of GDP was looted, GDP growth fell to its lowest in Kenya's history, inflation surged to an all-time record of 61.5 percent in January 1994, Treasury bill rates rose to a record 85 percent in July 1993, and the exchange rate depreciated by 142.6 percent between December 1991 and December 1993. Further, the banking sector weakened significantly and several banks collapsed.

The poor and vulnerable persons were hit hard, as the price of essential commodities rose significantly. Allowing illicit funds to move back freely will have comparable effects.

## Next Steps





Hon. Members, I am about to finish. As I mentioned earlier, these matters have been brought before the courts for determination. A Petition was filed on November 30, 2018 (High Court of Kenya at Nairobi Constitutional Petition No. 426 of 2018) challenging Section 65 of the Finance Act 2018 that introduced Section 33(C) of the Banking Act. The Attorney General is the first respondent and the National Assembly is the second respondent, while the Central Bank of Kenya is the first interested party. The High Court under its special Constitutional jurisdiction under Article 165(2)(d) will determine the matter and give an interpretation. The various parties have filed their submissions and the matter is scheduled for hearing on March 29, 2019.

We await a determination by the court.

## Key Messages

1. The Amendment (Section 33C, Banking Act) strikes at the heart of Kenya's AML/CFT framework and anti-corruption efforts
2. CBK's Banking Circular No. 1 of 2016 is part of complementary efforts to enhance the effectiveness of cash monitoring
3. The war against corruption, money laundering and terrorism financing will be significantly impaired if requirements for cash deposits and withdrawals are weakened. The economic consequences would be devastating
4. Kenya will be locked out of the global financial system
5. These matters have been brought to the High Court for determination (HC Constitutional Petition No. 426 of 2018). Hearing is on March 29, 2019

I thank you for your attention.