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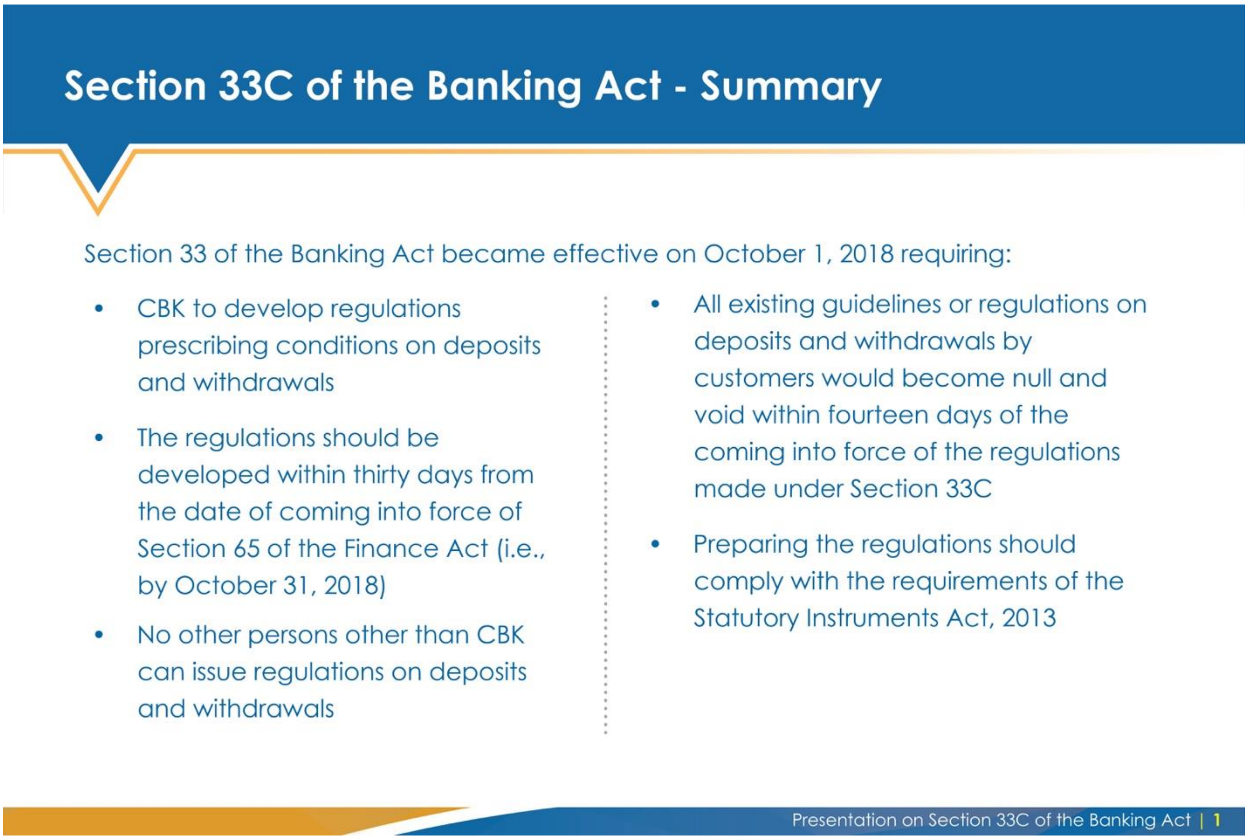
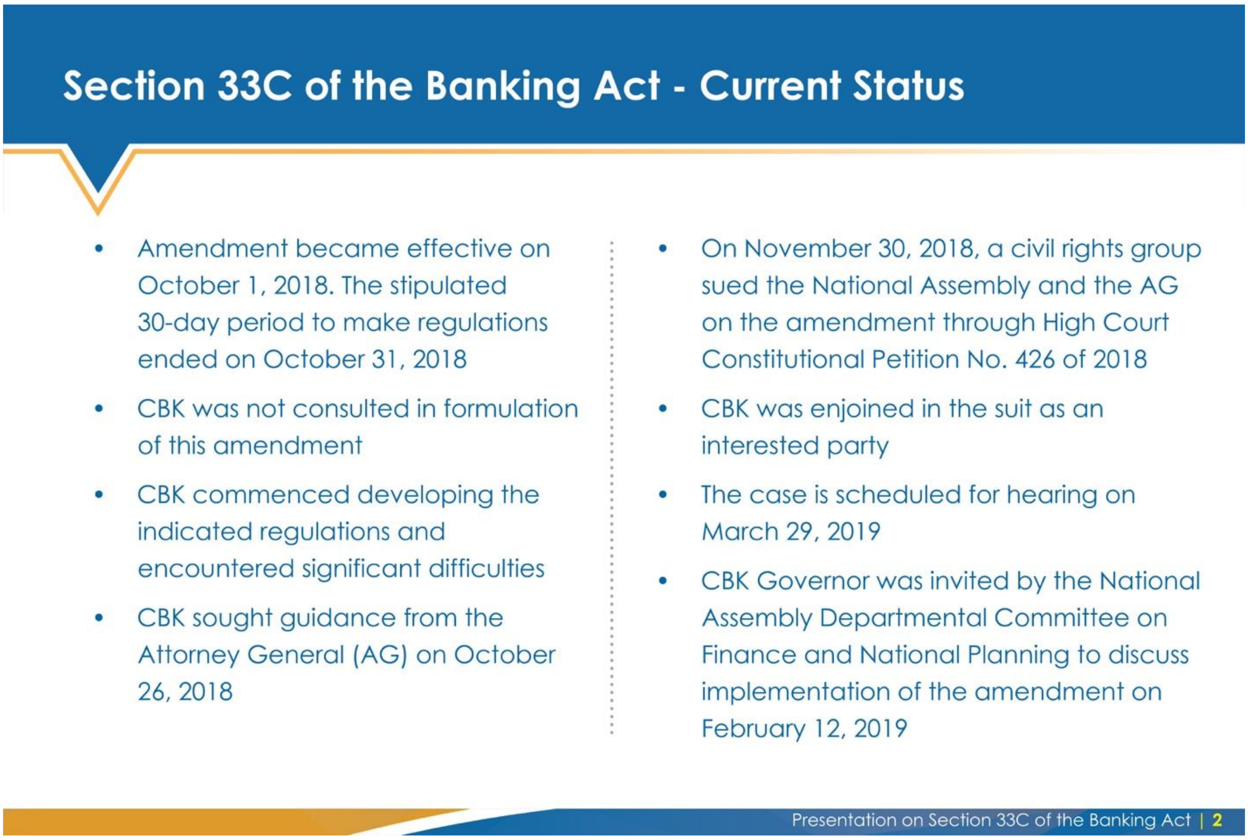
On October 1, 2018, following the coming into force of Section 65 of the Finance Act (2018) the Banking Act was amended to include a new Section 33C. In one stroke, Kenya was on the brink of rolling back key instruments in the fight against corruption, money laundering, and financing of terrorism, bringing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

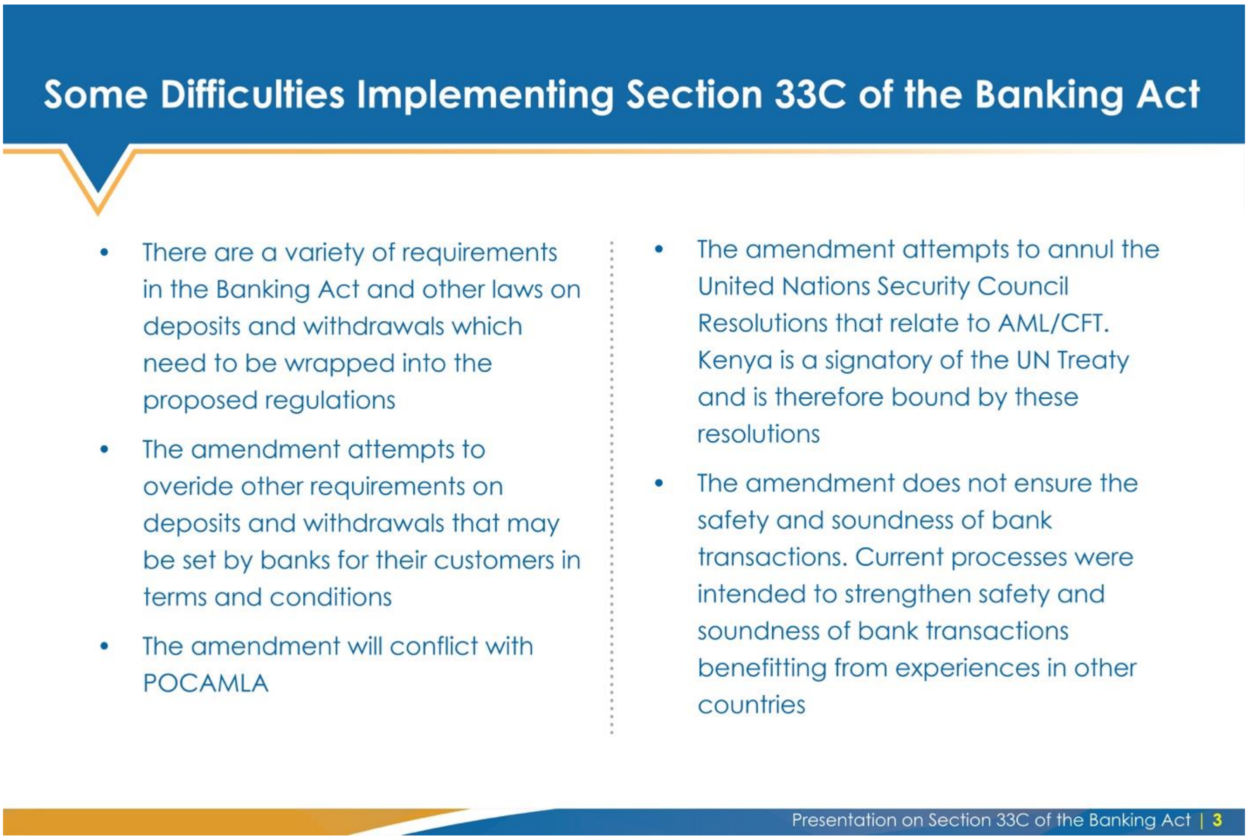


Has CBK acted to implement the Amendment? Yes, CBK first saw the amendment after it had become effective, but embarked on understanding and implementing it. To be clear, CBK had not been made aware or otherwise consulted in formulating the amendments, so we had no lead time.



- 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 $1\frac{1}{2}$ 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.

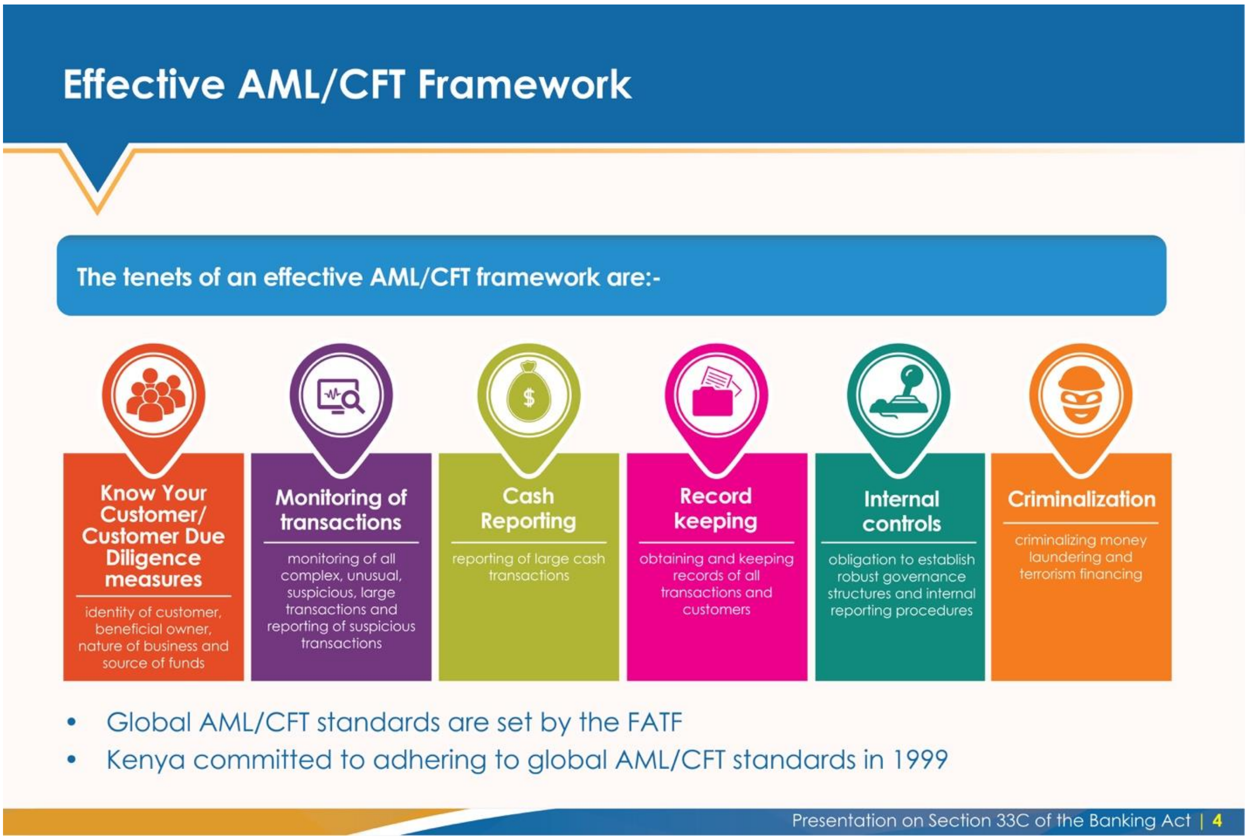
Why is it impossible to implement the Amendment? What difficulties arise?



- 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.

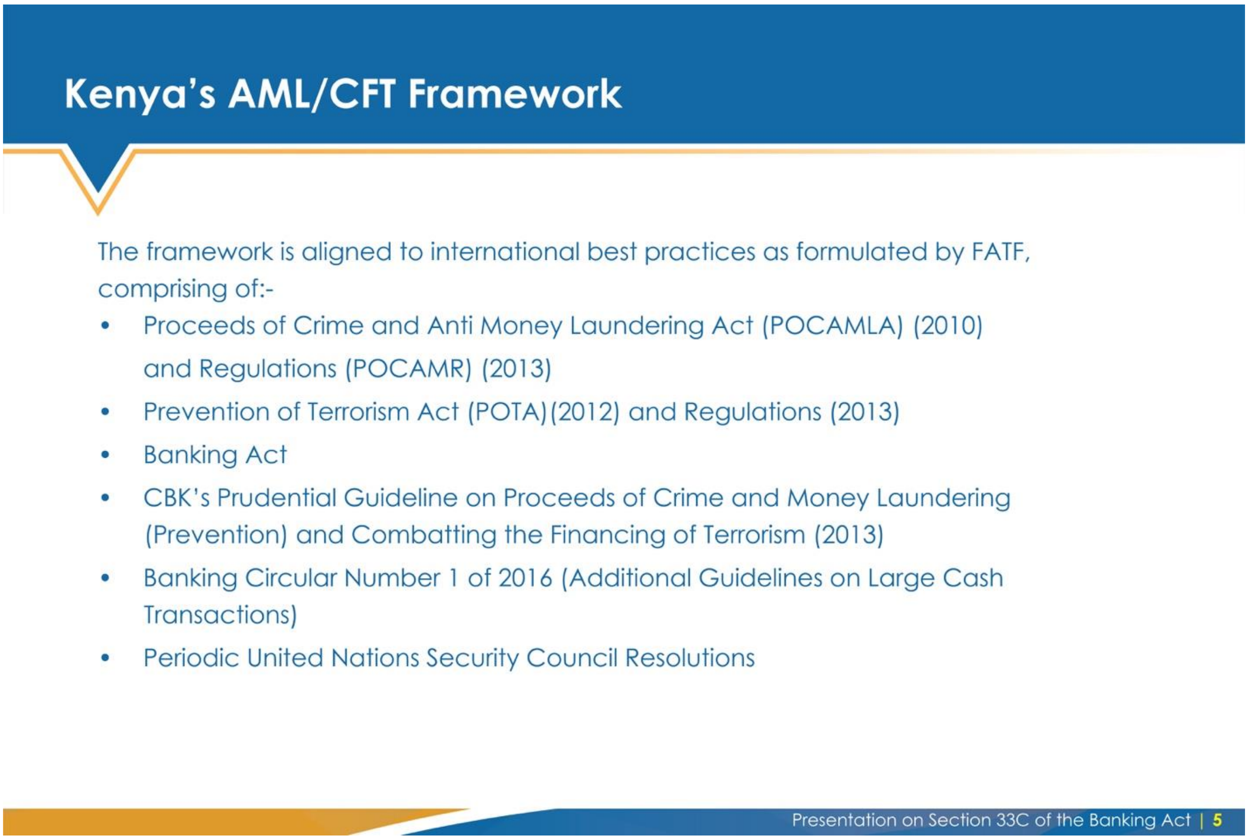
- The Amendment does not ensure the safety and soundness of bank transactions. In addition, it does not allow the needed flexibility even in cases of “clear and present” danger.

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.

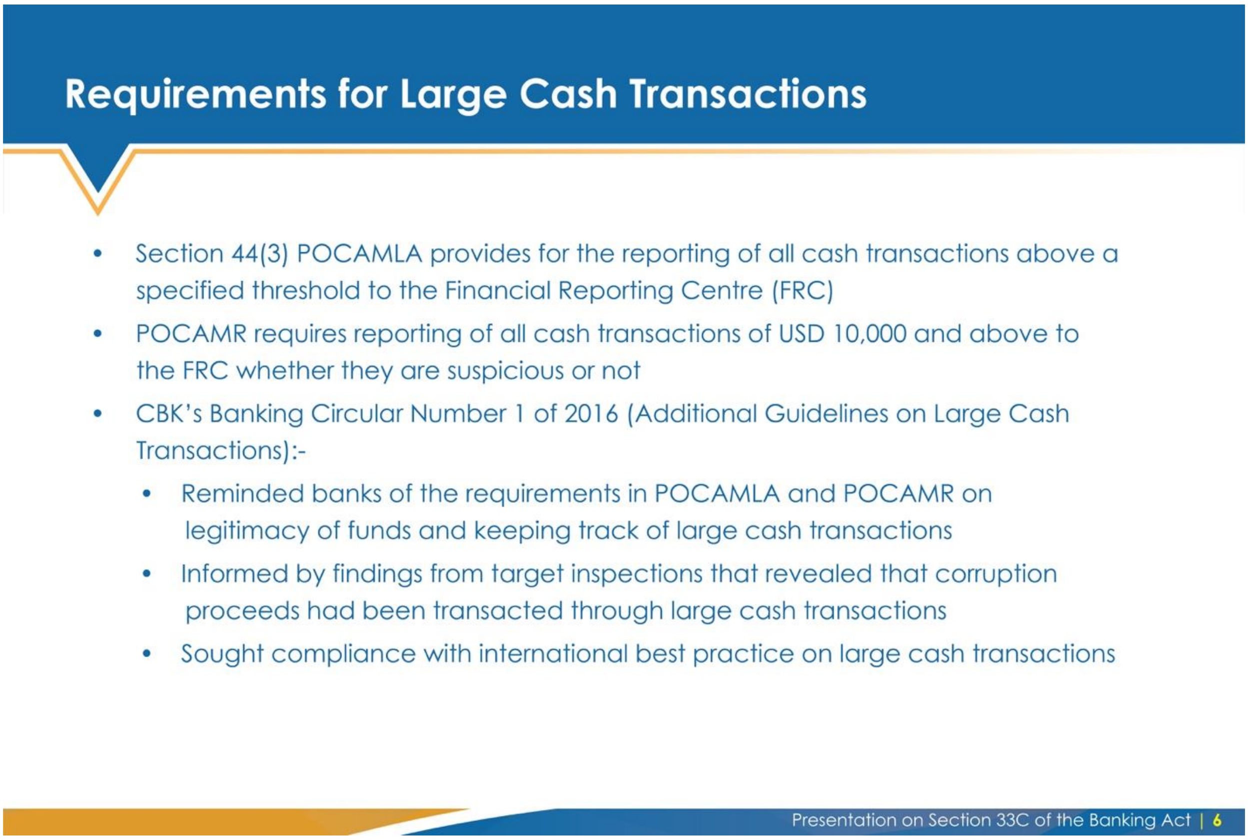


- The framework is intended to protect the financial sector from abuse. An effective framework strengthens the sector’s integrity, and that illicit funds do not flow through the financial sector.
- The tenets of effective AML/CFT include: KYC/customer due diligence measures; monitoring of transactions; 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 parctices and it is embedded in several complementary elements.



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

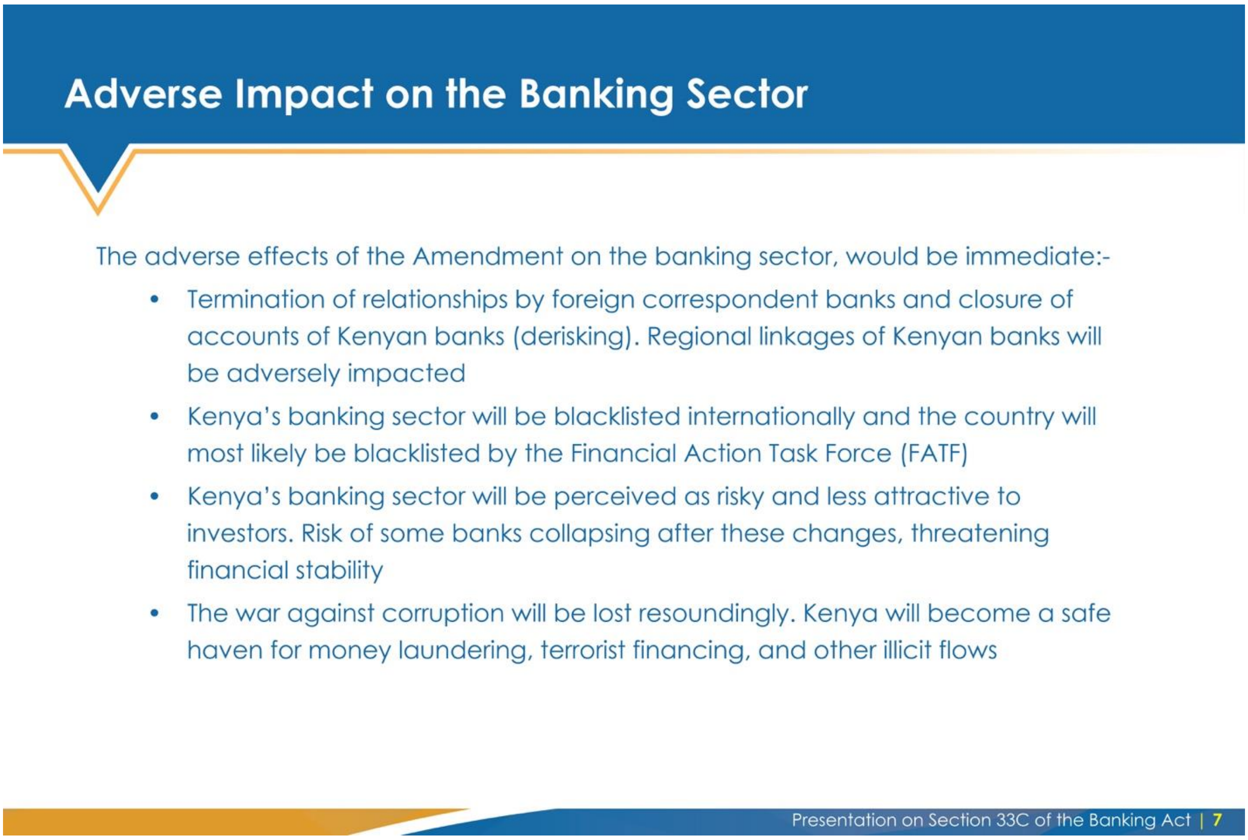


- Majority of suspicious transactions are triggered by unusually large cash transactions.
- CBK Circular No 1 of 2016 reminded banks of the requirements under POCAMLA on large cash transactions e.g. to determine the legitimacy of funds. The Circular was informed by:
  - Findings from target inspections 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.

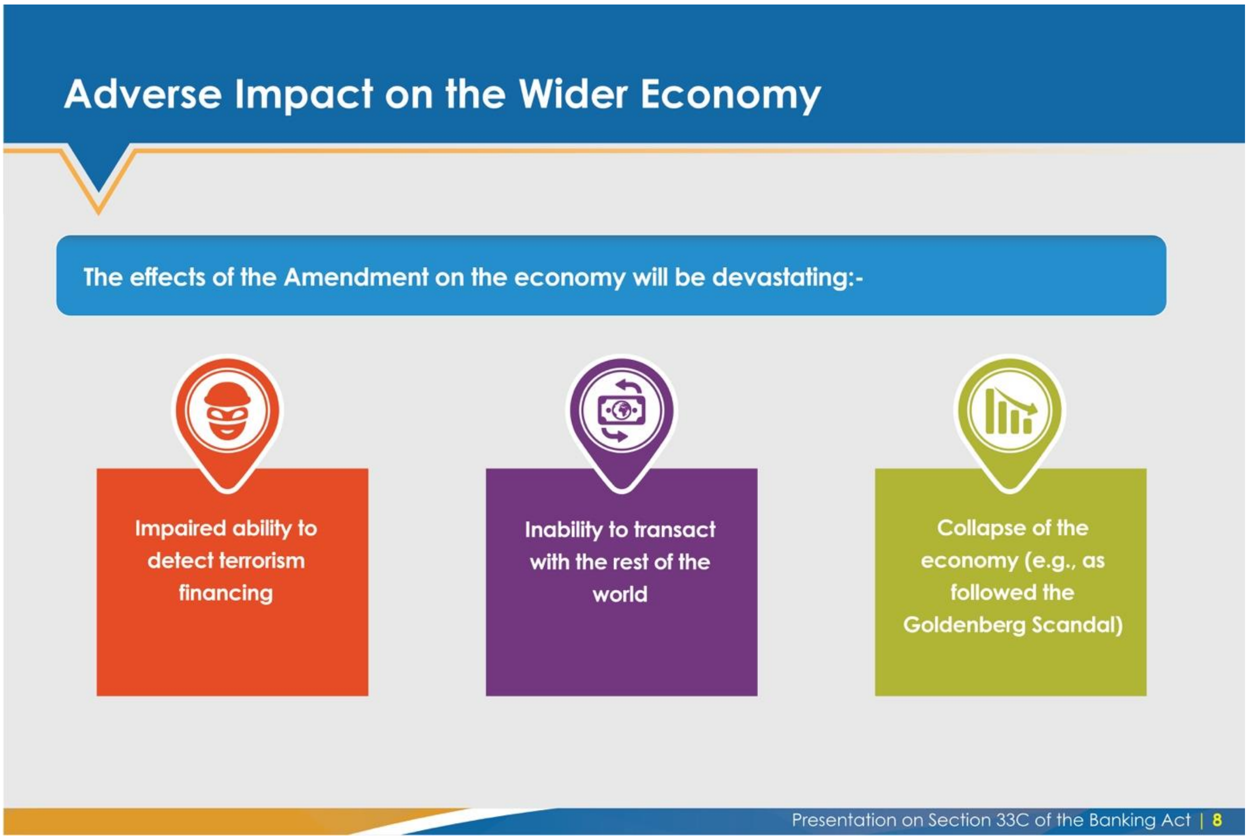
What is the impact of Circular No.1 of 2016? The circular is part of measures to enhance the effectiveness of monitoring cash transactions. As explained, monitoring each cash transaction is an essential pillar of an effective AML/CFT framework.

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.



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



- 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…

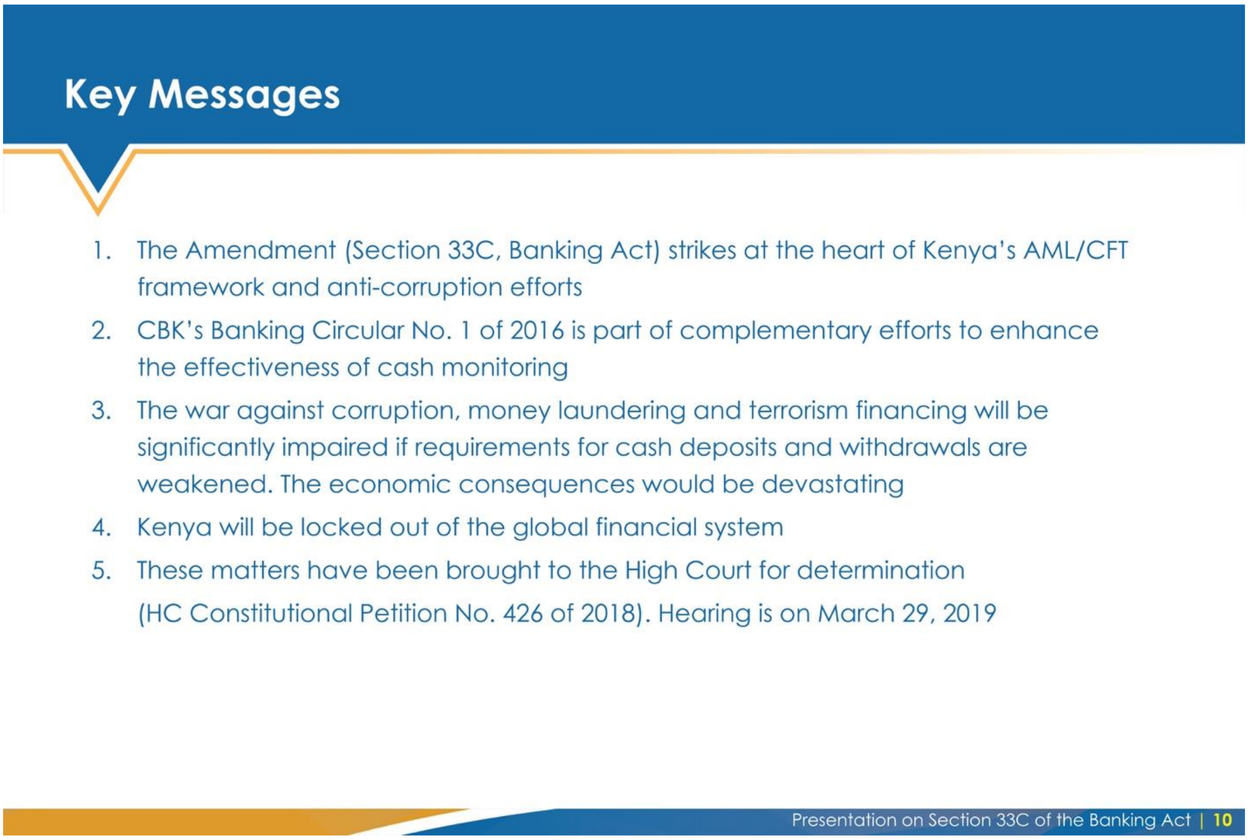
- External transactions would be inhibited: You will not be able to send or receive money from outside Kenya, except under very stringent conditions; You will no longer be able to use your credit card for international transactions, including when you travel; International payments, including school 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.

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.



I thank you for your attention.