

Use of Regulatory Policies in the Fight against Money Laundering in Kenya

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ABSTRACT
Purpose: It was found necessary to undertake this study so as to bridge the knowledge gap as concerns the use of regulatory policies in the fight against Money Laundering in Kenya. The general objective of the study was to examine the regulatory mechanisms that Kenya has adopted in dealing with money laundering and to suggest ways of enhancing the effectiveness of these mechanisms to serve as veritable models for other African states. The specific objectives of the study were: - to investigate the factors that have influenced the adoption of money laundering practices in Kenya; to analyze the extent to which money laundering regulatory policies have been adopted by financial institutions in Kenya; and to evaluate the challenges faced in implementation of money laundering regulatory policies among financial institutions in Kenya. The Nairobi Stock Exchange report of January 2009 indicates that the total number of Banks listed on the Nairobi Stock Exchange is nine, with their headquarters strategically located in Nairobi (Appendix I). Consequently, the study focused on the Banks listed on the Nairobi Stock Exchange. The study respondents were the Compliance Heads of the listed banks. In addition, the Researcher considered two telecommunication service providers that are licensed to undertake money transfer services. These are: - Safaricom and Zain. **Methods:** The study utilized a combination of quantitative and qualitative techniques in the collection of secondary and primary data. A semi-structured questionnaire (having both open and closed questions) will be the main data collection instrument. The researcher also use interview schedules with open questions, aimed at meeting the objectives of the study. Primary data was analyzed by employing descriptive statistics such as percentages, mean scores and standard deviations. Statistical Package for Social Sciences was used as an aid in the analysis. The researcher preferred SPSS because of its ability to cover a wide range of the most common statistical and graphical data analysis. Computation of frequencies in tables, charts and bar graphs was used in data presentation. The information was presented and discussed as per the objectives and research questions of the study.**Results and analysis:** Findings of the study show that the factors influencing adoption of money laundering practices in Kenya include the legal framework, corporate governance policies in institutions, quality of human capital, Information and Communication Technology (ICT), and innovations in the economy. The findings further show that the challenges faced in implementation of money laundering regulatory policies among financial institutions in Kenya include the following:- structural challenges, which include that liberalized and cash based economy, different legal systems among countries, different banks applying different money laundering policies, unstable neighboring regime and parallel banking and alternative remittance avenues (corruption); Legal and institutional framework challenges; difficulty in obtaining due diligence documents from customers; and perceived cost of implementing an AML regime.
Keywords: Regulatory policies, Money laundering, Blacklisting, Correspondent Banking, Financial Action Task Force, Financial Exclusion, Know Your Customer Concept, Money Laundering, Politically Exposed Persons, Shell Banks

ABBREVIATIONS AND ACCRONYMS

AML	Anti-Money Laundering
BCBS	Basel Committee on Banking Supervision
CBK	Central Bank of Kenya
CDD	Customer Due Diligence
CFT	Combating Financing of Terrorism
ECOWAS	Economic Community of West African States
ESAAMLG	East and Southern African Anti-Money Laundering Group
FATF	Financial Action Task Force
FIU	Financial-Intelligence Unit
GIABA	Inter-Governmental Action Against Money Laundering in Africa
IOSCO	International Organization of Securities Commissions
ML	Money Laundering
SPSS	Statistical Package for Social Sciences
UK	United Kingdom

1.0 INTRODUCTION

1.1 Background of the Study

One of the economic crimes that have adversely affected the level of economic development in Africa today is Money Laundering. Not only has it negatively impacted on the economies of African countries, but it has also seriously dented the image of the continent at the international arena. Indeed, it is the international aspect and adverse effect on international business and commerce that has galvanized national and international action to regulate it (Mclean, 1990; Rider, 1980). There seems to be consensus at a political level in the sub-region that money Laundering is a universal phenomenon, and that it is both iniquitous and problematic. However, it remains a relatively under-studied problem in Africa generally, and particularly in the Eastern and Southern Africa sub-regions. The extent of laundering in the sub-region is difficult to quantify. The number of reported crimes involving possible money laundering is steadily increasing across the sub-region whilst the number of cases actually prosecuted remains insignificant. (Kegoro 2008).

Money laundering (ML) is the processing of criminal, "dirty" money to disguise their illicit origin and make them appear legitimate and "clean." IMF Managing Director Michel Camdessus estimated in 1998 that between 2 and 5 percent of the global GDP is laundered annually (Kovalerchuk and Vityaev, 2003). Evidence also shows that ML finances terrorist attacks worldwide. So anti-money laundering (AML) research is of critical significance to national financial stability and international security (Kingdon, 2004). Money laundering has the notorious tendency to discourage or frustrate legitimate business enterprise, corrupt the financial system and ultimately, the socio-political system. It is the consequence of such activities that has negatively affected the level of direct foreign investment in a number of African countries (Adekunle, 1999). The effect of this crime is so devastating that certain business transactions are now on a gradual decline particularly in those areas where local businessmen do not have the necessary resources to meet the required investment profile. This is more worrisome for a continent that is economically underdeveloped, with low rate of capital formation, and per capital income, which is in an understandable is in hurry to accelerate the pace of economic development and improve the living conditions of Africans (Adekunle, 1999). The marked increase in money laundering activities in third world countries, Africa inclusive, has been attributed to a number of factors, all bordering on the dependent nature of their economies.

Many of these economies are cash-strapped and can hardly realistically be discriminating in the type of funds they accept into their economies. Second, as the major financial centres tighten their regulations on Money-Laundering and enter into treaties to stem the same in the well-known havens, attention is shifted to lesser known countries. Third, deregulation of many of these economies, in obedience to the imperatives of structural adjustment policies and the need to attract foreign investment has meant relaxation of foreign exchange regulations and other restrictions in their financial laws and fiscal policies (Osinbajo and Ajayi, 1991). According to Eze (1998), some developing countries may well be even more attractive targets considering that in addition to the above mentioned features, the country's foreign exchange earnings are substantial and this may facilitate transfer of the proceeds of drug trafficking abroad through financial institutions. Rider, (1980) asserts that Western European countries have in recognition of the negative impact of this crime on their economies taken a bold step to tackle it decisively through the creation of effective institutional and regulatory mechanisms. However, the response of African states to this pervasive crime has been diverse and disparate (Kalu and Osinbajo, 1990). As symptomatic of that response, the Kenyan approach was examined in this paper. The lessons to be learnt from these approaches were highlighted just as suggestions were equally be made for other states to adopt similar and improved mechanisms based on the experiences of Kenya.

1.2 Statement of the Problem

Money laundering and other financial-related crimes have significant economic and social consequences for nations worldwide. It weakens the financial systems which are the main players for global financial transactions. This in turn will jeopardize the socioeconomic development of these nations. For money laundering activities to be carried out, a medium to launder the illicit funds is required. The preferred medium chosen by money launderers is the financial institutions (Masciandaro, 1999) due to its efficiency and its low cost in carrying out financial transactions. These activities taint the integrity of financial institutions which has a negative impact on the soundness and stability of these financial institutions and potentially impacts on the stability of the financial systems. When the integrity of the financial institutions is weak, it has a discouraging effect on foreign direct investment due to lack of investor confidence. This in turn can distort the long-term growth of the economy. Studies by Quirk (1997), Barrett (1997), Paradise (1998) and Masciandaro and Portolano (2003) have argued that money laundering threatens economic and financial systems in countries.

To this extent, to develop a robust economy and sustained standard of living, countries should undertake all efforts to combat money laundering activities. Countries across the world have developed laws and regulations to curb money laundering. Anti-money laundering efforts world-wide were focused on enhancing the resilience of the financial institutions against money laundering and other related financial crimes. Countries, financial institutions and certain other businesses and professions are required to implement a set of anti-money laundering ("AML") and Combating of Financing of Terrorism ("CFT") measures (Basel Committee on Banking Supervision, 1988). Many African countries are currently in the process of drafting or implementing AML/CFT laws. These laws must comply with international standards that were set in this regard (Basel Committee on Banking Supervision 2001). The relevant standards require financial institutions and certain businesses and professionals to identify and verify the identities of prospective clients. The main aim with this strategy is to ensure that these institutions know who they are dealing with and can prevent criminals and terrorists from abusing their services. These aims are laudable. However, in this paper the author sounds a note of caution and argues that countries, especially developing countries, should design their AML/CFT customer due diligence (CDD) systems with care.

Kenya has drafted the Financial Bill, which has successfully gone through the second reading in Parliament. The bill provides the requisite regulatory framework for dealing with this crime in the country. In particular, the Bill contains novel provisions such as prohibition on cash transactions involving large sums of money, forfeiture of assets obtained from money-laundering transactions among others. The country must adopt strict and stringent measures to enhance the enforcement of the Money Laundering Laws, with the regulatory mechanisms, which ought to be put in place in tackling the menace, serving as veritable guideposts. A review of the literature indicates that much of the money laundering literature have focused more on the legal and regulatory framework and the recognition of technology as mechanisms for combating money laundering activities. Though there is voluminous literature available on serious financial crimes – for example, financial-intelligence unit (FIU) and terrorist financing – literature on money laundering in particular is still at an early stage, especially in Africa.

Academic papers that have focused on financial crimes in some context include those by Engen (2005), Masciandaro (2005), O'Reilly (2006) and Stana (2006). Engen deals with efforts made by several financial institutions to check internal fraud by establishing their own FIUs, which train tellers in identifying money laundering related activities. Masciandaro (2005) analyzes the relationship between the unification of financial supervision and the creation of a FIU from an economic and empirical point of view. O'Reily (2006) discusses FIUs in the context of the reporting requirements emanating from third directive on anti-money laundering issued in Ireland. Stana (2006) discusses how the US FIU (FINCen) has contributed to enhancing the capacity of foreign FIUs mainly in South Asia and Eastern Europe.

None of these papers present a framework for assessment of regulatory policies effectiveness and provide a comparison of a country with that of best practice in as far as the use of regulatory policies in the fight against money laundering is concerned. In addition, though there are numerous studies in the literature that critically examine factors that contribute to money laundering, the numbers of empirical studies that examine the factors that contribute to money laundering are rather scarce. To this end, this study hopes to fill this gap in the literature. The paper seeks to empirically examine and understand the factors that explain institutional measures undertaken to control money laundering. The factors considered in this study include technology (ICT infrastructure), quality of human capital, efficiency of the legal framework, ethical behavior of firms (corporate governance) and capacity for innovation in the economy. This study will contribute to the body of knowledge in Money Laundering by seeking answers to the following research questions: (i) what extent have money laundering regulatory policies been adopted by financial institutions in Kenya?; what are the factors that factors that contribute to adoption of money laundering practices in Kenya; and what are the challenges faced in implementation of money laundering regulatory policies among financial institutions in Kenya?

1.3 Objectives of the Study

The study was guided by the following objectives:

1.3.1 General objective

The general objective of the study was to examine the regulatory mechanisms that Kenya has been adopted in dealing with money laundering and to suggest ways of enhancing the effectiveness of these mechanisms to serve as veritable models for other African states.

1.3.2 Specific Objectives

The study was guided by the following specific objectives:-

(i) To investigate the extent to which money laundering regulatory policies have been adopted by financial institutions in Kenya.
(ii) To analyze the factors that contribute to adoption of money laundering practices in Kenya
(iii) To evaluate the challenges faced in implementation of money laundering regulatory policies among financial institutions in Kenya

1.4 Significance of the Study

The paper aimed at addressing regulators, enforcers and the academy, presenting reflections on some research-driven innovative approaches, strategies and tools in the fight against money laundering, with reference to some instances of concrete application deriving from the experience and know-how of other countries. The paper explored themes and issues to which the international community is becoming increasingly sensitive; the ideas and solutions expressed surely need further development, test and discussion, but they are bound to become part of the most significant prospective challenges in the combat against economic and financial crime.

Specifically, this study will benefit the following:

The Financial Services Sector: - The study will also make managerial contributions for players in the financial services sector, in that it provides a basis for the Compliance Heads of the various institutions to better understand the factors that would influence the effectiveness of the regulatory policies. It will also assist in the understanding of the challenges faced in the use of regulatory policies in the fight against Money Laundering in Kenya and could use the information to identify the shortcomings of the process and improve on it.

The regulatory bodies and the Government: - The research findings shall also aid in the improvement of the already formulated policies and enforcement of the same in order to facilitate full implementation and in conformity with the constitution of the country.

Academic Researchers – The study will make a significant contribution to the growing body of research on Money Laundering. Despite the growing interest in Money Laundering research, in the Kenyan context, there are limited studies, most of which are not even published. The findings may also be used as a source of reference for other researchers. In addition, other academic researchers may need the study findings to stimulate further research in this area of organization transformation and as such form a basis of good background.

1.5 Scope of the Study

The Nairobi Stock Exchange report of May 2008 indicates that the total number of Banks listed on the Nairobi Stock Exchange was eight, with their headquarters strategically located in Nairobi (Appendix I). Consequently, the study focused on the Banks listed on the Nairobi Stock Exchange. The study respondents were the Compliance Heads of the various banks. In addition, the Researcher considered three telecommunication service providers who are licensed to undertake money transfer services. These are: - Safaricom, Celtel and Postal Corporation of Kenya. Despite the researcher's intention to interview only the Compliance Heads, this was not possible as some of them were away for various reasons, ranging from leave and official duties to being busy, and as such, delegated to their juniors. In the Compliance Heads' absence, therefore, the researcher hopes that the responses from the officers who were delegated the responsibility of responding to the questionnaires were objective.

1.6 Limitations of the study

Notwithstanding the researcher's determination to undertake the study to completion within the given time frame, various constraints were encountered. For instance, some of the information being sought was of a confidential nature, which the respondents either deliberately refused to divulge or did not have access to. In addition, the time allocated to data collection may not have been sufficient to enable the respondents complete the questionnaires as accurately as possible, considering that they were at the same time be carrying out their daily duties. It was also quite difficult to measure aspirations and expectations resulting from answers from respondents. Owing to the nature of work undertaken by the respondents some of the responses could have been inaccurate due to divided attention.

In addition, a systemic approach in understanding and fighting financial crime and its complex issues implies pooling together knowledge and expertise gathered under different complementary disciplines. This may provide information on the manifold sides and tinges of the phenomenon. By the same token, it is essential to take into consideration the systemic effects that specific action undertaken by the authorities may entail due to the subsequent reactions from other parts in the system.

1.7 Definition of Terms

Blacklisting: *T*his is a list of countries or territories that are not cooperative in establishing AML regimes (Commonwealth Secretariat, 2006). In June 2000, Financial Action Task Force (FATF) made a list of 15 Money Laundering countries:- Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Philippines, Russia, St. Kitts and Nevis and St. Vincent and Grenadines. Pending changes to each blacklisted country's legislation, FATF recommended its members' financial institutions give special attention to business relations and transactions with non-cooperative countries and territories (Fitzgerald, 2001). The countries blacklisted typically offered one or more of the following services:- Bank secrecy; offshore bank offering anonymous accounts; Anonymous ownership of international business companies; Non-residents allowed to own and operate offshore banks; Layers who serve as nominees or managers of commercial banks.

Correspondent Banking: Correspondent Banking is the provision of services by one bank to another bank and has traditionally been regarded as a necessary and routine aspect of cross-border activity. The objectives of purchasing of correspondent banking facilities include contracting cost reduction service to customers. It can also be viewed as a strategic tool for international business expansion without setting up international representative offices, branches or otherwise directly investing in overseas markets. The correspondent banking has expanded from the processing of routine international trade transactions and payments, to embrace virtually every aspect of modern banking (Schott, 2004).

Financial Action Task Force (FATF): An inter-governmental body whose purpose is the promotion and development of policies both at national and international levels to combat money laundering and terrorist financing. FAFT issued 40 Recommendations that form a basic framework for anti-money laundering efforts. The FAFT established the list to enhance criminal justice and law enforcement capabilities, better regulation of the financial services sector, and promote international cooperation (FATF, 2003)

Financial Institutions: Financial Institutions mean banks, security firms, insurance companies, forex bureaus, and money remitters (FATF, 2003). FATF provides a definition for financial institutions that focuses on the nature of the business rather than names of the entities.

Financial Exclusion: Financial Exclusion refers to inadequate access to financial services (Basel, 2004). Persons who are financially excluded do not have bank accounts and long and short-term insurance products that are normally held by members of society (Basel, 2005). They are excluded from participation as customers in the financial services industry. Financial exclusion may be temporary or long-term and may be complete or partial. It is caused by factors such as geographic isolation, illiteracy, costs of financial products or simply by restriction on access to such products (Kempson and Whyley, 1999; FSA, 2000, Bester *et al,* 2004). Those who lack access to financial services are often socially and financially vulnerable and include groups such as the unemployed, the homeless and illegal immigrants (FSA, 2000).

Know Your Customer Concept (KYC): *B*asel (1988), introduced the KYC concept. According to Basel Committee, KYC ideally involves knowing the ultimate owner of the business or bank account and the nature of offshore funds received. There are a number of indications which should make banks and other vulnerable institutions particularly alert to the need to know that particular customer, because of the increased risk that they pose, for example: - Shell shelf or nominee companies; Accounts which are held in non co-operative jurisdictions; Directors who are professional advisers; Complicated transaction which may involve across border transaction; and Unnamed accounts.

Money Laundering: *T*raditionally, money laundering is the conversion or transfer of money knowingly or through negligence with intent of disguising or concealing its illicit origin. Money laundering was redefined by FATF and the USA custom service to include "the association with illicit activity". Money laundering is the process by which criminals attempt to hide and conceal their identity and the true origin and ownership and/or transfer of the proceeds of their criminal activities or where proceeds of lawful business are used for criminal activities (Commonwealth Secretariat, 2006).

Politically Exposed Persons (PESP): PEPS are individuals who are or have been entrusted with prominent public functions. For example, heads of government, senior politicians, senior government, judicial or military officials, and senior executives of state corporations, important political party officials. Business relationships with family members or close associates of PEPS also involve reputation risks similar to PEPS themselves (FATF, 2003).

Shell Banks: A shell bank is a foreign bank with no physical presence in any jurisdiction (Schott, 2004)

1.8 Chapter Summary

This chapter introduced the problem and the purpose of the study. The following areas of discussion were included as subsections in the chapter: - Background of the problem; Statement of the problem; Objectives of the study and specific objectives; Research questions; Importance of the study; Scope of the study; Chapter two presents a review of the literature relevant to the objectives of the study.

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the literature related to the purpose of the study. The chapter is organized according to the specific objectives in order to ensure relevance to the research problem. The review was undertaken in order to eliminate duplication of what has been done and provide a clear understanding of existing knowledge base in the problem area. The literature review is based on authoritative, recent, and original sources such as journals, books, thesis and dissertations.

2.2 Theoretical Framework

2.2.1 A Theory of "Crying Wolf": The Economics of Money Laundering Enforcement

Excessive reporting, called "crying wolf", can dilute the information value of reports. Excessive reporting is investigated by undertaking the first formal analysis of money laundering enforcement. Banks monitor transactions and report suspicious activity to government agencies, which use these reports to identify investigation targets. Banks face fines should they fail to report money laundering. However, excessive fines force banks to report transactions which are less suspicious, thereby diluting information. The empirical evidence is shown to be consistent with the model's predictions. The model is used to suggest implementable corrective policy measures, such as decreasing fines and introducing reporting fees.

Excessive reporting fails to identify what is truly important by diluting the information value of reports. The intuition can be best understood through an analogy with the tale: "The boy who cried wolf". In the tale, the boy rendered his cries useless by resorting to them too often, and failing to identify the wolf's presence. Similarly, excessive reporting, which will be referred to as "crying wolf", fails to identify what is truly relevant. More generally, the crying wolf phenomenon shows that information is not only data, but also able and expert identification of truly important data.

The reporting problem is investigated through the first formal analysis of money laundering enforcement. Choosing money laundering enforcement as the leading example is motivated by the fact that the identification role of reports is particularly strong. Furthermore, money laundering is an economically significant crime. For instance, several hundred billion dollars are washed through the financial sector in the United States, and money laundering facilitates crimes as harmful as drug tracking and terrorism, as detailed in the next section. Investigating reporting in this context is also motivated by a highly publicized case, when Bob Dole, former Senate majority leader and presidential candidate, was falsely reported for money laundering

(Wall Street Journal, 2004a).

The model explores the agency problem between the bank and government law enforcement agencies. The bank monitors transactions and reports suspicious activity to the government, which identifies targets for investigations based on these reports. The bank undertakes costly monitoring and reporting, because the government fines it if money laundering is successfully prosecuted and the bank did not report the transaction. Though Masciandaro (1999) abstracted from this agency problem in the first economic analysis of money laundering, it is crucial as the later survey by Masciandaro and Filotti (2001) shows.

The formal model builds on five main economic building blocks. First, communication is coarse between the bank and the government, as the bank cannot communicate in a short report all the local information it has. This communication problem is similar in spirit to the information hardening problem in Stein (2002), though here the problem is not with verifying the information, but rather with telling it precisely. Second, the bank's incentives to report are coarse; the bank is fined only for false negatives, i.e. for not reporting transactions which are prosecuted later as money laundering. Third, the bank is always uncertain about the transaction's true nature, i.e. every transaction can be potential money laundering. Fourth, the bank faces dual tasks: it has to monitor all transactions in order to report the suspicious ones. Fifth, the bank's information, i.e. its signal on the transaction, is not verifiable ex-post, because the local information at the time of the judgment cannot be reproduced later.

The model shows that harmful excessive reporting, called crying wolf, can arise in this setup. As the bank cannot share its signal with the government, the government must make decisions based on whether or not it observes the report. Intuitively, if the bank identifies all transactions as suspicious, then it fails to identify any one of them - exactly as if it would not have identified a single one. Thus, crying wolf can fully eliminate the information value of reports. Crying wolf can arise because excessively high fines for false negatives force the uncertain bank to err on the safe side and report transactions which are less suspicious. In the extreme case the bank is forced to report all transactions, thereby fully diluting the information value of reports.

In the United States, for instance, the model's findings are consistent with the available empirical

evidence. Fines have increased in the last ten years, especially so after the Patriot Act. In response, banks have reported an increasing number of transactions. However, the number of money laundering prosecutions has fallen - even though the estimates of money laundering volumes have been stable. Furthermore, regulatory agencies have identified 'defensive filing' which exhibits striking similarities with what happens under crying wolf. The model also provides implementable policy implications on how to stop crying wolf and thereby increase the efficiency of money laundering enforcement. First, the model calls for reduced fines to cease crying wolf, as optimal and not maximal fines are needed. The bank needs some fines in order to monitor and report, but excessively strong ones result in crying wolf. The intuition behind deviating from Becker's (1968) seminal proposal of maximal deterrence is that banks are not criminals, but rather honest informants. Thus, excessively strong incentives do not deter banks from committing a crime, but rather distort their information provision.

Second, reporting fees might be needed to elicit optimal reporting. As in Hailstorm and Milgrom (1991), single dimensional incentives might not be able to elicit efficient two dimensional banking efforts to monitor and report. Reporting fees provide an implementable second dimension of incentives by punishing the bank for false positives. Furthermore, reporting fees can be thought of as pricing reporting externalities. Each report dilutes the value of all other reports, and reporting fees would make banks internalize these externalities.

Third, the model's most important comparative static result shows that fines should decline in the harm caused by money laundering. The intuition is that the bank's effective incentives have two components: government investigation to identify false negatives and nominal fines. As money laundering becomes more harmful, optimal government investigation increases as the marginal benefit of prosecuting money laundering increases. However, the bank's incentives should be constant so as not to trigger crying wolf. Thus, the model shows that the fine increases of the Patriot Act could have been intuitive, but mistaken measures.

As it was argued earlier, crying wolf is a general economic problem. The main economic building blocks identified in money laundering enforcement can be found in many other situations. For instance, product information provision is very similar to suspicious activity reporting. Firms must use their expertise to identify the most relevant dangers related to using their product. There, coarse incentives are provided by the legal structure: omissions of warnings can result in damages and following lawsuits. False positives have no such easily identifiable victims. However, there is a real damage from crying wolf, because information is lost, as customers disregard warnings and accept contracts without reading the fine print.

The agency setup of the model is very similar to that of the auditing problems analyzed first in Tirole (1986). The government uses both auditors and banks to obtain information about their clients. More precisely, the government is interested in learning if there are problems such as accounting omissions or signs of money laundering. Naturally, both auditors and banks are reluctant to provide such negative information, which creates an agency problem. These similarities in the agency setup allow building on the Kofman and Lawarrée (1993) auditing model in setting up the action set. A major difference is, however, that the auditing literature focused on the disclosure of verifiable or certifiable information as reviewed in Verrecchia (2001).

The model's focus on coarse communication of unverifiable information is particularly relevant to investigate the increased role of auditors after the Sarbanes-Oxley Act. Auditors are not only supposed to disclose verifiable information, but they also have to identify material transactions, i.e. transactions that fundamentally affect the firm's value. Identifying material transactions is very similar to identifying suspicious activities, because in both cases reporting involves identification and coarse communication of unverifiable and uncertain information. Furthermore, auditors are also sanctioned for false negatives, i.e. for not disclosing transactions which later substantially affect the firm's value. Thus, excessive fines might make auditors report more transactions as material, thereby failing to identify the truly important ones. Lengthening auditing reports and firm disclosures, documented in Gordon (2005), might well signal crying wolf.

2.2.2 Money Laundering Enforcement

Money laundering is defined as an illicit money transfer. There are two main kinds of illicit money transfers. First, traditional money laundering entails transferring illegally obtained funds to conceal their origins and make them appear legal. For example, drug dealers deposit cash revenues in banks and later transfer them until the funds appear to originate from legitimate sources. Second, terrorism financing entails transferring mostly legal funds for illegal purposes. For instance, legal charity donations are transferred to fund terrorist attacks. In sum, both forms of money laundering are characterized by illicit and socially harmful fund transfers. Money laundering causes social harm because it facilitates crime and enables criminals to enjoy criminal revenues.

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

Money laundering is an economically significant crime, though precise estimates are hard to obtain. According to Camdessus (1998), the consensus range of money laundering volume is between 2 and 5 percent of the global GDP. The FBI (2001) estimates the volume of globally laundered funds as falling between \$600 billion and \$1.5 trillion. Laundering fees, i.e. what money launderers charge their criminal clients, are estimated at 5-15% of the laundered amount according to Lal (2003) and Reuter and Truman (2004). Thus, money laundering, including self-laundering, is estimated to be a \$30 to \$225 billion global 'industry'. Moreover, the harm caused by money laundering and its predicate crimes shows that money laundering is even more significant than what volumes and laundering revenues would suggest.

2.2.3 Model Setup

The model explicitly investigates the agency problem between the government and the bank, where the government needs information from the bank to investigate the transaction which may or may not be money laundering. The setup is illustrated in Figure 2.1. If the bank monitors the transaction, then it receives information, a signal about the transaction. The informed bank, which has received the signal is able to inform the government by filing a suspicious activity report. The government provides incentives, by means of fines, for the bank to monitor and report suspicious transactions.

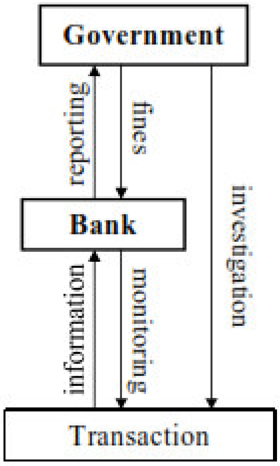

Figure 2.1: Model Scheme

Source: Takats (2006), A Theory of "Crying Wolf": The Economics of Money Laundering Enforcement, Princeton University, Department of Economics, pp.7

This study shows how excessive reporting, called "crying wolf", can dilute the information value of reports and how more reports can mean less information. Excessive reporting is investigated by undertaking the first formal analysis of money laundering enforcement. Banks monitor transactions and report suspicious activity to government agencies, which use these reports to identify investigation targets. Banks face fines should they fail to report money laundering. However, excessive fines force banks to report transactions which are less suspicious. The empirical evidence is shown to be consistent with the model's predictions. The model is used to suggest implementable corrective policy measures, such as decreasing fines and introducing reporting fees.

Sanctions include nominal fines (civil money penalties), the costs of public law enforcement actions (cease and desist orders or written agreements), the costs of private law enforcement actions (memoranda of understanding), and also implicit reputation costs. Regulatory language is somewhat different: banks are fined if suspicious activity detection and reporting procedures are not in place. Yet, the test of these policies is whether banks are able to identify and report those transactions which are considered to be suspicious ex-post.

2.2.4 The Origins of Money Laundering

The origins of money laundering can be traced back to as early as 1930s in organized criminal activities (Bosworth-Davies and Saltmarsh, 1994). As such money laundering is not a new concept but lately money laundering activities has gained momentum and became a worldwide problem debated widely. In response to this growing concern, international agreements were initiated to combat money laundering activities. Amongst the main agreements, the UN was the first international organization that initiated the combating of money laundering globally. Subsequently, the Financial Action Task Force (FATF) recognized as an international standard setter for anti-money laundering efforts was established in 1989 by the G-7 Summit in Paris to implement and monitor effective anti-money laundering programs. More importantly, the FATF has compiled 40 recommendations for money laundering control which provides a basic framework relevant to all parties involved in the effort to combat money laundering. According to FATF, money laundering is defined as:

> … the processing of a large number of criminal acts to generate profit for individual or group that carries out the act with the intention to disguise their illegal origin in order to legitimize the ill gotten gains of crime. Any crime that generates significant profit-extortion, drug trafficking, arms smuggling and some kind of white collar crime may create a "need" for money laundering (FATF).

2.3 Nature and scope of money laundering

Money laundering is basically the practice whereby funds obtained from illegal transactions are transferred into secret accounts to shield their detection and possible sanctions. It has also been described as "the processing of funds derived from illegal or illegitimate sources, through legal financial channels with a view to legitimizing and concealing or disguising the source of such funds" (Osinbajo and Ajayi, 1991). *Blacks Law Dictionary* (1990) refers to it as an "investment or other transfer of money flowing from racketeering, drug transactions, and other illegal sources into legitimate channels so that its original source cannot be traced".

These descriptions reveal the main essence of the offence of money laundering and indicate the stages or processes involved in the consummation of the offence. A typical scenario of money laundering could be as follows:

Mr B, a drug trafficker transports several quantities of cocaine from Nigeria to London undetected. The proceeds which are in foreign exchange are immediately transferred into an account in England in the name of B's company and the funds are subsequently scattered into several accounts belonging to B's company in several countries. The funds are then used to acquire choice properties in America and some invested in a high-flier enterprise in Nigeria.

A second example is where a highly placed government official in Zambia steals large sums of public funds entrusted to his control by virtue of his position and transfers same to the account of a company belonging to him in Paris. The proceeds are then used to acquire properties in France while some are used for investment in petroleum business in Nigeria (Amoah, 1992).

From the above analysis, it is clear that money laundering is a peculiar crime since it is often the expression of other economic crimes such as corruption (Johnson, 1991a, b), false pretences (Okogbule, 1993), drug trafficking (Rider, 1980), smuggling, illegal arms sales, and recently, human trafficking (Bowman and Kuenyehia, 2003). When these other crimes are committed, it is the instrumentality of money laundering that the proceeds are sought to be transferred and hidden to enable the perpetrators enjoy these profits without jeopardizing their source. This process necessarily implies the involvement of several persons in the commission of the offence. In addition to, the main offender himself, some officials of both the transferor and the transferee banks are usually active participants, just as the recipients of the proceeds of such activities with knowledge of their sources are equally culpable:

The propelling factor in money laundering is that these criminal activities generate huge profits which would ordinarily attract suspicion and attention. Consequently, the perpetrators devised the stratagem of striving to legitimize the ill-gotten profits by concealing the source of the funds. It is also one of their strategies in this enterprise to move the funds to a country or business activity where they are less likely to attract suspicion and detection (Rider, 1980). Rider further asserts that this is possible because while some jurisdictions have strict regulations on financial transactions that would easily expose such criminally generated profits, others do not have, or, where the regulations exist, they are not properly and effectively enforced. Money launderers therefore take advantage of the loopholes in the financial laws of such countries to undertake all sorts of corporate transactions and transfers.

It is in response to the dangerous effects of money laundering that the G-7 Summit in Paris in 1989 established the Financial Action Task Force to develop and co-ordinate international action against money laundering. Significantly, membership of the task force consists primarily of major financial centres of Europe, North and South America, and Asia and it recently developed 40 recommendations (Umozurike, 1992), embracing measures that national governments should take in the fight against money laundering. At the regional level, African countries have also taken giant strides to stem the ugly incidence of money laundering.

There is the East and Southern African Anti-Money Laundering Group (ESAAMLG) which was launched in August 1999 in Arusha, Tanzania. Similarly, in the West African sub-region, an institution known as Inter-Governmental Action Against Money Laundering in Africa (GIABA) was established in 2000 by the leaders of Economic Community of West African States (ECOWAS) to co-ordinate the war against money laundering and terrorism in the sub-region (*The Guardian*, 2005a).

2.4 The money-laundering process

Money laundering involves three different stages (Sharma, 1992). The first stage is called the placement stage. At this stage, the money launderer places the illegal money into the legal financial system. The aim of the placement stage is to insert the "black money" into the financial system without anyone getting suspicious about it. This is done by converting the money into smaller portions which are then deposited into bank accounts, or it may also be used to buy financial instruments such as bank cheques, bank drafts, bonds, money orders, etc.

The second stage in money laundering is called the layering stage. Once the money is in the legal financial system, the money launderer will then undertake a series of fund movements away from its source. This can be done by channeling the funds into various bank accounts around the globe, especially to countries which have less restriction on the movement of funds.

The last stage is known as the integration stage. After moving the funds away from its source, the money launderer will then re-enter the legal financial system. Investments into assets such as real estate, luxury goods, or in any other legitimate businesses will be made by the money launderer. Note that for the money-laundering process to be successful, the money launderer must not leave a "paper trail" while conducting his "transactions". Absence of a paper trail will enable the money launderer to evade regulatory requirements.

2.5 Customer Due Diligence

The money laundering control system enlists the financial services industry as one of the key partners in the combating of money laundering and the suppression of financing of terrorism. The industry is required to actively prevent its services from being abused to launder money. Financial institutions and certain other businesses and professions are required to employ appropriate CDD measures. The term "Customer Due Diligence" or "CDD" does not yet have a fixed content. However, it is often used to refer to a process that is slightly broader than the so-called "Know Your Customer" or "KYC" procedure which is aimed at gathering sufficient information about a customer to compile a profile of the customer (De Koker, 2002). The forty recommendations of the financial action task force ("FATF") are the leading international standards for such CDD measures in the AML/CFT context. In terms of Recommendation 5, the following CDD measures should be undertaken when business relationships are established or relevant occasional transactions are undertaken (De Koker, 2004):

(i) Identifying and verifying customer's identity using reliable, independent source documents, data or information; (ii) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include financial institutions taking reasonable measures to understand the ownership and control structure of the customer; (iii) Obtaining information on the purpose and intended nature of the business relationship; and (iv) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.

These measures may be applied on a risk-sensitive basis depending on the type of customer, business relationship or transaction. For higher risk customers, relationships and transactions enhanced due diligence are required, while reduced or simplified measure may suffice where there are lower risks. In terms of the recommendations, client identification and verification should normally take place before or during the course of establishing a business relationship or conducting transactions for occasional customers (Egmont Group, 2004). The identification and verification measures should apply to all new customers, although financial institutions should also apply them on the basis of materiality and risk to existing customers. Where the financial institution is unable to comply with these identification and verification requirements, it should not open the account, commence business relations or perform the transaction, or should terminate the business relationship. It should also consider filing a suspicious transactions report under the applicable AML/CFT laws in relation to that customer.

The recommendations are not the only international standards that are relevant to financial institutions. International associations of regulators have also published their own guidelines and principles. The Basel Committee on Banking Supervision, for instance, published a paper on CDD in 2001. This paper was consulted during the 2003 revision of the forty recommendations and it clearly influenced the drafting of recommendation 5 and the related recommendations. The International Organization of Securities Commissions (IOSCO) (2004) and the International Association of Insurance Supervisors (2004) have also adopted CDD principles that are based on the FATF recommendations. In addition to these regulatory standards there are also industry initiatives. The Wolfsberg group, for instance, drafted AML and CFT principles for private banks. The Wolfsberg principles were published in October 2000 and were subsequently revised in 2002. The Wolfsberg principles also influenced the drafters of the 2003 text of the recommendations.

2.6 The compliance challenge

Most financial institutions are required by national laws to follow CDD procedures. The legal requirements may be located in general financial laws but are more often created by specific AML and CFT legislation and regulations. These AML/CFT obligations in these laws are generally based on the core FATF recommendations, in many cases still in their pre-2003 form.

In keeping with international standards, these financial institutions normally have a compliance function and compliance officers to advise managements of the institutions on compliance and to assist them to ensure that the institutions and their employees comply with the applicable laws (IOSCO, 2005; BCBS, 2005). These compliance officers have the challenge to advice on and implement compliance risk management systems that are, on the one hand, affordable, realistic and supportive of the business of the institution and, on the other hand, ensure compliance with the law. Given the nature and relative novelty of most AML/CFT laws and the stance of their financial regulators, the compliance officers often interpret their national laws with reference to the relevant international principles and standards that were discussed above.

The compliance management systems that large financial institutions must employ are complex and expensive. The systems must also be designed to allow for a measure of flexibility. Since 1990 there were three versions of the FATF recommendations and, given the changes in the methodology of criminals and terrorists, further versions can be expected (Schneider and Enste, 2000). An amendment to the international principles require amendments to the national laws and, consequently, to the compliance systems of the relevant institutions. It is sensible, therefore, for a compliance officer to consider possible future developments of the AML/CFT when designing a compliance management system. In general the international CIV principles that were outlined above have tended to become more detailed and onerous. A wise compliance officer will attempt to design a compliance system that is flexible enough to allow for a cost-effective upgrade when required (Masciandaro, 2005).

A compliance officer of a financial institution that provides banking services, brokerage services as well as insurance products will consider the principles formulated by the FATF as well as the BCBS, the IAIS, IOSCO principles. The sets of principles formulated by the associations of regulators differ slightly from each other because each is industry-specific. A compliance management system could be designed that allows for the brokerage services to comply with the IOSCO principles and the banking services to comply with the BCBS guidance. In many cases this may prove too complicated and a general system may ultimately be designed that complies with the most onerous aspects of all three sets.

Enforcement experience in the UK and the hard-line stance of American regulators have made compliance officers world-wide very cautious (Manger, 2002). They are very alert to the legal risk of compliance failure. Legislatures and regulators have increased this risk by providing for crippling fines and other penalties where institutions fail to comply with the law. In addition, they are concerned about reputational risk. This is the risk of the impact that involvement in money laundering or terrorist financing could have on the reputation of and public confidence in the institution. The financial impact of loss of business reputation could exceed the impact of a fine.

Taken together, these factors tend to influence compliance officers to be as conservative and risk-averse as business reality in the institution allows them to be. Some of this conservatism is evident in the client acceptance practices of many institutions. In certain cases, fear of reputational risk and the emphasis of international standards on CDD have lead institutions to adopt CIV measures that exceed the statutory requirements. Given the nature of compliance management in large institutions, the CIV requirements are often expressed in procedures and documents that facilitate a tick-box approach. If a prospective customer is unable to provide all the documents that are required in the CIV process, the boxes cannot be ticked and the customer will not be accepted. Although the CIV measures were formulated to prevent criminals from abusing financial institutions, this approach creates a real danger to those honest customers who are unable to provide the required verification documentation, since they may also be refused financial services.

2.7 Factors that contribute to the adoption of Money Laundering Practices

The main strand of the literature on money laundering is concerned with the legal framework which includes legislation and regulatory issues and can be traced back to the US “War on Drugs” in the 1980s (Gill and Taylor, 2004). It is the repercussions of this war that subsequently led to the formation of the FATF in 1989. According to the FATF (2006b) annual report, many illegal activities are associated with corrupt practices and lack of transparency, which will subsequently give rise to weak governance. This in turn results in poor and ineffective implementation of anti-money laundering programs. Corrupt practices and poor governance arise from ineffective institutions such as the judiciary or regulatory authorities. A well-functioning legal system and efficient enforcement of laws and regulations are important precursors for a stable financial sector (Fergusson, 2006). This in turn can lead to effective implementation of international anti-money laundering programs. Hence, an institutional characteristic which include judicial independence, efficiency of the legal framework, and effectiveness of law making bodies of a country does give rise to a better developed financial sector. To this end, institutional economist, North (1990) stressed the importance of institutional environment as having an impact on economic performance.

New technology, especially ICT has introduced new ways for banks to offer products and services through new delivery channels. The features of these new products and services include increase speed of transmission of digitized information, facilitating the movement of funds and services transcending distance within and across national boundaries (Bradley and Steward, 2002) and anonymity (Philippsohn, 2001). According to Mishkin and Strahan (1999) and Berger (2003) speed, distance and anonymity are the key factors that are transforming the financial system. However, the new products and services which include electronic banking and the introduction of e-money technologies have made money laundering activities even more prevalent (Masciandaro, 1998, 1999; Philippsohn, 2001).

In fact the FATF (2001) report on Money Laundering Typologies identifies online banking and internet as major money laundering vehicle. According to the Chief Financial Officer (2002) report, "Technology changes have influenced the operating strategies of many banks and non-banks as they seek to compete in the increasingly fast-paced and globally interdependent business environment". Alexander (2001) argued that these alternative payment technologies has opened breaches that can be exploited for disguising profits from criminal activities, as money can be channeled through multiple accounts in a host of different sources. This poses problems relating to traceability of the individual transactions which requires vast amount of record keeping. Further, due to difficulties in traceability, law enforcement intervention occurs only after the event has taken place (FATF, 1998). Philippsohn (2001) and Vargas and Backhouse (2003) argued that legislation and regulation implemented to combat money laundering activities needs to deal with the use of new technology. As such a sound financial system to monitor and control transactional activities compounded with strong anti-money laundering regimes are vital to curb money laundering activities.

The number of studies empirically examining the factors that lower the pervasiveness of money laundering is rather scarce. Owing to this gap in the literature, this study will contribute to the literature by examining the impact of the five factors identified above on preventing money laundering in Kenya. These factors are: - technology (ICT infrastructure), quality of human capital, efficiency of the legal framework, ethical behavior of firms (corporate governance) and capacity for innovation in the economy.

2.8 Impact of anti-money laundering measures on the economy

Money laundering prevention influences both the illegitimate and the legitimate world.

2.8.1 Influence on the criminal world

Like any businessman, criminals are interested in keeping costs down and earnings up. In view of rising costs for money laundering, the first and simple solution could be backing out of predicate criminal activities which create a need for money laundering. The current anti-money laundering framework seems to be built on this concept. Reality shows that it does not work, though. Since, the beginning of the fight against money laundering about 20 years ago, the targeted predicate crimes (drug trafficking and organized crime) have grown and prospered.

The decision to undertake a predicate crime is determined by demand and expected gains. In the case of drug trafficking, the demand is still there, even though drug trafficking is illegal. This means that customers exist which are willing to pay for the good, no matter whether it is illegal or not. While suppliers have to bear the costs for doing illegitimate, covert activities, they are able to cover these burdens by raising the price of the good. In legitimate markets, there (mostly) is competition, which is carried out over product quality and price. Competition requires transparent markets, where suppliers and demands can acquaint themselves with the market condition. Monopolies and other market structures hampering competition and market transparency are actively fought against by the state. In the illegitimate world, the invisible hand of competition does not work well. This world is dominated by other forces. Relying on the addictiveness of the clients, suppliers are able to set the price at their discretion. Competitors are forcefully put out of business and cartel-like arrangements are usual, certainly in the world of organized crime. This enables the suppliers to effectively control the revenue variable of the profitability calculation. Even if money laundering contributes significantly to the overall costs, suppliers are able to get significant excess profits, which in turn make the business financially very attractive.

2.8.2 Reaction of the criminal world

The AML measures have made moving money from the criminal world into the clean world more costly. However, criminals are not forced to launder all the criminal proceeds on a gross basis. They can choose amongst several alternatives: (i) Criminals can keep the money in anonymous form: the most important medium where the distinction between criminal and clean is impossible are bank notes (and coins). In most countries cash is the only legal tender, and it is perfectly legal to store and move any amounts of cash. Although cash may have several disadvantages compared with bank deposits, the difference may not be too severe, especially in the case of currencies that are also accepted outside the respective country; (ii) Criminals could avoid money laundering altogether by keeping the dirty money in the criminal world. The bigger the criminal world relative to the clean world is, the easier and more valuable this alternative becomes; and (iii) Criminals may use the international financial system, thus exploiting legal, regulatory and other differences between different countries.

All alternatives require professional resources and long-term investments. Such an environment is typically provided by organized crime. It is conceivable that AML measures promote large, sophisticated organized crime structures rather than fight them (Commonwealth Secretariat (2005).

2.8.3 Influence on the legitimate world

By definition, crime prevention deals with criminal actions which have not been committed (Cuellar, 2003). So, from a criminal law point of view, persons and legal entities are not criminal yet, if at all. This raises the bar for acceptable costs and collateral damages. In contrast to prosecution, which affects only alleged criminals, everyone is subject to crime prevention and AML measures. Current money laundering law exactly requires that, as every financial transaction could involve illicit funds. Besides this direct cost of AML measures, there are also indirect costs in the form of collateral damage:

Damage for the society: A loss of civil liberties, especially privacy. The AML provisions are a threat to the privacy of the individual; and It is the goal of the official AML policy "to counter the use of the financial system by criminals". Society seems to accept that criminals use other parts of its systems jointly with non-criminals: examples are the transportation system, the education system, the legal system, or the health care system.

Economic damage: The AML mechanism increases the direct costs of legitimate market transactions in the same way as illegitimate ones. By increasing the transaction costs of the economy, the AML measures hinder the working of the invisible hand and reduce the wealth of the nations. The whole economy faces increased transaction costs for using the financial system and the payment mechanism in particular. The effect is not limited to transactions of the "financial sector" but it impacts also the "designated non-financial businesses and professions" in the same way. It also increases the production costs of most services provided by the "financial sector" and the "designated non-financial businesses and professions"; Economic sectors, actors and countries with a low sophistication of AML systems and probably a low reputation (Cuellar, 2003), face heavy discrimination, severely impacting chances of participating in the benefits of international trade and co-operation; and The risk exists of making the "complying institutions" and "complying countries" an exclusive club. This leads to regulation driven promotion of monopolistic or oligopolistic structures and results in high economic costs.

2.8.4 Interaction between criminal and legitimate sphere

Applying the AML framework described above, the attributes "criminal" and "legitimate" are not only given by law and courts, but actually by the private sector as well. Because the latter applies a risk-based approach, it may judge a person or an action as "doubtful" which is not "criminal" but "not legitimate enough" or "not profitable enough". Emphasis has to be put on the fact that "doubtful" for a bank does not need to mean "criminal" in any way. The actual "criminality" of clients and their funds is hardly recognizable. Hence, banks and other financial services providers rely on criteria such as nationality, religious affiliation, industry and domicile of a client to create a risk profile. Depending on the risk affinity the bank has and its regulator allows, prospect clients may be refused because they exhibit high-risk criteria, without any hints on the actual doubtfulness of a client. An example is the deliberate measures of not banking foreign bureaus by some banks.

By treating actually legitimate clients and transactions as "doubtful" they are moved from the legitimate world to the grey one, with many consequences: (i) Many services and provisions of the legitimate world are not available any more for all economic subjects or only available at prohibitively high costs; (ii) The illegitimate world will be happy to offer these services, but to their conditions; (iii) This will firstly lead to an extension of the criminal world, and secondly to the secluding criminalization of persons originally acting in the legitimate world; and (iv) The extension of the criminal world provides new liquidity and members to it, thus enabling the criminal world to acquire more services and products without leaving the criminal sphere.

The results of such a shift can be severe. The more services and products can be supplied out of the criminal world, the higher is the relative value of non-laundered money. This reduces the need for money laundering, strengthens the illegitimate economy and removes funds and resources from the legitimate sphere of the economy, which is subsequently weakened. Here, the fence is not shifted by the regulators and supervisors. Instead it moves by itself into the wrong direction. This is especially the case when the list of predicate offences is extended. When the predicate offence was drug dealing only, the chance to meet this criterion was very small. Today, given the extensive list of predicate offences, it is likely that there is at least a chance that a prospect client is engaged in such activities. Therefore, the investigation effort rises as does the risk and cost for all client relationships.

2.9 Challenges of Implementing Anti-Money Laundering Policies

2.9.1 Challenges on the global scene

Inadequate manpower and equipment: *C*ountries with large, extensive borders often do not have the manpower or equipment to adequately provide the type of control expected in the agreements. Several of the representatives from African countries noted this as being a problem. Kenya, for example, a country that established free movement across borders with other African countries, has found that, while this may stimulate trade and help develop communications among the countries, it makes it more difficult to control the movement of fugitives and international criminals (Sang, 1997; Cottam and Marenin, 1981). The same problems were mentioned in regard to India. It was stated that smuggling takes place in large dimensions, and criminals can cross borders without fear, because international policing is not available. Those involved with drugs and money laundering are able to operate easily (Bhattacharyya, 1997). As a result of its specific geographic location, Jordan is a transit country for drug trafficking. It is not a receiving country, but a connecting country, with drugs flowing through from north, south, and east. Jordan cooperates in international policing to the extent possible by intercepting drugs from other countries, and it has co-operated with France, Germany, the USA, Arabic countries, and European countries. Nevertheless, it is very difficult to maintain the borders and stem the flow (Nsour, 1997).

Language barriers and lack of knowledge of other countries: *L*anguage barriers and lack of knowledge of other countries' customs and cultures were cited as major factors that inhibited the effectiveness of some of the treaties or agreements (see Ingleton, 1994; Anderson, 1991). For example, Leong (1997), noted that the Australian Federal Police are not trained in cross-cultural diversity. He noted that most police are of Anglo origins, and they do not have appropriate knowledge and understanding of the Polynesian and Asian customs and cultures. Much of the training given in this area is not contextual enough to be useful to police officers in the field. Many of the African countries have a number of different languages and ethnic groups within a single country, which makes it extremely difficult to police internally as well as internationally (Ebbe, 1997). The problems created through language barriers and lack of understanding of the cultures of other countries was also cited by representatives from Kenya, Uganda, India, Canada, and the USA. The varieties of languages spoken within a country, and the lack of understanding and mutual distrust of the people of other countries lead to the agreements being less effective. Murray (1997) argued that more agreements could be developed between Ireland and Great Britain, if there were greater understanding and acceptance of their cultural differences. According to Marenin (1997), the USA approaches relations with Mexico with the assumption that the Mexicans are corrupt, and the Mexicans have a general opinion of the US police as being arrogant (Marenin, 1997).

High level corruption: *P*olice corruption and particularly the corruption of high level government officials are factors that create problems (McCormack, 1996; Chebotarev, 1989; Punch, 1985; Benveniste, 1983). If a country is known for being corrupt, it is not likely that agreements will be seriously explored (Koenig, 1997). At times, some agreements may be made by various countries at the diplomatic level, with knowledge on the part of both countries that it is a "paper" agreement, and there is little chance of the provisions of the agreement being operationalized. Many of the presenters, particularly those from newly independent or developing countries, noted that projects are not working because their countries lacked the personnel, equipment, and resources to implement the agreements at a level that would guarantee positive results. There is a need for more funding, personnel and more and newer equipment.

Inadequate training: The lack of resources to provide the officers with the appropriate training is a great handicap (Teck, 1997; Kumar, 1997) (see also Igbinovia, 1984, 1982). Often, the international criminal element has more resources in terms of money and communications equipment, and is more sophisticated in its procedures and techniques than the police who are attempting to control their criminal activities. Lack of training is major factor inhibiting police success. Specifically, the need is for training and skills that can be employed at the operational level (Benyon, 1997).

Lack of cooperation by some countries: Lack of co-operation, reluctance to allocate resources, and reluctance to participate in co-operative agreements are all challenges that must be faced. If a regional co-operative operation is established specifically to control smuggling, and one of the nations in that geographic region fails to co-operate or allows that country to be used as a "safe haven," the effectiveness of the operation is greatly reduced. With the help of organized crime, a number of illegal Chinese immigrants are quite successful in entering Japan and maintaining residence there (Ohara, 1997). Ohara argued that some countries are reluctant to provide information on violent criminals, and some allow drug trafficking to be routed through their countries. For instance, Egypt would like to establish a plan to control crimes committed by tourists and members of organized crime, but it has not always found other countries willing to co-operate (El Zein, 1997). There is a need for intelligence and general statistics on these types of crimes, so that they are able to develop a plan to combat them. Such a plan would have to take into consideration the other countries of that region (Fathi, 1997). The breakup of the Communist bloc in Eastern Europe and the subsequent disruption that these countries experienced for several years after the changes in government led to a number of problems for neighboring countries. Although there have been attempts to form agreements and provide assistance, there still are considerable communication problems (Edelbacher, 1997).

Civil wars and internal conflicts: In a few instances, the disadvantages or challenges of international police co-operation agreements are limited to specific countries or regions. For example, in parts of the African continent civil war or internal conflict is so pronounced that it is very difficult to develop effective external bilateral or regional international agreements (Ebbe, 1997). In the USA, there is no integrated federal police system, and the federal agencies that would be involved in international police organizations, such as the FBI, Secret Service, and the Drug Enforcement Administration, often do not even co-operate with each other internally. These agencies compete for resources and prestige. In addition, the resources available for funding international policing ventures tend to be chiefly limited to drug traffic control (Marenin, 1997) (see also Nadelmann, 1993; Lobe, 1975). In addition to the need to improve co-operation and participation of some countries in these informal agreements, it was mentioned by several representatives that there is a need to improve the legal framework through which the police co-operative activities are carried out (Vorniotakis, 1997). The standardization of extradition treaties, laws pertaining to organized crime, drug trafficking, counterfeiting, illegal immigration, and the standardization of passports would lead to an overall improvement in the effectiveness of the agreements, and would help define what forms or types of agreements are needed. Presenters from several countries implied that there may be more bilateral and regional agreements than resources, facilities and time available to adequately implement them.

Illegal immigration: The strengthening of efforts in the problem area of illegal immigration was considered to be an important area for increased international police co-operation and new agreements (Edelbacher, 1997; Vorniotakis, 1997; Wiarda, 1997). The standardization of the laws on illegal immigration is a matter that the international community should examine. A distinction between unrecorded and unauthorized entry into a country is a topic that should be considered (Ponce, 1997). The delegate from Egypt stated that his country needed assistance from those countries that allow various categories of criminals, such as terrorists and drug traffickers, to escape to their countries without fearing apprehension. New controls are needed that would give Egypt the ability to extradite these criminals. Egypt, through either informal or formal arrangements, will continue to provide assistance to other countries requesting help on matters relating to criminal investigations of an international nature, and other types of crimes that these countries are experiencing (Fathi, 1997).

2.9.2 Challenges of Implementing Anti-Money Laundering Policies in Kenya

Kenya was privileged to host the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), 16th Taskforce meeting of senior officials in August 2008. Sub Saharan countries vulnerability to money laundering was attributed mainly due to its cash based economies. This is further aggravated by porous borders and weak institutions for enforcements. These challenges are discussed in detail below:

Structural Displacement Factors: Money launders like most organized criminals seek out jurisdictions, which are unlikely to detect their activities (Commonwealth Secretariat, 2005). Kenya like most of the developing countries has unique factors that are conducive to money laundering, some of these factors are: liberalized and cash based economy; different legal system; porous borders; parallel banking and alternative remittance avenues (corruption).

Liberalized and Cash based Economy: Kenya's economy as is the case in most of the developing countries is largely cash based. More than 70% of the country's GDP is from the informal sector and majority of the players of this sector are not banked (Kenyan, Budget speech, 2005/6). Approximately only 10% of adult Kenyans hold bank accounts (CBK, 2003) because of the banking costs and negative banking perception (Beck *et al* 2005). The formal financial system is yet to develop to a stage of absorbing most of the non-cash transactions. Consequently, capturing and monitoring such transaction may be difficult and money launders may therefore be in the informal sector without being detected (Commonwealth Secretariat, 2005).

In an effective anti-money laundering regime, audit trail or the tracing of transactions for investigations are possible due to the kind of financial instruments used. On the other hand, cash based economies are more prone to the increasing and undetected use of underground banking system. It is therefore important to tackle the cash basis of the parallel economy using measures aimed at reducing the use of cash and where necessary, improving the efficiency of the domestic banking system to make it more attractive (Commonwealth Secretariat, 2005).

Different legal system: Money laundering is a cross-border crime, where launders target activities through which they may disguise their operation (commonwealth Secretariat, 2000). In order to combat money laundering more effectively the legal systems in various jurisdictions have to be synchronized. Synchronized laws ease investigation, extradition procedures and mutual legal assistance between jurisdictions, which are key activities in AML regimes.

Unstable Neighboring regime: The long period of conflict experienced by the countries that neighbor Kenya and the Kenyan boundary is porous. As a result there has been infiltration of criminal activities across the affected borders, particularly trade in small firearms and drugs. (Global Dialogue on Anti Money Laundering and terrorists Financial Activities Kenya's country Report: - September 2002).

Parallel banking and alternative remittance Avenues (Corruption): El Sheikh (2002) and Nwaz, McKinnon and Webb (2002) argued that existence of parallel banking activities, also known as "Hawallas" especially among certain members of communities encourages money laundering. Parallel banking units are also able to wire funds to and from other jurisdictions without going through the formal banking system, e.g. by using forex bureaus.

The corruption perception index published by transparency international (see table 2.1 below) shows that Kenya is quite corrupt. According to transparency International bribery and corruption are evident at all levels of society. For instance in a local survey conducted in early 2002 to determine public perception on corruption among public institutions in Kenya showed that the police are perceived as the most corrupted public institution in Kenya and the judiciary was sixth in the list (Goredema, 2003)

Table 2.1: Summary of transparency international corruption perception Index

Year	Ranking
1996	Third from bottom in the list of most corrupt countries, only Pakistan and Nigeria were below Kenya
1998	Kenya ranked 78th out of 85 countries survey
1999	Kenya was ranked 90th out of 99 countries
2000	Kenya was ranked 82nd out of 90 countries
2001	Kenya was ranked 84th out of 91 countries

Source: Goredema (2003).

Corruption undermines all AML/CFT efforts because it can weaken the judicial and legislative framework of jurisdiction and neutralize the powers of effective law enforcement in general. A number of international initiatives target structural corruption and advocates for strong AML/CFT efforts as part of this system because of the built-in safeguards against corruption found in the FATF recommendations. These can be found in recommendations and specifically in the area of PEPs. In addition, corruption may generate large amounts of proceeds to be laundered. By establishing corruption as a predicate offence, money-laundering arising as a result of corrupt activity can be more effectively targeted. Corrupt officials can in turn inhibit the implementation of effective AML/CFT measures, and this is recognized as an integral link between corruption and money laundering which needs to be combated (UN Report, 2006).

***Inadequate Legal and institutional framework*:** According to the Global Dialogue Tele-conference on Anti-money Laundering and Terrorist financial activities, Kenya's country report, (September 2002) most of the activities underlying money laundering are specified as criminal under various Acts of parliament. However, money laundering is not considered as a criminal activity except in relation to proceeds from narcotic drugs and psychotropic substances. Lack of legislation and money laundering in Kenya may encourage it.

Further, the AML disclosure obligations compromise the right to privacy. In an AML regime the bank secrecy obligations are overridden and there is also a requirement to report their client's suspicious activities. This cannot be done without legal protection of the reporting institution. This was demonstrated in the High court Case Number 761 of 1988, James Kanyitta Nderitu Vs Standard Chartered bank of Kenya Limited. This was a cheque from Customs and Excise department (for Khs 17 million), being an export compensation for locally manufactured good he had exported in 1980's. The bank got suspicious of this transaction and reported it to law enforcement agencies and froze the amount. The customer sued for unspecified general damages plus breach of bank/customer confidentially. The high Court awarded him six hundred and two million Kenya shilling (Shs. 602 million) .

In May 2002, a panel of judges from Tanzania, Uganda, South Africa and Canada were invited to review the state of the administration of justice and advice on how to booster public confidence in the institutions responsible for justice (the Constitution of Kenya review Commission, 2002). In their view, Kenya's judiciary is in need of a 'short shark shock'. Money laundering process, as a novel phenomenon is so intricate that enforcement officers, prosecutors and judicial offers need to continuously upgrade their understanding of the evolution of crime.

Perceived Cost of implementing an AML Regime: Like implementing any other financial regulation directives, there are costs associated with implementing effective AML regimes in the banking sector (De Koker, 2004). These include regulatory cost and costs incurred by the banking institutions. Regulatory cost include: licensing of the banks, vetting the directors and shareholders of the banks, issuing of AML directives to the industry, on-site supervision of the banks to ascertain compliance with the issued AML directives and establishment of remedial measures.

On the other hand, the AML implementation costs for the banking institutions include: the cost of preparing a policy, training of staff on AML issues, CDD retention of records, monitoring and reporting of suspicious transactions and cash transactions reports, setting- up of internal reporting mechanism and employment of a compliance officer. De koker (2002) further argues that, introducing stringent CDD requirements may reduce the usage of banks. In the absence of research on money laundering's effect on developing economies, some observers have advanced the view that developing country government should not devote their scarce resources to policies designed to reduce money laundering activity, thus implying that the course of action for developing countries with respect to money laundering is what might be called the inaction policy (Barlett, 2002).

The inactive is based on three inter-related arguments, each of which is flawed. First, money laundering funds flow from developed economies to developing economies and therefore result in a flow of capital and indeed; it can be shown that money laundering facilities illicit capital flight from developing economies. For instance the Nigerian former President, Sani Abacha invested US $ 4 billion stolen from the country's coffers, in various banks in Europe and America (Johnson 2001); the Kenya Goldenberg enquiry showed that most money was invested in the developed economies (Goredema, 2003).

Second, to the extent that money laundering occurs in developed economies, developing –country government should not be spending the limited resources on preventing crime in developed economies (The Asian Development bank, Regional Technical Project No. 5967, 2002). Third, in imposition of anti-money laundering financial regulations discourages the use of developing – country bank and encourages citizens to move their saving offshore. On the contrary, there is evidence that stronger financial regulatory regime encourages the use of financial system subject to such regulation and indeed, a review of net financial flows from banking systems during period in which anti-money – laundering policies have been imposed shows no evidence of savings –flight in response to such policies (IMF working paper 96/66 "Quick 1996").

2.10 The Kenyan approach

The adverse effects of the practice of money laundering had long been recognized in Kenya but it was not until the 16th of May 2007 that visible efforts to deal with the problem were taken, when the Anti Money Laundering Bill (2006) was tabled in parliament. The Bill was created to provide for the offence of money laundering and to introduce measures for combating the crime while ensuring the implementation of procedures that will enable institutions to identify, trace, freeze, seize and confiscate the proceeds of any financial crime or money laundering scheme (Crime and Anti Money Laundering Bill, 2006).

A similar Bill was passed and enacted into law in Nigeria in 1996. One major defect of the enactment in Nigeria was that it limited the source of the illegal activities that could precipitate money laundering to drug trafficking, thus creating an avoidable loophole for accused persons to escape justice when the criminal activity is not drug trafficking (Adekunle, 1999). It was in recognition of this inadequacy coupled with subsequent developments in this area that led to the enactment of the Money Laundering (Prohibition) Act, 2003 which makes comprehensive provisions relating to the offence. Barely one year after its enactment, it was amended through the Money Laundering Prohibition (Amendment) Act 2004. Two basic philosophies underline the provisions of the act. Kenya has thus got to be weary of the foregoing situation in Nigeria.

The current status of the Anti Money Laundering Bill in Kenya is that it passed the first reading in parliament and was referred to the departmental committee on finance which will scrutinize the Bill and propose amendments. It therefore does not have the force of law as yet and cannot be enforced or give protection to institutions which release customer information to any bodies that report suspicious transactions. Kenya is lagging behind such African states as Tanzania, which in November, 2001, enacted the Prohibition and Prevention of Money Laundering Act No. 14. The country was evidently propelled to take concrete action against money laundering after the establishment of the East and Southern African Anti-Money Laundering Group in Tanzania in 1999.

Despite the shortcomings, it is expected that once the Bill is enacted into law, Kenya will have taken a giant stride in the effort to stem the dangerous economic crime of money laundering.

The Bill is designed to attain the following main objectives: (i) To prevent money laundering by instituting certain measures such as the collection, evaluation, processing and investigation of financial information relating to financial and other business transactions suspected of being part of money laundering, or a conspiracy to commit such an offence; (ii) To enhance regional and international co-operation with law enforcement bodies responsible for the investigation of money laundering with a view to preventing and combating such crimes; (iii) To enable relevant authorities to conduct investigations and prosecutions of money laundering offences; (iv) To authorize the government, through its agencies, to adopt measures for the seizure and forfeiture of property derived or acquired from the proceeds of crime; (v) To punish persons convicted for the crime of money laundering by the imposition of appropriate fines or imprisonment for certain terms; and (vi) To establish appropriate machinery to assist the government develop and adopt measures necessary for the prevention, detection and suppression of money laundering (Anti Money Laundering Bill, 2006).

2.11 Summary and conclusions

Abuse of the financial system is not a new phenomenon in the global economy. However, in the wake of increased terrorism activities around the globe it has proliferated fresh interest on the issue of money laundering. In fact, money laundering has become one of the most feared finance-related criminal activities in recent years. While various measures have been undertaken at local, regional and international levels, there are still ways for money launderers to continue their "businesses."

International trade-based money laundering has proved to be an important channel for criminal activity. Trade-based money laundering activities vary in complexity. The most basic schemes are fraudulent trade practices (e.g. under or over pricing of receipts), while the more complex schemes integrate these fraudulent practices into a web of complex transactions (i.e. movement of value via the financial and international trade systems). The use of such complex systems complicates the detection of illegal money trails. It is a positive development that Kenya has taken concrete steps to prevent and prohibit money laundering in conformity with the zeal of the international community in this regard. This is being done through the establishment of the enabling legal and institutional structures.

It is now left for the appropriate enforcement agencies to ensure the due and effective implementation of the laws and reduce the incidence of money laundering in the country. This can only be done if the country demonstrates the requisite political will and commitment in the overall interest of the continent. That the Kenya Government is able to face the problem by arraigning before the court many suspects in the recent past for money laundering and other related offences is not only significant but also evidence of this commitment which needs to be sustained to serve as a deterrent to others. It is indeed an affirmation of the fact that there are no sacred cows in the fight against money laundering and other related offences in the country. Such efforts will invariably inspire other African countries to take similar measures to ensure effective prevention and prohibition of money laundering in their own countries.

African countries must work together in this laudable fight against money laundering; and be willing to share experiences, and even competences to ensure that money launderers do not have safe havens in the continent to run to, as they would readily do, where some countries do not have effective anti-money laundering legislations and mechanisms. It hardly needs to be stressed that the success of anti-money laundering initiatives depend, to a large extent, on the level of co-operation and co-ordination between the major role players in the fight namely: the financial institutions and law enforcement agencies, as well as between countries since the crime is essentially a trans-border one.

2.12 Chapter Summary

The review of literature reveals that the recent surge of interest in Anti Money Laundering raises a number of questions for the future structure and performance of financial institutions. Perhaps the most significant is whether the widespread focus on technological innovations and the related investment in infrastructure is justified and sustainable. Chapter three presents the research methodology.

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter covers a description of the study design, target population, sample design and size, data collection instruments and procedure.

3.2 Research design

According to Brown *et al* (2003), research design provides the glue that holds the research project together. A design is used to structure the research, to show how all of the major parts of the project - the samples or groups, measures, treatments or programs, and methods of assignment - work together to try to address the central research questions (ibid). The current study is qualitative in nature. To undertake the study, a descriptive research design will be used. This is a scientific study done to describe a phenomena or an object. In this case the study phenomenon is money laundering. This kind of study involves a rigorous research planning and execution and often involves answering research questions. It involved an extensive well-focused literature review and identification of the existing knowledge gap. The method is preferred as it permits gathering of data from the respondents in natural settings. In this case, it was possible for the researcher to administer the data collection tools to the respondents in their workstations, which was relatively easy, with high likelihood of increasing the response rate.

3.3 Population and Sampling Design

3.3.1 Population of the study

The population of interest in this study was the Banks listed on the Nairobi Stock Exchange and the Telecommunication services operators licensed to undertake money transfer business in Kenya. There was a deliberate decision to focus on the banks that are listed in the Nairobi Stock exchange for various reasons; these include:

Based on previous research and AML conferences in Sub Saharan Africa, AML policies have been applied by different financial institutions in differing degree. This study would like to confirm the extent of AML adoption in the big banks that are listed in the stock exchange. In addition, listed banks are normally expected to comply with stringent requirements including Capital Markets Authority policies and other disclosure requirements. Typically, we would expect them to have applied reasonable AML policies. This study will be able to confirm this. The respondents of study will be the Compliance Heads of the various organizations, and in their absence, the second person in command or persons who have been delegated duties of the Compliance Heads will participate in the study. According to the Nairobi Stock Exchange report of May 2008, the total number of Banks listed on the stock exchange was eight while according to the Central Bank of Kenya reports of May 2008, three Telecommunication service providers are licensed to undertake money transfer business, with their headquarters strategically located in Nairobi. The researcher thus undertook undertake a census, owing to the small number of organizations to participate in the study, all located within Nairobi and its environs.

3.3.2 Sampling design

It would have been desirable to undertake a census of both the telecommunication service providers and the financial institutions in Kenya, but owing to their big numbers and spread all over the country, which would have serious cost implications, a sample of only the eight banks listed on the Nairobi Stock Exchange and the three Telecommunication service providers were considered for the study. Specifically, purposive sampling was employed of judgmental nature to arrive at the sample size. The researcher selected sample members to conform to some criterion. In this case, the researcher sought information from Compliance Heads whose organizations have undertaken the anti money laundering initiatives.

3.4 Data collection methods

Primary data was collected from the Compliance Heads of the selected organizations using a semi-structured questionnaire. The questionnaire consisted of two sections, Section I and section II. Section I consisted of items pertaining to profile of the respondents while section II consisted of items pertaining to the area of study. The researcher also used interview schedules, which will have open questions, aimed at meeting the objectives of the study. The sets of questionnaires and interview guides were pre-tested on 4 randomly selected respondents to necessitate adjustments in order to make them more suitable and minimize bias in responses. The procedure that was used in collecting data was through distribution of the questionnaires that is, dropping and picking questionnaires from respondents at their most convenient time that was agreeable to both parties.

3.5 Research Procedures

Since all the organizations selected to participate in the study have their head offices in Nairobi, the researcher administered the questionnaires by hand delivery. A letter of introduction, which stated the purpose of the study, was attached to each questionnaire. In addition, the researcher made telephone calls to the respective respondents to further explain the purpose of the study and set a time frame for the completion of the questionnaires. Once completed, the researcher personally collected the questionnaires. This gave him the opportunity to conduct clarify certain issues arising from the various responses. In addition, personal interviews were conducted with 4 of the respondents selected at random, aided by an interview schedule. In this case the researcher was able to obtain additional information to corroborate findings from the questionnaire.

3.6 Data analysis and presentation

For purposes of the current study, the data was analyzed by employing descriptive statistics such as percentages, mean scores and standard deviations. Statistical Package for Social Sciences (SPSS) was used as an aid in the analysis. The researcher preferred SPSS because of its ability to cover a wide range of the most common statistical and graphical data analysis. Computation of frequencies in tables, charts and bar graphs was used in data presentation. The information was presented and discussed as per the objectives and research questions of the study.

3.7 Chapter Summary

The chapter gave insight into how the research was conducted. Specifically, the researcher discussed the Research Design, Study Population, Methods of data collection, Research procedures, Data analysis and presentation. A descriptive survey was undertaken, focusing on all the eight banks listed on the Nairobi Stock Exchange and three telecommunication service providers licensed to undertake money transfer business in Kenya. Both quantitative and qualitative methods of analysis were used. The quantitative data and qualitative information collected was coded and summarized in various forms. The data was analyzed by employing descriptive statistics such as percentages, frequencies and tables. Statistical Package for Social Sciences (SPSS) was used aid in analysis.

4.0 PRESENTATION OF FINDINGS

4.1 Introduction

This chapter covers the data analysis and presentation of findings. It presents findings on study of the use of regulatory policies in the fight against money laundering in Kenya. Out of the 11 questionnaires sent out, 10 were returned completed (91% response rate). The high response rate could be attributed to the researcher's efforts in making follow ups on every questionnaire sent out. The information is presented as per the objectives and research questions of the study.

4.2 Profile of respondents

Respondent organizations: The respondents were asked to indicate the organizations they represented. The responses indicate that the 10 organizations that participated in the study are - Diamond Trust Bank Ltd, Equity Bank Ltd, National Bank of Kenya Ltd, Kenya Commercial Bank Ltd, CFC Stanbic Bank Ltd, NIC Bank Ltd, Barclays Bank of Kenya Ltd, Standard Chartered Bank Kenya Ltd, Co-operative Bank of Kenya Ltd and Safaricom Ltd.

Period of operation in Kenya: The researcher sought to establish the time period the respondent organizations had been in operation in Kenya. The responses are summarized and presented in table 4.1 below.

Table 4.1: Period of operation in Kenya

Period of operation	Distribution	
	Frequency	Percentage
Less than 1 year	0	0
1 to 5 years	0	0
6 to 10 years	1	10
11 to 15 years	1	10
16 years and above	8	80
Total	**10**	**100**

The findings show that while 10% of the respondent organizations had been in operation in Kenya for less than 10 years, 10% had been in operation for between 11 and 15 years and 80% had been in operation for a period exceeding 16 years. The organizations had been in operation for long enough to be able to give objective responses to the study questions.

Ownership of respondent organizations: The respondents were asked to indicate the ownership of their respective organizations by ticking as appropriate against given alternatives. The responses are summarized and presented in table 4.2 below.

Table 4.2: Ownership of respondent organizations

Period of operation	Distribution	
	Frequency	Percentage
Predominantly local (51% or more)	7	70
Predominantly foreign (51% or more)	3	30
Balanced between foreign and local (50/50)	0	0
Total	**10**	**100**

The findings in table 4.2 show that whereas 70% of the respondent organizations were predominantly locally owned, 30% of the organizations were predominantly foreign owned.

Products and services offered by the respondent organizations: *T*he respondents were asked to indicate the products and services their respective organizations offered to their customers. The responses are summarized and presented in table 4.3 below.

Table 4.3: Products and services offered by the respondent organizations

Category of products and services	Actual products and services	Distribution	
		Frequency	Percentage
Personal banking	Savings accounts, Loans, Investments and Convenience services, Foreign exchange, e-Banking, Letters of Credit, Guarantees	9	90
Business Banking	Savings accounts, Current accounts, Treasury management and Commercial loans, Foreign exchange, e-Banking, Letters of Credit, Guarantees, Treasury and Investment banking	9	90
Mobile Telephone service	Voice, Data, SMS, M-PESA	1	10
N=10			

The findings show that whereas all the participating banks offered similar products, but slightly differentiated by the names given to the products, the only mobile telephone service provider offered voice, data and money transfer services.

Number of full time employees: The researcher sought to determine the size of the various organizations that participated in the study by asking the respondents to indicate the number of full time employees the organizations had. The findings indicate that all the respondent organizations had more than 100 full time employees.

Period of time respondents worked in the organization: The respondents were asked to indicate the period of time they worked in their respective organizations. The responses are summarized and presented in table 4.4 below.

Table 4.4: Period of time respondents worked in the organization

Period of operation	Distribution	
	Frequency	Percentage
Less than 1 year	0	0
1 to 5 years	4	40
6 to 10 years	3	30
11 to 15 years	1	10
16 years and above	2	20
Total	**10**	**100**

The findings show that whereas 40% of the respondents had worked for their respective organizations for between 1 and 5 years, 30% had worked for between 6 and 10 years, 10% had worked for between 11 and 15 years and 20% had worked for 16 years and above. The findings show that the respondents had worked for their respective organizations long enough to understand the operations of their respective organizations and hence be able to provide objective responses to the study questions.

Position and responsibilities of the respondents: The respondents were asked to indicate their respective positions and responsibilities. The researcher sought to establish the extent to which the respondents understood their responsibilities. The responses are summarized and presented in table 4.5 below.

Table 4.5: Position and responsibilities of the respondents

Position	Responsibilities	Responses (%)
Compliance Manager	Assist the Country Head of Legal & Compliance, in directing and overseeing the day-to-day management of Regulatory Compliance risks at the country level.	60
	Ensure proper functioning of day-to-day controls, periodic monitoring activities, and timely resolution of risk issues.	
	Create awareness on local regulations and compliance policies among members of staff through training and sensitization.	
	Help the businesses to design and implement control measures and monitoring plans for compliance risk management.	
	Review the controls in the businesses and other functions to ensure that controls are effective for compliance monitoring through sample testing in 'compliance assurance reviews', undertaken in the second line of assurance.	
	Ensure appropriate internal controls and procedures for money laundering prevention are in place and functioning as intended	
Head of Compliance	Money Laundering Compliance Officer	30
	Conduct compliance risk audits	
	In-house trainings	
	Investigation and reporting of suspicious activities	
Senior M-PESA AML & Fraud Officer	Ensuring that AML controls are in place and operational for M-PESA.	10
Total		**100**

The findings in table 4.5 show that the titles compliance manager and head of compliance were used by the various banks to refer to the person in charge of the anti-money laundering function while the title - Senior M-PESA AML & Fraud Officer was used by the only mobile telephone service provider that participated in the study. The findings further show that the respondents had a good understanding of their respective duties and responsibilities and were thus expected to provide objective answers to the study questions.

4.3 The use of regulatory policies in the fight against money laundering in Kenya

4.3.1 Extent to which Money laundering Regulatory policies have been adopted by financial institutions in Kenya

In order to meet the first objective of the study, "to investigate the extent to which money laundering regulatory policies have been adopted by financial institutions in Kenya" several questions were asked.

Verification of new account opening procedures: Firstly, the respondents were asked to indicate whether they verified the New Account opening procedures (New Customer acquisition) in respect of Anti-Money laundering compliance by ticking as appropriate. All the respondents indicated that they verified the New Account opening procedures. The respondents were further asked to briefly explain their respective verification process that is used for all new customers. The responses are summarized and presented in table 4.6 below.

Table 4.6: Verification process for new customers

Verification Process	Responses (%)
Identification; Address verification; and Sanctions Screening	
Screen names to ensure they are not sanctioned entities; In respect of Company/institutions/organization, search is carried out to determine the legality and they must complete and sign our Money laundering questionnaire; Positive identification of customers using valid Government documents.	20
Account Opening documentation; Address verification; Name matching to sanction lists; Purpose of the Account; and Risk classification	40
Ensuring that all relevant identity documentation such as Identity Cards, Passports, Photographs, and Employer/Business references are taken and verified as appropriate; and search customer surveillance database to confirm that the potential customer has not been blacklisted.	30
Verification done for MPesa customers and Post paid ones	10
Total	**100**

The findings in table 4.6 show that whereas all the respondent organizations undertake verification of their new account opening procedures, the process of verification differed slightly. The process involved identification, verification of contact information provided by the applicants and the sanctions screening.

Assessment of money laundering risk relative to the corporate products and services: The respondents were asked to indicate whether there has been any assessment of money laundering risk relative to the corporate products and services they offered. The findings show that whereas 20% of the respondents indicated that they have not had any risk assessment of money laundering risk relative to the corporate products and services they offered, 80% of them indicated that they had undertaken the assessment. The respondents who had undertaken the assessment were asked to briefly explain how they had undertaken the assessment. The responses are summarized and presented in table 4.7 below.

Table 4.7: Assessment of money laundering risk relative to the corporate products and services

Assessment procedure for money laundering risk	Responses (%)
All products identified by the institution were identified. Money Laundering risks posed by the products were identified focusing on the delivery channel; the geographical region; Nature of business and link / relationship to sanctioned countries are factored into the risk assessment. There is a scoring model that defines the risk levels as (i) High; (ii) Medium or (iii) Low. Appropriate due diligence is then defined for the respective segments.	3
Compliance assurance reviews are also carried out from time to time audit department must certify that all controls are in place before any new product is launched it must undergo risk assessment	3
Defined risk matrix in place.	2
Total	**8**

Risk Based Approach to Money Laundering: The respondents were asked to indicate whether their respective organizations had a process for identifying and rating higher risk clients (for instance politicians, high net worth individuals, foreigners, charity organizations and trusts) in respect of Money laundering. The findings show that whereas 70% of the respondent organization had a process for identifying and rating higher risk clients, 30% did not have. The respondent organizations that had a process for identifying and rating higher risk clients were further asked to briefly explain how the identification and rating is done. The responses are summarized and presented in table 4.8 below.

Table 4.8: Process for identifying and rating higher risk clients

Process for identification and rating higher risk clients	Responses (%)
PEPs are usually identified using the screening method, high worth individuals if not declared at inception are captured during account monitoring. In all cases there are risk graded appropriately for close monitoring. Bank has also List of high risk business used for risk grading.	3
Risk rating is accorded to a particular business relationship or transaction by a function of all factors, which may be relevant to the combination of the particular customer profile, product type and transaction.	2
Enhanced Due diligence with Approvals from Compliance function	2
Total	**7**

Identification of source of funds/origins of wealth: The respondents were asked to indicate whether their respective organizations identified source of funds for new customers. Whereas all the banks that participated in the study indicated that they identified source of funds for their new customers, the only mobile telephone service provider that participate in the study indicated that the organization did not identify source of funds for the new customers.

External/internal compliance policies: The respondents were asked to indicate the external/internal compliance policies that their respective organizations had put in place. The responses are summarized and presented in table 4.9 below.

Table 4.9: External/internal compliance policies

External/internal compliance policies	Responses (%)
There are clearly defined business rules for different corporate products that mitigate on all perceived risks including; Operational; AML; Market; Legal; Regulatory and Reputational risks.	4
The use of group money laundering policies and also guidelines set out in the prudential guidelines by CBK	1
Central Bank of Kenya Prudential Guidelines and NIC Bank Policies	1
Customer identification and verification procedures	
Transaction monitoring and procedures for the reporting of suspicious transactions to CBK	
An anti-money laundering policy	
Record keeping procedures	
Training on anti-money laundering compliance and general AML awareness	
Independent AML reviews by Internal Audit	
AML policy and KYC procedure	4
Total	**10**

The findings show that all the participating organizations had external/internal compliance policies in place, though they varied from bank to bank.

Initiatives to ensure staff compliance with policies: The respondents were asked to indicate how their respective organizations ensured that the staff met the compliance policies/money laundering policies mentioned above. The responses are summarized and presented in table 4.10 below.

Table 4.10: Initiatives to ensure staff compliance with policies

Initiatives to ensure staff compliance with policies	Responses (%)
Training	3
Testing and Monitoring Compliance by various risk teams.	
Attestations.	
Reviews and training are carried out from time to time to ensure compliance.	2
Semi-annual sign-offs by all staff.	1
Frequent review/audits on understanding.	
Training, Monitoring and Audit	1
Through training of relevant personnel and by conducting On site & off site assessments to confirm procedural compliance	3
Total	**10**

The findings show that all the participating organizations undertook certain measures to ensure that their respective staffs complied with the policies. These include training, testing and monitoring compliance by various risk teams, reviews and audits.

Customer transactions with sanctioned countries: The respondents were provided with a list of sanctioned countries and asked to indicate whether they allowed transactions with customers from those countries. The responses are summarized and presented in table 4.11 below.

Table 4.11: Customer transactions with sanctioned countries

Sanctioned Countries	Responses (Frequency)	
	Yes	No
Cuba	0	10
Iran	1	9
Iraq	1	9
Sudan	0	10
North Korea	0	10
Liberia	0	10
Nauru	0	10
Syria	0	10
Myanmar (Burma)	0	10

The findings show that all the organizations that participated in the study do not undertake transactions with the following sanctioned countries:- Cuba, Sudan, North Korea, Liberia, Nauru, Syria and Myanmar. Whereas two of the participating organizations indicated that they transacted with customers from Iraq and Iran, two organizations indicated that they undertook transactions with development organizations in Southern Sudan.

Compliance with sanctions list: The respondents were provided with a sanctions list and asked to indicate whether their respective organizations complied with the list. The responses are summarized and presented in table 4.12 below.

Table 4.12: Compliance with sanctions list

Sanctions List	Responses (Frequency)	
	Yes	No
United Nations	9	1
United States of America	10	0
Bank of England	10	0

The responses show that whereas only one of the organizations that participated in the study had not complied with United Nations sanctions, all the organizations had complied with United States of America and Bank of England sanctions. The organizations that complied with the sanctions were further asked to describe how the sanction checks are done and the type of system that was used to perform the sanctions screening. The responses are summarized and presented in table 4.13 below.

Table 4.13: Sanction checks and system used to perform sanctions screening

Sanction checks and system used to perform sanctions screening	Responses (Frequency)
Screening done using E Box system	1
A system called Norkom which has all the lists of sanctioned entities. Each and every name of the customer is checked against the list. Periodically all existing customers names are also run through the system to ensure there are not in the sanction list.	3
The screening is manual against download of sanctioned lists. All new accounts opened are independently screened by Compliance unit on quarterly basis.	2
Use of a Manual list	1
Automated Screening Tool	2
An internal blacklist register	1
Total	**10**

Controls surrounding organizations' correspondent arrangements regarding compliance issues: The respondents were asked to briefly explain the controls surrounding their respective organization's correspondent arrangements regarding compliance/money laundering policies. The responses are summarized and presented in table 4.14 below.

Table 4.14: Compliance controls

Compliance Controls	Responses (Frequency)
There is a defined due diligence undertaken every year and at the point of take on. There is also an attestation that all correspondent relationships are supposed to confirm adherence every year.	1
Financial institutions and Companies must attest to the fact that they have money laundering policies in place and also sign our ML and sanctions questionnaire.	2
Certification of compliance through completion of the Anti-Money Laundering and Know Your Customer questionnaire.	4
Carry out an annual due diligence verification for correspondent banks through appropriate AML/KYC questionnaires	3
Total	**10**

Politically Exposed Persons: The respondents were asked to indicate whether their respective organizations took Politically Exposed Persons as clients. All the respondents indicated that they took Politically Exposed Persons as customers. The respondents were further asked to indicate the type of control they put in place before Politically Exposed Persons are taken on board as customers. The responses are summarized and presented in table 4.15 below.

Table 4.15: Controls for Politically Exposed Persons

Controls for Politically Exposed Persons	Responses (Frequency)
There is additional due diligence as well as half yearly monitoring of PEP accounts.	2
The accounts must be approved by a senior manager and Risk graded appropriately for monitoring.	3
Due diligence on documentation and subsequent account monitoring.	3
Monitoring of all accounts for irregular/ suspicious activities	2
Total	**10**

Controls surrounding record keeping and document retention: The respondents were asked to indicate their respective controls surrounding record keeping and document retention. The responses are summarized and presented in table 4.16 below.

Table 4.16: Controls surrounding record keeping and document retention

Controls surrounding record keeping and document retention	Responses (Frequency)
There is a Record Management Policy in Place with defined procedures in place. There are also set record retention timelines for various record types.	2
All customers' identification documents are kept seven years after end of relationship. Transactions documents are retained for seven years as required by Kenyan law	2
All primary and secondary records and files are stored under dual control in book vault. Retention periods exist and destruction after expiry approved by management and certificate of destruction signed.	2
All primary and secondary records and files are stored under dual control in book vault. Minimum 7 years. Retention periods exist and destruction after expiry approved by management and certificate of destruction signed.	2
Have internal guidelines for record keeping and record retention	2
Total	**10**

Human resource function: The respondents were asked to briefly explain the type of training that is given to staff to ensure they comply with regulatory requirements for Compliance and Anti-money laundering/sanctions. They were further required to indicate whether the training is generic or tailored to specific roles (for instance Customer facing staff, Compliance staff, and Back office staff). The responses are summarized and presented in table 4.17 below.

Table 4.17: Compliance training

Compliance Training	Responses (Frequency)
There is mandatory training on regulatory requirements including AML & Sanctions that is tailor-made to the duties undertaken.	2
All staffs receive induction training on Money laundering. Thereafter each business conduct tailored ML trainings annually. Every 2 years each staff must completed in-house e-learning money laundering training.	1
Formal training conducted for all staff and specific for Compliance staff	2
Tailored to specific roles	1
Both generic and customized training are offered on KYC and AML to staff depending on their role	4
Total	**10**

The respondents were further asked to indicate whether any of their staff had been dismissed or reprimanded in the last three years for misconduct relating to Compliance issues such as Money laundering. The responses show that out of the 10 organizations that participated in the study, only 2 of them had dismissed their staff in the last three years for misconduct relating to Compliance issues.

Legal and regulatory function: The respondents were asked to indicate whether their respective organizations had any governance and internal reporting arrangements for regulatory and anti-money laundering/sanctions compliance activity such as reporting to CBK. Out of the 10 organizations that participated in the study, only 1 of them indicated that there were no governance and internal reporting arrangements for regulatory and anti-money laundering/sanctions compliance activities in place. The organizations that had governance and internal reporting arrangements in place were further asked to briefly explain the governance and internal reporting arrangements they had in place. All the 9 respondents indicated that they had a policy in place that defines the relationship.

Further, the respondents were asked to indicate whether there were any exceptional reports that are produced to highlight any suspicious customer activities regarding Money Laundering. Out of the 10 organizations that participated in the study, 3 of them indicated that there were no exceptional reports that are produced to highlight any suspicious customer activities regarding Money Laundering. The organizations that had exceptional reports that are produced to highlight any suspicious customer activities regarding Money Laundering were asked to briefly explain how the Suspicious Activities Reports (SAR's) are created (for instance exception reports produced by the system), Reviewed and sent to the Government agency. The responses are summarized and presented in table 4.18 below.

Table 4.18: Creation and review of Suspicious Activities Reports (SAR's)

Creation and review of Suspicious Activities Reports (SAR's)	Responses (Frequency)
Exceptional reports are produced based on daily transactions, weekly transactions, and monthly balances and churning reports. All exceptions are thoroughly investigated.	2
Any staff is allowed to raise SAR and forward the same to CMPLO for investigations. Other SARs are raised through transaction monitoring through exception monitoring MIS reports. Same are reviewed by Business money laundering officers and escalated to CMPLO.	2
Transaction journals are reviewed. No suspicious transactions reported.	3
Use of thresholds for specific customers	2
Total	**9**

Compliance function: The respondents were asked to indicate whether their respective organizations had a compliance function in place. All the participating organizations indicated that they had a compliance function in place. The organizations were further asked to indicate the number of compliance staff. The responses are summarized and presented in table 4.19 below.

Table 4.19: Number of staff in the Compliance function

Number of Staff	Distribution	
	Frequency	Percentage
Less than 3	3	30
Between 3 and 5	2	20
Between 6 and 8	1	10
Between 9 and 11	2	20
12 and above	2	20
Total	**10**	**100**

The responses in table 4.19 show that whereas 30% of the organizations that participated in the study had less than 3 compliance staff, 20% had between 3 and 5 compliance staff, 10% had between 6 and 8 compliance staff, 20% had between 9 and 11 compliance staff while 20% had at least 12 compliance staff. The respondents were further asked to indicate the reporting lines and the responsibilities of the compliance function. The responses are summarized and presented in table 4.20 below.

Table 4.20: Reporting lines and responsibilities of the Compliance function

Reporting Lines - To whom the Head of Compliance reports	Responsibilities of the Compliance function	Responses (Frequency)
Chief Financial Officer	Regulatory and Compliance; Compliance monitoring and training; Financial Crime monitoring.	2
Director of Risk Management	Identifies, assesses, advises, monitors and reports on the institutions compliance risk, which is the risk of legal or regulatory sanctions, financial loss or loss to reputation an institution may suffer as a result of its failure to comply with all applicable laws, guidelines, code of conduct and standards of good practice.	3
Function sits in Risk & Strategy Division	Implementation of AML controls such as transaction monitoring, customer screening coordinating AML training for staff and agents, investigating SARS, checking on Compliance.	2
Company secretary	Identification and assessment of compliance risks	3
	Reporting identified risks to Heads of Department, Senior Management & BOD	
	Advising on ways of mitigating against identified risks	
N= 10		

4.3.2 Factors that contribute to adoption of money laundering practices in Kenya

In order to meet the second objective of the study, "To analyze the factors that contribute to adoption of money laundering practices in Kenya", the respondents were provided with a list of possible factors that could influence adoption of Money laundering practices and asked to indicate the extent to which they agreed or disagreed that each of the listed factors has contributed to adoption of Money Laundering in Kenya. The responses are summarized and presented in table 4.21 below. ***Where:*** Strongly disagree = (1); Disagree = (2) Somehow agree

= (3); Agree = (4); Strongly agree = (5)

Table 4.21: Factors that contribute to adoption of money laundering practices in Kenya

Factors that have contributed to the adoption of money laundering practices in Kenya	Responses (Percentage)					Mean Score	Standard Deviation
	1	2	3	4	5		
Legal Frame work	30	20	30	20	0	0.613	1.225
Corporate Governance policies in Institutions (Ethical behavior of organizations)	0	0	20	50	30	1.061	2.121
Quality of Human Capital (Quality of Education system) in addressing Money Laundering	0	0	20	60	20	1.225	2.449
Information and Communication Technology (ICT)	10	40	40	10	0	0.936	1.871
Innovation in the economy	10	40	30	10	10	0.707	1.414
N = 10							

The findings in table 4.21 show that Legal Frame work - Enforcement of Laws and Regulations against Money Laundering was regarded as a factor contributing to adoption of Money laundering practices by at least 50% of the respondents. Whereas 20% of the respondents indicated "agree", 30% indicated "somehow agree", 20% indicated, "disagree" and 30% indicated, "Strongly disagree". Out of the 10 respondent organizations, 30% strongly agreed that corporate governance policies in Institutions (Ethical behavior of organizations) contributed to adoption of Monet laundering practices. Whereas 50% indicated "agree", the other 20% indicated, "Somehow agree". With regards to Quality of Human Capital (Quality of Education system) in addressing Money Laundering as a factor influencing adoption of Money laundering, while 20% of the respondents indicated, "strongly agree", 60% indicated "agree" and 20% indicated, "Somehow agree". Whereas 10% of the respondents strongly agreed that Information and Communication Technology (ICT) contributed to adoption of Money Laundering practices in Kenya, 40% indicated "agree", 40% indicated "disagree" and 10% indicated "strongly disagree". With regard innovation in the economy, whereas 10% of the respondents indicated "strongly agree", 10% indicated "agree", 30% indicated "somehow agree", 40% indicated "disagree" and 10% indicated "strongly disagree".

4.3.3 Challenge faced in implementation of Money laundering regulatory policies among financial institutions in Kenya

In order to meet the third objective of the study, "to evaluate the challenges faced in implementation of money laundering regulatory policies among financial institutions in Kenya", the respondents were provided with a list of possible challenges to the implementation of Money Laundering Regulatory Policies among financial institutions and asked to indicate the extent to which their respective organization's anti money laundering initiatives had been affected by each of the challenges by ticking as appropriate along the five point scale. The challenges were categorized and presented in table 4.22 below. ***Where:*** Not at all = **(1);** Neutral = **(2);** Somehow = **(3);** Much = **(4);** Very much = **(5)**

Table 4.22: Structural displacement challenges faced in implementation of Anti - Money laundering (AML) policies among financial institutions in Kenya

Structural displacement challenges faced in implementation of money laundering regulatory policies among financial institutions	Responses (Percentage)					Mean Score	Standard Deviation
	1	**2**	**3**	**4**	**5**		
Liberalized and cash based economy	0	10	30	20	40	0.791	1.581
Different legal systems among countries	0	10	20	40	30	0.791	1.581
Different banks applying different Money Laundering policies	0	0	20	20	60	0.895	1.789
Unstable neighboring regime	0	10	60	10	20	1.173	2.345
Parallel banking and alternative remittance avenues (corruption)	0	0	20	60	20	1.225	2.449
N = 10							

The findings in table 4.22 show that 90% of the respondents indicated that liberalized and cash based economy was a challenge faced in implementation of money laundering regulatory policies among financial Institutions in Kenya. The findings show that whereas 40% of the respondents indicated "very much", 20% indicated "much", 30% indicated "somehow", and 10% indicated "neutral". In reference to different legal systems among countries, whereas 30% indicated "very much", 40% indicated "much", 20% indicated "somehow", and 10% remained neutral. The findings also show that all the respondents indicated that different banks applying different money laundering policies posed a challenge to implementation of money laundering regulatory policies among financial institutions. Whereas 60% of the respondents indicated "very much", 20% indicated "much" and 20% indicated "somehow".

Further, the findings show that 90% of the respondents indicated that unstable neighboring regime posed a challenge to implementation of money laundering regulatory policies among financial institutions. Whereas 205 of the respondents indicated "very much", 10% indicated "much", 60% indicated "somehow" and 10% remained neutral. In reference to parallel banking and alternative remittance avenues (corruption), whereas 20% indicated "very much", 60% indicated "much" and 20% indicated somehow". The findings are summarized and presented in table 4.23 below. ***Where:*** Not at all = **(1);** Neutral = **(2);** Somehow = **(3);** Much = **(4);** Very much = **(5)**

Table 4.23: Legal and Institutional framework challenges faced in implementation of Anti - Money laundering (AML) policies among financial institutions in Kenya

Legal and Institutional Framework challenges faced in implementation of money laundering regulatory policies among financial institutions	Responses (Percentage)					Mean Score	Standard Deviation
	1	2	3	4	5		
Most Money laundering activities are specified as criminal activities under various acts of Parliament. However, money laundering is not considered as a criminal activity except in relation to proceeds from narcotic drugs and psychotropic substances. (Kenya does not have a legislation on Money Laundering)	0	0	20	20	60	1.225	2.449
Existence of customer confidentiality law that contravenes the AML disclosure obligations.	0	10	20	30	40	0.791	1.581
N = 10							

Findings in table 4.3 show that most money laundering activities having been specified as criminal activities under various acts of Parliament and the fact that money laundering is not considered as a criminal activity except in relation to proceeds from narcotic drugs and psychotropic substances is challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 60% of the respondents indicated "very much", 20% indicated "much" and 20% indicated "somehow". With reference to existence of customer confidentiality law that contravenes the AML disclosure obligations, whereas 40% of the respondents indicated "very much", 30% indicated "much", 20% indicated "somehow" and 10% remained neutral. ***Where:*** Not at all = **(1);** Neutral = **(2);** Somehow = **(3);** Much = **(4);** Very much = **(5)**

Table 4.24: Perceived cost of Implementing an AML Regime challenges faced in implementation of Anti - Money laundering (AML) policies among financial institutions in Kenya

Perceived cost of Implementing an AML Regime challenges faced in implementation of money laundering regulatory policies among financial institutions	Responses (Percentage)					Mean Score	Standard Deviation
	1	2	3	4	5		
The costs associated with implementing an effective AML regime in the banking sector are relatively High (Costs like systems, staff costs - Training, Record retention, Costs for Monitoring and Reporting Suspicious activities).	0	0	10	30	60	1.275	2.550
N = 10							

The findings in table 4.24 show that whereas all the respondents indicated that the costs associated with implementing an effective AML regime in the banking sector are relatively High (Costs like systems, staff costs - Training, Record retention, Costs for Monitoring and Reporting Suspicious activities) is a challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 60% of the respondents indicated "very much", 30% indicated "much" and 10% indicated "somehow". ***Where:*** Not at all = **(1);** Neutral = **(2);** Somehow = **(3);** Much = **(4);** Very much = **(5)**

Table 4.25: Difficulty in obtaining due diligence documents from customers as a challenge faced in implementation of Anti - Money laundering (AML) policies among financial institutions in Kenya

Challenges faced in implementation of money laundering regulatory policies among financial institutions	Responses (Percentage)					Mean Score	Standard Deviation
	1	2	3	4	5		
Difficulty in obtaining Due diligence documents from customers (for instance, difficulty in getting Physical addresses for customers.	0	10	10	40	40	0.866	1.732
N = 10							

The findings in table 4.25 show that all the respondents indicated that the difficulty in obtaining due diligence documents from customers (for instance, difficulty in getting Physical addresses for customers is a challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 40% of the respondents indicated "very much", 40% indicated "much" and 10% indicated "somehow" and 10% indicated "neutral".

Where: Not at all = **(1);** Neutral = **(2);** Somehow = **(3);** Much = **(4);** Very much = **(5)**

Table 4.26: Other challenges faced in implementation of Anti - Money laundering (AML) policies among financial institutions in Kenya

Other challenges faced in implementation of money laundering regulatory policies among financial institutions	Responses (Percentage)					Mean Score	Standard Deviation
	1	2	3	4	5		
Inadequate manpower and equipment to adequately provide the type of control expected in the agreements.	0	10	20	30	40	0.791	1.581
Language barriers and lack of knowledge of other countries' customs and cultures	10	10	20	40	20	0.613	1.225
Corruption	10	10	20	30	30	0.500	1.000
Lack of training is major factor inhibiting police success.	0	10	20	50	20	0.936	1.871
Lack of cooperation by some countries	0	10	30	40	20	0.791	1.581
Internal conflicts and civil wars external bilateral or regional international agreements	10	20	20	30	20	0.354	0.707
Illegal immigration	0	0	30	40	30	0.936	1.871
N = 10							

Findings in table 4.26 indicate that inadequate manpower and equipment to adequately provide the type of control expected in the agreements was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 90% of the respondents. Whereas 40% of the respondents indicated "very much", 30% indicated "much", 20% indicated "somehow" and 10% remained neutral. Language barriers and lack of knowledge of other countries' customs and cultures was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 80% of the respondents. Whereas 20% of the respondents indicated "very much", 40% indicated "much", 20% indicated "somehow", 10% remained neutral and 10% indicated "not at all".

Corruption was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 80% of the respondents. Whereas 30% of the respondents indicated "very much", 30% indicated "much", 20% indicated "somehow", 10% indicated "neutral" and 10% indicated "not at all". Lack of training being a major factor inhibiting police success was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 90% of the respondents. Whereas 20% of the respondents indicated "very much", 50% indicated "much", 20% indicated "somehow" and 10% remained neutral. Lack of cooperation was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 90% of the respondents. Whereas 20% of the respondents indicated "very much", 40% indicated "much", 30% indicated "somehow" and 10% indicated "neutral".

The findings in the table show that 70% of the respondents indicated that internal conflicts and civil wars external bilateral or regional international agreements was a challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 20% of the respondents indicated "very much", 30% indicated "much", 20% indicated "somehow", 20% remained neutral and 10% indicated "not at all". The findings of the study show that all the respondents indicated that illegal immigration was a challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 30% of the respondents indicated "very much", 40% indicated "much" and 30% indicated "somehow".

5.0 DISCUSSION OF FINDINGS

5.1 Introduction

The study aimed at examining the regulatory mechanisms that Kenya has been adopted in dealing with money laundering and to suggest ways of enhancing the effectiveness of these mechanisms to serve as veritable models for other African states. This chapter covers the discussion of the study findings. The chapter highlights the similarities and differences between the findings and those of studies reviewed.

5.2 Discussion of Findings

Profile of Respondents: Findings of the study show that that while 10% of the respondent organizations had been in operation in Kenya for less than 10 years, 10% had been in operation for between 11 and 15 years and 80% had been in operation for a period exceeding 16 years. The organizations had been in operation for long enough to be able to give objective responses to the study questions. The findings also show that whereas 70% of the respondent organizations were predominantly locally owned, 30% of the organizations were predominantly foreign owned. The findings further show that whereas all the participating banks offered similar products, but slightly differentiated by the names given to the products, the only mobile telephone service provider offered voice, data and money transfer services. The products of the banks were categorized into personal and business banking.

The findings also indicate that all the respondent organizations had more than 100 full time employees. Whereas 40% of the respondents had worked for their respective organizations for between 1 and 5 years, 30% had worked for between 6 and 10 years, 10% had worked for between 11 and 15 years and 20% had worked for 16 years and above. The findings show that the respondents had worked for their respective organizations long enough to understand the operations of their respective organizations and hence be able to provide objective responses to the study questions. The findings further show that the titles compliance manager and head of compliance were used by the various banks to refer to the person in charge of the anti-money laundering function while the title - Senior M-PESA AML & Fraud Officer was used by the only mobile telephone service provider that participated in the study. The findings further show that the respondents had a good understanding of their respective duties and responsibilities and were thus expected to provide objective answers to the study questions.

5.2.1 The use of regulatory policies in the fight against money laundering in Kenya

Extent to which Money laundering Regulatory policies have been adopted by financial institutions in Kenya: The findings of the study show that whereas all the respondent organizations undertake verification of their new account opening procedures, the process of verification differed slightly. The process involved identification, verification of contact information provided by the applicants and the sanctions screening. Whereas 20% of the respondents indicated that they have not had any risk assessment of money laundering risk relative to the corporate products and services they offered, 80% of them indicated that they had undertaken the assessment. Compliance assurance reviews are carried out from time to time audit department must certify that all controls are in place before any new product is launched it must undergo risk assessment

The findings also show that whereas 70% of the respondent organization had a process for identifying and rating higher risk clients, 30% did not have. EPs are usually identified using the screening method, high worth individuals if not declared at inception are captured during account monitoring. In all cases there are risk graded appropriately for close monitoring. Bank has also List of high risk business used for risk grading. Whereas all the banks that participated in the study indicated that they identified source of funds for their new customers, the only mobile telephone service provider that participate in the study indicated that the organization did not identify source of funds for the new customers. The respondents also indicated that there are clearly defined business rules for different corporate products that mitigate on all perceived risks including, operational, AML, market, legal, regulatory and reputational risks. The findings show that all the participating organizations had external/internal compliance policies in place, though they varied from bank to bank. The organizations that took part in the study undertook certain measures to ensure that their respective staffs complied with the policies. These include training, testing and monitoring compliance by various risk teams, reviews and audits. The findings show that all the organizations that participated in the study do not undertake transactions with the following sanctioned countries:- Cuba, Sudan, North Korea, Liberia, Nauru, Syria and Myanmar. Whereas two of the participating organizations indicated that they transacted with customers from Iraq and Iran, two organizations indicated that they undertook transactions with development organizations in Southern Sudan. The findings also show that whereas only one of the organizations that participated in the study had not complied with United Nations sanctions, all the organizations had complied with United States of America and Bank of England sanctions.

All the respondents indicated that they took Politically Exposed Persons as customers. The controls for Politically exposed persons included accounts being approved by a senior manager and risk graded appropriately for monitoring; additional due diligence as well as half yearly monitoring of PEP account; due diligence on documentation and subsequent account monitoring; and Monitoring of all accounts for irregular/ suspicious activities. There is mandatory training on regulatory requirements including AML & Sanctions that is tailor-made to the duties undertaken. All primary and secondary records and files are stored under dual control in book vault. Minimum 7 years. Retention periods exist and destruction after expiry approved by management and certificate of destruction signed.

Out of the 10 organizations that participated in the study, only 1 of them indicated that there were no governance and internal reporting arrangements for regulatory and anti-money laundering/sanctions compliance activities in place. Out of the 10 organizations that participated in the study, 3 of them indicated that there were no exceptional reports that are produced to highlight any suspicious customer activities regarding Money Laundering. The organizations that had exceptional reports that are produced to highlight any suspicious customer activities regarding Money Laundering were asked to briefly explain how the Suspicious Activities Reports (SAR's) are created (for instance exception reports produced by the system). Whereas 30% of the organizations that participated in the study had less than 3 compliance staff, 20% had between 3 and 5 compliance staff, 10% had between 6 and 8 compliance staff, 20% had between 9 and 11 compliance staff while 20% had at least 12 compliance staff.

Factors that contribute to adoption of money laundering practices in Kenya: Findings of the study show that Legal Frame work - Enforcement of Laws and Regulations against Money Laundering was regarded as a factor contributing to adoption of Money laundering practices by at least 50% of the respondents. Whereas 20% of the respondents indicated "agree", 30% indicated "somehow agree", 20% indicated, "disagree" and 30% indicated, "Strongly disagree". Further, 30% strongly agreed that corporate governance policies in Institutions (Ethical behavior of organizations) contributed to adoption of Monet laundering practices. Whereas 50% indicated "agree", the other 20% indicated, "Somehow agree". With regards to Quality of Human Capital (Quality of Education system) in addressing Money Laundering as a factor influencing adoption of Money laundering, while 20% of the respondents indicated, "strongly agree", 60% indicated "agree" and 20% indicated, "Somehow agree". Whereas 10% of the respondents strongly agreed that Information and Communication Technology (ICT) contributed to adoption of Money Laundering practices in Kenya, 40% indicated "agree", 40% indicated "disagree" and 10% indicated "strongly disagree". With regard innovation in the economy, whereas 10% of the respondents indicated "strongly agree", 10% indicated "agree", 30% indicated "somehow agree", 40% indicated "disagree" and 10% indicated "strongly disagree".

Challenges faced in implementation of Money laundering regulatory policies among financial institutions in Kenya: Findings of the study show that many various challenges were faced in implementation of money laundering regulatory policies among financial institutions in Kenya.

Structural displacement challenges: The findings in show that 90% of the respondents indicated that liberalized and cash based economy was a challenge faced in implementation of money laundering regulatory policies among financial Institutions in Kenya. The findings show that whereas 40% of the respondents indicated "very much", 20% indicated "much", 30% indicated "somehow", and 10% indicated "neutral". In reference to different legal systems among countries, whereas 30% indicated "very much", 40% indicated "much", 20% indicated "somehow", and 10% remained neutral. Money launders like most organized criminals seek out jurisdictions, which are unlikely to detect their activities (Commonwealth Secretariat, 2005). The findings also show that all the respondents indicated that different banks applying different money laundering policies posed a challenge to implementation of money laundering regulatory policies among financial institutions. Whereas 60% of the respondents indicated "very much", 20% indicated "much" and 20% indicated "somehow". Further, the findings show that 90% of the respondents indicated that unstable neighboring regime posed a challenge to implementation of money laundering regulatory policies among financial institutions. Whereas 205 of the respondents indicated "very much", 10% indicated "much", 60% indicated "somehow" and 10% remained neutral. In reference to parallel banking and alternative remittance avenues (corruption), whereas 20% indicated "very much", 60% indicated "much" and 20% indicated somehow".

Legal and Institutional framework challenges: The findings show that most money laundering activities having been specified as criminal activities under various acts of Parliament and the fact that money laundering is not considered as a criminal activity except in relation to proceeds from narcotic drugs and psychotropic substances is challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 60% of the respondents indicated "very much", 20% indicated "much" and 20% indicated "somehow". With reference to existence of customer confidentiality law that contravenes the AML disclosure obligations, whereas 40% of the respondents indicated "very much", 30% indicated "much", 20% indicated "somehow" and 10% remained neutral.

Perceived cost of implementing an AML regime: The findings show that whereas all the respondents indicated that the costs associated with implementing an effective AML regime in the banking sector are relatively High (Costs like systems, staff costs - Training, Record retention, Costs for Monitoring and Reporting Suspicious activities) is a challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 60% of the respondents indicated "very much", 30% indicated "much" and 10% indicated "somehow".

Difficulty in obtaining due diligence documents from customers: The findings show that all the respondents indicated that the difficulty in obtaining due diligence documents from customers (for instance, difficulty in getting Physical addresses for customers is a challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 40% of the respondents indicated "very much", 40% indicated "much" and 10% indicated "somehow" and 10% indicated "neutral".

Other challenges faced in implementation of Anti - Money laundering (AML) policies among financial institutions in Kenya: Findings indicate that inadequate manpower and equipment to adequately provide the type of control expected in the agreements was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 90% of the respondents. Whereas 40% of the respondents indicated "very much", 30% indicated "much", 20% indicated "somehow" and 10% remained neutral. Kenya, for example, a country that established free movement across borders with other African countries, has found that, while this may stimulate trade and help develop communications among the countries, it makes it more difficult to control the movement of fugitives and international criminals (Sang, 1997; Cottam and Marenin, 1981). Language barriers and lack of knowledge of other countries' customs and cultures was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 80% of the respondents. Whereas 20% of the respondents indicated "very much", 40% indicated "much", 20% indicated "somehow", 10% remained neutral and 10% indicated "not at all". According to Ingleton (1994) and Anderson (1991), language barriers and lack of knowledge of other countries' customs and cultures were cited as major factors that inhibited the effectiveness of some of the treaties or agreements.

Corruption was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 80% of the respondents. Whereas 30% of the respondents indicated "very much", 30% indicated "much", 20% indicated "somehow", 10% indicated "neutral" and 10% indicated "not at all". Police corruption and particularly the corruption of high level government officials are factors that create problems (McCormack, 1996; Chebotarev, 1989; Punch, 1985; Benveniste, 1983). If a country is known for being corrupt, it is not likely that agreements will be seriously explored (Koenig, 1997).

Lack of training being a major factor inhibiting police success was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 90% of the respondents. Whereas 20% of the respondents indicated "very much", 50% indicated "much", 20% indicated "somehow" and 10% remained neutral. Lack of cooperation was considered a challenge faced in implementation of money laundering regulatory policies among financial institutions by 90% of the respondents. Whereas 20% of the respondents indicated "very much", 40% indicated "much", 30% indicated "somehow" and 10% indicated "neutral". The lack of resources to provide the officers with the appropriate training is a great handicap (Teck, 1997; Kumar, 1997) (Igbinovia, 1984, 1982). Specifically, the need is for training and skills that can be employed at the operational level (Benyon, 1997). Although there have been attempts to form agreements and provide assistance, there still are considerable communication problems (Edelbacher, 1997). For instance, Egypt would like to establish a plan to control crimes committed by tourists and members of organized crime, but it has not always found other countries willing to co-operate (El Zein, 1997).

The findings show that 70% of the respondents indicated that internal conflicts and civil wars external bilateral or regional international agreements was a challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 20% of the respondents indicated "very much", 30% indicated "much", 20% indicated "somehow", 20% remained neutral and 10% indicated "not at all". For example, in parts of the African continent civil war or internal conflict is so pronounced that it is very difficult to develop effective external bilateral or regional international agreements (Ebbe, 1997). In addition, the resources available for funding international policing ventures tend to be chiefly limited to drug traffic control (Marenin, 1997) (see also Nadelmann, 1993; Lobe, 1975). The findings of the study show that all the respondents indicated that illegal immigration was a challenge faced in implementation of money laundering regulatory policies among financial institutions. Whereas 30% of the respondents indicated "very much", 40% indicated "much" and 30% indicated "somehow". The strengthening of efforts in the problem area of illegal immigration was considered to be an important area for increased international police co-operation and new agreements (Edelbacher, 1997; Vorniotakis, 1997; Wiarda, 1997).

5.3 Chapter Summary

The chapter has presented the data analysis and discussion of findings based on the objectives of the study.

Chapter six presents the study conclusions and recommendations.

6.0 CONCLUSIONS AND RECOMMENDATIONS

6.1 Introduction

This chapter presents the conclusions based on the study findings. The chapter also presents recommendations for policy and practice, besides presenting recommendations for further research.

6.2 Conclusions

In view of the findings of the study, the following conclusions are drawn:
Money laundering is a crime that affects every individual, business and government. It creates an important concern in that if unchecked it has the potential of fuelling crime and ultimately erodes the individual rights of citizens and affects national and international economic performance. The combating of money laundering requires first and foremost the crafting of appropriate laws and the creation of national and international capacity and the coordination thereof. All the above presupposes the need for political commitment at all levels.

A good understanding of the national money laundering activities requires concerted national research and studies of the money laundering typologies commonly practiced in each country. The anti money laundering laws protect the rights of individuals by providing for the articulation of what crime is, the acts of crime and the punishment thereof. Legislators, in consultation with their constituents through legislation on crime, lay the foundation for basic individual human rights and the attainment of inner individual self fulfillment. Crime and criminal acts work towards eroding these very basic individual rights. The problem of lack of accurate money laundering statistics in Africa is compounded where the setting-up of anti-money laundering regimes is only gaining momentum now. It will take some time for Africa to build up accurate statistics on money laundering as this would have to be sourced from actual cases investigated and finalized.

Crime and money laundering is indeed a global problem which requires a concerted global response. In order to protect our respective financial systems from the destabilizing effects of crime and money laundering, it is imperative that we act and respond to this scourge with unprecedented resolve and commitment to combating it. Everybody has, therefore, a responsibility to combat money laundering, because its negative impact has a unique way of creating far ranging negative consequences. By tackling money laundering we would be attacking the criminals at their weakest and most vulnerable point - their money sources.

The consequences of crime and money laundering are bad for business, development, and the general rule of law. Governments have therefore got real reasons for spearheading the combating of money laundering. Another reason why money laundering should be combated is that if left unchecked, it would lead to the accumulation of economic power to organized crime. This development has the potential of eroding our political and social systems based on elected representation as we know them today. In other words, the social consequences for allowing money launderers to operate unchecked could spell disaster for stability and the rule of law.

The financial sector, in particular the banking sector, more than any sectors, needs to operate in a crime and money laundering free environments. Banks deal with other people's money and therefore rely heavily on reputation for probity and integrity. Without the public confidence from the law abiding citizenry it would be difficult for banks to conduct business in the form they do now. In instances where banks may condone and are active parties to money laundering, the end result is that legitimate business would avoid such banks. It is also conceivable that money laundering if perpetrated on a high scale would complicate the ability of banks to manage their operations and risks. This is so because banks will not be able to predict the movement of laundered money.

The combating of money laundering should revolve around ensuring the ability of national and international agencies to find, freeze and the forfeiture of laundered money. This presupposes the existence of appropriate national and international laws and the capacity for implementation of those laws. In addition, the wide scope of affected stakeholders in anti money laundering efforts requires an unprecedented level of co-operation both at national and international levels. Another important aspect of money laundering is the tendency and need for perpetrators to operate cross border schemes for the purpose of concealment and/or to take advantage of the uneven developments in the national anti money laundering regimes. This requires that countries should develop anti money laundering regimes that are moving in tandem in terms of speed and standards for detection and law enforcement.

The combating of money laundering presupposes the existence of capacity and resources at national level. In Africa, this is a real challenge in that there are competing demands with regards to the procurement and utilization of scarce resources. The resources scarcity is more critical in the law enforcement spheres, since most national jurisdictions have less than efficient law enforcement agencies which are in most cases overwhelmed by the demands to enforce other national laws.

6.3 Recommendations

6.3.1 Recommendations for Policy and Practice

Based on findings of the study, it is expected that the stakeholders, who include the regulators and investors in the insurance industry will gain a better understanding of the adequacy of minimum capital requirements and challenges posed by changes in the capitalization requirements. The latest developments in the areas of insurance, risk management, financing techniques and financial reporting have paved the way for reforms in the Kenyan solvency system. The integration of international financial systems has increased the need for convergence of the regulatory environment. Since the consolidation in the range of products offered by insurance companies and banks is growing, therefore there is a need to harmonize banking and insurance rules.

The provisions regarding insurers' solvency capital should become stringent. There should be both a minimum solvency capital and a target solvency capital requirement. The minimum solvency capital should rely on the amount of business that the insurer underwrites.

The target solvency capital should be based on the economic risk capital that a company should have in case of unforeseen circumstances. There will be standard model available for the calculation of the target solvency capital in the insurance industry.

There should be strict supervision by the regulators. The supervisors should be responsible for monitoring the amount of the existing capital. The level of international cooperation between the supervisory authorities in each member state, particularly between the supervisory authorities for banks and insurers, needs to be enhanced. The audit process should also be coordinated and standardized according to requirement.

There should be enhanced disclosure such that the public will have greater access to information about the financial stability of insurers. The industry regulators should put in efforts to ensure that competition resulting from solvency will force insurers to comply with quality and security standards.

6.3.2 Recommended areas of Further Research

The findings of this study, it is hoped, will contribute to the existing body of knowledge and form basis for future researchers. The following areas of further researcher are thus suggested: - (1) Whereas the current study focused on responses from the management of the organizations enforcing anti-money laundering policies, future studies should focus on the Government policy makers; and (2) The current study should be replicated to other financial service providers such as foreign exchange bureaus in Kenya.

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APPENDIX I: BANKS LISTED ON THE NAIROBI STOCK EXCHANGE AND THE RESPONDENT TELECOMMUNICATION COMPANIES

NO.	BANK
1	Barclays Bank
2	CFC/Stanbic Bank
3	Co-operative bank of Kenya
4	Diamond Trust Bank
5	Equity Bank
6	Kenya Commercial Bank
7	National Bank Of Kenya
8	NIC Bank
9	Safaricom – Telecommunication Company
10	Standard Chartered Bank
11	Zain – Telecommunication Company

Source: Nairobi Stock Exchange, (January, 2009)

APPENDIX II: QUESTIONNAIRE

This questionnaire has been designed to collect information from the Heads of Compliance of selected Commercial banks and Telecommunication companies in Kenya and is meant for academic purposes only. The questionnaire is divided into two sections. Please complete each section as instructed. Do not write your name or any other form of identification on the questionnaire. All the information in this questionnaire will be treated in confidence.

SECTION I: BACKGROUND INFORMATION

1. Name of organization ____

2. For how long has this organization been in operation in Kenya? (Tick as appropriate)
   (a). Less than 1 year [ ]
   (b). 1 to 5 years [ ]
   (c). 6 to 10 years [ ]
   (d). 16 years and above [ ]

3. Please indicate the ownership of the organization using the categories below (Please tick one)
   a. Predominantly local (51% or more) [ ]
   b. Predominantly foreign (51% or more) [ ]
   c. Balanced between foreign and local (50/50) [ ]

4. Please list the products/services you offer to your customers'

____
____
____
____

5. How many full time employees does the organization have (Please tick as appropriate)?
(a) Less than 500 [ ]
(b) Between 500 and 1,000 [ ]
(c) Between 1,000 and 2,000 [ ]
d) Between 2,000 and 3,000 [ ]
(e) 3,000 and above [ ]

6. Using the categories below, please indicate the number of branches you have in Kenya
(a) Less than 40 [ ]
(b) Between 40 -80 [ ]
(c) Between 80- 120 [ ]
(d). Above 120 [ ]

7. For how long have you worked in the organization? (Tick as appropriate)
Less than 1 year [ ]
Between 1 and 5 years [ ]
Between 6 and 10 years [ ]
Between 11 and 15 years [ ]
16 years and above [ ]

8. Please state your Position and Responsibilities

____
____
____
____

SECTION II: THE USE OF REGULATORY POLICIES IN THE FIGHT AGAINST MONEY LAUNDERING IN KENYA

Objective 1: Extent to which Money laundering Regulatory policies have been adopted by Financial institutions in Kenya.

1. Do you verify the New Account opening procedures (New Customer acquisition) in respect of Anti-Money laundering compliance? (Please tick as appropriate)

Yes [ ] No [ ]

If yes, please briefly explain the verification process that is used for all new customers

____
____
____
____

2. Has there been any assessment of Money laundering risk relative to the Products and Services you offer? (Please tick as appropriate)

Yes [ ] No [ ]

If yes, please briefly explain how the assessment was done

____
____
____
____

3. Risk Based Approach to Money Laundering - Is there a process for identifying and rating Higher risk clients (e.g. Politicians, High Net worth individuals, Foreigners, Charity organization, Trusts etc) in respect of Money laundering? (Please tick as appropriate)

Yes [ ] No [ ]

If yes, please briefly explain how the identification and rating is done

____
____
____

4. Is the Source of funds / Origin of Wealth identified for new customers and documented? (Please tick as appropriate)

Yes [ ] No [ ]

5. What external / internal Compliance policies (Money laundering policies) exist in your organization?

____
____
____
____

6. How do you ensure staffs in your organization meet the Compliance policies / Money laundering policies above?

____
____
____
____

7. Do you allow customer transactions with the sanctioned countries listed below? (Please tick as appropriate)

Cuba	Yes	[ ]	No	[ ]
Iran	Yes	[ ]	No	[ ]
Sudan	Yes	[ ]	No	[ ]
North Korea	Yes	[ ]	No	[ ]
Liberia	Yes	[ ]	No	[ ]
Syria	Yes	[ ]	No	[ ]
Myanmar (Burma)	Yes	[ ]	No	[ ]

9. Does your organization comply with the following sanctions list (i.e. screening of all new customers against the sanction lists below)? (Please tick as appropriate)

United Nations	Yes	[ ]	No	[ ]
United States	Yes	[ ]	No	[ ]
Bank Of England	Yes	[ ]	No	[ ]

If Yes, please describe how the sanction checks are done and what System is used to perform the sanctions screening. ____

____
____
____

10. Briefly explain the controls surrounding your Correspondent Banking (or corresponding telecommunication companies in case of Safaricom and Zain) arrangements in regard to Compliance Issues / Money Laundering Policies.

____
____
____
____

11. Do you take on (Politically Exposed Persons) PEP's as clients? (Please tick as appropriate)

Yes [ ] No [ ]

If "Yes", what controls are in place before such clients are taken on board?

____
____
____
____

If "Not", how do you screen new customers to determine whether they are PEP's?

____
____
____

12. What are your controls surrounding Record keeping and Document Retention (Record management policy including retention period)?

____
____
____

Human Resources

13. Briefly explain the type of training that is given to staff to ensure they comply with regulatory requirements for Compliance and Anti-money laundering/sanctions? Is it generic or tailored to specific roles (Customer facing staff, Compliance staff, Back office staff etc)?

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14. Have any staff have been dismissed or reprimanded in the last three years for misconduct relating to Compliance issues e.g. Money laundering?

Yes [ ] No [ ]

Legal & Regulatory

15. Does the organization have any Governance and Internal reporting arrangements for Regulatory and Anti-money laundering compliance activity – e.g. reporting to CBK / CCK on compliance issues?

Yes [ ] No [ ]

16. Are there any exceptional reports that are produced to highlight any Suspicious customer activities (Suspicious Activities Reports - SAR's) regarding Money laundering?

Yes [ ] No [ ]

If yes, briefly explain how the Suspicious Activities Reports (SAR's) are created (e.g. exception reports produced by the system), Reviewed and sent to the Government agency. Also state how many SARs were reported in the last one year?

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Compliance function

18. Is there a Compliance function in the organization?

Yes [ ] No [ ]

a) If "Yes", please provide the following:

- Number of Compliance staff ______________________________

Reporting Lines (Where does the Head of Compliance report to) ______________________

- What are the responsibilities of the Compliance function?

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b) If "Not" (i.e. No Compliance function in the organization), please state who performs the compliance activities and what are their reporting lines?

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Objective 2: Factors that have influenced the adoption of money laundering practices in Kenya and effectively contribute in the reduction of Money Laundering.

1) Listed below are some of the factors that contribute to the adoption of money laundering practices. Please indicate the extent to which you agree/disagree that each of the listed factors contribute to adoption of Money Laundering.

Where: Strongly disagree = **(1);** Disagree = **(2);** Somehow agree = **(3);** Agree = **(4);** Strongly agree = **(5)**

Factors that have contributed to the adoption of money laundering practices in Kenya	1	2	3	4	5
Legal Frame work: Enforcement of Laws and Regulations against Money Laundering					
Corporate Governance policies in Institutions (Ethical behavior of organizations): Ethics is used by organizations to govern them on what is right or wrong as far as Money Laundering is concerned.					
Quality of Human Capital (Quality of Education system): in addressing Money Laundering					
Information and Communication Technology (ICT): Use of ICT like Internet Banking to prevent Money laundering.					
Innovation in the economy: Introduction of New products and processes.					
Others (Please specify):					
Others (Please specify):					

Objective 3: The challenges faced in implementation of Anti - Money laundering (AML) policies among financial institutions in Kenya

1). Listed below are some of the possible challenges to the implementation of Money Laundering Regulatory Policies among financial institutions. Please indicate the extent to which your organization's anti money laundering initiatives have been affected by each of the challenges by ticking as appropriate along the five point scale.

Where: Not at all = **(1);** Neutral = **(2);** Somehow = **(3);** Much = **(4);** Very Much = **(5)**

Challenges faced in implementation of money laundering regulatory policies among financial institutions	(1)	(2)	(3)	(4)	(5)
a) Structural Displacement factors					
Liberalized and cash based economy (More than 70% of the country's GDP is from the informal sector and majority of the players in these sector are not banked, hence monitoring such transactions may be difficult)					
Different legal systems among countries (Money laundering is a cross border crime, hence the need to synchronize legal systems in the various jurisdictions)					
Different banks applying different Money Laundering policies; conformance to the policy is not uniform and customers can move to banks that are less stringent on AML applications.					
Unstable neighboring regime (Existence of conflicts in neighboring countries leads to infiltration of criminal activities across the affected borders, particularly trade in small firearms and drugs)					
Parallel banking and alternative remittance avenues (corruption) (Parallel banking units are able to wire funds to and from other jurisdictions without going through the formal banking system) e.g. Forex Bureau					
b) Inadequate Legal and Institutional Framework					
Most Money laundering activities are specified as criminal activities under various acts of Parliament. However, money laundering is not considered as a criminal activity except in relation to proceeds from narcotic drugs and psychotropic substances. (Kenya does not have a legislation on Money Laundering)					
Existence of customer confidentiality law that contravenes the AML disclosure obligations.					
c) Perceived cost of Implementing an AML Regime					
The costs associated with implementing an effective AML regime in the banking sector are relatively High (Costs like systems, staff costs - Training, Record retention, Costs for Monitoring and Reporting Suspicious activities).					
d) Difficult in obtaining Due diligence documents from customers e.g difficulty in getting Physical addresses for customers.					
Other challenges					
Inadequate manpower and equipment to adequately provide the type of control expected in the agreements.					
Language barriers and lack of knowledge of other countries' customs and cultures were					
Corruption - Police corruption and particularly the corruption of high level government officials are factors that create problems					
Lack of training - Lack of training is major factor inhibiting police success. Specifically, the need is for training and skills that can be employed at the operational level. The lack of resources to provide the officers with the appropriate training is a great handicap.					
Lack of cooperation by some countries - Lack of co-operation, reluctance to allocate resources, and reluctance to participate in co-operative agreements are all challenges that must be faced.					
Internal conflicts and civil wars - In a few instances, the disadvantages or challenges of international police co-operation agreements are limited to specific countries or regions. For example, in parts of the African continent civil war or internal conflict is so pronounced that it is very difficult to develop effective external bilateral or regional international agreements					
Illegal immigration - The strengthening of efforts in the problem area of illegal immigration was considered to be an important area for increased international police co-operation and new agreements A distinction between unrecorded and unauthorized entry into a country is a topic that should be considered					

THANK YOU!