

**LEGAL RESPONSES TOWARDS TACKLING FINANCIAL CRIME IN
KENYA'S BANKING SECTOR: IS IT ENOUGH?**

BY

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Requirements for the Award of the Degree of Master of Laws (LL.M)**

DECLARATION

I declare that this thesis is my original work and has not been presented before for a degree in this or any other university.

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Date

This thesis has been submitted for examination with my approval as university supervisor.

Dr. Constance Gikonyo

Associate Professor, University of Nairobi

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Date

DEDICATION

This thesis is dedicated to Abby and Leo. May you lead your generation with integrity.

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I wish to acknowledge the inspiration and contribution of those without whom, this thesis would not have come to be. First, I thank the Lord Almighty for blessing me with good health, ability and the opportunity to undertake this study. Secondly, I thank my parents and siblings, for their encouragement to pursue higher learning. Thirdly, I acknowledge the contribution by my supervisor, Dr. Constance Gakonyo, for always challenging me and pointing me in the right direction. Any shortcomings in this thesis are mine entirely. I also wish to thank Deynes Muriithi for the encouragement to finish the journey. Last, but certainly not the least, Kimani Waweru for the opportunity to recharge.

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ABSTRACT

This study seeks to establish whether the legal and institutional framework in Kenya is sufficient for the prevention of financial crime in the banking sector. This study was motivated by the placing of three banks (Chase Bank, Imperial Bank and Dubai Bank) in receivership in a period of less than one year, which raised fears of a banking crisis in the country. The three banks were placed under statutory management due to financial impropriety.

This study established that there was no prosecution of persons responsible for the collapse of banks in Kenya before 2016. Following the collapse of Chase Bank (In Receivership) and Imperial Bank (In Receivership), the first such prosecutions were initiated against the directors and officers believed to be culpable in the failure of the two banks. This study established that the charges preferred against the said directors and officers were not comprehensive and the penalties likely to be imposed on accused persons are too lenient in light of the significance of the collapse of a bank (the cases are still in court). Such lenient penalties are unlikely to play a deterrent role in the fight against banking crime. The study further established that although the law and institutions established to regulate banking have developed over time, they have not been sufficient to prevent bank failures in Kenya. The law has not been enforced effectively through prosecution and conviction of persons responsible for failure of banks. The low conviction rates point to, among others, the quality of investigations and delays in concluding court cases.

This study recommends stricter penalties for banking sector crimes in order to adequately punish offenders and deter potential offenders. It also recommends the enhancement of the asset forfeiture regime through elaborate criminal and civil procedures. Further, the study recommends the encouragement of whistle blowing through rewards, statutory requirement for corporations to establish safe whistle blowing channels and enhanced protection of whistle-blowers. Finally, the study recommends the strengthening of institutions such as the Banking Fraud Investigations Unit and the Assets Recovery Authority in order to make them more effective.

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List of Abbreviations

AML - Anti-money laundering
ARA - Assets Recovery Agency
BFIU - Banking Fraud Investigation Unit
CBK – Central Bank of Kenya
CCCA - Comprehensive Crime Control Act of 1984
CEO - Chief Executive Officer
CMA - Capital Markets Authority
CPS - Crown Prosecution Service
DOJ - Department of Justice
DPFB - Deposit Protection Fund Board
DTI - Department of Trade and Industry
FCA - Financial Conduct Authority
FRC - Financial Reporting Centre
FIRREA - Financial Institutions Reform, Recovery and Enforcement Act of 1989
KDIC - Kenya Deposit Insurance Corporation
NSE - Nairobi Securities Exchange
ODPP - Office of the Director of Public Prosecutions
POCA - Prevention of Organised Crime Act
POCAMLA - Proceeds of Crime and Anti-Money Laundering Act, 2009
PRA - Prudential Regulation Authority
SBUK - Sonali Bank (UK) Limited
SEC - The Securities and Exchange Commission
SFO - Serious Fraud Office
S&L - Savings and Loans
SOX - Sarbanes-Oxley Act of 2002
RBS - Royal Bank of Scotland
TCS - Trust Capital Services
UK - United Kingdom
USA - United States of America

List of Statutes

Kenya

1. Constitution of Kenya
2. The Banking Act, Chapter 488 Laws of Kenya
3. The Capital Markets Act, Chapter 485A Laws of Kenya
4. The Companies Act, 2015
5. The Companies Act, Chapter 486 Laws of Kenya (Repealed)
6. The Kenya Deposit Insurance Act, 2012
7. The Penal Code, Chapter 63 Laws of Kenya
8. The Proceeds of Crime and Anti-Money Laundering Act, 2009
9. The Prevention of Organised Crimes Act No. 6 of 2010
10. The Witness Protection Act 2006

United States of America

1. The Bank Fraud Statute 18 U.S.C. § 225
2. Narcotic Drugs and Psychotropic Substances (Control) Act, 1994
3. Comprehensive Crime Control Act of 1984
4. Financial Institutions Reform, Recovery and Enforcement Act of 1989
5. National Banking Act of 1863
6. Racketeer Influenced and Corrupt Organizations Act
7. The Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990

8. Comprehensive Drug Abuse Prevention and Control Act of 1970
9. The Misapplication and Embezzlement Statute 18 U.S. Code § 1344
10. Sarbanes–Oxley Act of 2002

United Kingdom

1. Financial Services and Market Act 2000
2. Banking Act 2009
3. The Financial Services (Banking Reform) Act 2013
4. Proceeds of Crime Act 2002
5. Criminal Finances Act 2017
6. The Companies Act 2006
7. Theft Act 1968
8. Fraud Act 2006

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1. *Ajay Shah v Deposit Protection Fund Board as Liquidator of Trust Bank Limited (In Liquidation)* [2016] eKLR
2. *Jiang Nan Xiang v Cok Fas-St Company Limited* [2018] eKLR
3. *Trust Bank Limited v Paramount Universal Bank Limited* Civil Suit 1243 of 2001
4. *Ultimate Laboratories v Tasha B Loservice Ltd Nbi* HCCC No. 1287 of 2000

United States of America Cases

1. *United States v Duncan* 598 F. 2d 839 - Court of Appeals, 4th Circuit 1979
2. *Halliburton v Admin. Review Bd* 771 F.3d 254 (5th Cir. 2014)
3. *Sanford S. Wadler v Bio-Rad Laboratories* 17-16193 (9th Cir. 2019)

United Kingdom Cases

1. *R v Underson* [1996] AC 27 HL
2. *R v Ghosh* [1982] 1QB 1053
3. *R v Rezvi* [2002] UKHL 1
4. *Davidge v Bennet* [1984] Crim LR 297
5. *Scott v Metropolitan Police Commissioner* [1975] AC 910

Chapter 1

1.1 Introduction and Background

On 7 April 2016, the Central Bank of Kenya (CBK) placed Chase Bank Limited (In Receivership) (Chase Bank (IR)) under statutory management after the bank failed to meet its financial obligations.¹ This came just six months after Imperial Bank Limited (In Receivership) (Imperial Bank (IR)) was placed under statutory management in October 2015 due to financial misconduct.² Two months earlier, Dubai Bank Kenya Limited had been placed under statutory management due to violations of banking laws and regulations.³ The placing of three banks under statutory management in a period of less than one year raised fears of a banking crisis in the country, underlining the psychological importance of stability in the banking sector.

The implications of placing the three banks under statutory management were severe. Chase Bank (IR) closed its branches for twenty days and suspended withdrawals by customers for the same period⁴, ostensibly to prevent a run on the bank which would have led to a total collapse of the bank. Customers had no access to funds to pay suppliers and workers, savers were looking at a possible loss of years of savings while employees were looking at possible unemployment. Chase Bank (IR) was also a custodian holding funds belonging to pension funds and other corporate investors. The potential damage to the economy was enormous.

On its part, Imperial Bank (IR) was placed under statutory management just after a successful issue of a Kshs. 2 billion corporate bond. Following CBK's action to place the bank under statutory management, the Capital Markets Authority (CMA)

¹ Central Bank of Kenya, 'Press Release - Chase Bank Limited', (7 April 2016) <www.centralbank.go.ke/images/docs/MPC%20Press%20Releases/Press_Release_Chase_Bank_Limited_April_7_2016.pdf>, accessed 12 August 2018

² Central Bank of Kenya, 'Press Release- Imperial Bank Limited' (13 October 2015), <www.centralbank.go.ke/images/docs/media/Press%20Releases/Press_Release_-_Imperial_Bank.pdf>, accessed 12 August 2018

³ Central Bank of Kenya, 'Press Release – Dubai Bank Kenya Limited', (14 August 2015) <www.centralbank.go.ke/images/docs/media/2015/DubaiBankpressrelease.pdf>, accessed 12 August 2018

⁴ Central Bank of Kenya, 'Press Release – Chase Bank Limited (In Receivership)', (20 April 2016), <www.centralbank.go.ke/images/docs/media/2016/ChaseBankLimited-20042016.pdf>, accessed 12 August 2018

suspended the listing of the corporate bond at the Nairobi Securities Exchange.⁵ Investors in the corporate bond were looking at possible default on their funds.

In all the three banks, depositors, investors and employees were likely to face the adverse effects of closure of banks. The effects would be felt across the economy, considering for instance, that the investors in the corporate bond were likely to be insurance companies, pension schemes, fund managers and other major players in the economy. The CBK stated that the reason for placing the banks under statutory management was financial impropriety at the three institutions.⁶

The collapse of any bank inevitably causes a financial panic leading to runs on other banks in the market which affects confidence in the banking system generally.⁷ Considering the loss of savings, unemployment, lack of access to working capital for businesses and the loss of confidence in the banking sector, it is expected that the legal sanctions against those found culpable of actions or omissions which result in failure of banks should be robust. Such sanctions should be commensurate with the significance of the economic threat posed by failure of banks.

This study seeks to establish whether the legal framework regulating the banking industry in Kenya is sufficient for the prevention of banking sector crimes. It identifies the applicable laws and regulations which create banking sector-related offences and considers whether the sanctions provided offer sufficient deterrence in the face of rising banking sector crimes. In this study, the term ‘banking sector crime’ has been used to refer to offences under the Penal Code⁸, Banking Act⁹, Proceeds of Crime and Anti-Money Laundering Act, 2009 (POCAMLA) and Companies Act, 2015 arising from improper conduct by directors and management of banks. There is need to

⁵ Capital Markets Authority, ‘Press Statement on Imperial Bank’ (13 October 2015) <www.cma.or.ke/index.php?option=com_content&view=article&id=174:press-statement-on-imperial-bank>, accessed 4 August 2018

⁶ (n 3), (n 4)

⁷ E.P. Ellinger, E. Lomincka and C. Hare, *Ellinger’s Modern Banking Law*, 5th ed, OUP 2010

⁸ Chapter 63 Laws of Kenya

⁹ Chapter 488 Laws of Kenya

establish whether the penalties for various offences under the above statutes offer sufficient deterrence to prevent banking sector crimes.

This study will look at two cases in which directors and managers who have been prosecuted for offences leading to failure of banks. The cases against the directors and managers of Chase Bank (IR) and Imperial Bank (IR) respectively are the first and the only cases in Kenya where directors and managers of banks have been charged with offences leading to bank failure.

When one compares the gravity of the offences alleged to have been committed leading to the failure of Chase Bank (IR) and Imperial Bank (IR) mentioned above with the possible sanctions against the suspects, one starts to question the sufficiency of the sanctions to deter banking sector crimes. In the Imperial Bank case¹⁰, five top managers were charged with conspiring to defraud¹¹ the bank through criminal schemes and false accounting¹², and stealing¹³. In the Chase Bank case¹⁴, three former directors and the chairman were charged with conspiracy to defraud the bank¹⁵, while two members of staff faced charges of charges of stealing by servant¹⁶.

The table below shows sanctions for the possible offences which the suspects in the Chase Bank (IR) and Imperial Bank (IR) matters could be charged with.

¹⁰ 'Imperial Bank directors freed on Sh18m cash bail', *Daily Nation* (Nairobi, 29 March 2016) <www.nation.co.ke/news/Imperial-Bank-directors/1056-3138214-c8pwdnz/index.html>, accessed 25 November 2016

¹¹ S.317, Penal Code, Chapter 63 Laws of Kenya

¹² S.330, Penal Code, Chapter 63 Laws of Kenya

¹³ S.275, Penal Code, Chapter 63 Laws of Kenya

¹⁴ Maureen Kakah, 'Former Chase Bank boss Zafrullah Khan charged with Sh1.7 billion fraud', *Business Daily* (Nairobi, 28 June 2017) <www.businessdailyafrica.com/corporate/Former-Chase-Bank-chairman-Zafrullah-Khan-arrested/539550-3990862-hxnydvz/index.html>, accessed 15 May 2018

¹⁵ See note 11

¹⁶ See note 12

<i>Offence</i>	<i>Statute</i>	<i>Sanctions</i>
Conspiracy to defraud	Penal Code S. 317	Imprisonment for a maximum of three years
Theft	Penal Code S.275	Imprisonment for a maximum of three years
Fraudulent false accounting	Penal Code S.330	Imprisonment for a maximum of seven years
Fraudulent appropriation or accounting by directors or officers	Penal Code S.328	Imprisonment for a maximum of seven years
Failure to comply with the directions of CBK on the management of an institution	Banking Act, S.33(5)	Fine not exceeding Kshs. 50,000 or imprisonment for a term not exceeding two years or both (fine of Kshs. 100,000 if the offender is a body corporate) (S.49)
Contravention of any of the provisions of the Banking Act	Banking Act, S.49	Fine not exceeding Kshs. 50,000 or imprisonment for a term not exceeding two years or both (fine of Kshs. 100,000 if the offender is a body corporate)
Failure to comply with the Banking Act, failure to ensure accuracy of statements required by law or failure to supply any information required under the Banking Act	Banking Act, S.50(1)	Imprisonment for a term not exceeding one year or to a fine not Kshs. 20,000 or both (fine of Kshs. 100,000 if the offender is a body corporate) (S.49)
Money laundering (engaging in a transaction mean to conceal nature, source, location, or movement of proceeds of crime or to enable a person to avoid prosecution for a money laundering offence)	Proceeds of Crime and Anti-Money Laundering Act, 2009, S.3	Imprisonment for a term not exceeding fourteen years, or a fine not exceeding Kshs. 5 million (S. 16(1)(a))
Acquisition, possession or use of proceeds of crime	Proceeds of Crime and Anti-Money	Imprisonment for a term not exceeding fourteen years, or

	Laundering Act, 2009, S.4	a fine not exceeding Kshs. 5 million (S. 16(1)(a))
Fraudulent trading	Companies Act, 2015, S.1002(3)	Imprisonment for a term not exceeding ten years and/or a fine not exceeding Kshs. 10 million

Compared with the possible loss of billions of shillings in depositors' and shareholders' funds in the event of such banks collapsing, the above fines or prison terms would be a slap on the wrists of the banks' directors and managers.

1.2 Statement of the Problem

This study seeks to establish whether the legal framework regulating the banking industry in Kenya is sufficient for the prevention of banking sector crimes. It identifies the applicable laws and regulations which create banking sector-related offences and considers whether the sanctions provided offer sufficient deterrence in the face of rising banking sector crimes. It also seeks to establish the effectiveness of the institutions charged with prevention and investigation of banking sector crimes. Considering the implications of the collapse of a bank on the depositors, shareholders and the economy at large, the directors and managers found culpable should face significant sanctions. Indeed, such offences should not have the option of a fine, considering that the perpetrator may have made a tidy sum of money from their conduct and would therefore find it easy to pay the fines.

1.3 Research questions

- a. Are the penalties provided for offences under the Banking Act, Penal Code, POCAMLA and the Companies Act 2015 significant enough to deter the commission of banking sector offences in Kenya?
- b. Are the institutions charged with the prevention and investigation of banking sector crimes in Kenya effective?

- c. What lessons can Kenya learn from the legal and institutional framework in place to combat banking sector crime in USA and the UK?

1.4 Objective of the study

This study will seek to establish whether the laws and regulations that govern the banking industry in Kenya are sufficient to adequately address and deter banking sector crimes. Specifically, the research seeks:

- a) To examine the sufficiency of the sanctions provided for under the relevant laws.
- b) To evaluate the effectiveness of the implementation of the law by the regulators and law enforcement agencies.

1.5 Hypotheses

The maximum fines and length of prison terms provided for under the Banking Act, the Penal Code, POCAMLA and the Companies Act, 2015 for financial crimes are not sufficient to deter financial impropriety in the banking industry in Kenya.

1.6 Justification of the Study

The closure of three banks within period of one year raises the question of adequacy of the law in dealing with banking sector crime. This study will consider the adequacy of the applicable laws in dealing with banking sector crimes by highlighting the impact of closure of banks on the economy, and the possible sanctions on the perpetrators of offences that lead to such closure. The study will present the case for stiffer penalties for offences which lead to the collapse of banks as a way to deter potential offenders.

The findings of the study will contribute to the strengthening of the controls around the banking sector, leading to a more stable environment for growth of the banking sector which is a critical cog in the growth of an economy. Further, not enough research has been conducted in this area of the law. This study seeks to contribute to the limited literature in the study area.

1.7 Theoretical Framework

Deterrence Theory

Deterrence is defined as the preventive effect which actual or threatened punishment of offenders has upon potential offenders.¹⁷ The deterrence theory of punishment can be traced to the early works of classical philosophers such as Thomas Hobbes (1588–1678), Cesare Beccaria (1738–1794), and Jeremy Bentham (1748–1832). Proponents of deterrence believe that people choose to obey or violate the law after calculating the gains and consequences of their actions. The theory of deterrence that has developed from the work of Hobbes, Beccaria, and Bentham relies on three individual components: severity, certainty, and celerity. The more severe a punishment, the more likely that a rationally calculating human being will desist from criminal acts. Apprehension of offenders' conviction and punishment should be certain and swift in order to deter crime. To prevent crime, law must emphasize on penalties to encourage citizens to obey the law.¹⁸

According to Beccaria, to have a deterrent value, punishment must be proportionate to the crime committed. Further, he argues that the seriousness of crimes should be based on the extent of harm done to society.¹⁹ Posner suggests that penalties should completely deter offences by eliminating the prospect of gain on the part of the offender.²⁰ The sanctions of the law should be so high as to discourage the commission of crimes. Otherwise, those who can afford to pay will not be deterred from committing offences by insignificant fines.

Severity alone, however, cannot deter. There must also be some possibility that the sanction will be incurred if the crime is committed. Beccaria observed that the

¹⁷ John C. Ball, 'The Deterrence Concept in Criminology and Law', (1955) 46 *Journal of Criminal Law and Criminology*, 347

¹⁸ Ihekwoaba D. Onwudiwe, Jonathan Odo, and Emmanuel C. Onyeozili, 'Deterrence Theory', *Encyclopaedia of Prisons and Correctional Facilities*, (2005) 1, 233.

¹⁹ *ibid*

²⁰ Keith N. Hylton, 'The Theory of Penalties and the Economics of Criminal Law', (2005) Boston University School of Law Working Paper Series, Law and Economics Working Paper No. 02-17 <<https://ssrn.com/abstract=337460>>, accessed 23 November 2016

certainty of punishment even if moderate will always make a stronger impression.²¹ The regulators and law enforcement agencies must be prepared to bring the perpetrators of financial crime to account.

The deterrence theory has been criticised for being ineffective for deterring crime.²² With all the laws the world over and courts meting out punishment to offenders day in day out, crimes continue to be committed. It is difficult to tell whether the absence of laws and accompanying sanctions would lead to increased or decreased criminal conduct, but it is clear that even with the capital punishment for murder, homicides are committed daily both in the countries that have capital punishment and those that do not.

As posited by the proponents of the deterrence theory, the effectiveness of the law will depend on the severity of the sanctions. This study will recommend harsher penalties and punitive fines for perpetrators of financial crimes. Such penalties should be severe and commensurate with the effect of the actions of the offenders, especially considering the likely impact of banking sector crimes on individuals and the economy at large.

Rational Choice Theory

Rational Choice Theory refers to a set of ideas about the relationship between people's preferences and the choices they make. The conceptual foundations of the Rational Choice Theory originate in Cesare Beccaria's 1764 essay on Crimes and Punishments and Jeremy Bentham's 1789 work, 'An Introduction to the Principles of Morals and Legislation'.²³ According to this theory, perpetrators of financial crime weigh the potential huge financial benefits vis a vis the risk of getting caught, and if caught and convicted, the low fines or short prison terms that they could face. According to Cornish and Clarke, offenders have free will, and they choose to violate the law. They offend when they weigh the costs and benefits of crime and decide that the potential

²¹ Daniel S. Nagin, 'Deterrence in the Twenty-first Century: A Review of the Evidence', (2013) 42 Crime and Justice in America, 199

²² Kevin C. Kennedy, 'A Critical Appraisal of Criminal Deterrence Theory', (1983), <<https://digitalcommons.law.msu.edu/cgi/>>, accessed 24 November 2016.

²³ Brunisma, D. and D. Weisburd (Ed) *Encyclopaedia of Crime and Criminal Justice*, (2014)

benefits outweigh the potential costs.²⁴ Clarke and Felson argue that crime depends on the opportunities available. If a target is not protected enough, if it is worth the reward, crime will happen. Crime does not need hardened offenders, all it needs is just an opportunity.²⁵

Penalties for banking sector crimes should be so high, such that when potential offenders compare the expected monetary benefits with the sanctions, they are discouraged from committing the offences. The amount of financial benefit should be factored in the level of fines or prison sentences for those convicted of banking sector crimes.

1.8 Literature Review

In his book, 'Law of Financial Institutions in Kenya', Njaramba²⁶ argues that the current banking laws are outdated in terms of dealing with emerging banking practices. This study agrees with Njaramba and looks at the significance of financial crimes in the banking industry, whether or not related to the emerging practices and the related offences. This study goes further to establish the implications of offences whose accompanying sanctions are insignificant.

Akelola has written on the challenges faced by the banking industry in Kenya while dealing with fraud and analyses the structural and institutional weaknesses of public sector organs in prosecuting fraud cases in the banking industry.²⁷ Akelola limits her study to structural and institutional weaknesses that pose a challenge to prosecution of fraud. This study will consider whether the statutory framework is strong enough to support successful prosecution.

²⁴ Derek B. Cornish, and Ronald V. Clarke (eds), *The Reasoning Criminal: Rational Choice Perspectives on Offending* (Springer-Verlag: New York, 1986)

²⁵ Ronald V. Clarke and Marcus Felson (eds), *Routine Activity and Rational Choice: Advances in Criminological Theory, Vol 5* (Transaction Publishers: New Jersey, 1993)

²⁶ Gichuki Njaramba, *Law of Financial Institutions in Kenya*, 2nd ed, LawAfrica: Nairobi, 2013

²⁷ Serah Akelola, 'Prosecuting Bank Fraud in Kenya: Challenges faced by the Banking Sector' (2015) 14 Journal of Finance and Management in Public Services

In his article, 'From the Boardroom to the Cellblock: The Justifications for Harsher Punishment of White-Collar and Corporate Crime', Dutcher²⁸ looks at the damages caused by financial crime (referred to in the article as white collar crime). He observes that the collapse of Enron in 2001 led to the development of the Sarbanes Oxley Act which came up with harsher penalties for offenders found guilty of propagating financial crimes. The article looks at the justification for harsher punishment for financial crimes.²⁹

In his article, 'Deterrence in the Twenty-first Century: A Review of the Evidence' Nagin investigates the deterrent effect of punishment in the control of crime. He argues that both severity and certainty of punishment are required for effective deterrence.³⁰ This study will look into the severity of the sanctions against financial crime in Kenya and the application of the law in combating financial crime.

Writing on the issues affecting collapsed banks in Kenya in 2015 and 2016, Gathaiya notes that Chase Bank (IR) underreported its non-performing loans and had fishy special purpose vehicle accounts which were used to siphon billions from the bank. He further notes that Dubai Bank did not disclose its safety net operations as required by the Central Bank. The two banks were in breach of Central Bank's Prudential Guidelines. Gathaiya identifies poor corporate governance as one of the main causes of the collapse of Chase Bank and Imperial Bank.³¹ This study takes the view that the reporting breaches should be supported through statutory requirements for corporates to establish whistle blowing channels. Further, whistle blowing should be encouraged through better protection and rewarding of whistle-blowers.

Hollow³² argues that bank managers and employees have become more adept at bypassing internal controls that are put in place to reduce the opportunities for

²⁸ J. Scott Dutcher, 'From The Boardroom to The Cellblock: The Justifications for Harsher Punishment of White-Collar and Corporate Crime' [2006] Arizona State Law Journal, 1295

²⁹ *ibid*

³⁰ Nagin (n 21)

³¹ Robert N. Gathaiya, 'Analysis of Issues Affecting Collapsed Banks in Kenya from year 2015 to 2016', (2017) 7 International Journal of Management & Business Studies, 9

³² Matthew Hollow, 'Money, Morals and Motives: An Exploratory Study into why Bank Managers and Employees Commit Fraud at Work', [2014] Journal of Financial Crime, 174

fraudulent behaviour. As a result, there have been calls for greater efforts to combat fraud in the workplace. Hollow looks at the factors that motivate bank employees and managers to commit fraudulent offences. He observes that an employee is unlikely to commit fraud unless there is a motivation (benefit), opportunity to commit the fraud and conceal the same, and rationalisation to justify their actions.³³ This study focuses on the enhancement of punishment for fraudulent behaviour to de-motivate those who have the opportunity (as employees) to commit fraud. Serious punishment will make it difficult to rationalise fraudulent behaviour.

In his article, 'The Financial Crisis and the Haphazard Pursuit of Financial Crime', Tomasic³⁴ argues that the dominance of self-interest and a culture of greed have undermined trust in market institutions such as banks and the capacities of the legal system. He observes that there has been limited effectiveness of criminal sanctions against white collar crime. The Savings and Loans crisis of the 1980s in the United States of America (USA) saw much unlawful risk taking and looting by bank executives but few criminal actions, although many banks were closed down. In the recent times, there has been some momentum in pursuing perpetrators of financial crime, such as the conviction of the senior corporate officers of Enron and WorldCom for their roles in the scandals involving the two companies. It is notable that the Chief Executive Officers of Enron and WorldCom received sentences of 24 years and 25 years respectively after being convicted of fraud, conspiracy and filing of false statements. Bernard Madoff, who ran a massive Ponzi scheme, was given a 150-year sentence.³⁵

Tomasic argues that regulators have not been very effective at preventing financial crime, and a smarter approach is therefore required. What Tomasic does not mention is the involvement of law enforcement agencies in prosecuting financial crimes. Effective legal sanctions are required to deal with the culture of greed and self-interest which have undermined regulatory efforts to curb financial crime.

³³ *ibid*

³⁴ Roman Tomasic, 'The financial crisis and the haphazard pursuit of financial crime', (2011) 18 *Journal of Financial Crime*, 7

³⁵ *ibid*

Looking at financial crime in the United Kingdom, Ruggiero observes that financial crime is seen as ‘less criminal’ than other conventional criminal activity.³⁶ He argues that most available legislation is unable to deal with the variety and scale of financial malpractice, whose nature and multifaceted characteristics are not sufficiently understood. The attention paid to financial crimes is not proportional to the amount of social harm produced. For this to be said about the approach to fighting banking sector crimes by the United Kingdom (UK), which is a more advanced economy compared to Kenya, it begs comparing Kenyan’s legislation and enforcement of the laws to see how far back we are in terms of effectively fighting such crimes. It may be argued, however, that ours is a less advanced economy and therefore with much less to deal with in terms of complexity of banking sector crimes.

In conclusion, there is justification for harsher penalties and certainty of punishment for effective deterrence. Indeed, the world is moving towards stiffer penalties as seen in the Enron and WorldCom scandals. Kenya has been left behind in the fight against banking sector crimes, with outdated laws which carry light penalties. Not much has been written about the significance of punishment of banking sector crimes in Kenya or the strength of the statutory framework to support successful prosecution of such crimes. This study will seek to build knowledge in the punishment of banking sector crimes.

1.9 Research Methodology and Data Sources

This study will take the form of qualitative doctrinal research and will utilise both primary and secondary sources of information. The primary sources include the Banking Act, the Penal Code, POCAMLA and the Companies Act 2015. The primary sources are very useful to the research in that they state the current sectoral laws and outline the offences and the related penalties that are the subject of this study. The study will also utilize secondary sources including books, the internet, journal articles, newspapers reports and other publications. The secondary sources put into context the ineffectiveness of the law as a deterrent factor against the commission of banking

³⁶ Vincenzo Ruggiero, ‘Social Harm and the Vagaries of Financial Regulation in the UK’ [2015] International journal for Crime, Justice and Social Democracy, 91

sector crimes, and the impact of such offences on banks and the economy at large. The secondary sources also outline the legal and institutional framework for combating banking sector crime in USA and the UK.

A case study of Chase Bank (IR) and Imperial Bank (IR) will be undertaken to review the various charges preferred against the persons accused of culpability in the failure of the two banks and the related penalties vis a vis the potential impact of bank failure. These are the only two banks in Kenya whose directors and managers have been prosecuted for offences leading to failure of banks.

1.10 Limitations

The first two and only criminal prosecutions in Kenya against perpetrators of banking sector crime leading to the collapse of banks were filed in 2016 and are yet to be concluded. As such, there is no case law to refer to in analysing the effectiveness of the law in place.

Further, the institutions responsible for preventing and investigating banking sector crimes such as the Banking Fraud Investigation Unit and the Assets Recovery Agency have not published any data on their work and hence it is difficult to assess with accuracy the effectiveness of such institutions.

1.11 Chapter breakdown

Chapter one will introduce this study and give a background. Chapter two will look back into history and examine the collapse of two banks, Trust bank in 1998 and Charterhouse bank in 2004. Noting that there were no criminal charges against the directors or officers responsible for bank failure prior to 2016, it will examine the possible offences and sanctions that the directors and officers of Charterhouse bank and Trust bank would have faced. Further, chapter two will analyse the various charges preferred against the accused persons in the Chase Bank (IR) and Imperial Bank (IR) cases and the related penalties. It will compare the impact of the collapse of banks vis a vis the likely penalties for the persons found culpable for the collapse of the banks. Chapter three will look at how the law has dealt with the persons responsible for bank

failures in Kenya. It will look at the sufficiency of sanctions under the current legal regime, and the effectiveness of the legal framework in dealing with bank fraud. It will seek to establish the reasons why there has been no prosecutions for offences leading to bank failures. Chapter four will look at the measures taken by the USA and UK to combat banking sector crimes. Further, this chapter will outline the lessons that Kenya can learn from the two countries as it seeks to avoid the collapse of banks as has happened in the past. Chapter five will conclude the study and recommend necessary amendments to the legal and institutional framework in Kenya.

Chapter 2

Analysis of the charges preferred against the accused persons in the Chase Bank (In Receivership) and Imperial Bank (In Receivership) cases

2.1 Introduction

The placing of two banks under receivership in a period of six months between 2015 and 2016 raised questions over the stability of the banking sector in Kenya. These two banks were key players in the economy, being mid-tier banks¹, with several corporates among their customers, and having issued corporate bonds in which several financial sector players had invested. The regulator, Central Bank of Kenya and the law enforcement agencies acted fast to get the alleged perpetrators to face the law.

The collapse of Chase Bank (In Receivership) (Chase Bank (IR)) and Imperial Bank Limited (In Receivership) (Imperial Bank (IR)) was briefly discussed in Chapter One. It was observed that under the current legal regime, the penalties likely to be imposed on the persons responsible for the collapse of the two banks were quite lenient compared to the impact of the collapse of the banks.

This chapter will analyse the various charges preferred against the accused persons in the Chase Bank (IR) and Imperial Bank (IR) cases and the related penalties. It will compare the impact of the collapse of banks vis a vis the likely penalties for the persons found culpable for the collapse of the banks.

This chapter will begin by examining the history of Trust bank and Charterhouse bank which were put under receivership in 1998 and 2006 respectively, and the possible charges that would have been preferred against those responsible for the failure of the two banks. Further, it will examine the circumstances leading to the collapse of each of the two banks. It will then outline the negative effects of the failure of the two banks both on the persons directly affected by the failures and on the economy at large. This

¹ Imperial Bank Limited and Chase Bank Limited were rated as ‘Mid-Tier’ in 2015 by the CBK, see: Central Bank of Kenya, ‘Bank Supervision Annual Report 2015’, <www.centralbank.go.ke/uploads/399346751_2015%20Annual%20Report.pdf>, accessed 25 January 2019

will be followed by an evaluation of the adequacy of the charges facing the persons accused of various offences leading to the collapse of the banks, as well as other possible penalties. It will discuss the critical role that courts can play in determining the significance of penalties by preferring custodial sentences for financial crimes. This chapter will demonstrate that the maximum penalties likely to be imposed on those responsible for the failure of the two banks are far too lenient compared to the possible impact of bank failure.

2.2 History of collapsed banks in Kenya

The Kenya Deposit Insurance Corporation Annual Report and Financial Statements for the year ended 30th June 2016 lists 25 banks that went into liquidation between 1993 and 2016. The bank failures have been variously attributed to lack of liquidity, fraud and insider loans.² Out of the 25 banks, there has been no charges against the officers or directors of the banks, yet the officers and/or directors were responsible for the proper management of the banks.

2.2.1 Trust Bank

At the time it was placed under receivership, Trust Bank was Kenya's fifth largest bank. The bank was placed under receivership due to liquidity challenges arising from non-payment of loans extended to directors and shareholders.³ It was alleged that the bank operated an off-book banking system, with some funds passing through a parallel system that was not recorded on the main bank computers (presumably to avoid paying taxes). Connected persons extracted more than Kshs. 2.4 billion in non-performing loans. Depositors lost more than Kshs. 13 billion.⁴

Two of the bank's executive directors, Mr. Ajay Shah and Mr. Praful Shah were signatories to account number 25862-01 held by a company by the name Trust Capital Services (TCS) at the bank. Contrary to banking regulations, the bank held no account opening documents for this account. TCS also held another account at the bank,

² Charles Hornsby, *Kenya: A History Since Independence*, (I.B. Tauris, 2013), 648

³ Benedicto Kosgei Cheserek, 'The Determinants of Bank Failures: A Survey of Commercial Banks in Kenya', (MBA thesis, University of Nairobi, 2007)

⁴ Hornsby (n 2)

number 00059811-0001, which was not officially recorded in the bank's books. Over a period of seven days between 9 September 1998 and 16 September 1998, the account was overdrawn by over Kshs. 241 million. On 18 September 1998, Trust Bank was placed under statutory management by the CBK.⁵ The bank's receiver-manager commenced civil proceedings⁶ to recover the funds but no criminal charges were preferred against the directors or managers of the bank. In *Trust Bank Limited v Paramount Universal Bank Limited*⁷, where Mr. Ajay Shah and Mr. Praful Shah were enjoined in the case as employees and executive directors of the bank, the Court found that the two directors engaged in acts of intentional deception against the plaintiff and engaged in devices that led to loss to the plaintiff.

The facts of the case pointed to fraud, yet, no criminal proceedings were brought against the two directors as discussed hereunder.

Possible charges against the directors of Trust Bank (In Receivership)

Trust bank was said to have lost about Kshs. 241 million through the bank account operated by TCS, whose directors were also directors of Trust Bank.⁸ Given that the money was said to have gone through the TCS account only 9 days before the bank went into liquidation, there was a possible intention to defraud the bank. It is notable that on appeal, the court determined that the bank did not lose the Kshs. 241 million, since part of it was repaid and the balance reversed from the TCS account.⁹ The facts presented both in *Trust Bank Limited v Paramount Universal Bank Limited* and in *Ajay Shah v Deposit Protection Fund Board*¹⁰ indicate that the money left the bank through the TCS account under irregular circumstances. Simply, the money had been stolen or otherwise fraudulently appropriated, notwithstanding that it was eventually returned.

⁵ Wahome Thuku, 'Payback Time for those who Milked Banks to Death?' *The Standard* (Nairobi, 3 June 2013) <www.standardmedia.co.ke/article/2000085091/payback-time-for-those-who-milked-banks-to-death>, accessed 23 March 2019

⁶ Deposit Protection Fund Board as Liquidator of Trust Bank Limited (In Liquidation) v Ajay Shah and Praful Shah Miscellaneous Civil Application 294 of 2010

⁷ Civil Suit 1243 of 2001

⁸ Thuku (n 5)

⁹ *Ajay Shah v Deposit Protection Fund Board as Liquidator of Trust Bank Limited (In Liquidation)* [2016] eKLR

¹⁰ *ibid*

In *Trust Bank Limited v Paramount Universal Bank Limited*, the court found that the directors engaged in acts of intentional deception.¹¹ Section 11 (1) (h) of the Banking Act prohibits banks from granting credit facilities, giving guarantees, incurring any liability or entering into any transaction in a fraudulent or reckless manner or otherwise than in compliance with the provisions of the Banking Act. Section 11(1A) defines ‘fraudulent’ to include ‘intentional deception, false and material representation, concealment or non-disclosure of a material fact or misleading conduct, device or contrivance that results in loss and injury to the institution with an intended gain’. The facts presented in court in the above cases point to a violation of Section 11 of the Banking Act.

The facts can also support a number of offences under the Penal Code. The Penal Code provides for the offence of conspiracy to defraud, which occurs when a person conspires with another by deceit or any fraudulent means to defraud any person.¹² The Penal Code also provides for the offence of fraudulent appropriation or accounting by directors or officers, which is said to occur when a director or officer of a company, receives or possesses any of the property of the company otherwise than in payment of a just debt and with intent to defraud, omits to make a full and true entry in the books of the company.¹³ That the directors conspired to transfer the money from the bank through an irregular account indicates the possibility of a conspiracy to defraud. The transfer of the money through an irregularly opened account points to the offence of fraudulent appropriation by the directors.

Under Companies Act 2015, the above facts can support the offence of fraudulent trading. Notably, this offence did not exist under the repealed Companies Act (Chapter 486 Laws of Kenya), which was in operation at the time of the collapse of Trust Bank. Section 1002 of the Companies Act 2015 states that if the business of a company is carried on with intent to defraud or for any fraudulent purpose, each person who knowingly participates in carrying on the business in that manner commits an offence. Any person found guilty of an offence under this section is liable on conviction to

¹¹ n 7

¹² Section 317 of the Penal Code

¹³ Section 328 of the Penal Code

imprisonment for a term not exceeding ten years or a fine not exceeding ten million shillings, or to both.

Further, it has been established that the veil of incorporation, which shields directors from liability on the debts and other obligations of a company, may be lifted in exceptional circumstances.¹⁴ In *Jiang Nan Xiang v Cok Fas-St Company Limited*¹⁵ it was held that directors may be held personally liable if they act recklessly in the management of the business of the company and/or design a scheme, to perpetrate financial fraud.

2.2.2 The Charterhouse Bank Case

In 2004, some employees of Charterhouse Bank (In Receivership) blew the whistle on a raft of irregularities involving the bank and a number of its clients. Subsequently, CBK investigated the alleged irregularities and recommended that Charterhouse Bank (In Receivership) be shut down for allegedly helping some companies to evade taxes estimated at about Kshs. 18 billion. Earlier, in 2001, the bank was embroiled in a dispute with the CBK over a deposit of Kshs. 2 billion which had been paid into the account of a customer of the bank, Crucial Properties Limited. The customer claimed to have received the money as a loan to invest in the property market. CBK, in the belief that the money was proceeds of crime, obtained a court order to freeze the account to enable investigation into the source of the money. However, the order was later lifted before the investigations could be completed and the money was swiftly moved out of the bank.¹⁶ CBK did not pursue the matter further.

In March 2006, CBK recommended withdrawal of the bank's license citing massive financial malpractice at the bank. In April 2006, inspection conducted by CBK revealed unavailability of customer records for 45 accounts opened; engagement in offshore money transfers involving splitting of transactions; that cheques drawn on a customer's account were cleared through a lawyer's client account and that the same

¹⁴ *Ultimate Laboratories v Tasha B Loservice Ltd Nbi* HCCC No. 1287 of 2000

¹⁵ [2018] eKLR

¹⁶ Gladwell Otieno, 'Smouldering Evidence -The Charterhouse Bank Scandal', (Africa Centre for Open Governance (AfriCOG)), <https://africog.org/reports/Smouldering_Evidence.pdf>, accessed on 2 April 2019

lawyer's account was being used as a trading account for some customers. Based on the finding of the inspection, Charterhouse Bank (In Receivership) was placed under statutory management on 23 June 2006.¹⁷

Possible charges against the directors of Charterhouse Bank (In Receivership)

Over a long period, Charterhouse Bank (In Receivership) and its management had violated several provisions of the Banking Act. The bank had extended credit facilities to Nakumatt Holdings in contravention of Section 10 of the Banking Act, which prohibited banks from lending facilities whose total value was in excess of twenty-five per cent of the bank's core capital. The bank was also in contravention of Section 11 as it had advanced credit facilities to directors without approval by its board of directors. Further, one of the bank's shareholder owned 25.36% of the total capital (although disclosures to CBK indicated that he owned 10.87%) in contravention of Sections 13(1) and 13(3) of the Banking Act.¹⁸ None of the directors or officers of Charterhouse bank were charged with any of the offences outlined above (contravention of section 10, 11 and 13 of the Banking Act).

The 'irregularities' at Charterhouse Bank (In Receivership) including the receipt of an unexplained Kshs. 2 billion deposit in 2001, the opening of accounts without proper documentation, suspicious offshore transactions and the unusual transactions through a lawyer's client account are all elements of money laundering. There were attempts to conceal the source of the funds, the owners of the subject accounts and even the transactions.¹⁹ At the time of the above transactions, there were no comprehensive statutory provisions on money laundering, as POCAMLA only came into effect in 2010.

2.3 Collapse of Imperial Bank (In Receivership) and Chase Bank (In Receivership)

2.3.1 The Closure of Imperial Bank Limited (In Receivership)

¹⁷ ibid

¹⁸ ibid

¹⁹ ibid

On 13 October 2015, the CBK placed (Imperial Bank (IR)) under receivership due to, among other reasons, irregularities and malpractices in the bank which exposed depositors, creditors and the banking sector to financial risk.²⁰ The board of directors of Imperial Bank (IR) had brought to the attention of the CBK inappropriate banking practices that warranted immediate remedial action to safeguard the interest of both depositors and creditors.

On 26 October 2015, the CBK received a report on the state of financial affairs of Imperial Bank (IR) from the Kenya Deposit Insurance Corporation. The report²¹ confirmed fraudulent activities of substantial magnitude and the misrepresentation of Imperial Bank (IR)'s financial statements. The report revealed irregular granting of loans by Imperial Bank (IR)'s management contrary to legal and regulatory requirements, and the internal policies of the bank. In particular, these irregular loans were a violation of the statutory limit of lending to a single borrower and inadequate loan loss provisions, thereby overstating Imperial Bank (IR)'s capital adequacy position.²²

2.3.2 The Closure of Chase Bank (In Receivership)

On 7 April 2016, Chase Bank (IR) was placed under receivership by the CBK pursuant to the provisions of Sections 43(1), 43(2) and 53(1) of the Kenya Deposit Insurance Act, 2012. According to the CBK, Chase Bank (IR) had experienced liquidity difficulties following inaccurate social media reports and the stepping aside of two of its directors. Consequently, Chase Bank (IR) was unable to meet its financial obligations.²³

²⁰ Central Bank of Kenya, 'Press Release – Imperial Bank Ltd (In Receivership)', (13 October 2015)

<
www.centralbank.go.ke/images/docs/media/Press%20Releases/Press_Release_By_Kenya_Deposit_Insurance_Corporation_-_Imperial_Bank_Ltd.Pdf>, accessed 15 January 2019

²¹ Central Bank of Kenya, 'Press Release – Imperial Bank Ltd (In Receivership)', (26 October 2015)
<www.centralbank.go.ke/images/docs/media/2015/ImperialBank27102015.pdf>, accessed 15 January 2019

²² *ibid*

²³ Central Bank of Kenya, 'Press Release – Chase Bank Ltd (In Receivership)', (7 April 2016)
<www.centralbank.go.ke/images/docs/MPC%20Press%20Releases/Press_Release_Chase_Bank_Limited_April_7_2016.pdf>, accessed 15 January 2019

A few weeks before its closure, Chase Bank (IR) had reported a Kshs. 792 million loss in its 2015 financial statements down from a profit of Kshs. 2.3 billion in the previous year. The loss resulted from the reversal of under-reported insider loans worth about Kshs. 8 billion. The non-performing loans balance had increased from Kshs. 3 billion to Kshs. 11 billion related to unregulated insider lending to senior management and directors. The revelations by the bank's auditors to CBK led to the exit of two directors, Mr. Zafrullah Khan (Board Chairman) and Mr. Duncan Kabui (Group Managing Director).²⁴ Following widespread discussion of the above disclosures on social media, many customers withdrew their funds from the bank in large sums resulting in liquidity challenges.²⁵

It is at this point that CBK announced the closure of the bank and placed the bank under a receiver-manager. Investigations into the collapse of the bank led to the arrest and prosecution of some of the directors and managers of the bank.

2.4 The effects of placing Imperial Bank and Chase Bank under Receivership

The placing of the two mid-tier banks had significant negative effects on the economy. Depositors were denied access to their funds at least until the banks re-opened under the receiver-managers. Chase Bank (IR) was closed on 7 April 2016 and reopened on 26 April 2016. When it reopened, customers were only allowed to access their deposits up to Kshs. 1 million.²⁶ This meant that depositors had no access to their deposits for a period of about 20 days.

When Imperial Bank (IR) was put under receivership, it had about Kshs. 58 billion in customer deposits, the bulk of which was from the business community which was its target market. The bank was controlling about 1.76 per cent of the Kenyan banking

²⁴ Allan Olingo, 'Chase Bank Directors Blame Auditors Deloitte for Lender's Fall', *The East African* (Nairobi, 11 June 2016) <www.theeastafrican.co.ke/business/Chase-Bank-directors-blame-auditors-Deloitte-for-lender-fall-/2560-3245520-k5tkqc/index.html>, accessed 31 January 2019

²⁵ Zohreen Abdulla, 'Investigation of Strategic Issues Causing Receivership in Commercial Banks in Kenya: A Case Study of Chase Bank (K) Ltd', (2018), 4

²⁶ Central Bank of Kenya, 'Press Release – Chase Bank (In Receivership)', (20 April 2016), <www.centralbank.go.ke/images/docs/media/2016/ChaseBankLimited-20042016.pdf>, accessed 14 January 2019

market and had operations in Uganda as well.²⁷ This was a major disruption to businesses, which were unable to meet their financial obligations.

The most significant impact was the lack of confidence in the banking sector. While putting Chase Bank under receivership in April 2016, CBK observed that the bank ‘experienced liquidity difficulties following inadequate social media reports’.²⁸ If social media could bring down what was then a mid-tier bank²⁹, the going would get even tougher for smaller banks as depositors rushed to withdraw their deposits from the smaller banks amid social media reports of a ‘banking crisis’. To underline the threat of a possible banking crisis, the CBK went ahead to establish a liquidity support framework for commercial and microfinance banks to protect financial institutions which would face increased requests for withdrawals by customers.³⁰

Following the closure of Imperial Bank (IR) on 13th October 2015, the prices of shares of banks listed at the Nairobi Securities Exchange fell by up to 6.7% on 14th October 2015. This prompted the CBK to reassure investors of the stability of the banking sector.³¹

Just before Imperial Bank (IR) was put under receivership, it had had a successful fundraising through a Corporate Bond. The Bond was scheduled for listing at the Nairobi Securities Exchange (NSE) on the day that the bank was put under receivership. The CMA promptly directed the suspension of the introduction to listing

²⁷ George Ngigi, ‘Sh58bn Deposits Locked in Imperial Bank Shutdown’, *Business Daily* (Nairobi, 14 October 2015) <www.businessdailyafrica.com/markets/Sh58bn-deposits-locked-in-Imperial-Bank-shutdown/539552-2912296-tgtev2/index.html>, accessed 24 January 2019

²⁸ Central Bank of Kenya (n 23)

²⁹ Imperial Bank Limited and Chase Bank Limited were rated as ‘Mid-Tier’ in 2015 by the CBK, see: Central Bank of Kenya, ‘Bank Supervision Annual Report 2015’, <www.centralbank.go.ke/uploads/399346751_2015%20Annual%20Report.pdf>, accessed 25 January 2019

³⁰ Central Bank of Kenya, ‘Press Release – Central Bank of Kenya Introduces Liquidity Support Framework for Commercial and Microfinance Banks’, (20 April 2016), <www.centralbank.go.ke/images/docs/MPC%20Press%20Releases/Press_Release_CBK_Introduces_Liquidity_Support_Framework_for_Banks.pdf>, accessed 24 January 2019

³¹ Otiato Guguyu, ‘CBK Seeks to Reassure Investors of Banking Sector Stability’, *Daily Nation* (Nairobi, 14 October 2015) <www.businessdailyafrica.com/markets/Sh58bn-deposits-locked-in-Imperial-Bank-shutdown/539552-2912296-tgtev2/index.html>, accessed 24 January 2019

and trading of the Corporate Bond.³² On its part, Chase Bank (IR) had a Kshs. 10 billion Corporate Bond already trading at the NSE at the time the bank was placed under receivership. Similarly, this Bond was suspended from trading when the bank went into receivership.³³

The suspension of the bonds had serious implications in the financial services sector. Considering that it is mainly institutional investors such as pension schemes, fund managers and insurance companies that usually invest in corporate bonds, pensioners, corporate and individual investors stood to lose their investments. Even if they eventually get back their principal investments, they stood to interest and/or trading margins on the bonds.

Further, employees at these banks stood to lose their livelihoods. While there were no jobs losses immediately following the closure, Chase Bank (IR) eventually closed 10 branches leading to laying off of a number of workers.³⁴

If the potential effect of the collapse of a bank is disastrous, a banking crisis would spell doom for a country's economy.

2.5 Evaluation of the Charges against Officers and Directors of Imperial Bank (In Receivership)

Following the report on the state of affairs of Imperial Bank (IR), Mr. Naeem Ahmed Shah - Head of Credit, Mr. James Jamlick Kaburu – Chief Finance Officer, Mr. Nasir Haiderali Jessa, Mr. Zulfikar Haiderali Jessa, Nargis Aziz Jessa and M/s W.E Tilley (Muthaiga) Limited were charged with the following offences:

³² Central Bank of Kenya and Capital Markets Authority Joint Press Release - Imperial Bank Limited (In Receivership) (13 October 2015) <www.cma.or.ke/index.php?option=com_content&view=article&id=173:cbk-and-cma-joint-press-release-imperial-bank-ltd&catid=12&Itemid=207>, accessed 24 January 2019

³³ Geoffrey Irungu, 'NSE Suspends Chase Bank's Sh10bn Bond Trading', *Business Daily* (Nairobi, 12 April 2016) <www.businessdailyafrica.com/markets/NSE-suspends-Chase-Bank-Sh10bn-bond-trading-/539552-3156162-i2q5ffz/index.html>, accessed 24 January 2019

³⁴ Boniface Otieno, 'Chase Bank Set to Close 10 Branches on SBM takeover', *Daily Nation* (Nairobi, 20 July 2018) <www.nation.co.ke/business/Chase-Bank-set-to-close-10-branches-on-SBM-takeover/996-4673090-15b8mdwz/index.html>, accessed 24 January 2019

- i. Conspiracy to defraud contrary to Section 317 of the Penal Code³⁵ – According to the charge sheet, the accused persons conspired to defraud the bank and its depositors of at least Kshs. 29.75 billion through an irregular and illegal overdraft disbursement scheme.³⁶ In *R v Underson*³⁷, Lord Bridge stated that the necessary mens rea of the crime is established if and only if it is shown that the accused when he entered into the agreement intended to play some part in the agreed course of conduct in furtherance of a criminal purpose which the agreed course of conduct was intended to achieve. The prosecution must therefore present evidence that there was a common intention among the accused persons to defraud.
- ii. Engaging in organized criminal activities contrary to Section 3(c) as read with Section 4(1) of the Prevention of Organised Crime Act (POCA) – The accused persons were alleged to have acted in concert in the commission of a serious offence namely stealing for the purpose of obtaining financial benefit.³⁸ Section 3(c) of POCA provides that a person who acts in concert with other persons in the commission of a serious offence for the purpose of obtaining material or financial benefit or for any other purpose is guilty of engaging in organised criminal activity.
- iii. Fraudulent accounting by officers contrary to Section 328(b) (ii) of the Penal Code - The Head of Credit and the Chief Finance Officer were alleged to have made false entries in the banker's books maintained by Imperial Bank (IR) with intent to defraud.³⁹ The offence of fraudulent accounting is said to occur when a director, officer or member of a corporation or company, makes, or is privy to making, any false entry in any such book, document or account.⁴⁰

³⁵ Chapter 63 Laws of Kenya

³⁶ Court File No. 478/2016

³⁷ [1996] AC 27 HL

³⁸ n 36

³⁹ *ibid*

⁴⁰ Section 328(b)(ii) of the Penal Code

- iv. Stealing contrary to Section 268(I) as read with Section 275 of the Penal Code – The accused persons were said to have stolen Kshs. 7.13 million, the property of Imperial Bank (IR).⁴¹ Stealing is defined in Section 268 of the Penal Code as taking fraudulently and without claim of right anything capable of being stolen or converting to use of any person, other than the general or special owner thereof any property.
- v. Money Laundering contrary to Section 3(A)(1) as read with Section 16(1) of the Proceeds of Crime and Anti-Money Laundering Act, 2009 – The charge sheet read that the accused persons, knowingly or having reasons to have known that Kshs. 7.13 million was or formed part of proceeds of crime, engaged in transactions in connection with the said property whose effect was to conceal or disguise the nature, source, location, disposition or movement of the said property or ownership thereof or any interest which anyone may have in respect thereof.⁴²

2.6 Evaluation of the Charges against the Officers and Directors of Chase Bank (In Receivership)

Following the discovery of the financial malpractices at Chase Bank (IR), Mr. Zafrullah Khan – former Board Chairman and Mr. Duncan Kabui - former Managing Director, Mr. James Mwaura Mwenja - former General Manager for Corporate Credit, Mr. Makarios Omondi Agumbi - former General Manager, among others, were arrested and charged with the following:

- i. Stealing contrary to Section 268(I) as read with Section 275 of the Penal Code, Stealing by directors contrary to Section 282 of the Penal Code, and Stealing by servant contrary to Section 281 of the Penal Code - It was alleged that the accused persons had stolen Kshs. 1.15 billion belonging to Chase Bank (In Receivership). The Two directors, Mr. Khan and Mr. Kaburu, faced an additional charge of stealing by directors while Mr. Kabui, Mr. Mwenja and

⁴¹ n 36

⁴² ibid

Mr. Agumbi who were officer of the bank, faced the additional charge of stealing by servant.⁴³

The offence of stealing carries a maximum jail sentence of three years as provided for in section 275 of the Penal Code. In both cases, the alternative charge of stealing by directors was preferred where the accused persons were directors in the banks. Similarly, the alternative charge of stealing by servant was preferred against the accused persons who were employees of the banks. These alternative charges to the offence of stealing are brought against persons accused of misappropriating property by virtue of their positions as directors or officers of a company as the case may be. The maximum jail term for the offence of stealing by directors is seven years per Section 282 of the Penal Code. A similar jail term is provided as the penalty for the offence of stealing by servant. Accordingly, the accused persons face a potential jail term of seven years if convicted for theft.

The persons responsible for the loss of billions of shillings, failure of the banks, loss of business, loss of employment, loss of deposits and investment may only be jailed for a maximum of seven years. If fined, they may find it easy to pay the fines from the proceeds of their heist. A seven-year jail term, which in most cases is commuted to a much shorter term, is hardly a deterrence to persons who by virtue of their occupation have an opportunity to illegally access billions of shillings.

- ii. Conspiracy to defraud contrary to Section 317 of the Penal Code, for the loss of Kshs. 1.68 billion⁴⁴ - This offence carries a maximum jail term of three years. If not convicted of any other offence, persons found guilty of conspiracy to defraud whose actions led to a banking crisis would walk free after a mere three years in jail.

⁴³ Court File No. 622/2015

⁴⁴ *ibid*

- iii. Money Laundering contrary to Section 3(A)(1) as read with Section 16(1) of the Proceeds of Crime and Anti-Money Laundering Act, 2009, for moving Kshs. 740 million and Kshs. 409.68 million from Chase Bank (IR) to Paramount Universal Bank and KCB Bank respectively and for failing to report transactions involving cash in excess of Kshs. 1 million.⁴⁵

In both cases, the accused persons face the charge of money laundering contrary to Section 3(A)(1) of the Proceed of Crime and Anti-Money Laundering Act, 2009 (POCAMLA). Section 16(1) of the POCAMLA prescribes penalties for this offence as a jail term not exceeding fourteen years, or a fine not exceeding five million shillings or the amount of the value of the property involved in the offence, whichever is higher, or to both the fine and imprisonment.

The maximum jail terms for money laundering offences are more punitive compared to the offence of stealing. However, when we look at the description of the offence at Section 3 of POCAMLA⁴⁶, proving the offence of money laundering is quite tasking and in any case, the objective of POCAMLA is to tackle money laundering and not stealing or unfairly benefitting of directors and officers of a bank.

- iv. Fraudulent accounting: Section 328(b) (ii) of the Penal Code provides that a director or officer of a company who is found guilty of the offence of fraudulent appropriation or accounting is liable to imprisonment for seven years. Such a director or an officer will have benefitted from their misconduct

⁴⁵ *ibid*

⁴⁶ Section 3 of the Proceeds of Crime and Anti-Money Laundering Act: Money laundering:

“A person who knows or who ought reasonably to have known that property is or forms part of the proceeds of crime and— (a) enters into any agreement or engages in any arrangement or transaction with anyone in connection with that property, whether that agreement, arrangement or transaction is legally enforceable or not; or (b) performs any other act in connection with such property, whether it is performed independently or with any other person, whose effect is to— (i) conceal or disguise the nature, source, location, disposition or movement of the said property or the ownership thereof or any interest which anyone may have in respect thereof; or (ii) enable or assist any person who has committed or commits an offence, whether in Kenya or elsewhere to avoid prosecution; or (iii) remove or diminish any property acquired directly, or indirectly, as a result of the commission of an offence, commits an offence.”

and their privileged positions begging the question whether a seven-year term offers sufficient deterrence to such persons.

- v. Engaging in organized crimes: Section 3(c) of the Prevention of Organised Crime Act⁴⁷ provides that a person who ‘acts in concert with other persons in the commission of a serious offence for the purpose of obtaining material or financial benefit or for any other purpose’ is guilty of the offence of engaging in criminal activity. This is one of the charges preferred against the accused persons in the Imperial Bank (IR) case. According to Section 4(1) of the Prevention of Organised Crime Act, the sentence for this offence is a fine not exceeding five million shillings or imprisonment for a term not exceeding fifteen years, or both.

It is in realisation of the significance of the impact of the nature of misconduct that results in bank failure that the prosecution chose to add this to the list of charges facing the accused persons. It is notable that this is not among the charges preferred against the accused persons in the Chase Bank (IR) case.

2.7 Are the above charges comprehensive?

Considering the facts of the cases, the charges (above) brought against the accused persons are proper in law. The prosecution will have to prove that the accused had the intention to enrich themselves unfairly and that they actually benefitted from their actions in order to sustain the stealing-related offences. The accused persons occupied positions of directors and senior management and allegedly used their positions to perpetrate the said offences. To prove the charges on conspiracy to defraud and organised crime, the prosecution will need to prove that the accused persons acted in concert to commit the said crimes.

The facts of the two cases can be used to support other charges against the accused persons. For instance, the officers and directors could be charged with the offence of destruction, mutilation or falsification of documents contrary to Section 818 of the

⁴⁷ Act No. 6 of 2010

Companies Act 2015, whose penalty is a fine not exceeding one million shillings or to imprisonment for a term not exceeding seven years, or to both. The actions of the directors and managers (concealing insider loans) are intended to mislead the readers of the financial statements of the banks and conceal the facts of the operations of the banks.

The charge of engaging in organised crime ought to have been included in the Chase Bank case. From the facts presented in both cases, it is apparent that the directors and managers involved engaged in illegal transactions with the intention of procuring benefit from the said transactions. The directors and managers acted in concert, with a common goal of gaining illegal benefits from the bank.

The facts of the two cases can also support a charge under Section 50 of the Banking Act⁴⁸ for failure to ensure compliance with the Banking Act. Section 50 of the Banking Act provides that an officer of an institution who fails to:

- a) take all reasonable steps to secure the compliance of the institution with the Act;
- b) take all reasonable steps to secure the accuracy and correctness of any statement submitted under any other written law applicable to banks or financial institutions; or
- c) supply any information required under the Act;

shall be guilty of an offence and liable to imprisonment for a term not exceeding one year or to a fine not exceeding twenty thousand shillings or to both.

In the Imperial Bank (IR) case, there was a charge of fraudulent accounting. The bank officials were accused of misreporting on the bank's financial statements. There were irregular loans in violation of the statutory limit of lending to a single borrower and inadequate loan loss provisions. In the Chase Bank (IR) case, there were allegations under-reporting of insider loans worth about Kshs. 8 billion. In both cases, there are

⁴⁸ Chapter 488 Laws of Kenya

facts that support the offence of contravention of the requirements of the Banking Act and other applicable laws. This would support a charge under Section 50 of the Banking Act.

2.8 Other possible penalties

2.8.1 Non-Statutory Fines

Section 28(1) (a) of the Penal Code provides that where no sum is expressed to which the fine may extend, the amount of the fine which may be imposed is unlimited, but shall not be excessive. This gives discretion to the court to determine a suitable amount of fine. The court is under no obligation to impose a fine, and may therefore impose only a jail term without the option of a fine. For persons who have made a fortune from misconduct of which they are convicted, a jail term without the option of a fine may be the most suitable punishment. Such decisions may offer deterrence to white collar criminals who may have accumulated enough money from their heists to comfortably pay fines and still benefit from their crimes.

2.8.2 Confiscation Orders

According to Section 61 of POCAMLA, the court is required to issue a confiscation order against a person found guilty of an offence to recover the benefit derived from that offence or a related offence. Such an order may be issued on application by the Attorney General, the director of the Asset Recovery Agency or on the motion of the court. Such orders are made in addition to the punishment imposed on the convicted person.⁴⁹ The Penal Code provides that the court may order the forfeiture of any property which has passed in connection with the commission of the offence.⁵⁰ The courts have been given powers to issue forfeiture orders and can therefore use these powers to enhance the penalties against the accused persons.

Confiscation orders are issued at the end of a criminal case where the accused person is found guilty. As mentioned above, such orders are issued in addition to the prescribed penalty. The value of assets to be forfeited depends on the extent to which

⁴⁹ Section 61, Proceeds of Crime and Anti-Money Laundering Act

⁵⁰ Section 29, Penal Code

the convicted person has benefited from the offence committed. This is unlike a fine whose amount is usually fixed by statute. This makes forfeiture more effective at communicating that an activity is forbidden, rather than setting a price. Wealthy offenders forfeit more in assets than poor offenders, so wealthy offenders are not asked to pay an amount that is trivial to them.⁵¹ Confiscation punishes the offender and deters commission of further offences.⁵²

2.9 Sentencing

According to the Sentencing Guidelines (issued by the Judiciary, Republic of Kenya), where offences are committed in the course of multiple transactions and where there are multiple victims, the sentences should run consecutively.⁵³ If running consecutively, the accused persons could face up to thirty-one years in jail each if convicted of all the offences. However, should the court treat the offences as emanating from a single transaction, the sentences will run concurrently,⁵⁴ meaning that the maximum jail term for the offences in the Imperial Bank (IR) case is fifteen years (for engaging in organised crime) and fourteen years (for money laundering offences) in the Chase Bank (IR) case.

In terms of fines, the courts have discretion in most cases to impose hefty fines, and have an opportunity to pronounce deterrent penalties to deal with financial crimes. Considering the likely impact of the collapse of a bank as demonstrated in section 2.3, persons found liable for collapse of banks should face the stiffest possible penalty to act as deterrent to others charged with similar responsibilities.

2.10 Conclusion

This Chapter has outlined the circumstances leading to the collapse of Chase Bank (IR) and Imperial Bank (IR) and the negative effects of the failure of the two banks on the economy. It has analysed the charges preferred against the persons said to be

⁵¹ Catherine E. McCaw, 'Asset Forfeiture as a Form of Punishment: A Case for Integrating Asset Forfeiture into Criminal Sentencing', (2011) 38 (2) American Journal of Criminal Law, 185

⁵² R v Rezvi [2002] UKHL 1

⁵³ Sentencing Guidelines Paragraph 7.13

⁵⁴ *ibid*

criminally culpable in the collapse of the two banks. It has been demonstrated that the charges are not comprehensive and the penalties likely to be imposed on persons found liable for banks failure are too lenient in light of the significance of the collapse of a bank. It has noted that in addition to the fines and prison sentences related to the charges preferred against the accused persons, there is scope for confiscation of assets belonging to the persons convicted of the offences which are proceeds of crime. It has also noted that the courts of law can play a major role in making the penalties more stringent, including by preferring custodial sentences for financial crimes.

The next chapter will look at how the law has dealt with the persons responsible for bank failures in Kenya before 2016 when the first criminal prosecution against persons believed to be responsible for bank failures were commenced.

Chapter 3

The Application and Effectiveness of the Law against Banking Fraud in Kenya

3.1 Introduction

In the history of banking in Kenya, there have been tens of bank failures and up to 2016, there had been no criminal prosecution of persons responsible for the collapse of banks. The previous chapter highlighted the first two cases in Kenya where directors and officers believed to be responsible for the collapse of Chase Bank (In Receivership) and Imperial Bank (In Receivership) are facing a number of criminal charges. It was observed in the last chapter that if convicted, the directors and officers will be facing short jail times and/or low fines compared to the significant impact of a collapsed bank in an economy. An analysis of the two cases in chapter two indicate that the sanctions provided in the statutes for persons convicted on offences leading to the collapse of banks are too lenient.

This chapter will look at how the law has dealt with the persons responsible for bank failures in Kenya. It will look at the sufficiency of sanctions under the current legal regime, and the effectiveness of the legal framework in dealing with bank fraud. It will seek to establish the reasons why there has been no prosecutions for offences leading to bank failures.

3.2 Legal Framework Review

As seen in Chapter Two, there were gaps in law at the time of the collapse of the highlighted banks. For instance, there were no provisions on money laundering offences, which are currently covered by POCAMLA. This section shows the progress in the legal framework over time, indicating the tightening of controls against persons intent on mismanaging banks for illegal gain.

3.2.1 The Banking Act

Section 34 of the Banking Act gives the CBK powers to intervene in the management of a licenced institution in the event that such an institution fails to meet its financial obligations. The CBK may also make such intervention following an auditor's report on serious breach of the Banking Act, the Central Bank of Kenya Act or CBK Guidelines, or where a criminal offence involving fraud or other dishonesty has been committed by the institution or any of its officers or employees.¹ Such intervention may include the appointment of a receiver-manager, whose main responsibilities include tracing and preserving all the property and assets of the institution and the recovery of all debts and other sums of money owing to the institution.²

Section 34(2) of the Banking Act provides that the Kenya Deposit Insurance Corporation (KDIC) may be appointed as the receiver-manager of licenced banks which fall foul of the provisions of the Act. According to Section 5 of the Kenya Deposit Insurance Act 2012³, KDIC's mandate is to provide a deposit insurance scheme for customers of member institutions and to receive, liquidate and wind up any institution in respect of which the Corporation is appointed receiver or liquidator. Before the establishment of KDIC in 2012, the Deposit Protection Fund Board (DPFB) was charged with the management of banks which had been put under receivership by the CBK. Similarly, its mandate was to protect depositors' funds, and to recover as much as possible the assets of fallen banks for the benefit of the depositors.⁴

Over the years, KDIC and DPFB have, in their role as receiver-managers, filed civil cases against those believed to have unfairly benefited from the fallen banks seeking to recover assets of the banks. As seen in *Trust Bank Limited v Paramount Universal Bank Limited*⁵, the receiver-manager comes across information which could be incriminating to the officers and directors of the fallen banks. Such information is

¹ Section 24(4) Banking Act

² Section 34(5) Banking Act

³ No. 10 of 2012

⁴ The Kenya Deposit Insurance Corporation, which was formed in 2012, took over the assets, liabilities and functions of DPFB. The Deposit Protection Fund Board was established in 1986 under section 36 of the Banking Act, which section has since been repealed.

⁵ Civil Suit 1243 of 2001

shared with the Banking Fraud Investigating Unit which carries further investigations (see section 3.3.5 below).

3.2.2 Central Bank of Kenya Prudential Guidelines

Since 2006, the CBK has issued a total of 22 Prudential Guidelines for institutions licenced under the Banking Act. The Guidelines, issued under Section 33(4) of the Banking Act, provide guidance on various aspects including governance, capital adequacy, liquidity management, risk management and consumer protection. Prudential Guideline 4.2.7 (Insider Loans) prohibits institutions to grant loans to its directors or officers which are unsecured, fraudulent or are not in compliance with the requirements of the Banking Act or the Prudential Guidelines. Non-compliance with the Prudential Guidelines is an offence under Section 34(5) of the Banking Act, whose penalty is provided for under Section 49 of the Banking Act as a fine of Kshs. 1 million or imprisonment for a term not exceeding two years or both. The fine was only enhanced in January 2017, up from Kshs. 200,000.⁶ This was perhaps a reaction to the closure of banks in 2015 and 2016 due to alleged malpractice by management and is aimed as a deterrence to future violations.

3.2.3 The Penal Code

The Penal Code identifies several offences which would be applicable in cases where the actions (or omissions) of bank officers and directors lead to collapse of banks. Section 275 of the Penal Code provides for the offence of stealing, whose penalty is imprisonment for three years. Stealing is defined under section 268 (1) as taking fraudulently and without claim of right anything capable of being stolen, or fraudulently converting to the use of any person other than owner. In the case of *Ajay Shah v Deposit Protection Fund Board*⁷, the directors of TCS are said to have fraudulently taken Kshs. 241 million belonging to Trust Bank.

Section 317 of the Penal Code provides for the offence of conspiracy to defraud with a penalty of three years' imprisonment. In the two cases above, facts were presented

⁶ Finance Act 2016

⁷ [2016] eKLR

which indicated that the directors/officers of the banks had acted in concert with an intention to defraud. With proof of the actions/omissions of the directors/officers of the banks carried out with the intention to defraud, a charge of conspiracy to defraud would stand against the directors/officers responsible.

Further, the Penal Code provides for the offence of fraudulent appropriation or accounting by directors or officers. Section 328 of the Penal Code states that a director or officer of a company who receives or possesses the property of the company otherwise than in payment of a just debt or demand, and, with intent to defraud, omits either to make a full and true entry thereof in the books and accounts of the company, is guilty of a felony and is liable to imprisonment for seven years. In the Trust bank case, it is alleged that directors were said to have been involved in intentional deception. This involved misreporting of irregular transactions which benefited the directors, which would make the directors liable under section 328.

The misreporting or concealment of facts would also make the directors liable for the offence of false statements by officials of companies. Section 329 of the Penal Code provides that a director or an officer of a company who makes or publishes any false written statement or account with intent to deceive or defraud any member or creditor of the company is guilty of a felony and is liable to imprisonment for seven years.

3.2.4 The Proceeds of Crime and Money Laundering Act

The main objective of POCAMLA, which came into effect in June 2010, is to provide for the offence of money laundering and to introduce measures for combating the offence. It provides for the identification, tracing, freezing, seizure and confiscation of the proceeds of crime.⁸ It requires banks and financial institutions to monitor and report unusual or suspicious transactions. POCAMLA applies to all persons whether individual or corporate and to the proceeds from any criminal activity.

Prior to the enactment of POCAMLA, anti-money laundering initiatives in the country were spearheaded by the National Taskforce on Anti-Money Laundering and

⁸ Preamble, Proceeds of Crime and Anti Money Laundering Act, no. 9 of 2009

Combating the Financing of Terrorism, a multi-disciplinary taskforce comprising various government ministries, agencies and departments, established in 2003.⁹ Money laundering was primarily being dealt with under the Narcotic Drugs and Psychotropic Substances (Control) Act, 1994, which only dealt with proceeds of drug trafficking, and the Central Bank of Kenya Guideline on Proceeds of Crime and Money Laundering (Prevention) which only applies to banking institutions licensed under the Banking Act.¹⁰ POCAMLA repealed the anti-money laundering provision in the Narcotics Act. The CBK Prudential Guideline on Money Laundering has been in force since 2006.

POCAMLA establishes the Asset Recovery Agency and the Financial Reporting Centre which are semi-autonomous bodies to assist with the implementation of the Act.

3.2.5 The Companies Act 2015

Section 1002 of the Companies Act 2015 states that if the business of a company is carried on with intent to defraud or for any fraudulent purpose, each person who knowingly participates in carrying on the business in that manner commits an offence. Any person found guilty of an offence under this section is liable on conviction to imprisonment for a term not exceeding ten years or a fine not exceeding Kshs. 10 million shillings, or both. Notably, this is a new offence which was not provided for in the repealed Companies Act.¹¹

Section 818 of the Companies Act 2015 provides for the offence of destruction, mutilation or falsification of documents whose penalty is a fine not exceeding one million shillings or to imprisonment for a term not exceeding seven years, or both. Per section 215, any director/secretary who is convicted of an offence relating to the management of a company may be disqualified as a director for a period of up to 15 years. Disqualification of such persons as directors can help ensure that persons who

⁹ The Financial Reporting Centre, <<http://frc.go.ke/about-frc/background.html>>, accessed 23 April 2019

¹⁰ *ibid*

¹¹ Chapter 486 Laws of Kenya

have been convicted of certain offences do not get another opportunity to perpetuate crimes which may lead to bank failure.

3.3 Institutional Framework Review

3.3.1 The Central Bank of Kenya

The principal object of CBK is to formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices.¹² CBK has powers to undertake inspection¹³ and audit¹⁴ of banking institutions, and upon the findings, take intervention measures including removal of officers involved in misconduct. With proper inspection and audit, CBK has an opportunity to gather critical evidence to secure successful prosecution of persons responsible for financial crimes. While CBK may gather such evidence, it has no prosecutorial powers and therefore has little influence to secure convictions of the perpetrators of financial crime.

3.3.2 The Asset Recovery Agency

The Assets Recovery Agency (ARA) is created under section 53(1) of POCAMLA as a semi-autonomous body under the office of the Attorney-General. The functions of the Agency include the implementation of the provisions of POCAMLA on criminal and civil forfeiture (recovery of property that has been used or is intended for use in the commission of an offence or is proceeds of crime).¹⁵

To achieve maximum effect in deterring crime, there is need to ensure that the perpetrators of crime do not benefit from the proceeds of crime. Since the aim of criminal prosecution is conviction of the defendant and not recovery of funds, ARA plays a critical role in recovering proceeds of crime and denying the perpetrators of crime the benefit of such proceeds.

¹² Section 4(1) Central Bank of Kenya Act (Chapter 491 Laws of Kenya)

¹³ Section 32, Banking Act (Chapter 488 Laws of Kenya)

¹⁴ Section 24, Banking Act (Chapter 488 Laws of Kenya)

¹⁵ Section 82(2) POCAMLA

3.3.3 The Financial Reporting Centre

The Financial Reporting Centre (FRC), Kenya's Financial Intelligence Unit, is established under section 21 of POCAMLA. The FRC, which became operational in April 2012,¹⁶ is an independent body whose principal objective is to assist in the identification of the proceeds of crime and combating money laundering. The powers and functions of FRC include the receipt and analysis of reports of unusual or suspicious transactions and cash transactions reports made by reporting entities, and the dissemination of reports received under POCAMLA to appropriate law enforcement authorities or other supervisory bodies for further handling. FRC also inspects and supervises reporting institutions to ensure compliance with anti-money laundering reporting obligations as prescribed in POCAMLA. The Centre does not investigate or prosecute offenders; this role is left to the Office of the Director of Public Prosecutions.¹⁷

POCAMLA also provides for offences such as money laundering and the acquisition, possession or use of proceeds of crime whose penalty is imprisonment for a term not exceeding fourteen years, or a fine not exceeding the higher of Kenya Shilling five million and the value of the property involved in the offence, or both the fine and imprisonment. POCAMLA came into effect in 2010, and as such, did not apply to the Trust Bank cases (1998) and the Charterhouse cases (2004).

3.3.4 Office of the Director of Public Prosecutions

To convince the court to convict the perpetrators of criminal conduct, prosecution must present convincing evidence that proves the culpability of the accused persons beyond reasonable doubt. Such evidence can only arise from proper investigations. It is therefore important in this study to look at the efficacy of investigations and prosecution of offences which lead to collapse of banks.

¹⁶ *ibid*

¹⁷ <http://frc.go.ke/faq.html>

Under Article 157 of the Constitution,¹⁸ the Office of the Director of Public Prosecutions (ODPP) is mandated to institute and undertake prosecution of criminal matters. The Office was previously a department under the State Law Office, discharging responsibilities on behalf of the Attorney General. The ODPP delinked from the State Law Office in 2011 following the appointment of a Director of Public Prosecutions under the new Constitution. While the powers of the ODPP have remained largely the same under the new Constitution, its enhanced independence has improved its effectiveness; perhaps this is why offences that were not being prosecuted before are now being prosecuted.

3.3.5 The Banking Fraud Investigation Unit

The Banking Fraud Investigation Unit (BFIU), a unit of the Directorate of Criminal Investigations, is the body charged with the responsibility to investigate fraud complaints from commercial banks, other financial institutions and parastatals.

Where BFIU has conducted investigations and prosecuted fraud suspects (although none of the prosecuted matters has been against senior officers or directors of banks), the conviction rate has been very low. This raises questions about the quality of investigations. The low conviction rates have also been attributed to the inordinately long periods taken to conclude cases in court. In the process of the delays some witnesses die, relocate or forget the facts of the case, material evidence is lost and people even lose interest in the cases.¹⁹

It has been argued that BFIU has not been effective at investigating fraud due to a number of reasons. First, BFIU is understaffed and therefore does not have the capacity to conduct proper investigations. Secondly, BFIU staff are frequently transferred and as such, do not get time to conclude investigations. When new personnel come in, it takes them time to understand the case and this delays investigations, and consequently, court cases.²⁰ It has also been argued that BFIU's

¹⁸ Constitution of Kenya

¹⁹ Serah Akelola, 'Prosecuting Bank Fraud in Kenya: Challenges faced by the Banking Sector' (2015) 14 Journal of Finance and Management in Public Services

²⁰ *ibid*

ineffectiveness is due to the current reporting structure where they report to the Director of Criminal Investigations while it could be structurally beneficial if they report to the Governor of CBK.²¹ Non-professionalization of the BFIU, inadequate training and funding also affects the effectiveness of BFIU and does little to discourage flight of seasoned experienced investigators to greener pastures.²²

3.4 Conclusion

The law has developed over time especially in response to the problems faced in the industry over the years. The Banking Act was enacted in 1989, complementing the Central Bank of Kenya Act to create a stricter regulatory regime for the banking industry. This however did not prevent a wave of bank failures between 1993 and 1995 when close to 20 banks went into liquidation. In 2006, the CBK started issuing Prudential Guidelines which have been regularly revised and enhanced to cover many aspects of banking. The Guidelines identify offences which are punishable under the Banking Act. The enactment of POCAMLA in 2010 is perhaps the most significant step towards fighting financial crime in Kenya. In addition to prescribing high penalties (up to fourteen years' imprisonment for the offence of money laundering), POCAMLA also sets up the FRC and ARA which have enhanced the fight against banking sector crimes. Sanctions for banking sector crimes have also evolved over time. In 2017, there was an enhancement of fines under the Banking Act.

As shown by the Trust Bank (In Receivership) and Charterhouse Bank (In Receivership) cases, there has always been statutory provisions against offences such as stealing and fraud, but there were hardly any prosecutions against persons responsible for collapse of banks. The enhancement of offences, such as the provision of money laundering offences, has widened the breadth of offences, making it easier not only to identify offences but also to pursue conviction. The enhanced penalties are now more reflective of the nature and significance of financial crimes.

²¹ *ibid*

²² George Maingi, 'Effectiveness of Strategic Security Systems on Securing Financial Institutions in Nairobi County' (2014) 19 IOSR Journal of Humanities and Social Science, Issue 9

Despite the statutory developments, banks have continued to collapse with failure to observe the law being a major reason for the collapse. In the latest such bank failures, Chase Bank (In Receivership) and Imperial Bank (In Receivership), charges have been preferred against officers and directors responsible for the failures. The law has not been enforced effectively through prosecution and conviction of persons responsible for failure of banks. The deterrent role of the law has not been felt and as such, the collapse of banks in Kenya has continued.

The CBK's regulatory role has been seen more in the development of the legal framework than in the implementation of the law. CBK has overseen the establishment of laws, regulations and institutions, but has played a minor role in, for instance, ensuring that the persons responsible for collapse of banks face the full wrath of the law. While it is clear that the prosecutorial role lies with the ODPP, CBK has a role to play to ensure that the interests of depositors and investors are adequately protected. It may be worth considering giving CBK investigative or prosecutorial mandate to pursue the perpetrators of financial crime.

The low conviction rates point to, among others, the effectiveness of investigations and delays in concluding court cases. The effectiveness of BFIU as the investigating agency for bank fraud has been called into question. Where BFIU has conducted investigations and prosecuted fraud suspects (although none of the prosecuted matters has been against senior officers or directors of banks), the conviction rate has been very low. This raises questions about the quality of investigations. When taken to court, the cases take inordinately long periods to be concluded. In the process of the delays some witnesses die, relocate or forget the facts of the case, material evidence is lost and people even lose interest in the cases.

The next chapter will consider how the United States of America and the United Kingdom handle banking sector crimes, and the lessons that Kenya can learn from the two countries.

Chapter 4

Addressing crimes in the banking sector: Lessons from the United States of America and the United Kingdom

4.1 Introduction

The previous chapter looked at the history of collapse of banks in Kenya, specifically dwelling on Trust Bank (In Receivership) and Charterhouse Bank (In Receivership) which collapsed in 1998 and 2004 respectively. It established that before 2016, there had been no prosecution of persons responsible for the collapse of banks due to gaps in the law in the earlier years and lack of proper investigations. In 2016, the prosecution of persons accused of offences leading to the collapse of Chase Bank (In Receivership) and Imperial Bank (In Receivership) heralded a new era in the banking sector in Kenya, as discussed in Chapter Two. These cases are still in court.

Banks fail for different reasons, one of which is banking sector crimes. As seen in the Chapters Two and Three, such crimes are sometimes propagated by officers and directors of banks. The focus of this study is how the law can be used to prevent collapse of banks by combating such crimes. This chapter will look at the measures taken by the USA and UK to combat banking sector crimes in order to prevent the collapse of banks in these countries. Further, this chapter will outline the lessons that Kenya can learn from the two countries as it seeks to avoid the collapse of banks as has happened in the past.

The statutory framework in the USA and UK will be discussed in section 4.2, while the institutional framework in the two countries will be discussed in section 4.3. The lessons for Kenya's statutory and institutional framework will be outlined within the two sections above, while section 4.4 will outline other reforms to assist in addressing bank collapses in Kenya.

The USA has been considered for this study because it pioneered the development of sound banking regulations.¹ The UK has been considered since Kenya has borrowed

¹ Spong Kenneth, *Banking Regulation, its Purpose, Implementation and its Effect*, (5th edition, 2000).

most of its banking laws from the UK. The UK has also made significant progress in combating financial crime especially through its Serious Fraud Office.

Notably, the laws in place to combat banking sector crime are mainly developed in response to scandals in the banking industry. However in the recent past, the development of such laws has mainly been in response to money laundering and terrorism financing.

4.2 The Statutory Framework in the United States of America: Lessons for Kenya

American economic policy makers hold the view that regulation is key in sealing loopholes that may create an avenue for banking sector crimes to be committed. They believe that regulation is critical for the protection of depositors, maintenance of monetary and financial stability and enhancing a competitive financial system.² To achieve this, several statutes have been enacted to deal with banking sector crimes. In order to appreciate the statutory framework in USA on banking sector crimes, it is important to trace the history of the development of the law in this space.

Federal sanctions for banking crimes originated with the National Banking Act of 1863 and its 1864 replacement. The two statutes proscribed misapplication, embezzlement and false entries, each with a maximum ten-year prison sentence. In 1948, the penalties were reduced to a maximum of five years imprisonment. Subsequently, prosecutors no longer prioritized bank fraud prosecutions as the related penalties were deemed too insubstantial to justify the expense of lengthy investigations and trials. Further, the aged, technical statutes were proving ineffective in netting some latter-day financial schemes. Consequently, offenders were often charged with technical violations of other statutes, such as making false statements to a bank examiner.³

² *ibid*

³ Brian T FitzPatrick, 'Congressional Re-Election through Symbolic Politics: The Enhanced Banking Crime Penalties' (1994) 32 *Am Crim L Rev* 17

In the early 1980s, over 2,100 financial institutions in the USA collapsed in what came to be known as the Savings and Loans (S&L) crisis.⁴ The collapse was attributed to a variety of factors, including criminal conduct by bank officers and directors.⁵ Further, between January 1980 and July 1983 there were 75 commercial bank failures, fifty percent of which were largely attributed to the criminal misconduct of insiders.⁶

In order to punish those criminally responsible for the S&L crisis, the Department of Justice (DOJ) assembled a task force of prosecutors in order to manage the cooperation of interested government agencies and prosecute widespread financial abuses by executives of the S&Ls. Out of 1,100 individuals charged with major crimes for their roles at the failed S&Ls, 839 were convicted. The successful prosecution was attributed to the combined efforts of the various government agencies involved.⁷

4.2.1 Comprehensive Crime Control Act of 1984

The Comprehensive Crime Control Act of 1984 (CCCA 1984), which included the Bank Fraud Statute, was enacted in response to the failure of financial institutions in the USA in the 1970s and early 1980s. The CCCA 1984 amended several statutes to enhance the sanctions for offences against financial institutions and to deter similar wrongdoing in the future. For instance, the sanction for fraud was raised from a misdemeanor with a one year maximum sentence to a felony with a five year maximum sentence. Under the Bank Fraud statute, where fraud involved multiple transactions, there would be multiple counts. As such, the exposure would be 5, 10, 15 or 20 years depending on the number of transactions involved.⁸

The Bank Fraud Statute criminalizes, among others, the diversion of bank funds by bank employees. It provides that a person who knowingly executes, or attempts to

⁴ Nicholas Ryder, 'Too Scared to Prosecute and Too Scared to Jail? A Critical and Comparative Analysis of Enforcement of Financial Crime Legislation Against Corporations in the USA and the UK', (2018) 82 Journal of Criminal Law

⁵ Bruce A. Green, 'After the Fall: The Criminal Law Enforcement Response to the S&L Crisis', (1991) 59 Fordham L. Rev. S155

⁶ House Committee on Government Operations, 'Federal Response to Criminal Misconduct and Insider Abuse in the Nation's Financial Institutions', H.R. REP. No. 1137, 98th Cong., 2d Sess. 131-32

⁷ Jerry W Markham, 'Regulating the Too Big to Jail Financial Institutions' (2018) 83 Brook L Rev 526

⁸ *ibid*

execute, a scheme to defraud a financial institution or to obtain the moneys, assets, securities, or other property owned by or under the custody or control of a financial institution, shall be fined not more than US\$ 1 million or imprisoned not more than 30 years, or both.⁹ The federal appellate courts agree that the statute creates three elements of the crime: (a) knowingly; (b) executing or attempting to execute a scheme or artifice; (c) to defraud, or, through false or fraudulent representations, obtain the money of, a financial institution.¹⁰

4.2.2 Financial Institutions Reform, Recovery and Enforcement Act

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA)¹¹ enacted in 1989 was the initial, extensive legislative response to the S&L crisis. There were several statutes already on the books that could have been used to prosecute wrongdoers, such as the National Banking Act of 1863 which made embezzlement and misapplication of bank funds criminal and the Bank Fraud Statute. There were, however, relatively few successful prosecutions in the financial services industry and sentences imposed in those cases were typically light.¹² A new statute was seen as the answer.

FIRREA raised the maximum penalties for the primary financial institution offences and statutes from five to twenty years and extended criminal liability to institution-affiliated parties (including attorneys, accountants, and appraisers) who violate agency prohibition or removal orders. Moreover, FIRREA made bank fraud a predicate offense¹³ under the Racketeer Influenced and Corrupt Organizations Act, extending the statute of limitations for the principal banking crimes from five to ten years.¹⁴

⁹ 18 USC § 1344

¹⁰ Callister, Joseph, 'The Federal Bank Fraud Statute: A Plain Interpretation', (2005) 1 University of Chicago Legal Forum Iss. 1, Article 13, 462

¹¹ 12 U.S.C. § 1833a(c)(2)

¹² Nan S Ellis et al, 'Use of FIRREA to Impose Liability in the Wake of Global Financial Crisis: A New Weapon in the Arsenal to Prevent Financial Fraud' (2015) 18 U Pa J Bus L 119

¹³ A predicate offence is a crime that is a component of a more serious crime. For example, producing unlawful funds is the primary offence and money laundering is the predicate offence <<https://aml-cft.net/library/predicate-offence/>>, accessed 26 September 2019

¹⁴ FitzPatrick (n 3) 14

FIRREA provides the federal government with a significant amount of flexibility. First, it authorizes the DOJ to seek civil penalties for those who violate one of fourteen specified criminal laws involving financial institutions. Under Section 951, civil liability is attached if the defendant violates certain criminal statutes, including offences relating to fraudulent activity involving financial institutions, or conspiracy to engage in a scheme to defraud a financial institution. While the maximum fine is set at US\$ 1.1 million per violation¹⁵, the applicable penalty can be higher if any person derives any financial gain from violating any of the predicate offences, or if a victim suffers a loss from the activities of a violator, which exceeds the US \$1.1 million cap.

Secondly, because the fines are civil in nature, the burden of proof on the prosecution is lower. The burden of proof in civil matters is on a balance of probabilities; the prosecutor is required to present just enough evidence to establish that it was more probable than not that the accused committed the offence. This is in contrast with criminal cases where the burden of proof required to obtain a conviction is ‘beyond a reasonable doubt’, which is the more severe test of evidence. This lower burden of proof greatly enhances the prospects for successful enforcement of federal fraud statutes.¹⁶

FIRREA creates a mechanism to gather information using administrative subpoena power rather than having to commence litigation to trigger the discovery process.¹⁷ Further, it allows the DOJ to seize assets connected to bank fraud¹⁸, empowering the government to safeguard a financial institution's assets before they can be transferred offshore or otherwise put beyond the government's reach. It also extends the statute of limitations to ten years to provide regulators with sufficient time to uncover and take action against fraud.¹⁹ Lastly, it allows for payment of a reward to individuals to

¹⁵ 12 U.S.C. § 1833a(b)(1) (1966).

¹⁶ Ellis (n 12) 130

¹⁷ 12 U.S.C. § 1833a(g).

¹⁸ FIRREA, § 963.

¹⁹ 12 U.S.C. § 1833a(h).

provide crucial information to prosecutors and a whistle-blower provision to protect bank employees from retaliation.²⁰

In an effort to maximize the penalty for banking sector crimes, FIRREA directs the United States Sentencing Commission to promulgate sentencing guidelines to provide for a substantial period of incarceration if the particular offense substantially jeopardizes the safety and soundness of a federally insured financial institution.²¹

4.2.3 The Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990

Arguing that FIRREA had not had the desired, hard impact on the S&L crisis, in 1990, Congress enacted the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act which augmented the anti-fraud weaponry with, inter alia, greater penalties and resources.²² This statute, also known as the Bank Fraud Prosecution Act, increased the maximum prison sentences for banking crimes (bank bribery, misapplication of funds and embezzlement,²³ false statements, false entries in bank records, mail and wire fraud and bank fraud crimes) from twenty years to thirty years.²⁴ It also directed that the sentence for a defendant who grosses greater than US\$ 1 million from a banking crime be increased from fifty-one to sixty-three months imprisonment. Further, it created the offence of a continuing financial crimes enterprise, which carries a mandatory minimum prison sentence of ten years and a maximum of life imprisonment and a fine of not more than US\$ 10 million. A continuing financial crimes enterprise means a series of violations of theft, embezzlement, or misapplication, making false entries, making false statements or bank fraud in which at least four people act together and US\$ 5 million is derived

²⁰ Ellis (n 12) 130

²¹ John R Rowlett, 'Chilling Effect of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and the Bank Fraud Prosecution Act of 1990: Has Congress Gone Too Far' (1993) 20 Am J Crim L 239

²² FitzPatrick (n 3) 14

²³ Per the Misapplication and Embezzlement Statute 18 U.S.Code § 656, the offences of theft embezzlement and misapplication are said to occur when an officer, director, agent or employee of a bank, embezzles, abstracts, purloins or wilfully misapplies any of the moneys, funds or credits of such bank, branch, agency, or organization or holding company or any moneys, funds, assets or securities intrusted to the custody or care of such bank.

²⁴ Bank Fraud Prosecution Act § 2504, 140 Stat. at 4861

within a two year period.²⁵

4.2.4 Bank Fraud Statute

The Bank Fraud Statute²⁶ provides for a fine of not more than US\$ 1 million or imprisonment of up to 30 years, or both for fraud against financial institutions. Conviction also requires an order for victim restitution; property constituting the proceeds of a violation is subject to forfeiture under either civil or criminal procedure.²⁷ The Misapplication and Embezzlement Statute²⁸ provides for a fine of not more than US\$ 1 million or imprisonment of up to 30 years for an officer or a director of a bank who embezzles or wilfully misapplies any of the monies or assets under the custody of such bank. In *United States v. Duncan*²⁹ it was held that for a violation of the Misapplication and Embezzlement Statute to be proved, it must be shown that the defendant acted wilfully, that he misapplied funds, moneys, or credits belonging to or entrusted to the custody of the bank and that he did so with the intent to injure or defraud the bank.

It can be seen that over the years, the penalties for banking sector crimes have been made increasingly harsher in a bid to deter banking sector crime and protect banks and financial institutions against collapse occasioned by fraud and similar offences. While there is no evidence on the effectiveness of the harsher penalties in protecting banks against collapse, it is clear that the banking sector in the USA has remained strong. To buttress its banking sector against failures occasioned by rogue executives, Kenya can borrow from the stringent penalties in USA, as well as the deliberate prosecution efforts such as during the prosecution of those indicted in related to the S&L crisis when DOJ enlisted the cooperation of different government agencies.

²⁵ 18 U.S.C. § 225

²⁶ 18 U.S. Code § 1344

²⁷ Charles Doyle, 'Mail and Wire Fraud: A Brief Overview of Federal Criminal Law', Congressional Research Service. February 11, 2019 <<https://fas.org/sgp/crs/misc/R41930.pdf>>, accessed 24 September 2019

²⁸ 18 U.S.C. § 656

²⁹ 598 F. 2d 839 - Court of Appeals, 4th Circuit 1979

4.2.5 Sarbanes–Oxley Act of 2002 (Pub L. No. 107-204)

In July 2002, the Sarbanes-Oxley Act (SOX) was signed into law. The Act heightened the consequences for destroying or altering financial statements, and for trying to defraud shareholders.

SOX was enacted in response to the Enron Scandal. Enron was an American corporate which went into bankruptcy in 2002, whose collapse was attributed to significant debts and toxic assets which had been hidden from investors, creditors and regulators through creative accounting practices and special purpose vehicles. Its shareholders lost about US\$ 74 billion in the four years leading up to its bankruptcy, and its employees lost billions in pension benefits. The price of Enron's shares went from US\$ 90.75 at their peak to US\$ 0.26 at bankruptcy.³⁰

Several of Enron's executives were convicted of fraud and facilitating Enron's corrupt business practices. Enron's collapse and the financial havoc it wreaked on its shareholders and employees called for new regulations and legislation to promote the accuracy of financial reporting for publicly held companies.³¹

SOX implemented new rules for corporations, such as setting new auditor standards to reduce conflicts of interest and transferring responsibilities for the complete and accurate handling of financial reports to directors. To deter fraud and misappropriation of corporate assets, the Act imposed harsher penalties for violators. To increase transparency, SOX enhanced disclosure requirements, such as disclosing material off-balance sheet arrangements.³²

SOX criminalized the destruction, alteration, or falsification of records with the intent to obstruct or influence a federal investigation or bankruptcy proceeding and the failure to maintain all audit paperwork for at least five years from the end of the fiscal period in which the audit was concluded. Failure to comply with the document-

³⁰ Troy Segal, 'Enron Scandal: The Fall of a Wall Street Darling', <www.investopedia.com/updates/enron-scandal-summary/>, 2019, accessed 12 September 2019

³¹ *ibid*

³² Andriy Blokhin, 'The Impact of the Sarbanes-Oxley Act of 2002' <www.investopedia.com/ask/answers/052815/what-impact-did-sarbanesoxley-act-have-corporate-governance-united-states.asp>, accessed 12 September 2019

preservation requirements carries a penalty of up to US\$500,000 for corporations and up to US\$250,000 and 20 years' imprisonment for individuals, while failure to keep audit records carries a penalty of up to US\$500,000 for corporations or US\$250,000 and 10 years' imprisonment for individuals.

SOX increased the maximum sentence term for securities fraud to twenty five years, and the maximum prison time for the obstruction of justice to twenty years. It also increased the maximum penalties for mail and wire fraud from five to twenty years of prison time. Violations of the recordkeeping provisions of SOX may give rise to criminal prosecution for obstruction of justice.³³

SOX changed corporate behaviour as the number of companies' restatements (corrections) of their financial reports increased substantially in the early years after passage of the law.³⁴ The enhanced disclosure requirements have been adopted globally, and specifically in Kenya, through the International Financial Reporting Standards and through regulations such as the Code of Governance for Issuers of Securities to the Public 2015.³⁵

4.3 The Statutory Framework in the United Kingdom: Lessons for Kenya

4.3.1 The Fraud Act 2006

The Fraud Act 2006³⁶ provides for a maximum of ten years imprisonment for persons found guilty of fraud related crimes. The Act identifies three main fraud offences, namely fraud by false representation, fraud by failing to disclose information where there is a legal duty to disclose and fraud by abuse of position. Common to all three Fraud Act offences is the requirement that the person act dishonestly, intending to make a gain for himself or another or cause loss to another or expose another to a risk of loss. According to *R v Ghosh*³⁷ in order to establish whether certain conduct was dishonest, two questions have to be asked: First, was what was done dishonest

³³ *ibid*

³⁴ Peter Cleary Yeager, 'The Elusive Deterrence of Corporate Crime' (2016) 15 *Criminology & Pub Pol'y* 439, 442

³⁵ Published by the Capital Markets Authority

³⁶ 2006 Chapter 35

³⁷ [1982] 1QB 1053

according to the ordinary standards of reasonable and honest people? If the answer is ‘no’ the defendant is not guilty as there is no proved dishonesty and a vital element of the actus reus is unproved. If the answer is ‘yes’ then the second question has to be asked: Did the defendant realise that reasonable and honest people regard what he did as dishonest? If the answer is yes then the defendant is guilty.

Per section 2(1) of the Fraud Act 2006, fraud by false representation is said to be committed where a person dishonestly makes a false representation, and intends, by making the representation to make a gain for himself or another, or to cause loss to another or to expose another to a risk of loss. The actus reus of the offence requires proof that the defendant made a representation, which is untrue or misleading, while the mens rea requires proof that the defendant knew the representation was or might be false, and acted dishonestly in making that representation with intent to gain or cause loss or expose to loss.³⁸

According to section 3 of the Fraud Act 2006, fraud is committed where a person dishonestly fails to disclose to another person information which he is under a legal duty to disclose and intends, by failing to disclose the information, to make a gain for himself or another, or to cause loss to another or to expose another to a risk of loss. The actus reus comprises failing to disclose information to a person; being under a legal duty to disclose, while mens rea comprises acting dishonestly, with intention to make a gain or cause a loss or expose to loss.³⁹

Section 4 of the Fraud Act 2006 provides that fraud is committed when a person who occupies a position in which he is expected to safeguard, or not to act against, the financial interests of another person, dishonestly abuses that position, and intends, by means of the abuse of that position to make a gain for himself or another, or to cause loss to another or to expose another to a risk of loss. It provides that a person may be regarded as having abused his position even though his conduct consisted of an omission rather than an act. The actus reus comprises abusing a position of financial

³⁸ David Ormerod and Karl Laird, *Smith and Hogan's Criminal Law*, 14th ed, OUP 2015, 1003

³⁹ *ibid*

trust and the mens rea comprises acting dishonestly and intending by the abuse to make a gain or cause a loss.⁴⁰

Conspiracy to defraud is an offence at common law and is a popular charge with prosecutors where the evidence of actual fraud taking place is complex or weak.⁴¹ In *Scott v Metropolitan Police Commissioner*⁴², conspiracy to defraud was defined as “. . . an agreement by two or more by dishonesty to deprive a person of something which is his or to which he is or would be entitled and an agreement by two or more by dishonesty to injure some proprietary right of his”. The key elements of the offence are dishonesty (per *R v Ghosh*), and that if the conspiracy was undertaken, the victim's property rights would be harmed. There also has to be more than one defendant.

4.3.2 Theft Act offences

Section 1(1) of the Theft Act 1968 provides that a person is guilty of theft if they dishonestly appropriate property belonging to another with the intention to permanently deprive the other of it. The elements of theft are set out in sections 2-6 of the Theft Act 1968. The actus reus of theft consists of appropriation of property belonging to another. Section 7 of the Theft Act provides for a maximum penalty of 7 years imprisonment for theft. In *Davidge v Bennet*⁴³, it was held that where a person receiving the property deals with it in a way which is inconsistent with the instructions given by the owner of the property this can amount to theft.

Section 17 of the Theft Act 1968 provides that where a person dishonestly, with a view to gain for himself or another or with intent to cause loss to another destroys, defaces conceals or falsifies any account or record or document made or required for any accounting purposes, or in furnishing information for any purpose produces or makes use of any account or any such record or document which to his knowledge is or may be misleading, false or deceptive in a material particular, he shall, on conviction be

⁴⁰ Ormerod (n 38) 1026

⁴¹ Christopher David et al, 'Financial crime in the UK (England and Wales): overview' <[https://uk.practicallaw.thomsonreuters.com/8-520-4390?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/8-520-4390?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1)>, accessed 16 September 2019

⁴² [1975] AC 910

⁴³ [1984] Crim LR 297

liable to imprisonment for a term not exceeding seven years. The offence may be committed by any person who falsifies a document made or required for accounting purposes. It is not necessary to prove that anyone accepted or acted on a falsified document. False accounting is often the most suitable charge where the conduct did not involve a scheme which was fraudulent from the outset but became so when, for example, a business got into difficulties.⁴⁴

4.3.3 The Companies Act 2006

The Companies Act 2006⁴⁵ requires companies to keep adequate accounting records that are sufficient to show and explain the company's transactions and disclose, with reasonable accuracy, the financial position of the company. The maximum penalty for failure to keep accounting records is two years imprisonment or a fine or both. Further, section 418 of the Act provides that a person convicted of an offence of making a false statement to an auditor is subject to a maximum penalty of two years imprisonment or a fine or both. Every director who either knew that the statement was false, or was reckless as to whether it was false and failed to take reasonable steps to prevent the false report commits the offence.

4.3.4 The Financial Services (Banking Reform) Act 2013

Section 36 of the Financial Services (Banking Reform) Act (2013) provides that senior bank managers whose reckless misconduct causes their firm to fail are guilty of an offence. Four elements must be fulfilled. The senior manager must take, or agree to the taking of, a decision as to the way in which the business of a group institution is to be carried on. He or she must be aware of the risk that the implementation of the decision may cause the failure of the group institution. The incriminated conduct must fall far below what could reasonably be expected of a person in the same position. Lastly, the implementation of the decision must have caused the failure of the group institution.⁴⁶ The maximum penalty is seven years of imprisonment. The Act allows

⁴⁴ Ormerod (n 38) 1049

⁴⁵ The Companies Act 2006 Section 386

⁴⁶ Paul Davies and Klaus J. Hopt, 'Non-Shareholder Voice in Bank Governance: Board Composition, Performance and Liability', Working Paper N° 413/2018 August 2018

the punishment of senior bankers guilty of turning a blind eye on fraudulent transactions.⁴⁷

The penalty for fraud in the UK is much lighter compared to the USA. However, the Fraud Act 2006 comprehensively outlines the offence of fraud and along with the case law developed over the years, make it easier to prosecute the offence. As it will be seen under section 4.4, the law in the UK has significant provisions on asset forfeiture. Further, the institutions charged with the implementation of the law are quite effective. The real test of effectiveness of the UK's legal framework lies in the end result – the stability of banks in the UK.

4.4 The Institutional framework in the United States of America and the United Kingdom: Lessons for Kenya

4.4.1 United States of America

In USA, the key institution involved in combating banking sector crime is the Department of Justice (including the US Attorney's Office in each federal district and the Federal Bureau of Investigation). The DOJ prosecutes federal crimes and brings civil enforcement actions. Under FIRREA, DOJ may seek civil monetary penalties against entities and individuals for violations of the mail and wire fraud statutes if the government can prove that the violation affected a federally insured financial institution. Other civil fraud statutes provide the DOJ with other potential monetary penalties as well.

The Securities and Exchange Commission (SEC), whose mandate is to oversee the key participants in the securities sector, promote the disclosure of important market-related information and protect against fraud,⁴⁸ can file civil enforcement actions in federal court or before administrative tribunals, seeking disgorgement of ill-gotten gains, injunctions against future violations, and monetary penalties. The SEC can also bar

⁴⁷ Lefeuvre, Elise, 'Sentencing White-Collar Crime in the Wake of the 2008 Financial Crisis' (February 7, 2017). Available at SSRN: <<https://ssrn.com/abstract=2912881>>, accessed 26 September 2019

⁴⁸ U.S. Securities and Exchange Commission, 'What We Do', <www.sec.gov/Article/whatwedo.html>, accessed 26 September 2019

individuals that engaged in securities fraud from serving as officers or directors of publicly traded companies.

Crucial to the SEC's effectiveness is its enforcement authority. Each year the SEC brings hundreds of civil enforcement actions against individuals and companies for violation of the securities laws. Typical infractions include insider trading, accounting fraud, and providing false or misleading information about securities and the companies that issue them.⁴⁹

4.4.2 United Kingdom

Regulation of the banking sector is carried out by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) both of which are part of the Bank of England.⁵⁰ The two bodies are required to coordinate with each other to attain sound banking regulation. The regulatory authorities derive their functions from the Financial Services and Market Act⁵¹ as well as the Banking Act⁵² which provides for mechanisms to be followed in the resolution of banks in financial hitches.

The FCA is also mandated with the reduction of financial crime. The FCA is empowered to enforce against firms and individuals for breaches of the relevant rules. The PRA has similar rules and means of enforcement as the FCA. The FCA's 2015 Financial Crime Guide provides guidance to firms on steps they can take to reduce their financial crime risk across a number of areas, including fraud. The guidance is non-binding but is an indicator of the FCA's expectations and provides examples of good and poor practice.⁵³

The FCA has been very active in the investigation of offences and imposing fines on the offending persons or institutions. In December 2018, FCA imposed a fine of £76,400 on Mr. Mohammad Prodhan, the former Chief Executive Officer (CEO) of

⁴⁹ *ibid*

⁵⁰ Slaughter & May, 'Banking Regulations in United Kingdom', (April 2019) <www.lexology.com/library/detail.aspx?g=4e55a6bc-5f01-4abd-b242-d6e0bdf3f405> accessed 17 May 2019

⁵¹ Financial Service Market Act 2000.

⁵² Banking Act 2009.

⁵³ David (n 41)

Sonali Bank (UK) Limited (SBUK), for acting without due skill, care and diligence and for the breach by SBUK of its obligations to maintain effective anti-money laundering (AML) systems. In the FCA's view, Mr. Prodhon failed to take reasonable steps to assess and mitigate the AML risks arising from a culture of non-compliance among SBUK's staff.⁵⁴

In May 2018, the CEO of Barclays Bank was fined over £640,000 by the FCA for attempting to unmask a whistle-blower.⁵⁵ In January 2018, the FCA fined Mr. Neil Danziger, a former Royal Bank of Scotland (RBS) interest rate derivatives trader, a financial penalty of £250,000, after finding him complicit in RBS's failure to observe proper standards of market conduct. The FCA has imposed fines running into millions of pounds on banks and other institutions, but it is the fines on the individuals involved that show the focus on driving personal liability for financial misconduct.

There are many bodies responsible for the investigation and/or prosecution of fraud, namely the Serious Fraud Office (SFO), the Crown Prosecution Service (CPS), the Revenue and Customs Prosecuting Office, the Department of Trade and Industry (DTI), and the Financial Services Authority (FSA).⁵⁶ The Serious Fraud Office (SFO) is established to investigate serious or complex fraud. Fraud cases that do not fall into this category are investigated by the CPS.

The National Crime Agency is mandated to fight against serious and organised crime. It investigates fraud, bribery, corruption, sanctions evasion, cyber-crime, drugs trafficking and illegal firearms.⁵⁷

The above institutions play a critical role in the investigation, prosecution and confiscation of proceeds of crime. They ensure that those culpable of crimes, including

⁵⁴ Financial Conduct Authority, 'FCA Publishes Decision Notice Against Former CEO of Sonali Bank (UK) Ltd for AML Failings', <www.fca.org.uk/news/press-releases/fca-publishes-decision-notice-against-former-ceo-sonali->, accessed 16 September 2019

⁵⁵ Financial Conduct Authority, 'FCA and PRA Jointly Fine Mr James Staley £642,430 and Announce Special Requirements Regarding Whistleblowing Systems and Controls at Barclays' <www.fca.org.uk/news/press-releases/fca-and-pra-jointly-fine-mr-james-staley-announce-special-requirements>, accessed 16 September 2019

⁵⁶ Rosalind Wright, 'Developing Effective Tools to Manage the Risk of Damage Caused by Economically Motivated Crime Fraud', (2007) 14 Journal of Financial Crime, Issue 1, 17

⁵⁷ <www.nationalcrimeagency.gov.uk>, accessed 17 September 2019

banking sector crimes are punished according to the law. They ensure that those who propagate crimes do not benefit from it by confiscating proceeds of crime and that victims of fraud are compensated from the proceeds of crime confiscated from offenders. By ensuring that the law is implemented, and those found guilty of various offences face the force of the law, the institutions carry out an important function in deterring other would-be offenders. By extension, these institutions help avoid the collapse of banks. Indeed, the FCA and PRA are mandated to reduce financial crime.

Further, the publication of the fines levied by FCA on their website and asset forfeitures on the SFO website is a commendable approach by the two institutions to communicate that severe action is being taken against those who engage in criminal enterprise.

It is notable that the Kenya's Companies Act 2015 has adopted the provision of disqualification of directors due to fraud or breach of duty.⁵⁸ The Kenya Capital Markets Authority (CMA) has power to disqualify and/or fine directors or employees found to be in breach of the Capital Markets Act.⁵⁹ The Capital Markets Act is however only applicable to issuers of securities to the public and licencees of the CMA. Indeed, CMA has commenced enforcement proceedings against the former directors of Imperial Bank (In Receivership).⁶⁰ However, CMA noted in its own report that there was no 'clear action plan towards compensation/restitution of bond investors whose funds remained locked in Chase and Imperial Banks'⁶¹, betraying its lack of effectiveness as a regulator. The CMA therefore needs to be more proactive in carrying out its mandate as a regulator to ensure that action is taken against the perpetrators of

⁵⁸ Section 216 Companies Act 2015

⁵⁹ Section 25A Capital Markets Act, Chapter 485A Laws of Kenya

⁶⁰ Capital Markets Authority, 'CMA Commences Enforcement Proceedings Against Former Imperial Bank Directors', <www.cma.or.ke/index.php?option=com_content&view=article&id=188:cma-commences-enforcement-proceedings-against-former-imperial-bank-directors&catid=12&Itemid=207>, accessed 27 September 2019

⁶¹ Capital Markets Authority, 'Capital Markets Industry to Collaborate To Increase Product Uptake', Nairobi 03 July 2018, <www.cma.or.ke/index.php?option=com_content&view=article&id=457:listings-and-uptake-press-release&catid=12&Itemid=207>, accessed 27 September 2019

crime in the financial sector, as well as recovery of the assets acquired illegally through such crimes.

4.5 Other reforms to address bank collapses due to crimes in Kenya

4.5.1 Asset Forfeiture

There are two types of asset forfeiture, namely, criminal forfeiture and civil forfeiture. Criminal forfeiture is part of the sentence in a criminal case and it is an *in personam* order. Upon conviction, the accused is ordered to pay restitution to his victims; he is ordered to disgorge the proceeds of his crime, or the property he used to commit the offence.⁶² On the other hand, in civil forfeiture, the action is brought against the property (*in rem*). It is a civil case in which the government is the plaintiff, the property is the defendant, and the persons objecting to the forfeiture are the claimants.⁶³ Civil forfeiture is used where forfeiture is uncontested or where the defendant has died (and therefore cannot be convicted, such as in the Enron Case, where one of the defendants, Kenneth Lay, died before a criminal conviction was obtained against him). It is also used where the wrongdoer is unknown (but the criminal proceeds are available), where the wrongdoer is a fugitive or where the criminal is prosecuted in another country but the property is in the USA.⁶⁴

The first statutory provision of civil forfeiture in the USA was enacted in 1789.⁶⁵ In the 18th century, asset forfeiture was aimed at protecting territorial trading interests and punishing the crime of piracy. In the 1970s, asset forfeiture was considered as the more effective tool to combat drug-related organized crime, noting that imprisonment of offenders was not having the desired effect in the fight against drug trade. Thus, the Comprehensive Drug Abuse Prevention and Control Act of 1970 was enacted to allow the law enforcement agencies to take the profit out of drug money. In the 1980s, the

⁶² Stefan D. Cassella, 'The Case for Civil Forfeiture: Why in Rem Proceedings are an Essential Tool for Recovering the Proceeds of Crime', (2008) 11 Journal of Money Laundering Control, Issue 1, 8

⁶³ *ibid*

⁶⁴ *ibid*

⁶⁵ The Act of July 31, 1789, ch. 5, entitled, 'An Act to regulate the Collection of the Duties imposed by law on the tonnage of ships or vessels, and on goods, wares and merchandises imported into the United States', allowed the government to take parallel civil forfeiture action against the property and criminal prosecution against the individual based on the same underlying unlawful act.

DOJ increasingly relied on the forfeiture laws to combat and deter crime more effectively. To this end, the CCCA 1984 was passed in order to allow the state and local law enforcement agencies to forfeit the assets used in criminal activity. Today, forfeiture is used to protect the public from harmful objects, such as adulterated foods. Asset forfeiture also plays a deterrent role, as it takes away the benefit from the offenders, removing the incentive to commit crime. There are more than 400 federal forfeiture statutes in USA relating to several federal crimes, and each state has statutory provisions for some form of asset forfeiture.⁶⁶

Asset forfeiture has been applied more recently in recovering proceeds from financial crimes, mainly to facilitate restitution to victims. Bernie Madoff, the architect of the Madoff Investment Scandal in which thousands of investors lost more than US\$ 65 billion, has seen tens of billions⁶⁷ worth of his assets forfeited over the years, in addition to his prison sentence of 150 years.

In the UK, the Proceeds of Crime Act 2002 (POCA) provides the legislative framework for the granting of asset forfeiture orders in criminal proceedings. Under the new freezing and forfeiture powers inserted into the Proceeds of Crime Act 2002 (POCA) by the Criminal Finances Act 2017, investigators are empowered to freeze bank accounts, and courts to seize their contents. These powers are activated – respectively - when the investigator reasonably suspects, or the court is satisfied, that the money in the account is the result of, or is intended to result in, crime. The Criminal Finance Act 2017 also inserted the Account Forfeiture Notice into POCA, whereby a frozen account is automatically declared forfeit if no objection is received within 30 days of the notice issue.

The SFO has been quite successful at effecting asset forfeiture orders, delivering a net financial impact of over £450 million from 2015 to 2019.⁶⁸ Among the more recent asset forfeitures, in September 2019, Jolan Saunders and Michael Strubel, former company executives at Saunders Electrical Wholesalers Ltd, were ordered to pay £7.4

⁶⁶ Jozsef Kelemen, 'Civil Forfeiture in the United States' [2018] J E-Eur Crim L 148

⁶⁷ About USD 13.4 billion of Madoff's assets have been recovered as at September 2019 under the Madoff Recovery Initiative (see www.madofftrustee.com), accessed 21 September 2019

⁶⁸ SFO Annual Report 2018-2019

million, being the full realisable assets from their criminal benefit for conspiracy to defraud. The confiscation orders were in addition to prison terms of seven years each for conspiracy to defraud. Saunders and Strubel had enticed wealthy individuals to invest in Saunders Electrical Wholesale Ltd, which they claimed was a successful supplier of electrical goods to hotel chains and the Olympic Village.⁶⁹

Further, two former EURIBOR traders were convicted of conspiracy to defraud following a trial in 2018. Christian Bittar, former Principal Trader at Deutsche Bank, was sentenced to five years, four months imprisonment as well as a confiscation order of £2.5 million. Philippe Moryoussef, formerly of Barclays Bank, was sentenced to eight years imprisonment, as well as a confiscation order of £77,354.26 to be paid within three months, or face a further custodial sentence of 3 years.⁷⁰

In contrast, in Kenya, there are no records of asset recovery. The Asset Recovery Agency in Kenya was only recently established and has a lot to learn from the institutions in USA and UK in effecting asset forfeiture among other measures.

Asset forfeiture can be applied as a key deterrent factor against banking sector crime in Kenya. The perpetrators of such crimes reap massive benefits and any measure that ensures that the offender does not get to enjoy their wealth is likely to be an effective deterrent. As illustrated in Chapter One, prison sentences for banking sector crimes are relatively short and a convicted offender can still enjoy the benefits of their crime once the sentence ends. Fines may be seen as a price that some offenders may be willing to pay, and therefore may not serve as a deterrent factor.⁷¹ Moreover, asset forfeiture can be applied to bring back to life the banks which are on the verge of collapse, such as Chase Bank (In Receivership) and Imperial Bank (In Receivership). Assets can be recovered from the perpetrators of the crimes which brought these banks

⁶⁹ Serious Fraud Office, 'Saunders Electrical fraudsters ordered to pay over £7million', <www.sfo.gov.uk/2019/09/10/saunders-electrical-fraudsters-ordered-to-pay-over-7million/>, accessed 16 September 2019

⁷⁰ Serious Fraud Office, 'EURIBOR', <www.sfo.gov.uk/cases/euribor/>, accessed 16 September 2019

⁷¹ Catherine E. McCaw, 'Asset Forfeiture as a Form of Punishment: A case for integrating Asset Forfeiture into Criminal Sentencing', (2011) 38 AM. J. CRIM. L. 181

to suffer liquidity challenges and ploughed back into the banks. Imprisonment of the offenders will not resuscitate such banks.

4.5.2 Whistleblowing

Under SOX, it is a criminal offence to take any action harmful to a person who provides truthful information about a federal offence to a law enforcement office. Such an offence is punishable by fine and up to 10 years in prison. Companies are required under SOX to set up anonymous hotlines for reporting accounting and financial infringements. There are similar provisions in the Dodd-Frank Act 2010. Such requirements have seen the widespread use of hotlines in the US, a practice which has become the practice globally.⁷² A SOX whistle-blower need not show that an actual violation occurred so long as they reasonably believes that the violation is likely to occur.⁷³

SOX prohibits a broad range of retaliatory adverse employment actions, including discharging, demoting, suspending, threatening, harassing, or in any other manner discriminating against a whistle-blower. In *Halliburton v. Admin. Review Bd*,⁷⁴ a federal court of appeals held that mere disclosure of the identity of a whistle-blower is actionable retaliation under SOX. Further, it was held that a SOX whistle-blower can recover lost wages and benefits, reinstatement and special damages, which includes emotional distress, impairment of reputation, personal humiliation, and other non-economic harm resulting from retaliation.⁷⁵ There is no cap on special damages under SOX, and some state whistle-blower protection laws enable whistle-blowers to recover punitive damages.

The courts in the US have given huge awards to whistle-blowers, which practice is seen to encourage whistle blowing. In 2012, a former Swiss banker, Bradley Birkenfeld, was awarded US\$ 104 million by the Inland Revenue Services for his role in exposing a tax evasion scheme at the Swiss bank UBS AG. This is despite the fact

⁷² <www.soxlaw.com>, accessed 20 May 2019

⁷³ <www.zuckermanlaw.com/legal-services/sarbanes-oxley-whistleblower> accessed 25 May 2019

⁷⁴ 771 F.3d 254 (5th Cir. 2014)

⁷⁵ *ibid*

that Mr. Birkenfeld had been convicted as a conspirator in the tax evasion scheme.⁷⁶ In February 2017, in the case of *Sanford S. Wadler v Bio-Rad Laboratories*,⁷⁷ a former employee at Bio-Rad Laboratories was awarded US\$ 11 million in a SOX whistleblower retaliation suit. The former employee had reported (internally) of potential corrupt practices. He was subsequently terminated for alleged poor work performance and behaviour. The amount awarded to the employee included US\$ 8 million for retaliation.

In the UK, workers are protected from detriment when whistle-blowing, provided they make a protected disclosure under the Employment Rights Act 1996. Workers can disclose through the appropriate channels, information about criminal activity and other serious malpractice. Many organisations now have confidential reporting policies that govern internal disclosures. Firms regulated by the FCA and the PRA must comply with the FCA's and PRA's rules regarding whistle blowing, which include putting in place mechanisms to allow employees to raise concerns internally and appointing a senior person to take responsibility for the effectiveness of these arrangements.

In the world over, the fear of retaliation is one of the biggest challenges to whistle-blowers. As outlined above, the USA and the UK offer comprehensive protection to whistle-blowers. In Kenya, the enactment of the Witness Protection Act 2006 is a major step towards protection of witnesses. The Witness Protection Act was recently amended to include provisions for cooperation with other countries, which may enable the relocation of witnesses to safer jurisdictions.

Further, in UK and USA, firms are required by law to set up mechanisms for whistle blowing. Kenya can legislate such requirements in order to encourage whistle blowing. Notably, in the case of Imperial Bank (In Receivership) discussed in Chapter Two, it was a director who brought out the scandal which led to the placement of the bank under receivership. One can only imagine that there were employees of the bank who

⁷⁶ David Kocieniewski, 'Whistle-Blower Awarded \$104 Million by I.R.S.' *New York Times* (New York, 11 September 2012), <www.nytimes.com/2012/09/12/business/whistle-blower-awarded-104-million-by-irs.html>, accessed 25 May 2019

⁷⁷ 17-16193 (9th Cir. 2019)

were aware of the happenings at the bank and given the protection and the right facilities, would have raised the alarm early enough to avoid the collapse of the bank. Granted, a number of companies have adopted a whistle blowing policy, but without the protection afforded by the law, employees may not be keen to blow the whistle on misconduct within their organisations.

4.6 Conclusion

This chapter has highlighted the lessons for Kenya in its statutory and institutional framework from USA and UK, countries with stable banking industries. High fines for fraud offences in the USA, efficient and effective regulators in USA and UK backed by a well-established legal framework are among the tools employed in combating banking sector crime. Prosecution efforts are well coordinated which ensure high rates of conviction. Both civil and criminal procedures have been used to ensure successful asset forfeiture in the two countries. Whistle blowing is encouraged through rewards and protection of whistle-blowers through statute and institutions, as well as a requirement for corporations to establish whistle blowing channels for employees. There are also efforts to publicise the wins against criminal conduct - The FCA and SFO websites have detailed disclosures on convictions, fines and asset forfeiture; such disclosures can play a deterrent role in that those who choose to go against the law are aware of what awaits them in terms of sanctions. There are key lessons for Kenya in its efforts to ensure stability in the banking sector by preventing crimes which can lead to bank failures.

Chapter 5 Findings, Conclusion and Recommendations

5.1 Introduction

This study seeks to establish whether the legal framework regulating the banking industry in Kenya is sufficient for the prevention of banking sector crimes. This study was motivated by the placing of three banks (Chase Bank, Imperial Bank and Dubai Bank) in receivership in a period of less than one year, which raised fears of a banking crisis in the country. The three banks were placed under statutory management due to financial impropriety. Considering the potential loss of savings, unemployment, lack of access to working capital for businesses and the loss of confidence in the banking sector arising from bank failure, it would be expected that the legal sanctions against those found culpable of actions or omissions which result in failure of banks should be robust. Such sanctions should be commensurate with the conduct of those who threaten the stability of banks through crime.

According to the theory of deterrence, people choose to obey or violate the law after calculating the gains and consequences of their actions. The more severe a punishment, the more likely that a rational human being will desist from criminal acts. The apprehension of offenders, conviction and punishment should be certain and swift in order to deter crime. In order to have a deterrent value, punishment must be proportionate to the crime committed. Penalties should be so high as to discourage the commission of crimes and should be such that when potential offenders compare the expected monetary benefits with the sanctions, they are discouraged from criminal conduct. The amount of financial benefit should be factored in the level of fines or prison sentences for those convicted of financial crimes.

Section 5.2 will highlight the key findings of this study, while Section 5.3 considers the importance of these findings and Section 5.4 makes recommendations that can be implemented.

5.2 Key Findings

In answering the question on whether the penalties provided for offences under the Banking Act, Penal Code, POCAMLA and the Companies Act 2015 are significant enough to deter the commission of such offences in Kenya, this study established in Chapter One that the penalties are too lenient compared to the offences and are therefore unlikely to have much deterrence value.

In Chapter Two, the circumstances leading to the collapse of Chase Bank (In Receivership) and Imperial Bank (In Receivership) and the negative effects of the failure of the two banks on the economy were discussed. It was demonstrated that the charges preferred against the persons said to be criminally culpable in the collapse of the two banks are not comprehensive and the penalties likely to be imposed on accused persons are too lenient in light of the significance of the collapse of a bank. It was noted that in addition to the fines and prison sentences related to the charges preferred against the accused persons, there is scope for confiscation of assets belonging to the persons convicted of the offences, which are proceeds of crime. It was also noted that the courts of law can play a major role in making the penalties more stringent, including by preferring custodial sentences instead of fines for financial crimes.

This study also sought to evaluate the effectiveness of implementation of the law in combating banking sector crime in Kenya. In Chapter Three, it was established that the law has developed over time in response to the problems faced in the banking industry over the years. The Banking Act was enacted in 1989, complementing the Central Bank of Kenya Act to create a stricter regulatory regime for the banking industry. However, the enhanced legal regime did not prevent a wave of bank failures between 1993 and 1995 when close to 20 banks went into liquidation. Since 2006, the CBK has been issuing and updating Prudential Guidelines, which, in addition to other provisions, identify offences which are punishable under the Banking Act. The enactment of POCAMLA in 2010 is perhaps the most significant step towards fighting banking sector crime in Kenya with the establishment of the Financial Reporting Centre and the Assets Recovery Agency which have enhanced the fight against

banking sector crimes. Sanctions for financial crimes have also evolved over time - In 2017, there was an enhancement of fines under the Banking Act.

Chapter Three further established that there was no prosecution of persons responsible for the collapse of banks in Kenya before 2016. The circumstances around the collapse of Trust Bank (In Receivership) and Charterhouse Bank (In Receivership) showed probable evidence of criminal conduct, yet no charges were preferred against the culpable persons. The law has not been enforced effectively through prosecution and conviction of persons responsible for failure of banks. The low conviction rates point to, among others, the quality of investigations. The Bank Fraud Investigation Unit (BFIU), which conducts investigations and prosecutes fraud suspects, has not been effective. Notably, BFIU has initiated several cases against low cadre bank staff but none against senior officers or directors of banks. The low conviction rates have also been attributed to delays in concluding court cases, casting doubts on the effectiveness of the Judiciary.

It was further established that the Central Bank of Kenya (CBK)'s regulatory role has been seen more in the development of the legal framework than in the implementation of the law. CBK has overseen the establishment of laws, regulations and institutions, but has played a minor role in, for instance, ensuring that the persons responsible for collapse of banks face the full force of the law. While it is clear that the prosecutorial role lies with the Office of the Director of Prosecutions, CBK has a role to play to ensure that the interests of depositors and investors are adequately protected.

Chapter Four sought to consider the lessons that Kenya can learn from the UK and USA on addressing crimes in the banking sector. It was established that the high fines for fraud offences in the USA, efficient and effective regulators in USA and UK backed by a well-established legal framework are among the tools employed in combating banking sector crime. Prosecution efforts are well coordinated which ensure high rates of conviction. Both civil and criminal procedures have been used to ensure successful asset forfeiture in the two countries. Whistle blowing is encouraged through rewards and protection of whistle-blowers through statute and institutions, as well as a requirement for corporations to establish whistle blowing channels for

employees. There are also efforts to publicise the wins against criminal conduct - The FCA and SFO websites have detailed disclosures on convictions, fines and asset forfeiture, which can play a deterrent role in that those who choose to go against the law are aware of what awaits them in terms of sanctions. There are key lessons for Kenya in its efforts to ensure stability in the banking sector by preventing crimes which can lead to bank failures.

5.2 Importance of the findings

This study establishes the need for stricter penalties for banking sector crimes. The prevalence of bank failures in Kenya is attributed to low penalties that are not commensurate with the crimes that they seek to punish. The law therefore fails in its deterrence role as potential offenders find it beneficial to loot from banks. Further, the failure by the institutions to put in place measures to prevent such crimes means that those who perpetrate such crimes either go scot free or get away with a slap on the wrist. On the obverse, countries such as the UK and USA have taken tough sanctions against perpetrators of bank crime, which has ensured stability in their banking sectors. Even where they have faced crisis or major scandals, they have emerged stronger with more effective laws and institutions. This study thus identifies the challenges of combating banking sector crime in Kenya and points to the solutions in terms of stricter penalties and stronger institutions as those employed by countries with more stable banking sectors. This study further identifies asset forfeiture and whistle blowing as effective instruments in combating banking sector crime.

5.3 Recommendations:

5.3.1 Stricter penalties

Longer jail terms for such offences as fraud will go a long way in deterrence and therefore prevention of banking sector crimes.

5.3.2 Encouraging Whistle Blowing

Whistle blowing can be encouraged through rewards being part of the funds recovered from the offenders. Further, protection of whistle-blowers should be entrenched

through statute. Corporations should be required by law to put in place safe whistle blowing channels for employees.

5.3.3 Asset Forfeiture

Asset forfeiture should be enhanced through elaborate criminal and civil procedure, and the institutions charged with asset forfeiture should publish information on successful forfeiture as a deterrent measure.

5.3.4 Stronger Institutions

The capacity of institutions such as BFIU and ARA should be enhanced through training of their personnel to enhance their effectiveness in investigations and asset forfeiture.

5.4 Conclusion

For Kenya to achieve financial stability, there is need to ensure that banking sector crime is well addressed through strict penalties for offenders. Stiffer penalties will deter potential offenders and ensure that those responsible for collapse of banking institutions through criminal conduct receive adequate punishment. Further, an effective asset forfeiture programme will take the benefit away from those who seek to benefit illegally through fraud and similar crimes against banks. Asset forfeiture plays a key deterrence role, in addition to restitution to victims of crimes. Importantly, the forfeited assets can be restored to failing banks to help shore liquidity and capital and prevent total failure.

Strict penalties will only achieve the desired effect if implemented through proper investigations and prosecution of offenders, where the relevant institutions work in concert to achieve the common purpose in preventing bank failures. Proper investigations will be driven by stronger institutions and disclosure of information, such as through whistle blowing channels.

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