



# **PRUDENTIAL GUIDELINES**

**January 2013**

**CENTRAL BANK OF KENYA**  
**PRUDENTIAL GUIDELINES FOR INSTITUTIONS LICENSED**  
**UNDER THE BANKING ACT**

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# **GUIDELINE ON LICENSING OF NEW INSTITUTIONS CBK/PG/01**

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## **PART I PRELIMINARY**

- 1.1 **Title** - Guideline on licensing of new institutions.
- 1.2 **Authorization** – This Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.
- 1.3 **Application** - This Guideline applies to all applicants intending to be licensed to conduct banking, mortgage or financial business in Kenya.
- 1.4 **Definitions**
- 1.4.1 **Shell bank**- A company which exists only on paper with no physical presence and does not apparently trade or operate.
- 1.4.2 **Significant shareholder**- A person, other than the Government or a public entity, who holds, directly or indirectly or otherwise has a beneficial interest in more than five per cent of the share capital of an institution or if it is proposed that such a person shall so hold or have such a beneficial interest. Other terms used in this guideline are as defined in the Banking Act.

## **PART II STATEMENT OF POLICY**

- 2.1 **Purpose** - The purpose of this Guideline is to provide information and guidance to applicants seeking to secure a license to conduct the business of a bank, financial institution or mortgage finance company in Kenya in compliance with Sections 3, 4 and 5 of the Banking Act.
- 2.2 **Scope** - This Guideline provides clear guidance on the conditions applicants must fulfill to be eligible to be granted a license to conduct banking, financial or mortgage business in Kenya. This Guideline does not address the authorization procedures for Representative Offices in Kenya, which are provided for in the *Prudential Guideline on Representative Offices in Kenya (CBK/PG/17)*
- 2.3 **Responsibility** – It is the responsibility of applicants and the promoters proposing to conduct the business of an institution in Kenya to ensure compliance with this Guideline.
- 2.4 **Prohibition of shell banks** – CBK shall not license shell banks.

## **PART III APPLICATION PROCEDURES**

### **3.1 Preliminary Consultations**

All prospective applicants seeking a license to conduct the business of an institution are encouraged to contact the Central Bank of Kenya at an early stage for an initial meeting to discuss their plans prior to submission of a formal application. The purpose of the meeting would be to advise the applicants on CBK requirements for licensing and clarify any other pertinent issues that the applicant may raise.

### **3.2 Approval of Proposed Name**

Every applicant seeking to conduct the business of an institution will be required to submit the proposed name of the institution to the Central Bank of Kenya for consideration and approval.

### **3.3 Incorporation**

Once the name intended for use has been approved by the Central Bank of Kenya, the promoters will ascertain with the Registrar of Companies that the name selected is available for the Applicant's use. After confirmation by the Registrar of Companies, the promoters may proceed to incorporate the company as by law required.

### **3.4 Unincorporated Branches of Foreign Institutions**

Where the applicants intend to operate an unincorporated branch in Kenya rather than a subsidiary, the applicants may proceed to submit their application to the Central Bank once the name intended for use has been approved by the Central Bank. Except for the mode of incorporation, all licensing requirements for branches and subsidiaries are the same. The incorporation documents required for a branch are those of the parent.

### **3.5 Forwarding of Application**

Upon incorporation, all applicants seeking a license to conduct banking business are required to forward an application to the Central Bank which should include:

- a) A duly completed "Application for a License to Conduct the Business of an Institution" form (*Form CBK IF 1-1*),
- b) Duly completed "Fit and Proper" forms for proposed directors and Chief Executive Officer(CEO) (*Form CBK IF 1-2*),
- c) Duly completed "Fit and Proper" forms and schedules for all significant shareholders (*Form CBK IF 1-3*),
- d) A *non-refundable* application fee as specified under the Fourth Schedule to the Banking Act, (*The Banking (Fees) Regulations*), payable by banker's

cheque in favour of the Central Bank of Kenya, or such other mode of payment as the CBK may prescribe.

The forms for completion have been prepared as part of this Guideline and hard copies may be obtained from the Bank Supervision Department, Central Bank of Kenya. The forms may also be accessed on the CBK website at [www.centralbank.go.ke](http://www.centralbank.go.ke).

- 3.6 All applications duly completed including the additional information specified in Part IV below should then be submitted to the Director, Bank Supervision Department, Central Bank of Kenya, P.O. Box 60000-00200, Nairobi. The application should be submitted at least ninety (90) days prior to the proposed date of commencing operations.

#### **PART IV INFORMATION REQUIRED**

- 4.1 Every applicant will be required to submit the following additional information.
- 4.1.1 A certified copy of the certificate of incorporation of the institution from the Registrar of Companies.
  - 4.1.2 A certified copy of the Memorandum and Articles of Association of the proposed institution.
  - 4.1.3 A certified copy of the Memorandum and Articles of Association of any corporate body that proposes to have a significant shareholding in the institution.
  - 4.1.4 A certified copy of the latest audited statement of financial position and statement of comprehensive income for each of the three years immediately preceding the date of the application if the applicant has been operating in any sector under any name and laws or in cases where any of the shareholders is a corporate body. Where the shareholders are individual natural persons, certified personal statements of affairs for the past three years should be submitted.
- 4.2 In case of an institution incorporated outside Kenya, in addition to notarized copies of the documents specified in 4.1 above, the applicants should also submit the following:
- 4.2.1 A notarized copy of the signed minutes of the board of the institution or other prime oversight body passing the resolution to establish a branch or subsidiary in Kenya,

- 4.2.2 An undertaking by the board or other oversight body to maintain minimum assigned capital in the proposed branch in Kenya as per the Banking Act and that such capital shall be in Kenya shillings,
- 4.2.3 The name and contact details of a designated person(s) from the Head Office authorized to liaise with the Central Bank on the application on behalf of the institution.
- 4.2.4 A letter of no objection from the home supervisory authority recommending the applicant to establish a branch or subsidiary in Kenya should be obtained. The letter should be forwarded directly to the Director, Bank Supervision Department, Central Bank of Kenya, P.O. Box 60000-00200, Nairobi.
- 4.2.5 There shall be an understanding that the home country supervisor will exchange supervisory information with the Central Bank of Kenya.
- 4.2.6 Confirmation from the home country supervisor that the promoters of the foreign incorporated bank do not operate a shell bank should be obtained.
- 4.2.7 Where necessary, confirmation from the home supervisor that the supervisor conducts consolidated supervision.
- 4.3 A sworn declaration signed by every officer as specified in the application form.
- 4.4 A feasibility study of the future operations and development of the intended business for a minimum period of three years from the date of the application including:
  - 4.4.1 If the applicant has links to or is part of a group of companies (either as a parent, associate, subsidiary or joint venture) the application should include a comprehensive diagrammatic representation of the group structure, indicating details of all respective individual and institutional shareholding within the group as well as the ultimate beneficial shareholders.
  - 4.4.2 Proposed organization structure for the proposed institution showing:
    - Proposed Board of Directors
    - Proposed CEO , Executive Directors and Senior Officers
    - Proposed functional divisions
  - 4.4.3 Up-to-date and, detailed curriculum vitae of every significant beneficial shareholder, director and any senior officer who will take part in policy making, as well as certified copies of supporting documentation such as:
    - Academic and professional certificates.
    - Contact details (postal and e-mail addresses, phone contacts of at least three independent referees, one of whom should be a previous employer or business associate).

- Valid Personal Identification Number (PIN) and tax compliance certificate issued by the relevant tax authority in Kenya.
  - The latest credit report from a licensed credit reference bureau.
  - Certified statement of personal financial affairs.
  - Two recent passport-size photographs.
- 4.4.4 Schedule of all the preliminary expenses including organization costs, share-selling and brokerage costs and commission.
- 4.4.5 Projections of statements of financial affairs and statements of comprehensive income for the first three years of operations, with details of the following:
- a) The applicant's proposed products, planned channels of delivery, attendant risks and mitigation strategies – Including planned off-balance sheet items and off-shore activities;
  - b) Deposit mobilization and interest payable stating separately the proposed major sources of deposits;
  - c) Advances to be made and interest receivable, stating intended sectoral lending;
  - d) Investments to be made and earnings, stating the applicant's proposed investment policy(ies) and categories of business to be financed;
  - e) Operating expenses including rents, salaries, employee benefits, directors' remuneration;
  - f) Liquid and cash reserve assets;
  - g) Capital structure;
  - h) Provision for bad and doubtful debts;
  - i) Fixed assets, including business premises;
  - j) Other income, including commission and discounts; and
  - k) Net operating profit/loss.
- 4.4.6 The proposed operational arrangements of the applicant – This should show details of the proposed functional divisions and units, activities to be run in-house and those that shall be outsourced. For those activities to be outsourced, details should be provided on the rationale for outsourcing and the risk-mitigation measures in place.
- 4.4.7 Interest rate sensitivity analysis of the projections submitted or other similar analysis of the extent to which the forecasts will change when interest rate vary (the assumptions underlying the projections and the sensitivity analysis should be stated).



- 4.4.8 Statistical and other data which may have been collected in respect of the area in which the applicant intends to serve including population of the area, schemes of agriculture, business, industrial development and existing banking facilities.
- 4.5 Sources and evidence of availability of capital – The applicant should demonstrate capacity to meet the minimum capital requirements for the proposed institution as stipulated in the Banking Act. Such capacity may be evidenced by submission of copies of bank statements, Fixed Deposit Receipts (FDRs) and Government Securities. In addition, details should be provided on the sources of capital contributed by all proposed significant individual and institutional shareholders (*i.e. those controlling, directly or indirectly, more than 5% of the applicant's proposed issued equity*).
- 4.6 The proposed significant shareholders of the applicant institution should submit a collective undertaking signed by each significant shareholder to the effect that they accept their responsibility to ensure that the bank or financial institution is at all times adequately and appropriately capitalized. Additionally, every proposed individual and institutional shareholder should submit, as part of the sworn declaration in the application Form CBK IF 1-3, a statement to the effect that the proposed capital is not from proceeds of crime.
- 4.7 All submitted documents should be in the English language. Certified English translations should be provided for all submissions originally expressed in a language other than English. Translation certificates should be attached to the translated documents and should state, as a minimum:
- the name(s) and qualification(s) of the translator.
  - that the translator understands the language in which the original versions of the documents in question have been prepared, and
  - the translation is true, accurate, and correct to the best of the named translator's knowledge and ability.

The certificate should preferably be made under oath or notarized to provide assurance of its validity. The Central Bank reserves the right to request additional information, statements or documents as it shall deem necessary for purposes of determining an application.

## **PART V APPRAISAL OF APPLICATION**

### **5.1 Processing of Application**

Upon receipt of the application forms together with supporting documents and the requisite application fee, the Central Bank of Kenya shall within ten days send the applicant a formal letter of acknowledgement or a letter of deficiency.

- (a) A letter of acknowledgement shall officially advise the applicants that the documents submitted were found to be complete and that the application is under the Central Bank's appraisal process.
- (b) A letter of deficiency shall outline any requirements not met by the application and shall provide a time limit within which the outstanding requirements are to be met.
- (c) Upon issuing the letter of deficiency, the Central Bank of Kenya may not process the application any further until the outstanding requirements are fulfilled.
- (d) Upon receipt of complete documentation, the Central Bank of Kenya will appraise the application. The promoters of the proposed institution may, if the need arises, be invited for further consultations while the application is being assessed. Similarly, the proposed directors and Chief Executive Officer may be invited for an interview as part of the appraisal process.

## **PART VI: APPROVAL-IN-PRINCIPLE**

6.1 The Central Bank of Kenya shall within ninety (90) days or such other longer period as may be necessary, upon receipt of a complete application, determine the application through any of the following decisions.

- (i) Grant written approval-in-principle if it is satisfied that the application satisfies substantially the requirements of the Banking Act and these guidelines. With the approval-in-principle, the applicants may proceed to establish operating facilities and recruit staff for the proposed institution but may not yet commence operations until final issuance of the license.
- (ii) Request additional information or clarification from the applicant or the fulfillment of certain specified conditions by the applicant that it may deem necessary for the further processing of the application.

(iii) Decline to grant the license for reasons to be stated in writing.

6.2 Upon the Central Bank's issuance of the approval-in-principle or stipulation of further conditions to be met in respect of the application, the applicants will proceed to fulfill the requirements specified and advise the Bank in writing accordingly.

6.3 Upon issuing the approval-in-principle to the applicant or stipulating further conditions as the case may be, the Central Bank of Kenya may not process the application any further until the outstanding requirements are met.

#### 6.4 **Inspection of Premises, Operating Systems and Policy Manuals**

Upon the issuance of approval-in-principle and preparation of premises, the applicant will invite the Central Bank for an on-site inspection of the applicant's proposed operating premises, systems and policy manuals. The Central Bank of Kenya will visit the institution and carry out the requisite inspection.

6.4.1 In the on-site inspection, the Central Bank will among others:

- a) Confirm existence of comprehensive risk management policies and operating manuals. These manuals will as a minimum cover the under-listed areas:
  - i. Lending and Credit Administration policies.
  - ii. Human Resource and Manpower Development.
  - iii. Investments.
  - iv. Deposits and Marketing.
  - v. Capital.
  - vi. Liquidity.
  - vii. Management Information Systems.
  - viii. Planning and Budgeting.
  - ix. Accounting and Operating Procedures manuals.
  - x. Anti-Money Laundering.
  
- b) Determine the adequacy of premises and operating systems as stipulated in the CBK Prudential Guidelines on *Opening of New Place of Business, Closing Existing Place of Business or Changing Location of Place of Business (CBK/PG/11)*.

## **PART VII ISSUANCE OF LICENCE AND COMMENCEMENT OF OPERATIONS**

### **7.1 Granting of Approval**

After Central Bank of Kenya is satisfied that all the necessary conditions have been met, a letter to allow commencement of operations upon payment of the prescribed license fees will be issued to the applicant. A license will be granted only after the application fully satisfies all the conditions including viability as well as the proposed shareholders, directors and senior officers passing the “Fit & Proper” test and verification, by the Central Bank, of the source(s) of funds for the proposed institution and its ownership structure.

### **7.2 Payment of License Fees**

Prior to issuance of the license, the applicants will be required to pay the prescribed annual license fees as specified under the Fourth Schedule of the Banking Act. The prescribed annual license fees are payable *in full* for the year during which the license is initially issued, and shall not be prorated for validity periods less than 12 months. Similarly, no portion of annual license fees already paid shall be refundable in the event the license is revoked, withdrawn, surrendered or otherwise terminated at any time prior to the end of its stipulated validity period.

### **7.3 Issuance of the License**

Upon payment of the license fees, the applicant shall be granted a license allowing the commencement of operations. A license so issued shall remain valid for the remaining part of the calendar year during which it is issued, or such other period as may be stipulated in writing by the Central Bank. The license shall be renewable for the following calendar year. Applications for license renewals should be received by the Central Bank at least 90 days prior to expiry of current licenses.

A license of an institution shall be considered to have lapsed if the institution fails to commence operations within one year of the Central Bank’s approval. In the event of the license lapsing, the applicant shall be required to submit a fresh application if they still intend to conduct business.

### **7.4 Specification of Institution**

Every licensed institution is required to be specified by the Central Bank of Kenya under Section 2 of the Central Bank of Kenya Act, Cap 491.

## 7.5 **Post-Licensing On-Site Inspection**

Central Bank of Kenya will conduct an on-site inspection of the newly licensed institution within the first six to twelve months after commencement of operations. This will enable CBK to advise appropriately and ensure that the institution is on the right track from the start.

## **PART VIII: EFFECTIVE DATE**

8.1 **Effective date:** The effective date of this Guideline shall be 1<sup>st</sup> January 2013.

8.2 **Supersedence:** This guideline supersedes the Guideline on Licensing of New Institutions **CBK/PG/01** issued on 1<sup>st</sup> January 2006.

## **ENQUIRIES**

Enquiries on any aspect of this guideline should be referred to:

The Director,

Bank Supervision Department,

Central Bank of Kenya,

P.O. Box 60000 - 00200

NAIROBI.

TEL.2860000 e-mail: *fin@centralbank.go.ke*

**PART IX APPLICATION FORMS & NOTES ON COMPLETION  
FORM CBK IF 1-1**

**APPLICATION FOR A LICENCE TO CONDUCT THE BUSINESS OF AN  
INSTITUTION**

**NB:** (a) Read the declaration on Section 18 below before completing this form.

(b) In case the space provided is inadequate, use additional paper.

(c) This form should be submitted, duly completed, accompanied by the complete set of documents prescribed under Part IV (*Information Requirements*) of the Guideline on licensing (CBK PG/01).

1. Type of Business applied for.....
2. Name of Proposed Institution. ....
3. Physical Address of Head Office: L.R. No.....  
Street..... Building & Town/City .....
4. Postal Address and Postal Code.....  
Telephone No..... P.I.N. ....  
E-mail address.....
5. Date and Country of Incorporation.....
6. Names of branch offices and the number of years each has been established and has conducted or carried on business.....
7. Former name(s) by which the institution has been known.....

**8. Particulars of shareholding:**

Present & Former Name(s) of share-holder(s)	Postal Address of shareholder (s)	PIN No. & Identification No.	Designation	Age and Nationality	No. of shares held/allocated	Academic Professional Qualifications & Year obtained	Details of Previous Employment	Date of Appointment

*(Attach all necessary supportive documentation; please indicate N/A where requested details are not applicable)*

**9. Particulars of Officers:**

**a) Directors**

	Name of Proposed Director	Proposed Capacity (Executive / Non-Executive)	Age & Nationality	ID No. / Passport No.	Postal & E-mail address	Telephone contacts	Other Current Directorship (s)
1.							
2.							
3.							
4.							

**b) Senior Officers**

	Name of Proposed Officer	Proposed Designation	Age & Nationality	ID No. / Passport No.	Postal & E-mail address	Telephone contacts	Current Position
1.							
2.							
3.							
4.							

10. Names of the proposed institution's Bankers and their Address

.....  
 .....  
 .....

11. Sources of funds for the proposed business

.....  
 .....

12. Does the institution hold, or has it ever held any authority from a supervisory body to carry on any business activity in Kenya or elsewhere?

.....

.....

If any such authority has been revoked, give particulars

.....  
.....  
.....

13. Has the institution been put under receivership in the past or made any compromise or arrangement with its creditors in the past or otherwise failed to satisfy creditors in full?

.....  
If so, give particulars.....  
.....  
.....

14. Is an inspector or other authorized officer of any government ministry, department or agency, professional association or other regulatory body investigating or has such an investigation ever previously taken place into the affairs of the institution?

.....  
.....

15. Has the institution been refused entry in Kenya or elsewhere to any professional body or trade association concerned with banking or financial activities or decided not to apply for entry after making an approach?

If so, give particulars.....  
.....  
.....

16. Is the institution engaged or does it expect to be engaged in Kenya or elsewhere in any litigation which may have a material effect on the resources of the Institution?.....

If so, give particulars.....

17. Is the institution engaged or does it expect to be engaged in any business relationship with any of its officers or shareholders?

If so, give particulars.....  
.....



18. **DECLARATION**

We, the undersigned, being directors of the proposed institution, declare that to the best of our knowledge and belief, the information contained herein is complete and accurate. We also certify that the capital to be invested in the proposed bank is not from proceeds of crime.

Director (Name) .....

Signature.....Date.....

Director (Name).....

Signature.....Date.....

**SECOND SCHEDULE  
FORM CBK/ IF 1-2**

**CRITERIA FOR DETERMINING PROFESSIONAL AND MORAL SUITABILITY  
OF PERSONS IN CONTROL OF INSTITUTIONS LICENSED UNDER THE  
BANKING ACT**

- NB:**
- (a) Read the declaration on Section 6 below before completing this form.
  - (b) In case the spaces provided are inadequate, use additional paper.
  - (c) This form should be submitted as prescribed, duly completed, accompanied by the complete set of documents prescribed under Part IV (*Information Requirements*) of the Guideline on licensing (CBK PG/01).

**1. THE INSTITUTION**

Name.....

Type.....

Proposed position.....

**2. PERSONAL INFORMATION**

a) Surname .....

Other Names .....

b) Previous Names (if any) by which you have been known:

.....  
.....

Reasons for change of names.....

c) Year and Place of birth: .....

d) Nationality and how acquired.....

e) Personal Identification Number (PIN) .....

f) i) Identification Card number and date of issue .....

ii) Passport number, place and date of issue.....

g) Postal Address: .....

h) Previous Postal Addresses (if any) .....

i) Physical Address.....

ii) Telephone numbers.....

i) Educational Qualifications .....

	Qualifications	Year Obtained	Institution	Examining Body	Grade Obtained

j) Professional Qualifications and years obtained

.....

	Qualifications	Year Obtained	Institution	Examining Body	Grade Obtained

k) Name(s) of your bankers during the last 5 years

.....  
 .....  
 .....

l) Responsibilities of Proposed position

--

**3. EMPLOYMENT/ BUSINESS RECORD**

Period	Name of Employer/ Business and Address	Position Held & Dates	Responsibilities	Reasons for Leaving (where applicable)

#### 4. DESCRIPTION OF YOUR PAST AND CURRENT ACTIVITIES IN KENYA AND ABROAD

##### 4.1 SHAREHOLDING (DIRECTLY OWNED OR THROUGH NOMINEES)

Company's Name	Date of Incorporation	Number of Shares held	% of Shareholding	Past Share - holding A	Past Share - holding B	Remarks
<p>A: Refers to date of closure or surrender of shares            B: Refers to reasons for closure or surrender</p>						

##### 4.2 DIRECTORSHIPS

Company's Name	Date of Incorporation	Executive or Non-executive	Position held in case of Executive	Past Directorships C	Past Directorships D	Remarks
<p>C: Refers to date of retirement, resignation or dismissal.            D: Refers to reasons for retirement, resignation or dismissal.</p>						

##### 4.3 PROFESSIONAL BODIES

Name of body	Membership No.	Position Held (if any)	Position held in case of Executive	Past Membership		Remarks
				E	F	
<p>E: Refers to date when dismissed or ceased from membership.            F: Refers to reasons for dismissal or cessation.</p>						

**4.4 SOCIAL CLUBS**

Club Name	Membership No	Position Held (if any)	Past Club Membership		Remarks
			G	H	

G: Refers to date of retirement, resignation or dismissal.  
H: Refers to reasons for retirement, resignation or dismissal.

**4.5 BORROWINGS**

Name of Borrower*	Name of Lending Institution	Type of Facility	Amount Borrowed	Date of Offer	Terms of Facility	Security Offered	Value of Security	Current Outstanding Balance, KES	Remarks

*\*Applicant to indicate individual/personal as well as borrowings by associated private companies from lending institutions in which the applicant controls more than of 5% of equity.*

5.1 Have you or any entity with which you are associated as director, shareholder or manager, ever held or applied for a license or equivalent authorization to carry on any business activity in any country? If so, give particulars. If any such application was rejected or withdrawn after it was made or any authorization revoked, give particulars.

.....  
.....  
.....

- 5.2 Have you at any time been convicted of any criminal offence in any jurisdiction? If so, give particulars of the court in which you were convicted, the offence, the penalty imposed and the date of conviction .....
- 5.3 Have you, or any entity with which you have been involved, been censured, disciplined, warned as to future conduct, or publicly criticized by any regulatory authority or any professional body in any country? If so give particulars.....
- 5.4 Have you ever been disqualified, under any legislation or regulation from acting as a director or serving in a managerial capacity? .....
- 5.5 Have you, or has any entity with which you are, or have been associated as a director, shareholder or manager, been the subject of an investigation, in any country, by a government department or agency, professional association or other regulatory body? If so, give particulars. ....
- 5.6 Have you, in any country, ever been dismissed from any office or employment, or been asked to resign or resigned from employment or position of trust or fiduciary appointment, been subject to disciplinary proceedings by your employer or barred from entry of any profession or occupation because of questions about your honesty and integrity? If so give particulars .....
- 5.7 Have you ever been diagnosed as being mentally unfit or of unsound mind? .....
- 5.8 Have you failed to satisfy debt adjudged due and payable by you on order of court, in any country, or have you made any compromise arrangement with your creditors within the last 10 years? If so, give particulars. ....

5.9 Have you ever been declared bankrupt by a court in any country or has a bankruptcy petition ever been served on you? If so, give particulars.

.....  
 .....

5.10 Have you ever been held liable by a court, in any country, for any fraud or other misconduct? If so, give particulars

.....

5.11 Has any entity with which you were associated as a director, shareholder or manager in any country made any compromise or arrangement with its creditors, been wound up or otherwise ceased business either while you were associated with it or within one year after you ceased to be associated with it?

If so, give particulars.....

.....

5.12 Are you presently, or do you, other than in a professional capacity, expect to be engaged in any litigation in any country?

If so, give particulars.....

.....

5.13 Indicate the names, postal and e-mail addresses, telephone numbers and positions of at least three individuals of good standing who would be able to provide a reference on your personal and professional integrity. The referees must not be related to you, and should have known you for at least five years.

	Name of Referee	Postal Address	E-mail address	Tel no. (s)	Position (where applicable)	Relationship with applicant
1						
2						
3						

5.14 Is there any additional information which you consider relevant for the consideration of your suitability or otherwise for the position(s) held/to be held? The omission of material facts may represent the provision of misleading information.

.....

**N.B.** The information given in response to this questionnaire shall be kept confidential by the supervisory authorities, except in cases provided for by law.

**6. DECLARATION**

I am aware that it is an offence to knowingly or recklessly provide any information, which is false or misleading in connection with an application for a banking license. I am also aware that omitting material information intentionally or unintentionally shall be construed to be an offence and may lead to rejection of my application.

I certify that the information given above is complete and accurate to the best of my knowledge, and that there are no other facts relevant to this application of which the supervisory authority should be aware.

I undertake to inform the supervisory authority of any changes material to the applications which arise while the application is under consideration.

NAME..... POSITION HELD.....  
DATED..... AT..... THIS DAY OF.....  
SIGNED.....  
                  (Applicant)

(This declaration must be signed *in the presence of* the witness named below)

**WITNESSED BEFORE ME:**

**COMMISSIONER FOR OATHS/MAGISTRATE**

**Name:** .....

**Signature**.....

**Address:** .....

**Date and Stamp**.....



**SHAREHOLDERS' FORM & SCHEDULE**

**CRITERIA FOR DETERMINING THE SUITABILITY OF PERSONS INTENDING TO HOLD OR ACQUIRE A SIGNIFICANT STAKE IN AN INSTITUTION LICENSED UNDER THE BANKING ACT**

- NB: (a) Read the declaration on Section 6 below before completing this form.  
(b) In case the space provided is inadequate, use additional paper.  
(c) This form should be submitted, duly completed, accompanied by the complete set of documents prescribed under Part IV (*Information Requirements*) of the Guideline on licensing (CBK PG/01).

**1. THE INSTITUTION**

Name.....  
.....  
Type.....  
.....

**2. PERSONAL INFORMATION**

- a) Surname.....
- b) Other Names.....  
In case of a corporate body, give the name of the corporate body  
.....
- c) Previous Names (if any) by which you have been known:  
.....
- d) Year and place of birth.....  
In case of a corporate body, the year and date of incorporation  
.....
- e) Nationality and how acquired.....  
In case of a corporate body, state the country of incorporation  
.....
- f) Personal Identification Number.....
- g) Identification Card number and date of issue.....  
In case of a corporate body, Registration No. and date of registration.
- h) Passport Number and Date of issue.....
- i) Postal Address.....
- j) Previous Postal Addresses .....
- k) E-mail Address .....
- l) Telephone Numbers.....

m) Educational Qualifications (Post-Primary)

	Qualifications	Year Obtained	Institution	Examining Body	Grade Obtained

n) Name(s) of your bankers during the last 5 years .....

.....

.....

.....

.....

.....

.....

**3. EMPLOYMENT AND/OR BUSINESS RECORD**

Period	Name of Employer/ Business and Address	Position Held & Dates	Responsibilities	Reasons for leaving (where applicable)

**4. DESCRIPTION OF YOUR PAST AND CURRENT ACTIVITIES IN KENYA AND ABROAD**

**4.1 SHAREHOLDING (DIRECTLY OWNED OR THROUGH NOMINEES)**

Company's Name	Date of Incorporation	Amount of Shareholding	% of Shareholding	Past Shareholding		Remarks
				A	B	

A: Refers to date of closure or surrender of shares

B: Refers to reasons for closure or surrender

#### 4.2 DIRECTORSHIP(S)

Company's Name	Date of Incorporation	Executive or Non-executive	Position Held in case of Executive	Past Directorship		Remarks
				C	D	

C: Refers to date of retirement / cessation

D: Refers to reasons for retirement / cessation

#### 4.3 PROFESSIONAL ASSOCIATIONS

Name of body	Membership No.	Position Held (if any)	Past Directorship		Remarks
			E	F	

E: Refers to date of retirement / termination of membership

F: Refers to reasons for retirement or termination of membership

#### 4.4 SOCIAL CLUBS

Name of body	Membership No.	Position Held	Past Club Memberships		Remarks
			E	F	

- E: Refers to date of retirement / termination of membership  
 F: Refers to reasons for retirement or resignation / termination of membership

#### 4.5 OUTSTANDING BORROWINGS

Name of Borrower*	Name of Lending Institution	Type of Facility	Amount Borrowed KES	Date of Draw down	Terms of Facility	Security Offered	Value of Security KES	Current Outstanding Balance, KES	Current Status

*\*Applicant to indicate individual/personal as well as borrowings by associated private companies from lending institutions in which the applicant controls more than of 5% of equity.*

#### 4.6 SOURCES OF FUNDS

1. Please provide details of the actual source(s) of funds that you, as a shareholder, would like to invest or use in the acquisition of shares in the institution.

- a) .....
- b) .....
- c) .....

2. Declaration on the sources of funds

Please provide a sworn statement that the funds that you, as a shareholder, would like to invest or use in the acquisition of shares in the institution are not from proceeds of crime.

#### 5. QUESTIONNAIRE

5.1 Have you or any entity with which you are associated as director, shareholder or manager, ever held or applied for a license or equivalent authorization to carry on any business activity in any country? If so, give particulars. If any such

application was rejected or withdrawn after it was made or any authorization revoked, give particulars.....

5.2 Have you at any time been convicted of any criminal offence in any jurisdiction? If so, give particulars of the court in which you were convicted, the offence, the penalty imposed and the date of conviction

5.3 Have you, or any entity with which you have been involved, been censured, disciplined, warned as to future conduct, or publicly criticized by any regulatory authority or any professional body in any country? If so, give particulars

5.4 Have you, or has any entity with which you are, or have been associated as a director, shareholder or manager, been the subject of an investigation, in any country, by a government department or agency, professional association or other regulatory body? If so, give particulars

5.5 Have you, in any country, ever been dismissed from any office or employment, been subject to disciplinary proceedings by your employer or barred from entry of any profession or occupation? If so, give particulars.

Have you been diagnosed with any mental disability?

5.6 Have you failed to satisfy debt adjudged due and payable by you on order of court, in any country, or have you made any compromise arrangement with your creditors within the last 10 years? If so, give particulars

5.7 Have you ever been declared bankrupt by a court in any country or has a Bankruptcy petition ever been served on you? If so, give particulars

5.8 Have you ever been held liable by a court, in any country, for any fraud or other misconduct? If so, give particulars.....

5.9 Has any entity with which you were associated as a director, shareholder or manager in any country made any compromise or arrangement with its creditors, been wound up or otherwise ceased business either while you were associated with

it or within one year after you ceased to be associated with it? If so, give particulars .....

.....

5.10 Are you presently, or do you, other than in a professional capacity, expect to be engaged in any litigation in any country? If so, give particulars .....

.....

5.11 Indicate the names, postal and e-mail addresses, telephone numbers and positions of three individuals of good standing who would be able to provide a reference on your personal and financial integrity and honesty. The referees must not be related to you, and should have known you for at least five years.

	Name of Referee	Postal Address	E-mail address	Tel no. (s)	Position (where applicable)	Relationship with applicant
1						
2						
3						

5.12 Is there any additional information which you consider relevant for the consideration of your suitability or otherwise to own share capital of an institution? The omission of material facts may represent the provision of misleading information.

.....

.....

**In case of a corporate body;**

5.13 Does the entity have substantial shareholders, directors, key officers who fail to meet the fit and proper criteria? .....

If yes, state how the entity plans to deal with them.....

5.14 Does the entity have meaningful internal controls and procedures (including procedures to manage conflicts of interest).....

5.15 Has the entity been refused an application for registration, licensing or other authorization to carry on the business for which a license is sought? If yes, give the reason.....

- 5.16 Has the entity been subject to suspension, cancellation or revocation of its registration, license or other authorization to carry on the business for which a license is sought?..... if yes, give the reason.....
- 5.17 Has the entity been subject to any regulatory or enforcement action by any authority in any jurisdiction?.....  
If yes, why?.....
- 5.18 Has any judgment, order or conviction been made or any legal proceedings, action or other claims or other claims are pending against the entity whether civil or criminal in nature?..... if yes, why?
- 5.19 Are the directors, managers and other key officers of the entity qualified, knowledgeable and experienced? .....
- 5.20 Does the entity have adequate systems and controls in place to provide an efficient and reliable service?.....
- 5.21 Does the entity have in place Know Your Customer (KYC) procedures in line with the Proceeds of Crime and Anti – Money Laundering Act?  
.....
- 5.22 Does the entity have IT support to maintain the integrity of the operating system and security? .....
- 5.23 Has the entity been threatened with receivership, administration, liquidation or other similar proceedings? .....
- 5.24 Does the entity have the ability to meet any financial or capital requirements applicable to it? .....In case no, why? .....

**N.B.** The information given in response to this questionnaire shall be kept confidential by the supervisory authorities, except in cases provided for by law.

**6. DECLARATION**

I am aware that it is an offence to knowingly or recklessly provide any information, which is false or misleading in connection with an application for a banking license or approval to own significant shares in an institution. I am also aware that provision of false information in this regard may result in rejection of this application by the Central Bank.

I certify that the information given above is complete and accurate to the best of my knowledge, and that there are no other facts relevant to this application of which the supervisory authority should be aware.

I also certify that the capital to be invested in the proposed bank is not from proceeds of crime.

I undertake to inform the supervisory authority of any changes material to the applications which arise while the application is under consideration.

*NAME:* .....

*DATED AT:*.....*THIS*.....*DAY OF*..... 20.....

**WITNESSED BEFORE ME:**

**SIGNED** ..... (**Applicant**)

**COMMISSIONER FOR OATHS/MAGISTRATE**

**Name** .....

**Signature:** .....

**Address:** .....



## NOTES ON THE COMPLETION OF THE APPLICATION FORMS

The explanatory notes are intended to give further guidance on the completion of the application forms. It is deemed that further guidance is necessary for certain items. These include:

1. **Application for a license to conduct the business of an institution**
  - 1.1 **Item Number 1: Type of Business Applied For**

State whether the license being applied for is to transact the business of:  
a bank, mortgage finance company or financial institution
  - 1.2 **Item Number 3: Physical Address**

These details should be submitted to the Central Bank as soon as the permanent physical location is known.
  - 1.3 **Item Number 6: Names of Branches**

This item should be completed by:

    - a) A person licensed in Kenya operating under Act (s) other than the Banking Act, and is seeking to be licensed to operate under the Banking Act.
    - b) A foreign incorporated banking institution wishing to be licensed under the Banking Act.
  - 1.4 **Item Number 8: Particulars of Shareholding**

In case of institutions incorporated outside Kenya:

    - a) The term ‘shareholder’ refers to the foreign institution(s) proposing to assign capital to the Kenya branches for which the license is being applied.
    - b) This item is also to be used for the provision of information on the proposed assigned capital for the Kenya branches.
  - 1.5 **Item Number 9: Particulars of Officers**

In the completion of this item:

    - a) The term ‘officer’ should be used as defined in Section 2 of the Banking Act.
    - b) The officers referred to are those proposed or already engaged by the institution.
    - c) Where the institution is proposing to or has entered into a management agreement with another entity, details of the senior persons from the said entity heading or proposed to head the management team should be given.

1.6 Item No. 9: Nationality

Nationality and how it was acquired

- a) State your current nationality and indicate whether it was acquired through birth, marriage or naturalization.
- b) Present occupation and position held/Present employer and address

This item will only apply in case of non-executive directors, shareholders and executives who are yet to join the institution but have been proposed to take up executive positions when the institution starts operations.

Item No. 10-16 Complete as per attached form which is self-explanatory.

2. **Second Schedule “Fit and Proper” Form**

This should be completed by all persons proposed as Senior Officers, Chief Executive and Directors of the proposed institution.

3. **“Fit and Proper” Form and Schedule for Significant Shareholders**

This should be completed by all persons proposing to set up an institution or are about to acquire or intend to acquire a significant stake in an institution.

# **GUIDELINE ON CORPORATE GOVERNANCE CBK/PG/02**

## **CONTENTS**

### **PART I Preliminary**

- 1.1 Title
- 1.2 Authorization
- 1.3 Application
- 1.4 Definitions

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- 2.3 Responsibility

### **PART III Sound Corporate Governance Principles**

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## **PART I: PRELIMINARY**

### **1.1 Title** – Guideline on Corporate Governance

**1.2 Authorization** - This Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

**1.3 Application** - All institutions licensed under the Banking Act (Cap. 488).

**1.4 Definitions** - Terms used in this Guideline are as defined in the Banking Act (Cap. 488). Other terms used in this guideline shall be taken to have the meaning assigned to them hereunder:

**1.4.1 ‘Corporate Governance’** involves the manner in which the business and affairs of an institution are governed by its board and senior management and provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the institution and its shareholders, facilitate effective monitoring and define how an institution:

- a) sets corporate objectives, including generating economic returns to owners;
- b) runs the day-to-day operations of the business;
- c) considers the interests of recognized stakeholders; aligns corporate activities and behaviors with the expectation that the institution will operate in a safe and sound manner, and in compliance with applicable laws and regulations;
- d) And protects the interests of depositors and other creditors.

**1.4.2 ‘Compliance Function’** Means a function reporting independently to the Board, or committee of the Board, that identifies, assesses, advises, monitors and reports on the institution’s compliance risk, which is the risk of legal or regulatory sanctions, financial loss, or loss to reputation an institution may suffer as a result of its failure to comply with all applicable laws, guidelines, codes of conduct and standards of good practice.

**1.4.3 ‘Conflict of Interest’** refers to a situation in which a person has direct or indirect private or personal interest in a matter which is sufficient to directly or indirectly influence or has the potential to directly or indirectly influence the objective exercise of his or her official or professional duties or the making of impartial judgment over the same or related matter.

**1.4.4 ‘Executive Director’ (ED)** refers to a director who is involved in the day-to-day operations of the institution. The ED is a full time salaried employee of the institution or of its subsidiaries. The ED is assigned day-to-day responsibilities and is accountable to the Managing Director or the Board of Directors depending on the institution’s organizational structure.

**1.4.5 ‘Non-Executive Director’** means an individual not involved in the day-to-day management and not a full time salaried employee of a banking institution or of its subsidiaries. An individual in the full time employment of the bank holding company would be considered to be a non-executive director of the institution’s subsidiaries, unless such individual, by his / her conduct or executive authority, could be construed to be directing the day to day management of the concerned subsidiaries.

**1.4.6 “Independent Non-Executive Director”** means a director who:

- i. Has not been employed by the institution in an executive capacity within the last five years.
- ii. is not associated to an adviser or consultant to the institution or a member of the institution’s senior management or a major customer or supplier of the institution or with a not-for-profit entity that receives more than fifty percent (50%) of its contributions from the institution; or within the last five years, has not had any business relationship with the institution (other than service as a director) for which the institution has been required to make disclosure;
- iii. has no personal service contract(s) with the institution, or a member of the institution’s senior management;
- iv. is not a member of the family of any person described above or;
- v. has not had any of the relationships described above with any affiliate of the institution.
- vi. does not have direct or indirect interest in the institution which exceeds 5% of its equity interest or its related companies;
- vii. is not a direct or indirect representative of a significant shareholder who has the ability to control or significantly influence management or the board. Indirect representation includes a nominee or an associate of a shareholder.

**1.4.7 “Nominations Committee”** refers to a board committee responsible for all aspects of the appointment of an institution’s directors. The committee should be chaired by an independent non-executive director and its key responsibilities may include:

- a) Regular review of structure, size and composition of the board and make recommendations on any adjustments deemed necessary.
- b) Identify, nominate and recommend for the approval of the board, candidates to fill board vacancies as and when they arise.

- c) Satisfy itself with regard to succession planning, that processes and plans are in place with regard to both board and senior management appointments.
- d) To recommend the continuation (or not) in service of any director who has reached the institution's retirement age limit.
- e) To attend to any other tasks that may be assigned by the board from time to time.

**1.4.8 “Compensation Committee”** (which may also be referred to as ‘Remuneration Committee’) means a board committee responsible for overseeing the compensation system’s design and operation on behalf of the Board of Directors. The committee should be constituted in a way that enables it to exercise competent and independent judgment on compensation policies and practices. Majority of the compensation committee members should be independent non-executive directors with substantial knowledge about compensation arrangements.

## **PART II: STATEMENT OF POLICY**

### **2.1 Purpose**

This Guideline is intended to provide the minimum standards required from shareholders, directors, chief executive officers, management and employees of an institution so as to promote proper standards of conduct and sound banking practices, as well as ensure that they exercise their duties and responsibilities with clarity, assurance and effectiveness. The broad principles, standards and requirements under this Guideline are aligned with international best practices on corporate governance.

This Guideline should not restrict or replace the proper judgment of the management and employees in conducting day-to-day business. Each institution is therefore required to formulate its own special policies (taking into account the institution’s special needs and circumstances) on the duties, responsibilities and conduct of its directors, chief executive officers and management.

### **2.2 Scope**

This Guideline applies to the duties, responsibilities and code of conduct for shareholders, directors, chief executive officers, management and employees of an institution.

### **2.3 Responsibility**

The Board of Directors of each institution shall be responsible for formulating policies, procedures and guidelines, which ensure that:

- a) All directors, chief executive officers and management are made fully aware of their duties, responsibilities and code of conduct;
- b) all management decisions are made in accordance with prudent banking practices. The shareholders of each institution shall be responsible for the appointment of a competent and dedicated board of directors.

## **PART III: SOUND CORPORATE GOVERNANCE PRINCIPLES**

### **3.1 Principle 1- Ethical Leadership and Integrity**

*The board should provide effective leadership based on an ethical foundation. Good corporate governance is essentially about effective, responsible leadership characterized by the ethical values of responsibility, accountability, fairness and transparency.*

#### **Specific Requirements**

- 3.1.1** The board is responsible for ensuring that management actively cultivates a culture of ethical conduct and sets the values to which the institution will adhere. The board should align its conduct and the conduct of management with the values that drive the institution's business and ensure these values are incorporated in a code of conduct and adhered to in all aspects of its business.
- 3.1.2** The board should ensure that integrity permeates all aspects of the institution and its operations and that the institution's vision, mission and strategic objectives are ethically sound. The manner in which the institution conducts its internal and external affairs should be beyond reproach.
- 3.1.3** The board is responsible for considering the legitimate interests and expectations of the institution's stakeholders in its deliberations, decisions and actions. The following four ethical values underpin good corporate governance:
- a) **Responsibility:** The board should assume responsibility for the assets and actions of the institution and be willing to take corrective actions to keep the institution on a strategic path that is ethical and sustainable.
  - b) **Accountability:** The board should be able to justify its decisions and actions to shareholders and other stakeholders.
  - c) **Fairness:** The board should ensure that it gives fair consideration to the legitimate interests and expectations of all stakeholders of the institution.
  - d) **Transparency:** The board should disclose information in a manner that enables stakeholders to make an informed analysis of the institution's performance, and sustainability.
- 3.1.4** As a steward of the institution, each director should also discharge the following key moral duties:
- a) **Conscience:** A director should act with intellectual honesty and independence of mind in the best interests of the institution and all its stakeholders, in accordance with the inclusive stakeholder approach to corporate governance. Conflicts of interest should be avoided.

- b) **Inclusivity** of stakeholders is essential to achieving sustainability and the legitimate interests and expectations of stakeholders must be taken into account in decision-making and strategy.
- c) **Competence**: A director should have the knowledge and skills required for governing an institution effectively. This competence should be continually developed.
- d) **Commitment**: A director should be diligent in performing his duties and devote sufficient time to institution affairs. Ensuring institution performance and compliance requires unwavering dedication and appropriate effort.
- e) **Courage**: A director should have the courage to take the risks associated with directing and controlling a successful, sustainable institution, and also the courage to act with integrity in all board decisions and activities.

**3.1.5** The board should ensure that the company's ethical standards (as stated in the code of conduct and related policies) are integrated into all the institution's strategies and operations. The code of conduct should be supplemented by several ethics-related policies that provide detailed guidelines for dealing with specific issues which would adversely impact or influence the market or dent the reputation of the institution such as engaging in manipulative trading and unfair business practices.

## **3.2 Principle 2- Responsibilities of Shareholders**

*Shareholders of banking institutions shall jointly and severally protect, preserve and actively exercise the supreme authority of the institution in general meetings. They have a duty, jointly and severally, to exercise that supreme authority.*

### **Specific Requirements**

- 3.2.1** To the extent that the duty is vested in general meetings, the shareholders must ensure that only credible persons who can add value to the institution's banking business are elected or appointed to the board of directors;
- 3.2.2** No shareholder with more than five percentage (5%) shareholding in a banking institution shall be an executive director or form part of the management of the institution or institution's holding company.
- 3.2.3** Shareholders must ensure that, in general meetings and related forums, the board is constantly held accountable and responsible for the efficient and effective governance of the banking institution. In the event that the board of directors does not perform to expectation or in accordance with the mandate of the institution, shareholders are expected to take appropriate action to change the composition of the board.



**3.2.4** Shareholders are expected to ensure that the institution applies to Central Bank of Kenya for approval in the following circumstances, with respect to shareholding of financial institutions:

- Transfer of existing shareholding in excess of 5% of an institution's share capital;
- Acquisition of more than 5% of the share capital of an institution where there is fresh capital injection, or from existing shareholders.

It is similarly the institutions responsibility to ensure that the above approvals relating to significant shareholders are obtained from the Central Bank of Kenya, before allotment of shares. The applications relating to significant shareholders should include forms containing details of significant shareholders as specified in the form CBK/IF1-3 annexed to Guideline No. CBK/PG/01 on Licensing of New Institutions.

### **3.3 Principle 3 - Overall responsibilities of the Board**

*The board has overall responsibility for the bank, including approving and overseeing the implementation of the bank's strategic objectives, risk strategy, corporate governance and corporate values. The board is also responsible for providing oversight of senior management.*

#### **Specific Requirements**

##### **3.3.1 Board Charter**

The Board of Directors (BOD) of every institution is required to formulate a Board Charter that outlines, among others, the principal role of the BOD, the demarcation of the roles, functions, responsibilities and powers of the Board, various Board Committees and matters reserved for final decision-making or pre-approval by the Board; and the policies and practices of the Board in respect of matters such as conflicts of interest and convening of Board meetings. The charter should require all directors to declare any interests that may give rise to a potential or perceived conflict including multiple directorships, business relationships or other circumstances that could interfere with exercise of objective judgment. It should define the policy on directorships in other entities by board members and the terms/tenure limits for board members where applicable.

The Charter should define the specific responsibilities of the BOD, in order to enhance coordination and communication between the Chief Executive and the Board and more specifically, to clarify both Board and Management accountability for the benefit of the institution, its shareholders and other stakeholders. The roles of the Chairman of the

Board and the Chief Executive Officer should be clearly outlined and demarcated in the charter.

### **3.3.2 Regulating the manner in which the business is conducted.**

The board must provide clear objectives and policies within which senior executive officers are to operate. These should cover all aspects of operations, including strategic planning, credit administration and control, asset and liability management encompassing the management of liquidity risk, interest rate risk and market risk, accounting and internal control systems, service quality, automation plan, prevention of money laundering, profit planning and budgeting, adequacy of capital, and human resource development. Clear lines and limits of authority for all levels of staff should be established. The seriousness of infringing on the authorized limits should be emphasized to staff at all levels.

A vital part of the responsibilities of directors is to formulate the future direction of the institution of which planning, organizing, and controlling, are three fundamental functions. Sound planning is of vital importance, and as such projections/targets must be periodically reviewed and amended as circumstances dictate.

### **3.3.3 Attend Board meetings regularly**

Every director has a duty to attend board meetings regularly and to effectively participate in the conduct of the business of the Board. Every member of the board shall attend at least 75% of the board meetings of an institution in any financial year. Attendance of board meetings may include physical appearance, video conferencing (refer to Schedule Part VII: Guidance notes on video conferencing) or such other method that the Central Bank may allow or prescribe upon application by an institution on the method sought and the controls to be put in place to ensure adherence to the recommendations of this guideline. This is to ensure every board member discharges his or her duties and responsibilities effectively.

### **3.3.4 Be informed about business condition of the institution**

Since the directors are jointly and severally responsible for the effective supervision of the affairs of the institution, they should be informed on a regular basis of the business condition of the institution. For the purpose of deliberating on this information and providing guidance to the management, the Board should meet regularly, preferably at least once in a quarter.

In addition, the Board and each director should exercise independent judgment in evaluating the performance of the management. This could be enhanced by the provision of independent reviews of the operations by third parties such as external auditors, internal auditors, audit committees and other experts reporting directly to the Board.

### **3.3.5 Observe Laws and guidelines**

The board should ensure cognizance is taken by management and themselves of all applicable laws and guidelines, and systems to effectively monitor and control their compliance. This will likely include provisions for training of personnel in these matters and, when violations do occur, ensure compliance immediately. It is a duty inherent with the office of directors (or management) to know the laws and guidelines, and to ensure that compliance of all laws and guidelines receives the highest priority, and violations are not knowingly committed by themselves or by anyone in their employment. In particular, every director should be conversant with the provisions of the Banking Act, Central Bank of Kenya Act and any guideline issued hereunder or other relevant laws and guidelines. Directors should also review the institutions Central Bank of Kenya's inspection reports and audit reports and also ensure implementation of any recommendations made.

### **3.3.6 Organizational Structure**

The board should ensure that the bank's organizational structure facilitates effective decision making and good governance. This should include setting and enforcing lines of responsibility and accountability throughout the organization, which define clearly the key responsibilities and authorities of the board itself, as well as of senior management and the control functions.

### **3.3.7 Oversight of senior management**

It is the duty of the Board of Directors to define the duties of management and appoint those persons who are competent, qualified and experienced to administer the institution's affairs effectively and soundly. It is also the responsibility of the Board to dispense with the services of staff considered undesirable. In providing oversight of senior management the board should:

- a) Select and, where necessary, replace senior management and have in place an appropriate plan for succession.
- b) monitor that senior management's actions are consistent with the strategy and policies approved by the board, including the risk tolerance/appetite;
- c) meet regularly with senior management;
- d) question and review critically explanations and information provided by senior management;
- e) set formal performance standards for senior management consistent with the long-term objectives, strategy and financial soundness of the bank, and monitor senior management's performance against these standards.

### **3.3.8 Policies, Processes and Controls**

The board should regularly review policies, processes and controls with senior management and/or internal control functions (including internal audit, risk management and compliance) in order to determine areas needing improvement, as well as to identify and address significant risks and issues. The frequency of the review should be clearly stated in the institution's own policies. The board should ensure that the control functions are properly positioned, staffed and resourced and are carrying out their responsibilities independently and effectively.

### **3.3.9 Corporate values and code of conduct**

The board should ensure that appropriate steps are taken to communicate throughout the bank the corporate values, professional standards or codes of conduct it sets, together with supporting policies and procedures. In doing so the board should ensure:

- a) The institution's code of conduct, or comparable document, articulates acceptable and unacceptable behaviors. It is especially important that such a document disallows behavior that could result in the bank engaging in any improper or illegal activity, such as money laundering, fraud, bribery or corruption. It should also discourage excessive risk taking activities.
- b) The institution's corporate values recognize the critical importance of timely and frank discussion and elevation of problems to higher levels within the organization. Communication should be allowed to be channeled to the board - directly or indirectly (e.g. through an independent audit or compliance process or through an ombudsman) - and independent of the internal "chain of command".

### **3.3.10 Maintain Positive Image**

It is the duty of the directors to ensure that the institution maintains a positive image within the industry and the economy as a whole. To this extent, therefore, the institution is expected to provide adequate services and facilities both efficiently and competitively in line with safe and sound banking practices.

In discharging their responsibilities, the board should take into account the legitimate interests of shareholders, depositors and other relevant stakeholders. It should also ensure that the bank maintains an effective relationship with its supervisors.

## **3.4 Principle 4 - Role and competence of Board members**

*Board members should be and remain qualified, including through training and Continuous Professional Development (CPD), for their positions. They should have a clear understanding of their role in corporate governance and be able to exercise sound and objective judgment about the affairs of the bank.*

## **Specific Requirements**

- 3.4.1** No director shall take up his/her position prior to being cleared by the Central Bank. The Institution shall submit to the Central Bank duly completed form CBK/IF 1-2 annexed to Guideline No. CBK/PG/01 on Licensing of New Institutions.
- 3.4.2** The board should possess, both as individual board members and collectively, appropriate experience, competencies and personal qualities, including professionalism and personal integrity.
- 3.4.3** To ensure objective judgment about the affairs of an institution, the following individuals are not eligible to be appointed as directors:
- a) Professionals (e.g. lawyers, accountants and valuers) involved in the provision of professional services to the relevant institution;
  - b) Senior officers and non-executive directors of a government regulatory body where there may be a conflict of interest.
- 3.4.4** The board collectively should have adequate knowledge and experience relevant to each of the material financial activities the bank intends to pursue in order to enable effective governance and oversight. Examples of areas where the board should seek to have, or have access to, appropriate experience or expertise include finance, accounting, strategic planning, communications, governance, risk management, bank regulation, auditing and compliance.
- 3.4.5** In order to help board members acquire, maintain and deepen their knowledge and skills and to fulfill their responsibilities, the board should ensure that board members have access to programmes of tailored initial training (e.g. induction) and Continuous Professional Development (CPD) on relevant issues. Directors who have acquired professionally recognized CPD (locally or internationally) can be considered to have met the CPD requirements. The board should dedicate sufficient time, budget and other resources for this purpose. The Chief Executive Officer is required to report to the Central Bank of Kenya on an annual basis the CPD programmes in which the board members participated in together with the board members annual evaluations as required under Part VI of this Prudential Guideline.
- 3.4.6 Board Composition**
- i. The Companies Act (Cap 486) of the Laws of Kenya provides for the appointment of a minimum of two directors for every company incorporated under the Act. However, due to the special nature of deposit-taking institutions which gives them an added responsibility of safeguarding the interests of the depositors, the Central Bank of Kenya requires all institutions licensed under the Banking Act, to have at least five directors. To be effective, the board must have an appropriate number of directors that

are commensurate with the complexity, the size, the scope and operations of the Institution.

- ii. Every board should consider whether its size, diversity and demographics make it effective. Diversity applies to academic qualifications, technical expertise, relevant banking knowledge, experience, nationality, age and gender. Every institution is required to submit an annual report to the Central Bank of Kenya highlighting the initiatives taken to ensure that the board is properly constituted and is appropriately diverse. The report should be submitted together with the board members annual evaluations as required under Part VI of this Prudential Guideline.
- iii. Foreign owned locally incorporated institutions are required to have local representation in the board.
- iv. The board should be composed of both Executive and Non-Executive Directors with the Chief Executive being one of the board members. The non executive directors should not be less than three-fifths of the directors in order to enhance accountability in the decision-making process. Non-executive directors could mitigate any possible conflict of interest between the policy-making process and the day-to-day management of the Institution.
- v. Further, independence and objectivity can be enhanced by including qualified independent non-executive directors. Independent directors should provide the necessary checks and balances on the board of the institution so as to ensure that the interests of minority shareholders and general public are given due consideration in the decision-making process. Qualified independent directors can also bring new perspectives from other businesses that may improve the strategic direction given to management, such as insight into local conditions, and can also be significant sources of management expertise. It is therefore required that independent directors should constitute not less than a third (1/3) of the total members of the board.
- vi. In identifying potential board members, the board through the board Nominating Committee should ensure that the candidates are qualified to serve as board members and are able to commit the necessary time and effort to fulfill their responsibilities. Serving as a board member or senior manager of a company that competes or does business with the bank can compromise board independent judgment, as can cross-membership of boards.
- vii. No person shall be permitted to hold the position of a director in more than two institutions licensed under the Banking Act unless the said institutions are associates, subsidiaries or holding companies. This rule shall not apply to government bodies represented in institutions' boards by virtue of their position as shareholders.
- viii. Shareholders are ultimately responsible for the composition of the board and it is in their own interests to ensure that the board is properly constituted from the viewpoint of skill and diversity. Procedures for appointments to the board should be formal, transparent and incorporate the following aspects;

- (a) The reasons for the removal, resignation or retirement of directors.

- (b) The composition of the board and board committees and the number of meetings held, attendance at those meetings and the manner in which the board and its committees have discharged its duties;
- (c) The education, qualifications and experience of the directors;
- (d) The length of service and age of the directors and;
- (e) Any other relevant information.

ix. Occasionally, a person may act as an alternate to a director of an institution. The “alternate directors” have all the obligations imposed on the primary directors and shall therefore be subject to the approval requirement as outlined in 3.4.1 above.

### **3.5 Principle 5 - Board’s Governance practices**

*The board should define appropriate governance practices for its own work and have in place the means to ensure such practices are followed and periodically reviewed for improvement.*

#### **Specific Requirements**

##### **3.5.1 Role of the chair**

- a) The chair of the board plays a crucial role in the proper functioning of the board. He or she provides leadership to the board and is responsible for the board’s effective overall functioning. To achieve appropriate checks and balances, the chair of the board must be a non-executive director.
- b) The chair should ensure that board decisions are taken on a sound and well-informed basis. He or she should encourage and promote critical discussion and ensure that dissenting views can be expressed and discussed within the decision-making process.
- c) The Chair should also ensure:
  - the smooth functioning of the board, the governance structure and inculcating positive culture in the board;
  - guidelines and procedures are in place to govern the board’s operation and conduct;
  - all relevant issues are on the agenda for board meetings and all directors are able to participate fully in the board’s activities;
  - the board debates strategic and critical issues;
  - the board receives the necessary information on a timely basis from the management;
  - avenues are provided for all directors to participate openly in the discussion; and that he provides leadership to the board and is responsible for the developmental needs of the board.
- d) The institution should apprise CBK when the chair vacates office within 7 days after his / her departure and the reasons for the exit should be disclosed.

### **3.5.2 Board committees**

#### **i) Specific requirements**

- a) To increase efficiency and allow deeper focus in specific areas, the board shall establish specialized board committees; however, the board remains accountable. The number and nature of committees depends on many factors, including the size of the bank and its board, the nature of the business areas of the bank, and its risk profile. However, the Board Audit Committee, Board Risk Management Committee and Board Credit Committee are mandatory.
- b) Each committee should have a charter or other instrument that sets out its mandate, scope and working procedures. In the interest of greater transparency and accountability, a board should disclose the committees it has established, their mandates, and their composition (including members who are considered to be independent). To avoid undue concentration of power and to promote fresh perspectives, it may be useful to consider occasional rotation of membership and chairmanship of such committees.
- c) There should be a formal procedure for certain functions of the board to be delegated, describing the extent of such delegation, to enable the board to properly discharge its duties and responsibilities and to effectively execute its decision making process.
- d) Board committees should be free to take independent professional advice as and when necessary, and to invite Senior Management to provide technical advice when needed.
- e) The board shall not delegate any matters to a board committee, chief executive officer, executive directors or key management personnel, to an extent that such delegation would significantly hinder or reduce the ability of the board as a whole to discharge its functions.

#### **ii) Board Audit Committee (BAC)**

##### **a. Objective**

To provide independent oversight of the institution's financial reporting and internal control system, ensure checks and balances within the institution are in place and to recommend appropriate remedial action regularly, preferably at least once in three months.

##### **b. Composition**

To enhance independence and effectiveness of the Board Audit Committee, the composition and structure of the BAC should meet the following requirements;

- The Audit Committee shall comprise only non-executive directors with at least three members;
- The majority of the BAC members should be independent non-executive directors;
- The committee should be chaired by an independent director;



- The Chairman of the board should neither be the chairperson nor a member of the BAC but may be invited to attend meetings as necessary by the chairperson of the committee;
- At least one member should have accounting expertise or experience in the field of finance and be a member of the Institute of Certified Public Accountants of Kenya (ICPAK) or an equivalent institute recognized by the East Africa Community member states, or an equivalent international institute recognized by ICPAK.

The Audit Committee may invite the Chief Executive or any other member to attend the meetings occasionally for consultation only. However, the committee should meet at least twice in a year with the external and internal auditors without management being present. These may be separate meetings or meetings held before or after a scheduled audit committee meeting.

The BAC is required to hold regular meetings, at least **once every quarter** and should report regularly to the full board. Alternate directors are not allowed to be appointed as members of the Audit Committee.

The external and internal auditors of a banking institution should have free access to the Audit Committee. The auditors should be allowed to attend and be heard at any meeting of the Audit Committee. Upon the request of the auditors, the Chairman of the Audit Committee should convene a meeting to consider any matter that auditors believe should be brought to the attention of directors or shareholders.

### **c. Roles and Responsibilities**

- i. Ensure establishment of a permanent internal audit function. In fulfilling its duties and responsibilities, the board and senior management should take all the necessary measures to ensure that the institution has a permanent internal audit function commensurate with its size, nature and complexity of its operations.
- ii. Ensure that senior management establishes and maintains an adequate, effective and efficient internal control framework and internal audit function.
- iii. Have explicit authority to investigate any matter within its terms of reference, full access to and co-operation by management.
- iv. Have full and unrestricted access to information and be able to obtain independent professional advice.
- v. Ensure that the accounts are prepared in a timely and accurate manner to facilitate prompt publication of annual accounts.
- vi. Review internal controls, including the scope of the internal audit programme, the internal audit findings, and recommend action to be taken by management.

- vii. Review internal audit reports and their overall effectiveness, the scope and depth of audit coverage, reports on internal control and any recommendations, and confirm that appropriate action has been taken.
- viii. Review coordination between the internal audit function and external auditors.
- ix. Nominate external auditors for appointment by shareholders.
- x. Review and monitor the external auditors' independence and objectivity, taking into consideration relevant professional and regulatory requirements.
- xi. Review with the external auditors, the scope of their audit plan, system of internal audit reports, assistance given by management and its staff to the auditors and any findings and actions to be taken.
- xii. Review management reports and reports from external auditors concerning deviations and weaknesses in accounting and operational controls.
- xiii. Review the institution's audit plan, with specific reference to the procedures for identifying regulatory risks and controlling their impact on the institution, including reviewing correspondence from regulatory authorities and management's responses.
- xiv. Consider any matter of significance raised at the risk management committee meetings.
- xv. Monitor the ethical conduct of the institution and consider the development of ethical standards and requirements, including effectiveness of procedures for handling and reporting complaints.
- xvi. Review any related party transactions that may arise within the banking institution.
- xvii. The audit committee should play a key role in ensuring that the company's internal audit function is independent and has the necessary resources, budget, standing and authority to enable it to discharge its functions effectively.
- xviii. Regardless of whether internal audit activities are outsourced, the board of directors remains ultimately responsible for ensuring that the system of internal control and the internal audit function are adequate and operating effectively.
- xix. In a group structure, the board of directors and senior management of the parent institution have the overall responsibility for ensuring that an adequate and effective internal audit function is established across the group and for ensuring that internal audit policies and mechanisms are appropriate to the structure, business activities and risks of all of the components of the group.
- xx. The audit committee should be responsible for the performance assessment of the Head of Internal Audit. Additionally, the committee should be consulted on the appointment and dismissal of the internal auditor.
- xxi. The audit committee should approve the internal audit plan, as well as oversee staffing and objectives of the internal audit function.

### **iii) Board Credit Committee (BCC)**

#### **a. Objective**

To assist the board of directors in reviewing and overseeing the overall lending of the institution.

#### **b. Composition**

The board shall determine the composition of the BCC which should be guided by the skill and experience of the directors. However, to enhance independence and objectivity of the BCC, institutions are required to appoint an independent non-executive director as the chairperson of the BCC. The chairman of the institution's board should not chair the Board Credit Committee but can be included as a member.

#### **c. Roles and Responsibilities**

- a) Review and oversee the overall lending policy of the banking institution;
- b) Deliberate and consider loan applications beyond the discretionary limits of the Credit Risk Management Committee;
- c) Review lending by the Credit Risk Management Committee;
- d) Ensure that there are effective procedures and resources to identify and manage irregular problem credits, minimize credit loss and maximize recoveries;
- e) Direct, monitor, review and consider all issues that may materially impact on the present and future quality of the institution's credit risk management; and
- f) Delegate and review lending limits to the sanctioning arms of the institution;
- g) Assist the board with discharging its responsibility to review the quality of the banking institution's loan portfolio, and ensuring adequate provisions for bad and doubtful debts in compliance with requirements of the prudential guidelines.
- h) Conduct loan reviews independent of any person or committee responsible for sanctioning credit; and
- i) Ensure that the credit policy and risk lending limits are reviewed at least on an annual basis and as and when the environment so dictates;

### **iv) Board Risk Management Committee (BRMC)**

#### **a. Objective**

The responsibility to ensure quality, integrity and reliability of the institution's risk management shall be delegated to the BRMC. The Committee shall assist the board of directors in the discharge of its duties relating to the corporate accountability and associated risks in terms of management, assurance and reporting.

#### **b. Composition**

The Board Risk Management Committee shall comprise mainly non-executive directors and should be chaired by an independent non-executive director.

**c. Roles and Responsibilities**

- i. The committee shall review and assess the integrity of the risk control systems and ensure that the risk policies and strategies are effectively managed.
- ii. The committee shall set out the nature, role, responsibility and authority of the risk management function with the banking institution and outline the scope of risk management work.
- iii. The committee shall monitor external developments relating to the practice of corporate accountability and the reporting of specifically associated risk, including emerging and prospective impact. The committee shall provide independent and objective oversight and review of the information presented by management on corporate accountability and specifically associated risk, also taking account of risk concerns raised by management in the Audit Committee, Asset and Liability Committee meetings on financial, business and strategic risk.
- iv. The committee, in carrying out its task under these terms of reference, may obtain such outside or other independent professional advice as it considers necessary to carry out its duties. The Executive Committee will ensure that the committee will have access to professional advice both inside and outside of the banking institution in order for it to perform its duties.
- v. The risk management function shall have access to any information it needs to fulfill its responsibilities.

**3.5.3 The Board and Director Evaluation**

The Board through its nomination committee, similar board committee or an independent service provider shall regularly review its required mix of skills and experience and other qualities in order to assess the effectiveness of the board. Such review shall be by means of peer and self-evaluation of the board as a whole, its committees and the contribution of each and every director, including the Chairman. Assistance from external facilitators in carrying out board assessments can contribute to the objectivity of the process. Where the board has serious reservations about the performance or integrity of a board member, the board should take appropriate actions.

The evaluations for the board, board committees and the individual directors shall be conducted annually and the fact that it has been done should be disclosed in the annual report. The Chief Executive Officer / Managing Director shall submit a report, including the peer and self-evaluations to the Central Bank of Kenya annually on the

board and directors' evaluations and effectiveness. Board and peer evaluation shall be based on the guidance provided in the attached Board Evaluation Form CBK/PG/19/F1 and Individual Director Evaluation Form CBK/PG/19/F2 of this guideline respectively. The report shall be submitted by 31st March of the following year.

#### **3.5.4 Board and Committee evaluation**

- Effective and meaningful evaluation is only possible once the board has determined its own role, functions, duties and performance criteria as well as those for directors on the board and on board committees.
- The board should carefully consider whether the evaluations of performance and independence should be done in-house or conducted by independent service providers or other criteria that may be prescribed by CBK. Evaluation procedures and results should be reviewed by the nomination committee or such similar committee of the board.
- The Chairman, through the nominating committee, may lead the overall performance evaluation of the board and board committees with the assistance of the Company Secretary. However, independent performance appraisals should be considered in the interest of eliciting candid responses. The board should discuss the board evaluation results at least once a year.

#### **3.5.5 Individual Director Evaluation**

- The same principles adopted in the evaluation of the board should be applied when evaluating the board chairman and individual directors.
- A director's contribution to the board should be measured against his / her duties. The nomination for re-appointment of a director at the AGM should not be an automatic process and should only occur after the proper evaluation of the performance and attendance of the director in question.
- Evaluations should be led by the Chairman through the nominating committee, or by an independent service provider. The Chairman should ensure that directors know that they will be subject to evaluation, and understand the criteria used for evaluation, and the evaluation procedures that will be followed.
- Should a deficiency in a director's performance be identified, a plan should be developed and implemented for the director to acquire the necessary skills or to develop appropriate behavioral patterns. The director evaluation should be approached in an open, constructive and non-confrontational manner.
- The board should appoint or elect an independent non-executive director from within its ranks to lead the process of the evaluation of the Chairman's performance if an independent service provider is not used.

### **3.5.6 Conflicts of Interest**

- i. Persons empowered with decision-making authority (including directors) should exercise care to avoid situations that may give rise to a conflict of interest situation. The Code of Conduct as detailed under Part IV of this Guideline must strictly be observed.
- ii. The board should establish procedures to address conflicts of interest and should ensure that senior management implement policies to identify, prevent or appropriately manage and disclose potential conflicts of interest situations that may arise. Such policies should ensure that an institution's activities that may give rise to conflicts of interest are carried out with sufficient degree of independence from each other. This could be done by, for example, ensuring appropriate segregation of duties so that employees are not assigned potentially conflicting responsibilities, providing for separate reporting lines and internal controls and establishing information barriers between different activities.
- iii. The board should appoint or select one of the independent directors to chair the board meetings which deal with the succession of the Chair Person, the Chair Person's performance appraisal and when the Chair Person has conflict of interest. Where board members have an interest in a matter, they should be excluded from discussions on the said matter to ensure that the matter is objectively dealt with.

### **3.5.7 Controlling shareholders**

Where there are controlling shareholders with power to appoint board members, the board should exercise corresponding caution. In such cases, it is useful to bear in mind that the board members have responsibilities to the shareholders and the bank. In cases where there are board members appointed by a controlling shareholder, the board may wish to set out specific procedures or conduct periodic reviews to ensure the appropriate discharge of responsibilities by all board members.

### **3.5.8 Resignation / Removal of Directors**

It will be the responsibility of the Board of Directors to report to the Central Bank of Kenya, the resignation and/ or removal of any of its members (either executive or non-executive directors) within seven days of the date of resignation. The board should disclose the reasons for the removal, resignation or retirement of directors.

### **3.5.9 Local Committees**

Branches of foreign banks should have at least five members in their local committees whose responsibilities shall be as those of the Board of Directors as specified in this

guideline. While it is acknowledged that the strategies and policies are driven by the head office, in order to be consistent with its own strategies, the local board is expected to:

- a. Discuss, evaluate and provide input on strategies and policies to suit local environment;
- b. Deliberate and approve major issues and decisions affecting its operations.
- c. Evaluate head office policies and ensure they are aligned to the Kenyan laws and regulations.

### **3.6 Principle 6 - Corporate Governance in a Group structure**

*In a group structure, the board of the parent company has the overall responsibility for adequate corporate governance across the group and ensuring that there are governance policies and mechanisms appropriate to the structure, business and risks of the group and its entities.*

#### **Specific Requirements**

##### **3.6.1 Subsidiary / Group Relationship**

The board of a regulated banking subsidiary at the legal entity level should adhere to the same corporate governance principles as those expected for its parent company in the absence of other legal requirements or reasons of proportionality. However, the group dimension is likely to affect to a certain extent the corporate governance structure of both parent and subsidiaries, and therefore boards should pay attention to how to apply the principles, including taking in consideration the following points;

##### **3.6.2 Board of Parent Company**

- I. In the discharge of its corporate governance responsibilities, the board of the parent company should be aware of the material risks and issues that might affect both the bank as a whole and its subsidiaries. It should therefore exercise adequate oversight over subsidiaries, while respecting the independent legal and governance responsibilities that might apply to regulated subsidiary boards.
- II. In order to fulfill its corporate governance responsibilities, the board of the parent company should:
  - a) establish a governance structure which contributes to the effective oversight of subsidiaries and which takes into account the nature, scale and complexity of the different risks to which the group and its subsidiaries are exposed;
  - b) set and approve a corporate governance policy at the group level for its subsidiaries, which includes the commitment to meet all applicable governance requirements;

- c) ensure that enough resources are available for each subsidiary to meet both group standards and local governance standards; and
- d) have appropriate means to monitor that each subsidiary complies with all applicable governance requirements.

### **3.6.3 Board of Regulated Subsidiary**

The board of a regulated banking subsidiary should retain and set its own corporate governance responsibilities, and should evaluate any group-level decisions or practices to ensure that they do not put the regulated subsidiary in breach of applicable legal or regulatory provisions or prudential rules. The board of the regulated banking subsidiary should also ensure that such decisions or practices are not detrimental to:

- a) the sound and prudent management of the subsidiary;
- b) the financial health of the subsidiary or,
- c) the legal interests of the subsidiary's stakeholders.

### **3.7 Principle 7 – Senior Management.**

*Under the direction of the board, senior management should ensure that the bank's activities are consistent with the business strategy, risk tolerance/appetite and policies approved by the board.*

#### **Specific Requirements**

- 3.7.1** Senior management consists of senior officers who are responsible and should be held accountable for overseeing the day-to-day management of the bank. They include the chief executive officer, the executive director, deputy chief executive officer (where applicable), general manager (s), chief risk officer, chief operating officer, chief financial officer, secretary to the board of directors, treasurer, chief internal auditor, or manager of a significant unit of an institution.
- 3.7.2** Institutions are required to set up management committees to support its decision making structures, increase efficiency and allow detailed deliberation on specific areas. Each committee should have comprehensive terms of references that sets out its mandate, scope of operations and working procedures. The composition and number of committees will depend on factors such as the size of the institution, nature of its business operations and its risk profile. However, the following committees are deemed mandatory and should be constituted;



### **a) Executive Committee**

The Executive Committee is the link between the board and management and is responsible for implementation of operational plans, annual budgeting and periodic reviews of operations, strategic plans, ALCO strategies, credit proposals review, identification and management of key risks and opportunities. The committee shall review and develop guidelines for employees' remuneration for board approval.

The Executive Committee is constituted to assist the Chief Executive Officer to manage the banking institution. The board of directors takes cognizance of authorities delegated to the Chief Executive Officer (CEO) by means of resolutions from time to time. The Executive Committee assists the CEO guide and control the overall direction of the business of the banking institution and acts as a medium of communication and co-ordination between business units and the board.

The Executive Committee shall also ensure that the risk management function has access to any information it requires to fulfill its responsibilities.

### **b) Asset and Liability Committee (ALCO)**

ALCO shall derive the most appropriate strategy for the banking institutions in terms of the mix of assets and liabilities given its expectations of the future and the potential consequences of interest-rate movements, liquidity constraints, and foreign exchange exposure and capital adequacy.

The committee shall ensure that all strategies conform to the banking institution's risk appetite and levels of exposure as determined by the Board Risk Management Committee or other committee assigned responsibility of risk management. In view of the importance of ALCO in managing the bank's balance sheet, it is required that every institution should establish ALCO as a mandatory management committee. The committee shall primarily be responsible for recommending to the Board of Directors prudent asset/liability management policies and procedures that enable the bank to achieve its goals while operating in full compliance with all requirements of the Banking Act and CBK Prudential Guidelines.

- 3.7.3** No Senior Officer shall take up his position prior to being cleared by the Central Bank. The institution shall submit to the Central Bank of Kenya duly completed fit and proper form as prescribed in Guideline No. CBK/PG/01 on Licensing of New Institutions.

Where a non-executive director who is cleared by the Central Bank is subsequently appointed in an executive position, specific approval of the appointment shall be

obtained prior to taking up the position. The Central Bank of Kenya may use its powers, under section 32 of the Banking Act to verify the accuracy of the information on the fit and proper forms.

**3.7.4** Senior management contributes substantially to a bank's sound corporate governance through personal conduct by providing adequate oversight of those they manage, and by ensuring that the bank's activities are consistent with the business strategy, risk tolerance/appetite and policies approved by the bank's board. These individuals should have the necessary experience, competencies and integrity to manage the businesses under their supervision as well as have appropriate control over the key individuals in these areas.

**3.7.5** The Head of Finance and Head of Internal Audit should be members of the Institute of Certified Public Accountants of Kenya (ICPAK) and the Company Secretary must be a member of the Institute of Certified Public Secretaries of Kenya (ICPSK) or similar institutes recognized by the Central Banks of the East African Community member states or an international institute recognized by ICPAK and ICPSK.

#### **3.7.6 Major duties and responsibilities of management**

The primary responsibility of the management is to operate and administer the institution on a day-to-day basis paying attention to the following:

- a) The implementation and adherence to the policies, practices and standards as laid down by the Board of Directors;
- b) The systems that have been established to facilitate efficient operations and communications;
- c) The planning process that has been developed to facilitate achievement of targets and objectives;
- d) All staff matters, particularly human resource development and training;
- e) Adherence to the established code of conduct and with all the relevant banking laws and CBK guidelines; and
- f) Maintain adequate records to comply with all the reporting requirements.

#### **3.7.7 Appointment and responsibilities of the Chief Executive**

The board should appoint the chief executive and establish a framework for the delegation of authority. The chief executive, who may be referred to as the Chief Executive Officer (CEO), the Managing Director (MD) or by any other title, shall be wholly responsible to the Board for the day to day running of the institution. The collective responsibility of management is vested in the Chief Executive and bears ultimate responsibility for all management functions.

The Chief Executive is expected to undertake the following key responsibilities;.

- a) Ensure that the policies spelt out by the board in the institution's overall corporate strategy of the institution are implemented;
- b) Identify and recommend to the board competent officers to manage the operations of the institution. In the fulfillment of this duty, the Chief Executive should ensure that the institution's human resources policy is adhered to;
- c) Co-ordinate the operations of the various departments within the institution;
- d) Establish and maintain efficient and adequate internal control systems;
- e) Design and implement the necessary management information systems in order to facilitate efficient and effective communication within the institution;
- f) Ensure that the board is frequently and adequately appraised about the operations of the institution through presentation of relevant board papers, which must cover, but not limited to, the following areas:
  - Actual performance compared with the past performance and the budget together with explanations of all the variances.
  - Capital structure and adequacy.
  - Advances performance in particular problem loans, losses, recoveries and provisions.
  - Income and expenses.
  - Deposits: sources and distribution profile.
  - All insider transactions that benefit directly or indirectly any officer or shareholder of the institution.
  - Report on violation of laws and remedial activities undertaken to ensure compliance with the banking laws and CBK guidelines.
  - Large exposures.
  - Non-performing insider loans.
  - CBK, external, internal and audit committee reports.
  - Any other areas relevant to the institution's operations.
  - Ensure that the institution complies with all the relevant banking and other applicable laws in the execution of its operations.
  - Any other duties as may be assigned by the board from time to time.

### **3.8 Principle 8 - Risk Management Framework**

*The board must ensure that the banking institution has adequate systems to identify, measure, monitor and manage key risks facing the banking institution and adopt and follow sound policies and objectives which have been fully deliberated.*

## Specific Requirements

- 3.8.1** The board's responsibility for risk management should be manifested in a documented risk management policy and plan. Management should develop both the risk management policy and the plan for approval by the board.
- 3.8.2** The board's scope of responsibility for risk governance should be expressed in its board charter and supported by induction and training processes for all board members. Where the board has delegated its responsibility for risk management to a board committee, such board committee's terms of reference should reflect this responsibility and should be approved by the board.
- 3.8.3** Institutions should have an independent risk management function with sufficient authority, stature, independence, resources and access to the board. The oversight of risk management should be assigned to a senior officer who may be referred to as the Chief Risk Officer (CRO) or a Risk Manager (RM), and should report independently to the Board Risk Management Committee. The CRO/RM should be a suitably experienced person who should have access to, and interact regularly with the board and appropriate board committee and executive management. The CRO/RM must sufficiently be independent of the business lines in order to ensure an adequate separation of duties and the avoidance of conflicts of interest.
- 3.8.4** Management is accountable to the board for designing, implementing and monitoring the system and process of risk management and integrating it into the day-to-day activities of the company. Risks should be identified and monitored on an ongoing firm-wide and individual entity basis, and the sophistication of the bank's risk management and internal control infrastructures should keep pace with any changes to the bank's risk profile (including its growth), and to the external risk landscape.
- 3.8.5** As part of its quantitative and qualitative analysis, the bank should utilize forward-looking stress tests and scenario analysis to better understand potential risk exposures under a variety of adverse circumstances. These should be key elements of a bank's risk management process, and the results should be communicated to, and given appropriate consideration by, the relevant business lines and individuals within the bank. A forward-looking approach to risk management should include ongoing monitoring of existing risks as well as identifying new or emerging risks.
- 3.8.6** Banks should have approval processes for new products. These should include an assessment of the risks of new products, significant changes to existing products, the introduction of new lines of business and entry into new markets. The risk management function should provide input on risks as a part of such processes. This should include a full and frank assessment of risks under a variety of scenarios, as well as an assessment

of potential shortcomings in the ability of the bank's risk management and internal controls to effectively manage associated risks. In this regard, the bank's new product approval process should take into account the extent to which the bank's risk management, legal and regulatory compliance, information technology, business line, and internal control functions have adequate tools and the expertise necessary to manage related risks.

- 3.8.7** Effective risk management requires robust internal communication within the bank about risk, both across the organization and through reporting to the board and senior management. Information should be communicated to the board and senior management in a timely, complete, understandable and accurate manner so that they are equipped to make informed decisions.

### **3.9 Principle 9 – Compliance with Laws, Rules, Codes and Standards**

*The board should ensure that the institution complies with applicable laws and considers adherence to the institution's rules, codes and standards.*

Compliance risk can be described as the risk of damage, arising from non-adherence to the law and regulations, to the institution's business model, objectives, reputation, going concern, stakeholder relationships or sustainability.

#### **Specific Requirements**

- 3.9.1** The Institution should develop a compliance policy and the board should approve it. Management should be responsible for implementing this policy and report to the board regarding compliance with it.
- 3.9.2** Compliance risk should form part of the institution's risk management process. The risks of non-compliance should be identified, assessed and responded to through the institution's risk management processes.
- 3.9.3** As part of the broader risk management structure, the institution should establish an independent compliance function that provides assistance to the board and management in complying with applicable laws, rules, codes and standards. The compliance officer should report independently to the board, committee of the board or through the head of risk and compliance function depending on the institution's size and its organizational structure.
- 3.9.4** Each institution should consider the suitable structure and size of its compliance function, considering what is appropriate for the adequate management of the

compliance risk of the particular company and having regard to the legislative requirements that apply to the compliance function. The structure of the compliance function, its role and its position in terms of reporting lines, should reflect the institution's decision on how compliance is integrated with its ethics and risk management.

**3.9.5** The board is responsible for the institution's compliance with applicable laws and with rules, codes and standards with which the company may elect to comply. One of the important responsibilities of the board is therefore to monitor the company's compliance with all applicable laws, rules, codes and standards.

**3.9.6** Directors should familiarize themselves sufficiently with the general content of applicable laws, rules, codes and standards to be able to adequately discharge their fiduciary duties in the best interests of the institution and their duty of care, skill and diligence. Included in this duty is to make use of the rights and protection that the law presents in the best interests of the institution.

### **3.10 Principle 10 - Internal Control Functions**

*The board and senior management should effectively utilize the work conducted by internal audit functions, external auditors and internal control functions.*

#### **Specific Requirements**

**3.10.1** The board should recognize and acknowledge that independent, competent and qualified internal and external auditors, as well as other internal control functions (including the compliance functions), are vital to the corporate governance process in order to achieve a number of important objectives. Senior management should also recognize the importance of the effectiveness of these functions to the long-term soundness of the bank. Towards this end, the board shall:

- a. Set-up an effective internal audit department, staffed with qualified personnel to perform internal audit functions, covering the traditional function of financial audit as well as the function of management audit.
- b. Set-up an independent Compliance Function that, among other things, routinely monitor compliance with laws, corporate governance rules, regulations, codes and policies to which the bank is subject and ensure that deviations are reported to an appropriate level of management and, in case of material deviations, to the board.

### **3.11 Principle 11 - Compensation Systems**

*The board should actively oversee the compensation system's design and operation, and should monitor and review the compensation system to ensure that it operates as intended.*

#### **Specific Requirements**

**3.11.1** The board is responsible for the overall design and operation of the compensation system for the entire bank. The board may constitute a board compensation committee (may be referred as remuneration committee) as an integral part of their governance structure to oversee the compensation system's design and operation on behalf of the board of directors. Members of the compensation committee should be independent, non-executive members with substantial knowledge about compensation arrangements and the incentives and risks that can arise from such arrangements. Because compensation should be aligned with risk, an understanding of the firm's risk measurement and management, and of how different compensation practices can impact the firm's risk profile, is important as well.

**3.11.2** The policy on the remuneration of directors, CEO and senior management should be developed under conditions of objectivity and transparency. The levels of remuneration should be sufficient to attract and retain directors of high caliber, but at the same time, should also be balanced against the need to ensure that an institution's funds are not used to subsidize excessive remuneration packages and not compromising the ongoing viability, solvency and reputation of an institution:

- a. The compensation of the control function (e.g. Chief Risk Officer and risk management staff) should be structured in a way that is based principally on the achievement of their objectives and does not compromise their independence (i.e. compensation should not be substantially tied to business line revenue).
- b. Since employees can generate equivalent short-term revenues while taking on vastly different amounts of risk in the longer term, a bank should ensure that variable compensation is adjusted to take into account the risks an employee takes. This should consider all types of risk over a timeframe sufficient for risk outcomes to be revealed. It is appropriate to use both quantitative risk measures and human judgment in determining risk adjustments. Where firms make such adjustments, all material risks should be taken into account, including difficult-to-measure risks (eg reputational risk) and potentially severe risk outcomes.
- c. In addition to adjustments for future prospects or forecasted returns (ex ante risk adjustments), institutions should take steps to better align compensation with prudent risk taking measures. One characteristic of effective compensation outcomes is that

they are symmetric with risk outcomes, particularly at the bank or business line level. That is, the size of the bank's variable compensation pool should vary in response to both positive and negative performance. Variable compensation should be diminished or eliminated when a bank or business line incurs substantial losses.

- d. Compensation should be sensitive to risk outcomes over a multi-year horizon. This is typically achieved through arrangements that defer compensation until risk outcomes have been realized, and may include "claw back" provisions whereby compensation is reduced or reversed if employees generate exposures that cause the bank to perform poorly in subsequent years or if the employee has failed to comply with internal policies or legal requirements. "Golden parachute" arrangements under which terminated executives or staff receive large payouts irrespective of performance are generally not consistent with sound compensation practice.
- e. The mix of cash, equity and other forms of compensation (e.g. options) should be consistent with risk alignment and will likely vary across employees, depending on their position and role in the bank.
- f. The remuneration of directors and the chief executive shall be commensurate with the nature, size of operations of the institution and the remuneration offered for similar positions in the market. Non-executive directors should not receive any salary.
- g. As a matter of principle, the chief executive of a group should draw all his salary, including benefits, from one source, usually the parent company. Where the chief executive of an institution is entitled to receive director's fees from that institution's subsidiaries, such fees should be nominal.
- h. Key particulars of compensation should be disclosed in the Annual Report to the public on a timely basis. The information should include the decision-making process used to determine the compensation policy, criteria used for performance measurement and risk adjustment, the amounts of remuneration for the financial year and other key information on the incentive and compensation systems.

### **3.12 Principle 12 – Governance of Information Technology**

*The board should be responsible for Information Technology (IT) Governance. IT governance can be considered as a framework that supports effective and efficient management of IT resources to facilitate the achievement of a institution's strategic objectives. IT governance is the responsibility of the board.*



## Specific Requirements

- 3.12.1 The board should ensure that an IT governance charter and policies are established and implemented. The charter and policies should outline the decision-making rights and accountability framework for IT governance that will enable the desirable culture in the use of IT within the company.
- 3.12.2 The board should oversee the cultivation and promotion of an ethical IT governance and management culture and awareness. The board should provide the required leadership to achieve this institution's strategic objective.
- 3.12.3 The board should ensure that an IT internal control framework is adopted and implemented and that the board receives independent assurance on the effectiveness thereof. The necessary steps should be taken to ensure that there are processes in place to ensure complete, timely, relevant, accurate and accessible IT reporting.
- 3.12.4 The board should ensure that the IT strategy is integrated with the institution's strategic and business processes. IT should be seen to add value by enabling the improvement of the institution's performance and sustainability.
- 3.12.5 The board may appoint an IT steering committee or similar forum or function to assist with its governance of IT. There should be relevant representation from business and IT functions.
- 3.12.6 Each institution should consider the suitable strategy, structure and size of its IT function, considering what is appropriate for the adequate management of the IT function and associated risk of the particular institution and having regard to any legislative requirements that apply to the IT function. The structure of the IT function, its role and its position in terms of reporting lines, should reflect the company's decision on how IT is integrated with its operations.
- 3.12.7 The board should oversee the proper value delivery of IT and should ensure that the expected return on investment from significant IT investments and projects is delivered and that the information and intellectual property contained in the information systems are protected.
- 3.12.8 Where the responsibility for the provision of IT goods or services has been delegated to another party (or division), all parties (including the board) remain accountable for enforcing and monitoring effective IT governance.
- 3.12.9 Management should regularly demonstrate to the board that the institution has adequate business resilience arrangements in place for disaster recovery and business continuity.

### **3.13 Principle 13 - Bank's Operational Structure**

*The board and senior management should know and understand the bank's operational structure and the risks that it poses (i.e. "know-your-structure").*

#### **Specific Requirements**

- 3.13.1 The board and senior management should understand the structure and the organization of the group, i.e. the aims of its different units/entities and the formal and informal links and relationships among the entities and with the parent company. This includes understanding the legal and operational risks and constraints of the various types of intra-group exposures and transactions and how they affect the group's funding, capital and risk profile under normal and adverse circumstances. Sound and effective measures and systems should be in place to facilitate the generation and exchange of information among and about the various entities, to manage the risks of the group as a whole, and for the effective supervision of the group.
- 3.13.2 The board should approve policies and clear strategies for the establishment of new structures and should properly guide and understand the bank's structure, its evolution and its limitations.
- 3.13.3 In order to enhance the sound governance of a banking group, internal audits of individual entities could be complemented with regular assessments of the risks posed by the group's structure. Periodic reports that assess the bank's overall structure and individual entities' activities, confirm compliance with the strategy previously approved by the board, and disclose any possible discrepancies could be useful for the audit and risk committees, senior management and the board of the parent company.
- 3.13.4 The bank should discuss with, and/or report to, the Central Bank regarding policies and procedures for the creation of new structures and the complexity of the group. This should provide the bank with further guidance about ensuring adequate governance and management throughout its operational structure.

### **3.14 Principle 14 - Disclosure Requirements**

*The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.*

## **Specific Requirements**

- 3.14.1 The bank should disclose relevant and useful information that supports the key areas of corporate governance. Such disclosure should be proportionate to the size, complexity, ownership structure and risk profile of the bank.
- 3.14.2 Accordingly disclosure should include, but not be limited to, material information on the bank's objectives, governance structures and policies (in particular the content of any corporate governance code or policy and the process by which it is implemented), major share ownership and voting rights and related parties transactions.
- 3.14.3 The bank should also disclose key points concerning its risk tolerance/appetite (without breaching necessary confidentiality), with a description of the process for defining it and information concerning the board involvement in such process. When involved in complex or non-transparent structures, the bank should disclose adequate information regarding the purpose, strategies, structures, risks and controls around such activities.
- 3.14.4 Disclosure should be accurate, clear and presented in an understandable manner and in such a way that shareholders, depositors, other relevant stakeholders and market participants can access it easily. Timely public disclosure is desirable on a bank's public website, in its annual and periodic financial reports or by other appropriate forms. It is good practice that an annual corporate governance-specific and comprehensive statement is in a clearly identifiable section of the annual report depending on the applicable financial reporting framework. All material developments that arise between regular reports should be disclosed without undue delay.

## **PART IV: CODE OF CONDUCT**

### **4.1 APPLICABILITY**

This code of conduct contained in this guideline is applicable to directors, chief executive officers and management of institutions licensed under the Banking Act (Cap. 488). The Board of Directors should ensure that all officers adhere to the prescribed code of conduct.

### **4.2 PRESCRIBED CODE OF CONDUCT**

#### **4.2.1 Conflict of Interest**

Directors, chief executive officers and management should not engage directly or indirectly in any business activity that competes or conflicts with the institution's interest. These activities include, although not necessarily limited to, the following:

- **Outside Financial Interest**

Where directors, chief executive officers and management have a financial interest in a customer, whether a sole proprietor, shareholder, creditor or debtor, such an interest must be disclosed immediately to the management. Thereafter, the affected director, chief executive officer and management should not be directly involved in the institution's dealings with the customer so long as the interest continues to exist.

The above restriction does not apply in cases where employees have holdings of public quoted securities unless the management views the interests to be material, and that the financial interest is considered likely to impair the objectivity of the member of staff concerned. The holding of five per cent or more of the voting shares of a publicly quoted company would be regarded as material.

- **Other Business Interests**

It is considered a conflict of interest if an executive director, chief executive officer or management conducts business other than the institution's business during office hours.

Where the acquisition of any business interest or participation in any business activity outside the institution and office hours demands excessive time and attention from the member of staff, thereby depriving the institution of the employee's best efforts on the job, a conflict of interest is deemed to exist.

- **Other Employment**

Before making any commitment, employees are to discuss possible part-time employment or other business activities outside the financial institution's working hours with their manager or departmental head. A written approval of the manager or departmental head should be obtained before an employee embarks on part-time

employment or other business activities. Approval should be granted only where the interest of the institution will not be jeopardized.

- **Corporate Directorship**

Employees must not solicit corporate directorships. An employee should not serve as a director of another corporation without approval of the Board of Directors (or Chief Executive, in case of foreign banks). Employees who hold directorships without such approval must seek approval immediately, if they wish to remain as directors of other corporations.

However, employees may act as directors of non-profit public service corporations, such as religious, educational, cultural, social, welfare, and philanthropic or charitable institutions, subject to policy guidelines of the institution.

- **Trusteeships**

Directors, chief executive officers and management must not solicit appointments as executors, administrators or trustees of customers' estates. If such an appointment is made and the employee is a beneficiary of the estate, his signing authority for the estate's bank account(s) must be approved by the Board of Directors, who will not unreasonably withhold approval.

#### **4.2.2 Misuse of Position**

- a) Directors, chief executive officers and management must not use the institution's name or facilities for personal advantage in political, investment or retail purchasing transactions, or in similar types of activities. Directors, chief executive officers and management, and their relatives must also not use their connection with the institution to borrow from or become indebted to customers or prospective customers. The use of position to obtain preferential treatment, such as purchasing goods, shares and other securities, is prohibited.
- b) Directors, chief executive officers and management must not solicit or otherwise accept inducements either directly or indirectly whether in cash or in kind in order to provide any favours to a customer in the provision of loans, acceptance of deposits or any other conduct of the business of the institution to which they are entrusted either jointly or individually.
- c) Further, directors, chief executive officers and management must not use the institution's facilities and influence for speculating in commodities, gold, silver, foreign exchange or securities, whether acting personally or on behalf of friends or relatives. Such misuse of position may be ground for dismissal and/or prosecution. Directors, chief executive officers and management should also not engage in "back-scratching" exercises with employees and directors of other institutions to provide

mutually beneficial transactions in return for similar facilities, designed to circumvent these ethical guidelines.

#### **4.2.3 Misuse of Information**

- a) Directors, chief executive officers and management should not deal in the securities of any company listed or pending listing on a stock exchange at any time when in possession of information, obtained by virtue of employment or connection with the institution, which is not generally available to shareholders of that company and the public, and which, if it were so available, would likely bring a material change in the market price of the shares or other securities of the company concerned. “Insider dealing” as this is called, is a crime.
- b) Directors, chief executive officers and management who possess insider information are also prohibited from influencing any other person to deal in the securities concerned or communicating such information to any other person, including other members of staff who do not require such information in discharging their duty.

#### **4.2.4 Integrity of Records and Transactions**

- a. Accounting records and reports must be complete and accurate. Directors, chief executive officers and management should never make entries or allow entries to be made for any account, record or document of the institution that are false and would obscure the true nature of the transaction, as well as to mislead the true authorization limits or approval authority of such transactions. Members of staff and directors of institutions should note carefully the provisions of Sections 48 and 50 of the Banking Act.
- b. All records and computer files or programmes of the institution, including personnel files, financial statements and customer information must be accessed and used only for management purposes for which they were originally intended.

#### **4.2.5 Confidentiality**

- (a) Confidentiality of relations and dealings between the institution and its customers is paramount in maintaining the institution’s reputation. Thus directors, chief executive officers and management must take precaution to protect the confidentiality of customer information and transactions. No member of staff or director should during, or upon and after termination of employment with the institution (except in the proper course of his duty and or with the institution’s written consent) divulge or make use of any secrets, copyright material, or any correspondence, accounts of the institution or its customers. No employee or director shall in any way use information so obtained for financial gain.

- (b) Business and financial information about any customer may be used or made available to third parties only with prior written consent of the customer or in accordance with the arrangements for the proper interchange of information between institutions about credit risks, or when disclosure is required by law.

#### **4.2.6 Fair and Equitable Treatment**

All business dealing on behalf of the institution with the current potential customers, with other members of staff and with those who may have cause to rely upon the institution, should be conducted fairly and equitably. Staff and directors must not be influenced by friendship or association, either in meeting a customer's requirement, or in recommending that they be met. Such decisions must be made on a strictly arms-length business basis. All preferential transactions with insiders or related interests should be avoided. If transacted, such dealings should be in full compliance with the law, judged on normal business criteria basis and fully documented and duly authorized by the Board of Directors or any other independent party.

#### **4.2.7 Insider Loans**

Directors, chief executive officers and management should not use their positions to further their personal interests. An institution shall not in Kenya therefore:

- (a) Grant or permit to be outstanding any unsecured advances in respect of any of its employees or their associates.
- (b) Grant or permit to be outstanding any advances, loans or credit facilities which are unsecured or advances, loans or credit facilities which are not fully secured to any of its officers, significant shareholders or their associates.
- (c) Grant or permit to be outstanding any advance, loan or credit facility to any of its directors or other person participating in the management of the institution unless it is:
  - approved by the full board of directors of the institution upon being satisfied that it is viable.
  - made in the normal course of business and on terms similar to those offered to ordinary customers of the institution. The institution shall notify the Central Bank of Kenya of every such approval within seven days of the granting of the approval.
- (d) Grant or permit to be outstanding any advance, loan or credit facility or give any financial guarantee or incur any other liability to, or in favour of, or on behalf of, any associate or any of the persons mentioned in paragraphs 4.2.7 (a),(b) and (c) in excess of twenty per cent of the core capital of the institution; or
- (e) Grant or permit to be outstanding advances or credit facilities or give any financial guarantee or incur any other liabilities to or in favor of, or on behalf of, its associates and the persons mentioned in paragraphs 4.2.7 (a), (b) and (c)

amounting in the aggregate to more than one hundred per cent of the core capital of the institution; or

- (f) Grant any advance or credit facility or give guarantee or incur any liability or enter into any contract or transaction or conduct its business or part thereof in a fraudulent or reckless manner or otherwise than in compliance of the Banking Act and Central Bank of Kenya guidelines.

## **PART V: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS**

### **5.1 Remedial measures**

**5.1.1** When an officer is assessed and found to be unfit and not proper to work for an institution, the affected institution shall be required to dispense with the services of such an officer forthwith and to inform the Central Bank of Kenya of such a decision as soon as possible. An institution that contravenes any of the provisions of this guideline may be subject to corrective measures and administrative sanctions set out below.

**5.1.2** When an institution contravenes any of the provisions of the Banking Act or is not in compliance with these guidelines then:

- a) All officers of the institution shall be liable jointly and severally to indemnify the institution against any loss arising in respect of the contravention of Section 11 of the Banking Act.
- b) In the case of violation of guidelines on an advance, loan or a credit facility to a person other than a director of the institution or a person participating in the general management of the institution, an officer shall not be so liable, provided he or she shows that, through no act or omission on his or her part, he or she was not aware that the contravention was taking place, or he or she took all reasonable steps to prevent it taking place.
- c) The Central Bank of Kenya may in the case of violation of guidelines on an advance, loan or credit facility to a director of the institution, direct the removal of such director from the Board of Directors of the institution. The Central Bank of Kenya may direct the suspension of any other officer or employee of the institution who sanctioned the advance, loan or credit facility. The institution shall comply with every direction of the Central Bank of Kenya under this paragraph forthwith.



- d) Any director of an institution who defaults in the repayment of any advance or loan made to him by the institution for three consecutive months shall forthwith be disqualified from holding office as such.

### **5.1.3 An institution which;**

- a) Fails to comply with any direction of the Central Bank of Kenya under subsection 5.1.2 (c) or;
- b) Permits a director who is disqualified by virtue of subsections 5.1.2 (c) and (d) to continue holding office shall be guilty of an offence punishable as specified in Section 49 and 50 of the Banking Act, and in addition may be assessed for penalties as specified in Legal Notice No. 77 of June, 1999.

## **PART VI: GUIDANCE ON BOARD AND INDIVIDUAL DIRECTORS' PERFORMANCE EVALUATION**

In conducting Board and Individual Directors' performance evaluations, the questions set out in the attached forms CBK/PG/19/F1, CBK/PG/19/F2 and CBK/PG/19/F3 should be taken into consideration. These however, are by no means definitive or exhaustive and individual institutions should tailor the questions to suit their own needs and circumstances.

The responses to these questions and others should enable institution's boards to assess how they are performing and to identify how certain elements of their performance areas might be improved.

### **BOARD EVALUATION FORM**

**(CBK/PG/19/F1)**

This evaluation should be completed by a committee of the board or an independent service provider appointed by the board. Please read each of the following statements and rate the institution by indicating your level of agreement with each of the statements; where **1 = Strongly Disagree** and **5 = Strongly Agree**. (Please circle only one number for each statement and provide reasons and justification for ratings under each item).

	<b><u>Strongly Disagree</u></b>				<b><u>Strongly Agree</u></b>
1. The board has contributed adequately in formulating and approving the institution's mission and business strategy. .....	1	2	3	4	5
2. The board has performed well against set performance objectives. .....	1	2	3	4	5
3. The board has contributed in ensuring robust and effective audit and risk management functions. .....	1	2	3	4	5
4. Composition of board and committees is appropriate with right mix of knowledge. .....	1	2	3	4	5
5. The board responded well to any problems or crises that emerged. .....	1	2	3	4	5
6. Decisions made by the board are thoroughly discussed and agreed to before they are put into action. .....	1	2	3	4	5
7. There is a productive working relationship between the board and the shareholders, CEO and the Management. .....	1	2	3	4	5
8. The board has a plan for the succession of the Chief Executive Director. .....	1	2	3	4	5

9. The board formally evaluates the performance of the Chief Executive at least annually. .....	1	2	3	4	5
10. The board is up-to-date with developments in the regulatory environment and market. .....	1	2	3	4	5
11. The frequency of Board and committee meetings was considered appropriate. .....	1	2	3	4	5
12. The Chairman demonstrates effective leadership of the board. .....	1	2	3	4	5
13. New board members receive adequate training and orientation so that they are able to effectively discharge their responsibilities. .....	1	2	3	4	5
14. The board's capacity to govern effectively is not impaired by excessive, or lack of conflict between board members. .....	1	2	3	4	5
15. Board members are recruited through a formal process considering their skills and competencies. .....	1	2	3	4	5
16. Directors demonstrate willingness and devote time to deliver on their mandate. .....	1	2	3	4	5
17. Information flows quickly & accurately between board members.	1	2	3	4	5

**BOARD CHAIR PERSON EVALUATION FORM (CBK/PG/19/F2)**

The evaluation should be completed by each director or an independent service provider appointed by the board. Please read each of the following statements and rate the chair person by indicating your level of agreement with each of the statements; where **1 = Strongly Disagree** and **5 = Strongly Agree**. (Please indicate only one number for each statement and provide comments on significant issues that support your justification).

	<b>Evaluation Question</b>	<b>Director 1</b>	<b>Director 2</b>	<b>Director 3</b>	<b>Director 4</b>	<b>Director 5</b>
1)	The Chair person demonstrates effective leadership of the board.					
2)	The Chair person acts independently of any stakeholder in decision making and discharge of responsibilities.					
3)	The Chair person is up-to-date with developments in market and regulatory environment.					
4)	The Chair person demonstrates willingness to devote time and effort to lead the institution.					
5)	The Chair person adheres to the institution's values and beliefs.					
6)	The Chair person has brought in knowledge and experience in strategy formulation and implementation.					
7)	The Chair person was formally appointed through an open, transparent and competitive process.					
8)	The Chair person encourages feedback on how the Board / Chair person's performance could be enhanced.					
9)	The Chair person has a positive working relationship with the CEO.					
10)	The Chair person has a positive working relationship with other directors.					
11)	The Chair person enhances public image and benefits the institution through personal and professional contacts.					

**Comments:** .....

**Director's Name:** \_\_\_\_\_

**Date** \_\_\_\_\_

**Signature** \_\_\_\_\_

**INDIVIDUAL DIRECTOR EVALUATION FORM****(CBK/PG/19/F3)**

The evaluation should be completed by each director led by the chairman or an independent service provider appointed by the board.

Please read each of the following statements and rate the director by indicating your level of agreement with each of the statements; where **1 = Strongly Disagree** and **5 = Strongly Agree**. (Please indicate only one number for each statement and provide comments on significant issues that support your justification).

	<b>Evaluation Question</b>	<b>Director 1</b>	<b>Director 2</b>	<b>Director 3</b>	<b>Director 4</b>	<b>Director 5</b>
1)	The director has contributed adequately in formulating and approving institution's mission and business strategy.					
2)	The director is up-to-date with developments in regulatory environment and market.					
3)	The director demonstrates willingness to devote time and effort to understand and deliver on assigned responsibilities.					
4)	The director has contributed quality and value at Board meetings.					
5)	The director has brought in knowledge and experience in strategy formulation and implementation.					
6)	The director was formally appointed through an open, transparent and competitive process.					
7)	The director exercises diligence and is not driven by personal or individual shareholder's interests that may disadvantage the institution.					

**Comments:** .....

**Director's Name:** \_\_\_\_\_

**Date** \_\_\_\_\_

**Signature** \_\_\_\_\_

## **PART VII: GUIDANCE ON HOLDING OF BOARD MEETINGS THROUGH VIDEO CONFERENCING**

### **1. BACKGROUND**

Board meetings are critical to all institutions. These meetings afford boards of directors an opportunity to exercise their statutory and supervisory duties over institutions. Approvals, evaluations and reviews by the boards on the activities of the institutions are carried out during board meetings. Board meetings also enable board members to be updated on the general management of the institutions.

Traditionally, board meetings have been held in physical premises where participating members are present. Under this set up, members have to travel from their places of abode to the meeting place to attend board meetings. The advent of information technology has dramatically changed the ways of doing business. Technology has made it possible for meetings to be held without the need to physically meet in one place. Teleconferencing, Skype and video conferencing have become additional means by which meetings can be held. The Central Bank takes cognizance of the convenience and cost saving opportunities brought about by video conferencing. Many organizations and business entities are increasingly embracing the practice of holding meetings through video conferencing. The Central Bank is of the view that institutions that are desirous of holding some board meetings through video conferencing should be able to do so under predetermined guidelines.

The Central Bank views the use of video conferencing as a means by which institutions can hold meetings where to do so would not jeopardize or prejudice the agenda of the meeting or the expected deliberations. In this regard, the Central Bank hereby sets out minimum requirements which should be met by institutions which would like to hold some of their board meetings through video conferencing. It must however be noted that video conferencing should not wholly substitute the traditional method of holding board meetings. Physical contact during meetings is an integral part of an effective meeting and must therefore continue to remain the main mode of holding meetings, even if video conferencing is embraced.

### **2. MINIMUM REQUIREMENTS**

Institutions are required to formulate documented policies and procedures on video conferencing detailing amongst other things, the following;

1. The nature or kind of meetings that can be held through video conferencing.
2. There should be a mix of both physical meetings and video conferencing with respect to the minimum number of meetings that a board should hold in one year.

3. Video conferencing as a means of holding meetings should be permitted in the Articles of Association of the institution. It is also desirable that shareholders of the institution approve the adoption of this technology.
4. The role of the board secretary for purposes of organizing, holding, taking minutes and subsequent confirmation of the minutes of the last meeting held through video conferencing is central. In this regard, the secretary should assume the following responsibilities;
  - i) To facilitate the overall conduct of the meeting.
  - ii) To find reliable video conference equipment/facilities.
  - iii) To record the proceedings and prepare the minutes of the meeting.
  - iv) To store for safekeeping and mark the tape recordings and/or other electronic recording mechanism as part of the records of the institution.
  - v) To send out the notices of the meeting to all directors in accordance with the manner of giving notice as stated in the corporate by-laws. The notice should contain the following information;
    - a) Inquiry on whether the director will attend physically or through video conferencing;
    - b) Contact number(s) of the Secretary and office staff whom the director may call to notify and state whether he shall be physically present or attend through video conferencing;
    - c) Agenda of the meeting;
    - d) All documents to be discussed in the meeting, including attachments, should be numbered and duly marked by the Secretary in such a way that all the directors, physically or electronically present, can easily follow, refer to the documents and participate in the meeting.
5. The Chair and the Secretary should have a well-coordinated plan on how to conduct the meeting through video conferencing.
6. If the director chooses video conferencing, he should give notice of at least seven days prior to the scheduled meeting to the Secretary. He should also inform the Secretary of his contact number/s and furnish any other relevant information necessary for him to effectively participate in the meeting via video conferencing. In the same way, the Secretary shall inform the director concerned of the contact number/s he will call to join the meeting. The Secretary shall keep the records of the details, and on the date of the scheduled meeting confirm and note such details as part of the minutes of the meeting.
7. In the absence of a confirmation from a director that he will participate in the meeting through video conferencing, it is presumed that the director will physically attend the board meeting. At the start of the scheduled meeting, a roll call shall be made by the Secretary. Every director and participant shall state, for the record, the following:
  - a. Full Name.



- b. Location.
  - c. For those attending through video conferencing, they shall confirm that:
    - i. they can completely and clearly hear and see the others who can clearly hear and see them on the other end.
    - ii. they have received the agenda and all the materials for the meeting
8. A roll call shall be taken and the Secretary may certify the existence of a quorum.
  9. All participants shall identify themselves for the record, before speaking and must clearly hear and/or see each other in the course of the meeting. If a person fails to identify himself, the Secretary shall quickly state the identity of the last speaker. If the person speaking is not physically present and the Secretary is not certain of the identity of the speaker, the Secretary must inquire to elicit a confirmation or correction.  
If a motion is objected to and there is a need to vote, the Secretary should call the roll and note the vote of each director who should identify himself.  
If a statement of a director/participant in the meeting via video conferencing is interrupted or unclear, the Secretary shall request for a repeat or reiteration, and if need be, the Secretary shall repeat what he heard the director/participant was saying for confirmation or correction.
  10. The Secretary shall prepare minutes which should be circulated to everyone who attended the meeting for comments. The Secretary should then consider the comments received and prepare revised draft minutes which should be presented to the board members in the next meeting for their approval and adoption. The draft minutes can further be amended shortly before adoption.
  11. If for any failure arising from human or machine error or power outage it is not possible to hold the meeting in the manner described herein above even if the meeting has commenced, the meeting shall be deemed not to have been held.
  12. Meetings held through video conferencing should not be rushed or otherwise conducted in a manner as to leave some participants dissatisfied with the way the meeting is being held. Participants should be accorded reasonable opportunity to make their contributions to the discussions.
  13. Up to twenty five (25%) of the actual meetings to be held in a year may be conducted through video conferencing, provided that the majority of the directors are physically present.
  14. No director shall attend all board meetings in any given year through video conferencing. While these are the minimum requirements, institutions have the responsibility of formulating appropriate policies and procedures for holding effective

meetings. The policies once formulated should be approved by the board of directors before implementation.

## **PART VIII: EFFECTIVE DATE**

**5.1** The effective date of this Guideline shall be 1<sup>st</sup> January 2013. However, the implementation date of the following understated sections shall have a transition period and will be effective on the respective dates as specified below:

**5.1.1 Section 3.4.6: Board Composition** – Institutions will be granted 18 months from the effective date of this Guideline to ensure the board is properly constituted as provided in the Guideline.

**5.1.2 Section 3.5.2: Board Audit Committee** – Institutions will have a transition period of 18 months from the effective date of this Guideline to ensure that the Board Audit Committee is constituted as provided in the Guideline.

**5.1.3 Section 3:11: Compensation Systems** – A transition period of 12 months from the effective date of this Guideline will be granted for institutions to ensure establishment of compensation systems as prescribed in this Guideline.

**5.2 Supersedence** – This Guideline supersedes and replaces the Guideline on Corporate Governance CBK/RG/02 of 1<sup>st</sup> January 2006 and Guidance Note No. 2 of 2011 on Holding of Board Meetings through Video Conferencing.

## **ENQUIRIES**

Enquiries on any aspect of this guideline should be referred to:

The Director,

Bank Supervision Department

Central Bank of Kenya

P. O. Box 60000 - 00200

**NAIROBI**

TEL.2860000 e-mail: *fin@centralbank.go.ke*

# **GUIDELINE ON CAPITAL ADEQUACY CBK/PG/03**

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## **PART I PRELIMINARY**

### **1.1 Title – Guideline on Capital Adequacy**

### **1.2 Authorization – This Guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.**

Section 18 of the Banking Act empowers the Central Bank of Kenya to prescribe the minimum ratios that shall be maintained by institutions as between their core capital and total capital on the one hand and their risk weighted assets and off-balance sheet items on the other, and for that purpose, may also determine the method of classifying and evaluating assets.

### **1.3 Application - Banks, financial institutions and mortgage finance companies licensed to conduct banking business in Kenya under the Banking Act.**

### **1.4 Definitions - Terms used within this guideline are as defined in the Banking Act and as further defined below, or as reasonably implied by contextual usage:**

**1.4.1 “Commodity risk”** is the risk that on- or off-balance sheet positions will be adversely affected by movements in commodity prices. Commodities include agricultural products, minerals (including oil) and precious metals (excluding Gold). Commodity risk only has a general market risk component because commodity prices are not influenced by specific market risk. Commodity risk comprises of directional risk which is the most important risk, basis risk, interest rate risk and forward gap risk. Directional risk is the exposure to changes in spot prices arising from net open positions. Basis risk is the risk that the relationship between the prices of similar commodities changes over time. Forward gap and interest rate risk is the exposure to changes in forward prices arising from maturity mismatches.

**1.4.2 “Core Capital” (Tier 1) -** Is as defined in Section 2(1) of the Banking Act namely as permanent shareholders’ equity (issued and fully paid-up ordinary shares and perpetual non-cumulative preference shares), disclosed reserves such as ordinary share capital and perpetual non-cumulative share premium, retained earnings and 50% un-audited after tax profits less investments in subsidiaries conducting banking business, investment in equity instruments of other institutions, intangible assets (excluding computer software) and goodwill. The current year to date 50% un-audited after tax profits will qualify as part of core capital, if and only if, the institution has made adequate provisions for loans and advances, proposed dividends and other appropriations have been deducted.

- 1.4.3 **“Capital Conservation Buffer”** - is a ratio of extra capital to risk weighted assets over and above the set minimum capital ratios, required to be maintained by institutions as a buffer for losses during periods of financial and economic stress.
- 1.4.4 **“Credit Risk”** - is the current or prospective risk to earnings and capital arising from an obligor’s failure to meet the terms of any contract with the bank or if an obligor otherwise fails to perform as agreed.
- 1.4.5 **“Financial Instrument”** - is any contract that gives to both parties a financial asset of one entity and a financial liability of another entity. Financial instruments include both primary financial instruments (and cash instruments) and derivative financial instruments. A financial asset is any asset that is cash, the right to receive cash or another financial asset; or the contractual right to exchange financial assets on potentially favourable terms. A financial liability is the contractual obligations to deliver cash or another financial asset or to exchange financial liabilities under conditions that are potentially unfavourable.
- 1.4.6 **“Foreign Exchange Risk”** refers to the risk that the value of on or off-balance sheet positions will be adversely affected by movements in exchange rates. Positions denoted in foreign currency may decline in value due to movements in exchange rates. Foreign currency is any currency other than the bank's reporting currency. Foreign exchange risk only has a general market risk component because movements in exchange rates are not affected by issuer- or issuance-specific factors.
- 1.4.7 **“General Market Risk”** refers to the risk of loss arising from changes in the general market behaviour. It is the risk of a price change in the underlying instrument owing (in the case of a traded loan-stock instrument or loan-stock derivative), to a change in the level of interest rates or (in the case of a security or security derivative), to a broad market movement unrelated to any specific attributes of the individual securities. In the case of a fixed income instrument, general market risk is driven by a change in the yield curve.
- 1.4.8 **“Interest Rate Risk”** is the potential for losses in on- or off-balance sheet positions from adverse changes in interest rates. Interest rate-dependent instruments can be affected by both general and specific market risk.
- 1.4.9 **“Market Risk”** is defined as the risk of losses in on and off-balance sheet positions arising from movements in market prices. These risks pertain to interest rate related instruments in the trading book, commodities risk though out the bank, equities risk and foreign exchange risk both in the trading and banking book of financial institutions.

- 1.4.10 **“Market risk Qualifying Assets”** includes interest rate risk assets in the trading book and foreign currency and commodities risk assets throughout the bank.
- 1.4.11 **“Market Risk Weighted Equivalents”** Capital charge emanating from the market risk calculation to a risk weighted equivalent.
- 1.4.12 **“Operational Risk”** is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
- 1.4.13 **“Positions Held with Trading Intent”** - are those held intentionally for short-term resale and/or with the intent of benefiting from actual or expected short-term price movements or to lock in arbitrage profits, and may include for example proprietary positions, positions arising from client servicing (e.g. matched principal broking) and market making.
- 1.4.14 **“Specific Risk”** - Refers to potentially adverse movement in the price of an individual loan/debt owing to factors related to the individual issuers. **Specific risk** does not affect foreign exchange- and commodities-related instruments. This is because changes in FX rates and commodities prices are completely dependent on general market movements.
- 1.4.15 **“Supplementary Capital” (Tier 2)** – Is as defined in Section 2(1) of the Banking Act and includes 25% of asset revaluation reserves which have received prior Central Bank’s approval, subordinated debt, issued and paid-in hybrid (debt equity) capital instruments or any other capital instrument approved by Central Bank. Supplementary capital must not exceed core capital.
- 1.4.16 **“Subordinated Debt”** - includes issued and paid-in unsecured subordinated debt instruments (debt equity, lines of credit, bonds, commercial paper or loan capital) having an original maturity of at least five years. Principal should be repayable after at least five (5) years. It also includes issued and paid-in limited life redeemable preference shares and loan loss reserves held against future, presently unidentified losses. During the last 5 years to maturity, a cumulative discount (amortization) factor of 20% per annum will be applied to reflect the diminishing value of these instruments as a continuing source of strength. Since subordinated debt is not normally available to participate in losses, the amount included for capital adequacy calculations is limited to 50% of core capital.
- 1.4.17 **“Trading Book”** Consists of positions in financial instruments which are held with trading intent or in order to hedge other elements of the trading book and are free of

any restrictive covenants on their tradability, frequently and accurately valued and are actively managed.

1.4.18 “**Total Capital**” - means core capital plus supplementary capital.

## **PART II STATEMENT OF POLICY**

### **2.1 Purpose**

This Guideline is intended to ensure that each institution maintains a level of capital that is adequate to protect its depositors and creditors, commensurate with the risk associated with activities and profile of the institution, and promotes public confidence in the institution.

### **2.2 Responsibility**

The Board of directors of each institution shall be responsible for establishing and maintaining, at all times, an adequate level of capital. The capital standards herein are the minimum acceptable for institutions that are fundamentally sound, well-managed, and which have no material financial or operational weaknesses. Higher capital ratios may be required for individual institutions based on circumstances listed under Part IV, section 4.2 below.

## **PART III CAPITAL REQUIREMENTS**

**3.0** Capital requirements for a specific institution may increase or decrease depending upon its risk profile. An institution’s minimum capital requirement (MCR) will be calculated by dividing its Core and Total Capital by the sum of the value of its Risk-Weighted Assets for Credit Risk, Market Risk and Operational Risk, to arrive at the minimum Tier One and Regulatory capital adequacy ratios respectively.

### **3.1 Capital Charge for Credit Risk**

Credit risk arises from the possibility of losses associated with reduction of credit quality of borrowers or counterparties. In institutions’ portfolio, losses arise from outright default due to inability or unwillingness of an obligor to meet commitments in relation to lending, trading settlements, or any other financial transaction. Alternatively, losses occur from reduction in portfolio value due to deterioration in credit quality.

The capital risk charge for credit risk is therefore the allocation of capital for the various risk assets by assigning them risk weights based on their category and risk profiles.

## **3.2 Capital Charge for Market Risk**

Institutions are required to assess, measure and apply capital charges in respect of their market risks in addition to their credit risk. Market risk is defined as the risk of losses in on and off-balance sheet positions arising from movements in market prices. For the purpose of this guideline the risks subject to this requirement are;

- a) The risks pertaining to interest rate related instruments;
- b) Foreign exchange risk and commodities risk throughout the bank.

### **3.2.1 Basis for Capital Charge for Market Risk**

The basis and framework for Central Bank of Kenya to apply capital charges in respect to specific and general market risks will be done using the Standardized Measurement Approach. All the institutions will initially be required to use the Standardized Measurement Method (**as shown in Forms C, C1, C2 & C3**), from the effective date of this guideline. At such time to be determined by the Central Bank of Kenya, institutions that wish to use internal rating models may apply to Central Bank for approval to use such models in applying capital charge for market risk.

## **3.3 Capital Charge For Operational Risk**

The guideline also introduces a capital charge for operational risk. Generally there are three methods for calculating operational risk capital charges in a continuum of increasing complexity and risk sensitivity. These are; the Basic Indicator approach (a fixed percentage of gross income amount), the Standardized approach (sum of a certain percentage of an institution's income in each business line) and Internal Measurement approach (Statistical measure of an institution's operational loss based on its historical loss data). For the purposes of this guideline, Basic Indicator Approach shall be used for calculating the capital charge against operational risk.

CBK encourages institutions to adopt more advanced approaches as they develop more sophisticated operational risk measurement systems and practices. However, the use of such models shall only be approved by CBK at such time to be determined.



## PART IV SPECIFIC REQUIREMENTS

### 4.1 Minimum Capital Requirements

#### 4.1.1 Minimum Ratios

Unless a higher minimum ratio has been set by the Central Bank of Kenya for an individual institution based on criteria set under Section 4.2 below, every institution shall, at all times, maintain:

- a) A core capital of not less than eight per cent of total risk weighted assets plus risk weighted off-balance sheet items;
- b) A core capital of not less than eight per cent of its total deposit liabilities;
- c) A total capital of not less than twelve per cent of its total risk weighted assets plus risk weighted off-balance sheet items. The computation of total capital requirement is as shown below;

Eligible Tier I and Tier II Capital	The Institution's Capital Adequacy
(Credit Risk Weighted Assets – Assets Associated with market Risk) + Market Risk Qualifying Assets + Operational Risk Charge	= Ratio (Ratio must be at least 12% of which 8% is Core Capital)

#### 4.1.2 Capital Conservation Buffer

In addition to the above minimum capital adequacy ratios of 8% and 12%, institutions are required to hold a capital conservation buffer of 2.5% over and above these minimum ratios to enable the institutions withstand future periods of stress. This brings the minimum core capital to risk weighted assets and total capital to risk weighted assets requirements to 10.5% and 14.5%, respectively. The capital conservation buffer should be made up of high quality capital which should comprise mainly of common equity, premium reserves and retained earnings.

Institutions that currently meet the minimum capital ratios of 8% and 12% but remain below the buffer-enhanced ratios of 10.5% and 14.5% (current minimums plus conservation buffer) should maintain prudent earnings retention policies with a view to meeting the conservation buffer within 24 months from the effective date of this guideline.

	Core Capital (Tier1) to RWA	Total Capital (Tier 2) to RWA
Minimum Ratio	8.0%	12.0%
Conservation Buffer	2.5%	2.5%
Minimum plus Conservation Buffer	10.5%	14.5%

The above ratios are subject to review and may be changed from time to time.

#### **4.1.3 Minimum Absolute Core Capital Requirement**

Minimum core capital for banks, mortgage finance companies and financial institutions is as stated below:

- a) Banks and Mortgage Finance Companies: Kshs.1,000 million (1 billion).
- b) Financial Institutions: Kshs.200 million.

Institutions' minimum core capital levels will be monitored on a continuous basis by the Central Bank of Kenya. These levels will apply to all institutions and may be reviewed from time to time.

#### **4.2 Criteria for Higher Minimum Capital Ratios**

The Central Bank may require higher minimum capital ratios for an individual institution based on, but not limited to any one or more of the following criteria:

- a) The institution has incurred or is expected to incur losses resulting in a capital deficiency;
- b) The institution has significant exposure to risk, whether credit, concentrations of credit, market, interest rate, liquidity, operational, or from other non-traditional activities;
- c) The institution has a high or particularly severe volume of poor quality assets;
- d) The institution is growing rapidly either internally or through acquisitions;
- e) The institution is adversely affected by the activities or condition of its holding company, associates or subsidiaries; or
- f) The institution has deficiencies in ownership or management (i.e. shareholding structure; composition or qualifications of directors or senior officers; risk management policies and procedures).

## **4.3 Capital Charge for Risk Weighted Assets**

### **4.3.1 Risk Weighted Assets for Credit Risk**

Risk based approach to capital adequacy measurement applies to both on and off-balance sheet items. The focus of this section is credit risk, namely the potential risk of counter party default.

#### **4.3.1.1 On-Balance Sheet Items**

This framework uses only four weights, i.e. 0%, 20%, 50% and 100%. Credit exposures are risk weighted and classified into the four categories according to their relative risk.

##### **a) Zero % Weight**

The on-balance sheet assets which have been assigned a 0% weight include: cash (both domestic and foreign); loans and advances secured by cash; balances with the Central Bank of Kenya (including repo purchase transactions); claims on the Kenya Government by way of Government securities; and loans duly guaranteed by the Government of Kenya. Such Government guarantees should have been approved by the appropriate authorities in accordance with applicable laws and Government procedures; and loans duly guaranteed by OECD<sup>1</sup> Central Governments. However, the weight for loans guaranteed by an OECD Central Government whose credit rating has been downgraded will be enhanced based on the extent of the downgrade.

##### **b) 20% Weight**

The 20% weight will be assigned to deposits and balances due from commercial banks, financial institutions, mortgage finance companies and building societies in Kenya. They should also include securities issued by foreign governments and banks and balances due from foreign banks; loans duly guaranteed by other EAC member states<sup>2</sup> approved by the appropriate authorities in accordance with applicable laws and government procedures; claims (loans and advances) guaranteed by the following Multi-Lateral Development Banks (MDBs):

- (i) The International Bank for Reconstruction and Development
- (ii) The Inter-American Development Bank

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<sup>1</sup>OECD members are Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

<sup>2</sup> The other EAC member states other than Kenya are Burundi, Rwanda, Tanzania and Uganda.

- (iii) The Asian Development Bank
- (iv) The African Development Bank
- (v) The European Investment Bank
- (vi) Other MDBs in which G10 countries (Belgium, Netherlands, Canada, Sweden, France, Switzerland, Germany, United Kingdom, Italy, United States and Japan) are shareholding members.

**c) 50% Weight**

Mortgage loans fully secured by first legal charge over residential properties located within cities and municipalities in the Republic of Kenya that are either occupied by the borrower or rented will attract risk weight of 50%. The 50% weight will not be applied to loans granted to companies engaged in speculative residential building or property development. The underlying security held must be perfected in all respects and its forced sale value (FSV) should cover in full the outstanding debt with at least 20% margin. Any portion of the loan in excess of 80% of the FSV of the residential property should attract a risk weight of 100%. The account should neither be in arrears nor exhibit any weakness. Rescheduled facilities shall carry a risk weight of 100%.

**d) 100% Weight**

The on-balance sheet items assigned the 100% weight are all other claims on the public and private sector which are not covered under the other categories, including deposits in institutions under statutory management, balances from other foreign entities other than banks, premises and other fixed assets, loans and advances, bills discounted and all other assets of the institution.

**4.3.1.2 Off-Balance Sheet Exposures**

Off balance sheet items shall be converted to credit risk equivalents by multiplying the nominal principal amounts by a credit conversion factor. The resulting amounts will then be weighted depending on the nature of counterparty. For example, if the counterparty is a local bank, then the resulting amount shall be multiplied by a risk weight of 20%. The credit conversion factors listed below shall apply for various categories of off-balance sheet items, except for interest rate and exchange rate related items.

**a) Zero % conversion factor**

Short-term commitments with an original maturity of up to one year and cancellable unconditionally at any time e.g. bills for collection and any other contingent liability fully secured by cash.

**b) 20% conversion factor**

Short-term self-liquidating trade related contingencies arising from the movement of goods e.g. documentary credit collateralized by underlying shipments, and guarantees by Multilateral Development Banks specified in 4.3.1.1 (b)

**c) 50% conversion factor**

Transactions related to contingent items and other commitments with an original maturity exceeding one year e.g. performance bonds, bid bonds and standby letters of credit relating to a particular transaction.

**d) 100% conversion factor**

These are off- balance sheet items, which are substitutes for loans, e.g. letters of guarantee, bank acceptances and standby letters of credit serving as financial guarantees for loans and securities.

**4.3.1.3 Foreign exchange and interest rate related contingencies**

Foreign exchange and interest rate related contracts need special treatment, as the banks are not exposed to credit risk for the full face value of their contracts but only to the cost of replacing the cash flow if the counterparty defaults. While computing the credit risk of these contracts, financial institutions shall use the original exposure method. Institutions will apply one of the two sets of the conversion factors to the original principal amounts of each instrument according to the nature of the instrument and its maturity. The resulting amounts will then be weighted against the risk weight associated with the counterparty.

The conversion factors for interest rate and exchange rate contracts are to be based on residual maturity period as shown in the table below:

<b>Residual maturity</b>	<b>Exchange rate contracts</b>	<b>Interest rate contracts</b>
One year or less	0.5%	2.0%
Over one year to two years	1.0%	5.0%
For each additional year	1.0%	3.0%

**4.3.2 Capital Charge for Market Risk**

**4.3.2.1 Purpose**

The purpose of this section is to ensure that institutions which have significant exposure to market risks maintain adequate capital to support that exposure, in addition to capital

requirements for credit and operational risks. The section also sets out the CBK's approach in determining the adequacy of capital to support potential losses arising from market risk.

#### **4.3.2.2 Applicability of market risk capital requirements**

In the same way as for credit risk, the market risk capital requirement applies to all institutions under the supervision of the CBK. Institutions are required to report their market risk exposures on a monthly basis using the Market Risk Reporting templates (**Forms C, C1, C2 & C3**), attached to this guideline. Institutions are required to complete the templates on:

- A solo basis, covering the market risk exposure positions of the institution on a monthly basis, and
- A consolidated basis, covering the market risk exposure positions of the institution and its subsidiaries on an annual basis.
- No netting or offsetting requirements is permitted.

The subsidiaries of foreign banks operating in Kenya, where the CBK is not the lead/home supervisor, are subject to the market risk capital requirements on a solo basis

#### **4.3.2.3 Risk measurement framework**

Generally market risk covers interest rate risk, foreign exchange risk, commodity risk and equity risk. For the purpose of this guideline equity risk is not covered since trading in equities by institutions is prohibited in the Banking Act. To determine the level of capital to be held against market risk an institution should calculate capital charge on the following risks:

- Risks pertaining to interest rate related instruments in the trading book,
- Foreign exchange risk and Commodity risk throughout the institution.

#### **4.3.2.4 Positions Eligibility Requirements**

The following will be the basic requirements for positions eligible to receive trading book capital treatment:

- i) Clearly documented trading strategy for the position/instrument or portfolios, approved by senior management (which would include expected holding horizon).
- ii) Clearly defined policy and procedures for the active management of the position, which must include:
  - positions are managed on a trading desk;
  - position limits are set and monitored for appropriateness;
  - dealers have the autonomy to enter into/manage the position within agreed limits and according to the agreed strategy;

- positions are marked to market at least daily;
  - positions are reported to senior management as an integral part of the institution's risk management process; and
  - Positions are actively monitored with reference to market information sources (assessment should be made of the market liquidity or the ability to hedge positions or the portfolio risk profiles). This would include assessing the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market, etc.
- iii) The institutions are expected to have an established policy for allocating transactions (including internal deals) to the trading or non-trading book, as well as procedures to ensure compliance with such a policy. In addition, there must be a clear audit trail at the time each transaction is entered into. The Central Bank will examine the adequacy of such policy and procedures and its consistent implementation. For this purpose, institutions which engage in trading activities should submit to CBK a policy statement covering the definition of trading activities and the financial instruments which can be traded or used for hedging the trading book portfolios.
- iv) Clearly defined policy and procedures to monitor the positions against the bank's trading strategy including the monitoring of turnover and stale positions in the bank's trading book.

The financial instruments and transactions allocated to the regulatory trading book as referred to in the preceding paragraphs include:

- (i) Equity assets including forwards.
- (ii) Bonds, notes obligations, Treasury bills bonds; similar financial instruments, rated or unrated, even forward acquisitions.
- (iii) Short sales on (i) and (ii) above.
- (iv) Derivatives on interest rate risk
- (v) Hedging derivatives.
- (vi) Financial futures contracts (excluding equity futures)
- (vii) Forward contracts including forward rate agreements;
- (viii) Swaps, and
- (ix) Options
- (x) Other similar capital market instruments; (excluding equity related instruments)

The CBK considers transactions to carry a trading intent on the part of the financial institution if:

- (i) The position arising there from is marked to market on a daily basis (where possible) as part of the internal risk management process.
- (ii) The positions are not, or not intended to be, held to maturity; and

- (iii) The positions satisfy other criteria the financial institution applies to its trading portfolio.

Although regular reporting will in principle take place only at intervals, banks are expected to manage the market risk in such a way that the regulatory capital requirements are being met on a continuous basis i.e. at the close of each business day.

#### **4.3.2.5 Measurement Methods**

Two common methods for the measurement of market risk are:

- i) The standardised approach; and
- ii) The internal models approach.

##### **(a) Standardised approach**

For the purpose of this guideline, all institutions will be required to adopt the standardised approach in calculation of capital charge for market risk. Under this approach, market risk is measured by a standardised risk-weighting system in which the risk weights are based on the types of positions and financial instruments held by an institution. The approach will be used to measure and report interest rate risk, foreign exchange risk and commodity risk. Details of the method of measurement are set out in the returns and (c) below.

##### **(b) Internal Models Approach**

The internal models approach allows those institutions with the necessary systems to use their own internal risk management models to calculate market risk. The use of this approach will be considered in the future and subject to approval of CBK.

##### **(c) Interest Rate Risk under the Standardised Approach**

The use of the standardized approach to calculate interest rate risk uses the “building-block” approach for specific risk and general risk.

The capital charges for interest rate related instruments will apply to the current market value of items in a banking institution’s trading book(s). Interest rate related instruments include all fixed-rate and floating-rate debt securities, interest rate derivatives and instruments that behave like them, including non-convertible preference shares and traded mortgage securities. Interest rate derivatives include all derivatives contracts and off-balance-sheet instruments which react to changes in interest rates, e.g. interest rate futures, forward rate agreements (FRAs), interest rate and cross currency swaps, interest rate options, forward foreign exchange positions, and mortgage derivative products.



Convertible bonds, i.e. debt issues or preference shares that are convertible, at a stated price, into common shares of the issuer, will be treated as debt securities.

Institutions are required to notify the CBK whenever new instruments are introduced.

The trading portfolio attracts two types of risk capital charges:

- i) Specific risk charges, and
- ii) General risk charges.

The specific risk component is the risk of a price change in the underlying instrument owing to factors related to the issuer of the instrument, or, in the case of a derivative, the issuer of the underlying instrument.

The general risk component is a capital charge for the risk of a price change in the underlying instrument owing (in the case of a traded loan-stock instrument or loan-stock derivative) to a change in the level of interest rates or (in the case of a security or security derivative) to a broad market movement unrelated to any specific attributes of the individual securities.

The Market Risk template (Form C1) provides the framework for calculating a notional capital charge for interest rate risk. Separate maturity ladders should be used for each currency and capital charges should be calculated for each currency separately and then summed with no offsetting between positions of opposite sign.

In the case of those currencies in which business is insignificant, separate maturity ladders for each currency are not required. Rather, the bank may construct a single maturity ladder and slot, within each appropriate time-band, the net long or short position for each currency. However, these individual net positions are to be summed within each time-band, irrespective of whether they are long or short positions, to produce a gross position figure.

#### **(d) Foreign Exchange Risk**

Foreign exchange risk is the risk that the value of foreign exchange positions may be adversely affected by movements in currency exchange rates. Foreign exchange risk incurs only general market risk. The capital charge requirement for positions held in foreign currencies, including gold, is calculated at 10% of the overall net open position using the 'Shorthand' method. The two steps followed to calculate the overall net open position are;

- i) Determine the exposure in each currency.
- ii) Determine the overall net open position across FX exposures using the 'Shorthand' method. Under this method, the overall net open position is the higher of the sum of all

net open short positions or the sum of long positions in all currencies (refer to computation in the completion notes).

All on- and off-balance sheet items in foreign currency, whether held in the trading book or banking book, are subject to this charge. Banks and financial institutions shall report exposures for individual currencies separately, although small currency holdings may be aggregated.

#### **(e) Commodities Exchange Risk**

Commodity risk is the risk that on- or off-balance sheet positions will be adversely affected by movements in commodity prices. A commodity is defined as a physical product that can be traded on a secondary market. They include agricultural products, minerals (including oil) and precious metals (excluding gold which is treated as a foreign currency).

Commodity risk comprises directional risk which is the most important risk, basis risk, interest rate risk and forward gap risk. Directional risk is the exposure to changes in spot prices arising from net open positions. Basis risk is the risk that the relationship between the prices of similar commodities alters over time. Forward gap and interest rate risk is the exposure to changes in forward prices arising from maturity mismatches.

All commodity derivatives and off-balance sheet positions which are affected by changes in commodity prices should be included in this measurement framework. Long and short positions in each commodity may be reported on a net basis for the purposes of calculating open positions. However, as a general rule, positions in different commodities are not off-settable in this manner.

### **4.3.3 Capital Charge for Operational Risk**

#### **4.3.3.1 Purpose**

The purpose of this section is to guide all institutions which by nature of their business are exposed to operational risk, to maintain adequate capital to support their exposure to operational risk, in addition to the capital requirements for credit and market risk.

#### **4.3.3.2 The Basic Indicator Approach**

Under the Basic Indicator Approach (BIA), the capital charge for operational risk is a fixed percentage (denoted by alpha) of average positive annual gross income of the institution over the past three years. Figures for any year in which annual gross income is negative or zero, should be excluded from both the numerator and denominator when calculating the average. The formula for calculating operational risk together with the data capturing form is provided with this guideline (**See Form D below**).

#### **4.4 Internal Capital Assessment Adequacy Planning (ICAAP)**

ICAAP is a system of sound, effective and complete strategies and processes that allow institutions to assess and maintain, on an ongoing basis, the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of risks to which they are or might be exposed.

Institutions are required to ensure that they at all times plan their capital ahead for a minimum of three years and ideally for five years, and to establish and maintain on an ongoing basis an adequate level of capital, which would include an appropriate buffer, as determined by the board, above the regulatory required minimum capital. This requires institutions to have in place appropriate and proportionate capital management strategy.

A sound capital assessment process should include the following elements:

- (i) A clear and documented process for evaluating risks and determining whether or not a risk should result in an explicit amount of capital being held.
- (ii) Policies and procedures designed to ensure that the institution identifies, measures and reports all material risks requiring capital.
- (iii) A process that relates capital to current and anticipated future levels of risk in accordance with board approved risk tolerance.
- (iv) A process that states capital adequacy goals with respect to risk, taking account of the institution's strategic focus and business plan.
- (v) A process of internal controls reviews and audits to ensure the integrity of the overall risk management process.

#### **Comprehensive assessment of risks**

The ICAAP should address all material risks faced by the institution as they relate to the adequacy of capital, including all risks explicitly captured in minimum regulatory capital requirements as well as risks that are not fully captured under minimum regulatory capital requirements. The techniques used in assessing material risks should be commensurate with the scope and complexity of the institution's risk taking activities.

#### **Stress testing**

An institution's capital planning process should incorporate rigorous, forward-looking stress testing that identifies possible events or changes in market conditions that could

adversely impact the institutions. In their ICAAPs, institutions should examine future capital resources and capital requirements under adverse scenarios. The results of forward-looking stress testing should be considered when evaluating the adequacy of an institution's capital.

For further guidance on stress testing expectations, institutions should refer to Guideline on Stress Testing (CBK/PG/20).

### **Monitoring and reporting**

The institution should establish an adequate system for monitoring and reporting risk exposures and assessing how changes to the institutions risk profile affects the need for capital. The institution's senior management and board of directors should receive regular reports on the institution's risk profile and capital needs.

### **Internal control review**

The institution should conduct periodic reviews of its risk management process to ensure its integrity, accuracy, and reasonableness. Effective control of the capital assessment process includes an independent review and, where appropriate, the involvement of internal and external audits.

## **4.5 Reports to Central Bank**

Each institution shall submit to Central Bank of Kenya the return on Capital to Risk Weighted Assets, Form CBK/PR3, at the end of every month, to be received by the 10th day of the following month in which the return relates. The Central Bank may require such other information as is necessary to evaluate compliance with this guideline and may call for adjustments to capital where necessary.

## **PART V REMEDIAL MEASURES**

**5.1 Remedial measures** – Central Bank may pursue any or all remedial actions as provided under Sections 33, 34 and 55 of the Banking Act and the Prompt Corrective Action Guideline (CBK/PG/21).

**5.2 Administrative sanctions** - In addition to the use of corrective actions noted in 5.1 above, the Central Bank may pursue any or all of the following administrative sanctions against an institution, its board of directors, or its officers:

- i) Prohibition from declaring or paying dividends;
- ii) Prohibition from establishing new branches;
- iii) Prohibition from engaging in new activities or from expanding existing activities;

- iv) Suspension of lending, investment, and credit extension operations;
- v) Prohibition from acquiring, through purchase or lease, additional fixed assets;
- vi) Prohibition from accepting further deposits or other lines of credit;
- vii) Prohibition from declaring or paying bonuses, salary incentives, severance packages, management fees or other discretionary compensation to directors or officers.

## **PART VI EFFECTIVE DATE**

**6.1 Effective date** - The effective date of this Guideline shall be 1<sup>st</sup> January 2013.

However, the following sections shall be subject to the indicated transition and or observation period.

**6.1.1 Section 4.1.2 Capital Conservation Buffer** – Institutions will be granted 24 months from the effective date of this Guideline to build up their capital conservation to the required levels provided in the Guideline.

**6.1.2 Section 4.3.2 Capital for Market Risk & Section 4.3.3 Capital for Operational Risk** – An observation period of 12 months from the effective date of this Guideline will be granted to institutions during which institutions shall submit to CBK data on market risk and operational risk as required by this guideline but for purposes of compliance with capital adequacy requirements, they shall be assessed against credit risk during the observation period. After the 12 months observation period institutions shall comply with capital adequacy requirements for credit, market and operational risks.

**6.2 Supersedence** - This guideline supercedes the Guideline on Capital Adequacy (CBK/RG/03) issued on 1<sup>st</sup> January 2006.

**ENQUIRIES** - Any enquiries on this Guideline should be forwarded to:

Director, Bank Supervision Department

Central Bank of Kenya

P. O. Box 60000 - 00200

NAIROBI

TEL..2860000 e-mail: *fin@centralbank.go.ke*

**CAPITAL ADEQUACY COMPUTATION INCORPORATING MARKET & OPERATIONS RISK**

**FORM A: CBK/PR3**

**Institution:** .....

**Period:** .....

**Ksh. ('000')**

<b>1.1. Core Capital (Tier 1)</b>	
1.1.1 Paid-up ordinary share capital/Assigned Capital	
1.1.2 Non-repayable share premium	
1.1.3 Retained earnings/Accumulated losses	
1.1.4 Net After tax profits, current year to-date (50% only)	
1.1.5 Non-cumulative irredeemable preference shares	
1.1.6 Other reserves	
1.1.7 Sub-Total (1.1.1 to 1.1.6)	
<b>Less Deductions</b>	
1.1.8 Investments in shares of unconsolidated subsidiary institutions and equity instruments of other institutions	
1.1.9 Goodwill	
1.1.10 Deferred Tax Asset	
1.1.11 Other Intangible Assets	
1.1.12 Total Deductions (1.1.8 to 1.1.11)	
1.1.13 CORE CAPITAL (1.1.7 Less 1.1.12)	
<b>1.2 Supplementary Capital (Tier 2)</b>	
1.2.1 Revaluation reserves (25%)	
1.2.2 Cumulative irredeemable preference shares	
1.2.3 Convertible notes and similar capital investments	
1.2.4 Perpetual subordinated debt	
1.2.5 Limited life redeemable preference shares	
1.2.6 Term subordinated debt	
1.2.7 Statutory Loan Loss Reserve	
1.2.8 Total supplementary capital (1.2.1 to 1.2.7)	
1.2.9 Supplementary Capital/Core Capital (%)	
1.3. TOTAL CAPITAL (1.1.13 + 1.2.8)	

1.4 Total shareholder's funds (Per CBK BSM)	
1.5 Difference (1.4 Less 1.3)*	

\* - A reconciliation for the difference to be attached on a separate sheet.

<b>2. On – Balance Sheet Assets</b>			
	Amount (‘000’)	Risk Weight	Risk Adjusted Asset Value (Shs. ‘000’)
2.1 Cash (including foreign notes and coins)		0	
2.2 Balances with Central Bank of Kenya		0	
2.3 Kenya Government Treasury Bills		0	
2.4 Kenya Government Treasury Bonds		0	
2.5 Lending fully secured by cash		0	
2.6 Loans guaranteed by the Government of Kenya and OECD Central Governments		0	
2.7 Loans guaranteed by the Governments of other EAC Members States		0.2	
2.8 Deposits and balances due from local institutions		0.2	
2.9 Deposits and balances due from foreign institutions		0.2	
2.10 Foreign Treasury Bills and bonds		0.2	
2.11 Claims guaranteed by Multi-Lateral Development Banks		0.2	
2.12 Mortgage Loans secured by residential property		0.5	
2.13 Other Loans and advances (net of provisions)		1.0	
2.14 Other investments		1.0	
2.15 Fixed Assets(net of Depreciation)		1.0	
2.16 Amounts due from group companies		1.0	
2.17 Other assets		1.0	
2.18 TOTAL (2.1 to 2.17)			
2.19 Total assets (per CBK BSM)			
2.20 Difference (2.19 Less 2.18)*			

\* - A reconciliation for the difference to be attached on a separate sheet.

### 3. Risk Weighted Assets Summary

3.1 Total Risk Adjusted off-balance sheet Assets (See Form B)	
<b>4. Adjusted Credit Risk Weighted Assets (2.18 above)</b>	
4.1 Total Risk Weighted Assets for on and off balance sheet items (3 + 4)	
4.2 Market Risk qualifying Assets included in 4.1 above (2.3+2.4+2.10 plus	

any other trading book asset included above e.g. in 2.14)	
4.3 Adjusted Credit Risk Weighted Assets (4.1 less 4.2)	

<b>5. Total Market Risk Weighted Assets Equivalent( from Form C)</b>	
--	--

<b>6. Operational Risk Equivalent Assets (from Form D)</b>	
--	--

<b>7. Capital Ratio Calculations</b>
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7.1 Core Capital as per 1.1.13 above	
7.2 Total Capital as per 1.3 above	
7.3 Adjusted Credit Risk Weighted Assets as per 4.3 above	
7.4 Total Market Risk Weighted Assets Equivalent as per 5 above	
7.5 Total Risk Weighted Assets Equivalent for Operations Risk as per 6 above	
7.6 Total Risk Weighted Assets (7.3 + 7.4 +7.5)	
7.7 Total Deposits	
7.8 Core capital to Total Risk Weighted assets ratio (7.1/7.6)%	
7.9 Minimum core capital to Total Risk Weighted assets requirement	8%
8.0 Excess/(Deficiency) (7.8 less 7.9)	
8.1 Core capital to Deposit ratio (7.1/7.7)%	
8.2 Minimum core capital to deposits requirement	8%
8.3 Excess/(Deficiency) (8.1 less 8.2)	
8.4 Total capital to Total Risk Weighted assets ratio (7.2/7.6)%	
8.5 Minimum total capital to risk assets requirement	12%
8.6 Excess/(Deficiency) (8.4 less 8.5)	

Name:.....  
Designation.....  
Signature.....  
Date.....



## **COMPLETION INSTRUCTIONS**

### **RETURN CBK/PR3: CAPITAL TO RISK WEIGHTED ASSETS**

#### **1. CAPITAL COMPONENTS**

##### **1.1 CORE CAPITAL (TIER 1)**

###### **1.1.1 Paid-up ordinary share capital/Assigned Capital**

This is the nominal value of the ordinary shares issued and fully paid, or capital assigned to Kenyan branch(es).

###### **1.1.2 Non-repayable share premium/(discount)**

This is the difference between the nominal price and purchase price of shares, which is not refundable/recoverable.

###### **1.1.3 Retained Earnings/ Accumulated losses**

These are retained earnings or accumulated losses from the profits/losses of the prior years. They should however exclude reserves arising from revaluation of investment properties and cumulative unrealized gains and losses on financial instruments.

###### **1.1.4 Current year 50% un-audited after tax profits**

This is 50% of the current year to date un-audited after tax profits. The institution must have made adequate provisions for loans and advances, depreciation, amortization and other expenses. In arriving at the applicable figure, any proposed or interim dividends have to be taken into account. This should however exclude reserves arising from revaluation of investment properties and cumulative unrealized gains and losses on financial instruments. In case of a loss, full amount should be included.

###### **1.1.5 Non-cumulative irredeemable preference shares**

These are shares, which have a standing claim on the company every year, but the claim is not carried forward in event of not being paid and they are not redeemable.

### **1.1.5 Other reserves**

These are all other reserves, which have not been included above. Such reserves should be permanent, unencumbered, uncallable and thus able to absorb losses. Further, the reserves should exclude cumulative unrealized gains and losses on available-for-sale-instruments.

### **1.1.6 Sub-total**

Enter in this line the sub-total of all the items from 1.1.1 to 1.1.6.

## **DEDUCTIONS FROM CORE CAPITAL**

### **1.1.8 Investments in subsidiary institutions and equity instruments of other banking institutions**

To prevent multiple use of the same capital resources in different banking institutions both in Kenya and abroad, the institutions should deduct any investment in subsidiaries conducting banking business and equity instruments of other banking institutions.

### **1.1.9 Goodwill**

This is the difference between the value of the business as a whole and the aggregate of the fair values of its separable net assets at the time of acquisition.

### **1.1.10 Deferred tax asset (DTAs)**

These are DTAs relying on future profitability of the institution and must be deducted from Tier 1 capital. DTA balance as at 31<sup>st</sup> December 2012 shall be recognised (not deducted) but for a period not exceeding five years from that date. DTAs relating to temporary differences such as allowance for credit losses can be recognized up to a limit of 10% of the institution's core capital. DTAs with deferred tax liabilities (DTLs) can be netted but only if the DTAs and DTLs relate to taxes levied by same tax authority and offsetting is permitted by that tax authority.

### **1.1.11 Other intangible assets**

These are assets without loss absorption capacity on a going concern basis or without physical existence e.g. patents, copyrights, formulae, trademarks and franchises. However, computer software should not be deducted.

### **1.1.12 Total deductions**

This is the total of all the items from 1.1.8 to 1.1.11.

### **1.1.13 Core Capital**

Core Capital is the deduction of line 1.1.12 from line 1.1.7.

## **1.2 SUPPLEMENTARY CAPITAL (TIER 2)**

### **1.2.1 Revaluation reserves**

This is the revaluation reserves of land and buildings based on independent and professional valuation as to the market value of such assets. The valuation should not be more than 3 years. Only 25% of revaluation should be included after obtaining Central Bank of Kenya's approval. Revaluation surplus may be included in Tier II capital not more than once in 5 years.

### **1.2.2 Cumulative irredeemable preference shares**

These are irredeemable shares with standing claim on the company and the claim is carried forward in event of it not being paid in the current year.

### **1.2.3 Convertible notes and similar capital investments**

Convertible notes are instruments that evidence a company promise to pay a loan on maturity, which can be converted, into shares any time before maturity date. Other similar capital investments are convertible debentures, bonds, loans.

### **1.2.4 Perpetual subordinated debt**

This is a debt equity or loan capital, which is not redeemable.

### **1.2.5 Limited life redeemable preference shares**

These are preference shares with limited life of at least five years and are redeemable.

### **1.2.6 Term subordinated debt**

This refers to loan capital, bonds, commercial paper or debt equity with original maturity period of five years and above. Principal should be repayable after at least five (5) years.

### **1.2.7 Statutory Loan Loss Reserve**

These are provisions that have been appropriated from retained earnings (revenue reserves). This will only apply if provisions computed under Risk classification of Assets and Provisioning Guideline is in excess of impairment losses computed under International Financial Reporting Standards. However, loan loss reserve qualifying as supplementary capital should not exceed 1.25% of risk weighted assets total value.

### **1.2.8 Total supplementary capital**

This is the sub-total of the items in line 1.2.1 to 1.2.7.

### **1.2.9 Supplementary Capital/Core Capital (%)**

This is the percentage of the supplementary capital to core capital. Total supplementary capital should not exceed core capital. Where supplementary capital exceeds core capital, then qualifying supplementary capital is limited to the amount of core capital.

### **1.3 Total Capital**

Total capital is the sum of core capital and supplementary capital, i.e. Total of lines 1.1.13 and 1.2.8.

### **1.4 Total Shareholders' funds**

The figure reported in this line should agree with the total shareholders' funds as reported in the BS (M).

### **1.5 Difference**

Any difference between total capital and total shareholders' funds should be reported in this line and a reconciliation of the same be attached.

## **2.0 ON-BALANCE SHEET ASSETS**

### **2.1 Cash (including foreign notes and coins)**

Enter in this line cash at hand (both domestic and foreign).

## **2.2 Balances with Central Bank**

This includes Repos purchase with Central Bank of Kenya, reserve requirement and balances held in clearing accounts

## **2.3 Kenya Government Treasury Bills**

These are Treasury bills issued by the Government of Kenya.

## **2.4 Kenya Government Treasury bonds**

These refer to the Treasury Bonds issued by the Government of Kenya.

## **2.5 Lending fully secured by cash**

Enter here all other debts that are fully secured by cash and supported by signed lien documents.

## **2.6 Advances guaranteed by the Government of Kenya and OECD Central Governments.**

This refers to all loans and advances duly guaranteed by the Government of Kenya and OECD central governments.

## **2.7 Advances guaranteed by governments of other EAC Member States**

This refers to all loans and advances duly guaranteed by other EAC Member States.

## **2.8 Deposits and balances due from local institutions**

These are deposits and balances held with local banks, financial institutions, mortgage finance companies and building societies including overnight balances.

## **2.9 Deposits and balances due from foreign institutions**

These are balances held with correspondent banks, other banks and financial institutions abroad (including banks in the group).

## **2.10 Foreign Treasury Bills and Bonds**

These are bills and bonds issued by foreign governments, banks and other multilateral institutions.

### **2.11 Claims guaranteed by Multi-Lateral Development Banks (MDB's)**

These are loans, advances and capital market instruments such as commercial paper that are guaranteed by the following MDB's: -

- (i) The International Bank for Reconstruction and Development.
- (ii) The Inter-American Development Bank.
- (iii) The Asian Development Bank.
- (iv) The African Development Bank.
- (v) The European Investment Bank.
- (vi) Other MDB's in which G-10 countries are shareholding members. The G-10 member countries are Belgium, Netherlands, Canada, Sweden, France, Switzerland, Germany, United Kingdom, Italy, United States and Japan.

### **2.12 Mortgage Loans secured by Residential Property**

These are mortgage loans which are fully secured by first legal charge on residential property within cities and municipalities in the Republic of Kenya that is or will be occupied by the borrower or that is or will be rented. Such facilities should only be those classified as normal under CBK Guideline No. CBK/PG/04 and are performing in accordance with the original terms and conditions specified in the letter of offer. In addition the security should be perfected in all respects and its current forced sale value should, cover in full, the outstanding debt with at least a 20% margin. The 50% risk weight will not be specifically applied to loans to companies engaged in speculative residential building or property development.

### **2.13 Other loans and advances (net)**

These refer to loans and advances that are not guaranteed by the Government of Kenya and not secured by cash. These also include commercial paper and corporate bonds and should be reported net of provisions. Provisions must be computed in accordance with the Risk Classification of Assets and Provisioning Guideline (CBK/PG/04). However, provisions appropriated from retained earnings should not be netted off from loans and advances.

### **2.14 Other investments**

These are investments in other companies other than financial institutions.

### **2.15 Fixed assets**

These are assets acquired for use in the operation of the business or for investment purposes, e.g. furniture, computers, freehold and leasehold land and buildings. They should be shown net of accumulated depreciation, amortized cost, or at fair value.

### **2.16 Amount due from group companies**

This is the claim of the reporting institution from other group companies that are not financial institutions.

### **2.17 Other assets**

These are other assets, which have not been dealt with above.

### **2.18 Total on-balance sheet assets**

Enter in this line total on-balance sheet asset i.e total of line 2.1 to 2.16. Total deductions from core capital should also be deducted from the assets for the purposes of computing the risk weighted asset values. All interest bearing assets should be reported inclusive of interest earned.

### **2.19 Total Assets (per CBK BSM)**

Total asset figure as reported in the CBK/BS(M) should be indicated in this line.

### **2.20 Difference**

This is the difference between total on-balance sheet assets and total assets as reported in the CBK BS (M). The difference should be explained in the form of reconciliation.

## **3. OFF-BALANCE SHEET ITEMS**

**3.1** Enter in this line total risk adjusted off-balance sheet assets as computed in form B.

## **4. ADJUSTED CREDIT RISK WEIGHTED ASSETS**

**4.1** Enter in this line the Total Risk Weighted Assets for on and off balance sheet items (2.18 + 3.1).

**4.2** Enter the total market risk qualifying assets included in 4.1 above.

**4.3** Subtract the market qualifying assets from the total risk weighted assets to avoid double counting (4.1 less 4.2).

**5. TOTAL MARKET RISK WEIGHTED ASSETS EQUIVALENT**

Enter in this line the total market risk weighted assets equivalent as computed in form C.

**6. TOTAL OPERATIONAL RISK ASSETS EQUIVALENT**

Enter the total operational risk weighted assets equivalent as computed in form D.

**7. CAPITAL RATIO CALCULATIONS**

Compute as per the formulae provided in the form.

**7.7 Total Deposits**

This refers to margins on letters of credit, local and foreign currency deposit liabilities plus accrued interest repayable on demand, after fixed period or after notice.

**OFF-BALANCE SHEET ITEMS**

In Form B (1-6) below, institutions should compute credit risk equivalents for different categories of off-balance sheet transactions by multiplying the nominal principal amount for each category by a credit conversion factor as provided in **Section 4.3.1.2 (a)–(d)** above. The resulting amounts should be weighted against the risk weight of the counterparty as indicated. Under line 5 of the return, foreign banks include the Multi-lateral Development Banks specified under item 2.11 of the completion notes of Form A above. Under line 6, institutions should include undelivered spot transactions.

		Ksh. ('000')		FORM B
	Counterparty/Security	Credit Risk Equivalent	Weight	Weighted Assets Value
1	Transactions Secured by Cash		0.0	
2	Government of Kenya & EAC Members States		0.0	
3	OECD Central Governments		0.0	
4	Local Financial Institutions		0.2	
5	Foreign Banks & Foreign Governments		0.2	
6	Others		1.0	



**MARKET RISK WEIGHTED ASSETS: CAPITAL CHARGE SUMMARY REPORT  
FORM C**

	Ksh. ('000')
<b>1. Total Interest Rate Risk capital Charge (Specific and General) Form B1</b>	-
<b>2. Total Foreign exchange risk capital charge (Form B2)</b>	-
<b>3. Total Commodities Risk capital charge (Form B3)</b>	-
<b>4. Total market risk capital charge (1+2+3)</b>	-
<b>5. Conversion Factor (inverse of 8%)</b>	12.50
<b>6.Total Market Risk Weighted Assets Equivalent (4X5)</b>	-

**MARKET RISK RETURN COMPLETION INSTRUCTIONS**

Market Risk is a sum of interest rate risk, foreign exchange risk and commodity risk.

**1. Market Risk Summary Report**

The total of market risk weighted assets equivalent is determined by summing the amounts determined in:

- total Interest Rate Risk (Form C1);
- total Foreign Exchange Risk (Form C2);
- total Commodity risk (Form C3); and
- multiplying by the conversion factor of 12.5 to get the market risk weighted assets equivalent.

**2. Interest rate risk**

All on and off balance sheet interest rate positions held in the trading book are subject to this charge. The charge encompasses two calculations: one for specific risk and one for general risk.

To calculate the general market risk capital charge, banks and financial institutions must calculate separately their positions in shillings and each other currency that represents a significant holding. In addition, other currencies that represent insignificant holdings are to be combined into a single reporting schedule that has the same format as those for individual currencies.

**Form C1- Specific and General Risk for Interest Rate Related Instruments (The MS-Excel template will be provided separately with the returns compilation software).**

Gross unweighted exposure	-
Net unweighted exposure	-
Capital Charges:	-
Specific risk capital charge	-
Vertical disallowance	-
First horizontal disallowance	-
Second horizontal disallowance	-
Residual charge	-
Total Interest Rate Risk Capital Charge (Specific + General)	-

**Specific Risk Classification Key**

**ID: Issuer type**

G - Government (weight = 0%)

Q1 - Qualifying: 0 to < 6 months (weight = 0.25%)

Q2 - Qualifying: 6 to < 24 months (weight = 1.0%)

Q3 - Qualifying: 24 months and more (weight = 1.6%)

O - Other (weight = 8%)

	<i>Col. 1</i>	<i>Col. 2</i>	<i>Col. 3</i>	<i>Col. 4</i>	<i>Col. 5</i>	<i>Col. 6</i>	<i>Col. 7</i>	<i>Col. 8</i>
					<b>Specific Risk Capital Charge (KSh)</b>	<b>General Risk Weighted Value (KSh)</b>	<b>Risk-weighted Long Positions</b>	<b>Risk-weighted Short Positions</b>
<b>#:</b>	<b>Instrument</b>	<b>Issuer Type</b>	<b>Time Band</b>	<b>Unweighted Exposure (KSh)</b>				
1								
2								
3								
4								
5								
6								
7								
8								
9								

**Form C1 (Continued)**

<i>Col. 9</i>	<i>Col. 10</i>	<i>Col. 11</i>	<i>Col. 12</i>	<i>Col. 13</i>	<i>Col. 14</i>	<i>Col. 15</i>	<i>Col. 16</i>
<b>Time Zone</b>	<b>Time Band</b>	<b>Remaining Maturity (Fixed Rate)/Next Repricing Date (Floating Rate)</b>	<b>Risk Weight</b>	<b>Risk-weighted Long Positions</b>	<b>Risk-weighted Short Positions</b>	<b>Matched Positions in Time Bands</b>	<b>Vertical Disallowance</b>
1	1	0 - 30 days	0%	-	-	-	-
	2	31 - 91 days	0.20%	-	-	-	-
	3	91 - 182 days	0.40%	-	-	-	-
	4	183 - 365 days	0.70%	-	-	-	-
2	5	1 - 2 years	1.25%	-	-	-	-
	6	2 - 3 years	1.75%	-	-	-	-
	7	3 - 4 years	2.25%	-	-	-	-
3	8	4 - 5 years	2.75%	-	-	-	-
	9	5 - 7 years	3.25%	-	-	-	-
	10	7 - 10 years	3.75%	-	-	-	-
	11	10 - 15 years	4.50%	-	-	-	-
	12	15 - 20 years	5.25%	-	-	-	-
	13	20 years	6.00%	-	-	-	-

**Form C1 (Continued)**

<i>Col. 17</i>	<i>Col. 18</i>	<i>Col. 19</i>	<i>Col. 20</i>	<i>Col. 21</i>	<i>Col. 22</i>	<i>Col. 23</i>
Net (Unmatched) Positions in Time bands	Matched Positions in Time Zones	First Horizontal Disallowance	Net (Unmatched) Positions in Time Zones	Matched Positions between Time Zones	Second Horizontal Disallowance	Net (Unmatched) Positions between Time Zones
- - - -	-	-	-	Zones 1&2  -	Zones 1&2  -	
- - -	-	-	-	Zones 2&3  -	Zones 2&3  -	
- - -	-	-	-	Zones 1&3  -	Zones 1&3  -	
- - -	-	-	-	- -	- -	

**3. Completion instructions for the Specific and General Risk for Interest Rate Related Instruments (Form C1 above)**

- i) In column 1 of Form C1 indicate the general identification of the instrument e.g. specific issue of Treasury bills or bonds, commercial paper, Contractor bonds.
- ii) In column 2 of Form C1 indicate the issuer of the instrument e.g. government, qualifying, or other, in accordance with the issuer types described in Table 1 below.
- iii) In column 3 of Form C1 classify the interest rate related instruments into time bands based on remaining time to maturity for fixed rate instruments and the next repricing date for floating rate instruments i.e. 0-1 months,1-3 months etc.
- iv) In column 4 of Form C1 fill in the amounts held in shillings for each of the security instruments. This is the un-weighted exposure.
- v) In column 5 of Form C1 the specific risk charge is a product of column 4 and the “Key to instrument for type for specific risk classification” as indicated in Form C1 above (G, Q1, Q2 Q3 and O also See Table 1) for details.

**Table 1: Specific Risk Charges**

<u>Issuer /counterparty</u>	<u>Risk charge</u>
Government	0%
Qualifying	<ul style="list-style-type: none"><li>▪ 0.25% (residual term to maturity six months or less)</li><li>▪ 1.00% (residual term to maturity six -24 months)</li><li>▪ 1.60% (residual term to maturity more than 24 months)</li></ul>
Other	8%

The *Government* category, which includes all forms of government paper (local and foreign) including bonds, treasury bonds and other short term instruments, has zero risk weight.

The *Qualifying* category attracts risk charges between 0.25% and 1.6% depending on the residual term to maturity. This category includes securities issued by public sector entities and multilateral development banks and other securities subject to supervisory authority that are deemed to be of comparable investment quality by the reporting bank.

The *Other* category receives a specific risk charge of 8%. Both a short portion and a long position in these securities is given the same 8% charge. This category will include non-qualifying corporate debt (i.e. debt issued by corporate entities that are internally classified substandard, doubtful or loss) and any other interest rate related securities not covered in other securities described above.

General Risk charges are designed to capture the market risk arising from a change in interest rates on the entire trading book i.e. a general risk charge should be applied on all the instruments on which specific risk charge would have been applied as described above. Institutions are required to use the maturity methodology to calculate the general risks.

### **Maturity Method**

In the maturity method long or short positions in debt securities and other sources of interest rate exposures including derivative instruments are slotted into a maturity ladder comprising thirteen time-bands as shown in Form C1 above and Table 2 below. When the bank utilises the supplied spread sheet to calculate its market risk charges, the bank is required to complete columns 1 through 4. The remainder of the calculations are programmed for calculation by the spread sheet.

General Risk charges are calculated using the information in column 4 of form C1 multiplied by the risk weight depending on the time band and time zone as indicated in the section showing “Key to Time Zones / Bands”.

The first step in the calculation of general risk charges is to weight the positions (Form C1 column 4) in each time-band by a factor designed to reflect the price sensitivity of those positions to assumed changes in interest rates. The factors (weights) for each time-band are set out in Table 2 (also listed in column 12 of Form C1).

**Table 2: Maturity method time bands and weights**

Zones	Time Bands	Risk Weight (%)	Assumed change in yield (%)
Zone 1	0 – 1 month	0	1.0
	1 – 3 months	0.2	1.0
	3 – 6 months	0.4	1.0
	6 – 12 months	0.7	1.0
Zone 2	1 – 2 years	1.25	0.90
	2 – 3 years	1.75	0.80
	3 – 4 years	2.25	0.75
Zone 3	4 – 5 years	2.75	0.75
	5 – 7 years	3.25	0.70
	7 – 10 years	3.75	0.65
	10 – 15 years	4.5	0.60
	15 – 20 years	5.25	0.60
	>20 years	6	0.60

The next step is to get to produce a weighted long (i.e. column 7 of Form C1) or short position (i.e. column 8 of Form C1) in each time band. The position for all time bands is then aggregated to get the residual general risk.

### **Vertical disallowances within same time bands**

In calculating the general risk charges, short positions are given negative signs and long positions positive signs. This applies to the general risk charge of any short position in any security, regardless of instrument or maturity. For this reason, disallowances of offsets are introduced.

The first step in the calculation of disallowances is to produce two sets of weighted positions, the net long and short positions in the each time-band. These amounts are entered into columns 13 and 14 respectively for Form C1 above. The next step in the calculation is

to offset the matched positions in each time-band, resulting in a single short or long position for each bands.

To determine the vertical disallowances within the same time-bands enter the smaller of the short and long position in a time band, disregarding the sign, into column 15 as the matched position. Since each band may include different instruments and different maturities, a 10% capital charge will be levied on the smaller of the offsetting positions, be it long or short to reflect basis risk and gap risk. This amount is entered into column 16 of Form C1.

The result of the above calculations is to produce weighted positions called the vertical disallowances, which have no sign and are aggregated to give the total vertical disallowance.

### Horizontal Disallowances

In addition, institutions will be allowed to conduct two rounds of “horizontal offsetting”, first between the net positions in each of three time zones (zero to one year, one year to four years and four years and over), and subsequently between the net positions in the three different zones. The offsetting will be subject to a scale of disallowances expressed as a fraction of the matched positions, as set out in Table 3.

**Table 3: Horizontal Disallowances**

Time Zone	Disallowance factor within time zone	Disallowance factor between adjacent time zones	Disallowance factor between time zones 1 and 3
1	40%		
2	30%		
3	30%		

### Horizontal disallowances within same time zones

In column 17 of Form C1 enter the net unmatched positions in the time bands including the sign, indicating whether it is a long and short position.

In column 18 Form C1 enter the matched position in each time zone. This is the smallest exposure in the zone regardless of whether short or long position. Should the net unmatched position in any time band for a particular time zone be zero, the corresponding matched position for that time zone is consequently also zero.

Offsetting positions in each of three time zones attracts a disallowance factor that is part of the capital charge (i.e. 40% for zone 1, 30% for zone 2 and 30% for zone 3), as shown in Table 3. This is entered into column 19 Form C1. The total of the weighted horizontal offsets in column 19 gives total offsets within time zones. This represents the first horizontal disallowance.

### **Horizontal disallowances between time zones**

The net unmatched positions in each time zone, is the residual net position, calculated by summing together the net unmatched positions (Form C1 column 17) for all the time bands associated with a particular time zone, and entering this amount into column 20. This amount may be carried over and offset against opposite positions in other time zones, thereby subjecting the unmatched time zone positions to a second set of disallowance factors.

Matched positions between time zones are calculated as the absolute value of the lower amount of net unmatched positions (Form C1 column 20) between two time zones, and are reported in column 21. Column 22 of Form C1 indicates the second horizontal disallowance. The matched positions between zones 1 and 2, zones 2 and 3, zones 1 and 3 should be weighted with the following factors 40%, 40% and 100% respectively, as indicated in Table 3. The total of the weighted horizontal offsets in column 22 of Form C1 gives total offsets between time zones. This represents the second horizontal disallowance.

Form C1 Column 23 holds the net unmatched position between all time zones, also known as the residual net amount. It is weighted at 100% for capital. The residual net amount can be calculated in three ways, all of which should produce the same result. The net unmatched position is calculated as the net amount resulting from adding together the net unmatched positions in the time bands (Form C1 column 17), with signs applied, or the net unmatched positions in the time zones (Form C column 20), with signs applied. The same amount should result from adding together all the weighted long positions and weighted short positions, as reported in columns 7 and 8 of Form C1 prior to sorting them into time bands.

The general interest rate risk charge is the aggregate of the vertical offset, horizontal offsets and the residual net amount.

**THE TOTAL INTEREST RATE RISK CAPITAL CHARGE CALCULATED ACCORDING TO THE FORM C1 IS INDICATED IN THE TABLE AS “TOTAL INTEREST RATE RISK CAPITAL CHARGE (SPECIFIC + GENERAL)”**

## **2. Calculation of Foreign Exchange Risk Exposure.**

The open position in a currency is the sum of the net spot positions and the net forward positions.



**(a) Net Spot Position**

The net spot position is the difference between on-balance sheet foreign currency assets and liabilities in each particular currency. This must also include all accrued income and accrued expenses.

**(b) Net Forward Position**

The net forward position represents all amounts to be received less all amounts to be paid in the future in a particular currency as a result of foreign exchange transactions which have already taken place. These are off-balance sheet transactions as indicated in the table C2 below.

- i) All amounts to be received less all amounts to be paid in the future as a result of transactions in currency futures, and also the principal on currency swaps, must be measured and included in the net forward position.
- ii) For each currency report any net future income or expense that is not yet accrued but has already been fully hedged. Banks and financial institutions have discretion in whether to report these positions; however they must be consistent in their treatment. The selection of positions that are only beneficial to reducing the overall position will not be permitted.
- iii) To be included in the calculation guarantees must be certain to be called and likely to be unrecoverable.
- iv) Other off-balance sheet items that represent either a profit or loss in foreign currency should be recorded as other items.

**(c) Calculating Overall Net Open FX Position using the Shorthand Method**

Under the Shorthand method the overall net open position shall be arrived at as follows;

- (i) Adding together all net short positions.
- (ii) Adding together all long positions.
- (iii) The Overall Net Open Position is the higher of (i) and (ii).

**(d) Calculation of Capital Charge**

The absolute value of the overall net open position in currencies is then added to the open position in gold to get the overall net open position in currencies and gold. The total capital for foreign exchange risk under the shorthand method is then obtained by multiplying the overall net open position in currencies and gold by a factor equivalent to the required minimum capital adequacy ratio for the overall net open position (**10%**).

**FORM C2 - Foreign Exchange Risk completion**

**Ksh. ('000') FORM C2**

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	<b>CURRENCY TYPE</b>	<b>USD</b>	<b>GBP</b>	<b>EURO</b>	<b>JPY</b>	<b>CHF</b>	<b>ZAR</b>	<b>OTHERS</b>	<b>TOTALS</b>
	<b>EXCHANGE RATE</b>								
<b>1.</b>	<b>FOREIGN CURRENCY ASSETS</b>								
<b>1.1</b>	<b>Balance Sheet Items</b>								
1.1.1	Cash and Balances with Banks Abroad								
1.1.2	Loans & Advances								
1.1.3	Investment in Govt. Securities								
1.1.4	Other Foreign Assets								
<b>2.</b>	<b>Off-Balance Sheet Items</b>								
2.1	Undelivered Spot Purchases								
2.2	Forward Purchases								
2.3	Other Off-balance Items								
<b>3.</b>	<b>Total Foreign Assets (1.1.1 to 2.3)</b>								
<b>4.</b>	<b>FOREIGN CURRENCY LIABILITIES</b>								
<b>4.1</b>	<b>Balance Sheet Items</b>								
4.1.1	Balances due to Banks abroad								
4.1.2	Deposits								
4.1.3	Loans & Advances								
4.1.4	Other Foreign Liabilities								
<b>5.</b>	<b>Off-balance Sheet Items</b>								
5.1	Undelivered Spot sales								
5.2	Forward Sales								
5.3	Other Off-balance Sheet Items								
<b>6.</b>	<b>Total Foreign Liabilities (4.1.1 to 5.3)</b>								
<b>7.</b>	<b>NET OPEN POSITION (3 less 6)</b>								
7.1	Long Position (where 3 less 6 is positive)								
7.2	Short Position (where 3 less 6 is negative)								
<b>8.0</b>	<b>OVERALL FOREX EXPOSURE</b>								
8.1	Exposure (higher of net long/short position)								
<b>8.2</b>	<b>Gold</b>								
8.3	Overall net open position								
8.4	Risk weight								
8.5	Capital charge for foreign exchange risk								

### 3. Commodities risk

#### (a) Commodities Risk Completion instructions (Form C3)

The return Form C3, on computation of a capital charge on commodities risk is to be completed as follows:

- (i) List the commodities in which the institution holds positions under column A of Form C3.
- (ii) Convert the positions in each commodity at current spot rates into Kenya Shillings.
- (iii) Determine the long and short positions in each commodity and enter the same into respective columns B & C of Form C3.

Note: Institutions are only expected to complete the 3 steps above.

#### (b) Commodities Capital Charge Computation

- (i) The capital charge for directional risk will be equal to 15% of the net position, long or short, in each commodity.
- (ii) In order to protect the bank against basis risk, interest rate risk and forward gap risk, the capital charge for each commodity will be subject to an additional capital charge equivalent to 3% of the bank's gross positions, long plus short, in that particular commodity. In valuing the gross positions in commodity derivatives for this purpose, banks should use the current spot price.
- (iii) The total capital charge for commodities risk will be the sum of the charges obtained in (i) and (ii) above for all the commodities.

#### COMMODITIES RISK REPORTING - SIMPLIFIED APPROACH CAPITAL CHARGE FOR COMMODITIES RISK RETURN

Ksh. ('000) FORM C3

No.	Commodity	Long position	Short position	Net position	Directional Risk Capital Char
	A	B	C	D=Absolute(B-C) -	E=D*15% (F)
1				-	-
2				-	-
3				-	-
4				-	-
5				-	-
6				-	-
7				-	-
	Total		-		-

### Capital Charge Computation

1	Capital charge for directional risk (15% of the net position, long or short in each commodity)	Sum F* 0.15
2	Additional capital charge against basis, interest rate and forward gap risk (3% of gross positions i.e. long plus short positions in all commodities)	(Sum B + sum C)*0.03  -
	<b>Total Capital Charge for Commodities Risk (1+2)</b>	-

### FORM D: CAPITAL CHARGE CALCULATION FOR OPERATIONAL RISK USING BASIC INDICATOR APPROACH

The capital charge for operational risk under BIA may be expressed as follows:

$$K = [(GI 1 + GI2 + GI3) \times \alpha] / n, \text{ where,}$$

K = capital charge under the Basic Indicator Approach

GI = only positive annual gross income over the previous three years (i.e. negative or zero gross income if any shall be excluded),

$$\alpha = 15\%$$

n = number of the previous three years for which gross income is positive.

#### Gross income

Gross Income (GI) is defined as “Net interest income” plus “net non-interest income”. This measure should; -

- a) be gross of any provisions (includes interest suspense)
- b) be gross of operating expenses, including fees paid to outsourcing service providers
- c) exclude realized profits/losses from the sale of securities held to maturity in the banking book.
- d) exclude extraordinary or irregular items.

**Ksh. ('000)****FORM D**

No	Item	Year 1	Year 2	Year 3
		(A)	(B)	(C)
1	Net Interest Income			
2	Net non-interest income			
3	Gross Income	GI1 =	GI2 =	GI3 =
4	Capital Charge Computation	Capital Charge = $\{\text{sum}(\text{GI1} + \text{GI2} + \text{GI3}) \times \alpha\} / t$		
5	Conversion factor (8% inverse)	12.5		
6	<b>Operational Risk Weighted Assets Equivalent</b>	4 x 5		

**GENERAL**

All reported items reported in the returns above should agree with or be capable of being derived from the figures reported under CBK BS (M) of the same period. This is a monthly return and should be submitted by the 10th day of the following month.

**GUIDELINE ON RISK CLASSIFICATION OF ASSETS, PROVISIONING AND  
LIMITATION ON INTEREST RECOVERABLE ON NON-PERFORMING LOANS  
(CBK/PG/04)**

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## **PART I: PRELIMINARY**

### **1.1 Title**

Guideline on Risk Classification of Assets, Provisioning and Limitation of Interest on Non -Performing loans.

### **1.2 Authorisation**

1.2.1 The Guideline is issued under Sections 33(4) and 44A of the Banking Act, which empowers the Central Bank to issue guidelines, advise and direct business of institutions for the general carrying out of the purposes and provisions of the Banking Act (Cap.488).

1.2.2 Sections 20, 31 and 44A of the Banking Act place the following requirements upon institutions:

- Section 20 requires institutions to maintain adequate provisions for bad and doubtful debts prior to declaring profits or dividends.
- Section 31 (3) (b) requires institutions to exchange information on non-performing loans.
- Section 44A limits the amount of interest institutions may recover on non-performing loans.

### **1.3. Application**

All institutions licensed under the Banking Act.

### **1.4. Definitions**

Terms used in this Guideline are as defined in the Banking Act and as further defined below:

1.4.1 “**interest owing**” for purposes of section 44A (6) of the Banking Act, this refers to the interest accrued in accordance with the contract between the debtor and the institution but not paid by the date the requirements for the limitation of interest recoverable on non-performing loans came into operation.

1.4.2 **“limitation of interest recoverable on non-performing loans”** refers to the restrictions imposed by section 44A of the Banking Act.

1.4.3 **Loans and loans advances** may be used inter-changeably to mean a financial asset resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on a specified date or dates, or on demand, usually with interest. Loans comprise business and personal lending, overdrafts, credit card lending, Hire purchases, Residential and Commercial Mortgage, Project Finance, finance lease and other financing arrangement that are in substance loans.

1.4.4 **Gross loan** in a loan or group of loans is the face or principal amount, taking into account payments applied to reduce principal, and adjusted to reflect accrued but uncollected interest, charge-offs, unamortized premium or discount (i.e., a difference between acquisition cost and principal) and unamortized loan fees and costs.

1.4.5 **Interest in Suspense** is interest accrued on non-performing loans that is not recognized as income in institution’s income statements.

1.4.6 **Net Loan** is gross loan less interest in suspense less provisions for loans

1.4.7 **Impaired loan’** is a loan which has deteriorated in the credit quality such that it is probable that the institution will be unable to collect, or there is no longer reasonable assurance that the institution will collect, all amounts due according to the contractual terms of the loan agreement(s).

1.4.8 **“non-performing loans and advances”** - for purposes of Sections 20, 31 and 44A of the Banking Act means:

1.4.8.1 In respect of loan accounts and other credit extensions having pre-established repayment programs, when any of the following conditions exist:

- principal or interest is due and unpaid for 90 days or more; or
- interest payments for 90 days or more have been re-financed, or rolled-over into a new loan.

1.4.8.2 In respect of current accounts (overdrafts) and other credit extensions not having pre-established repayment programs, when any of the following conditions exist:



- balance exceeds the customers approved limit for more than 90 consecutive days;
- the customers borrowing line has expired for more than 90 days;
- interest is due and unpaid for more than 90 days;

1.4.8.3 In respect of off balance sheet items, when the off balance sheet items crystallizes and the customer's account is debited and the principal and interest is thereafter unpaid for 90 days or more.

1.4.9 **Off balance sheet items**" means an asset or a debt or a financing activity that does not appear on the institution's balance sheet. Such items include guarantees, acceptances, performance bonds, letters of credit, and other off balance sheet items deemed to constitute credit risk by the Central Bank of Kenya.

1.4.10 **"Provisions for loan" or "allowance for loan"** - is the amount that reduces the gross loan in a loan or a group of loans to the carrying amount on the balance sheet.

- *Specific provision* 'is a provision that is established against a loss that is identified in an individual loan.
- *General provision* ' is a provision that is established for latent losses that are known to exist, but cannot yet be ascribed to individual loans.

1.4.11 **"Other Provisions"**

Is provision other than provision for loans losses.

1.4.12 **"past due" or "overdue"** - means any loan for which:

- principal or interest is due and unpaid for more than 30 days; or
- interest payments equal to more than 30 days interest have been refinanced, or rolled-over.

Current accounts (overdrafts) and other credit extensions are considered "past due" when any of the conditions below exist:

- balance exceeds the customers approved limit for more than 30 consecutive days;
- the customers borrowing line has expired for more than 30 days;

- interest is due and unpaid for more than 30 days; or
- the account has been inactive or credits are inadequate to meet the outstanding interest for more than 30 days.

The balance outstanding (not just the amount of delinquent payments) is used in calculating the aggregate amount of “past due” loans.

1.4.13 **“Principal owing”** – for purposes of section 44A of the Banking Act, this refers to the loan and advance that is still outstanding or unpaid excluding interest accrued when the loan and advance becomes non-performing.

1.4.14 **“Performing loans and advances”** - for purposes of Sections 31 and 44A, means loans and advances which are otherwise not defined as non performing under this guideline.

1.4.15 **Renegotiated loans and advances** may be used **interchangeably with restructured loans and advances** to mean loans and advances where the lender, for economic or legal reasons related to the borrower’s financial difficulties, grants a concession to the borrower that it would not otherwise consider. Restructured troubled loans and advances are loans and advances for which the lender has granted a concession to the borrower due to a deterioration of the borrower’s financial condition. The restructuring may include:

- A modification of terms, e.g., a reduction in the interest from that originally agreed or a reduction in the principal amount.
- The transfer from the borrower to the bank of real estate, receivables from third parties, other assets, or equity interest in the borrower in full or partial satisfaction of the loan.

1.4.16 **“Fully secured loan”** means that a credit facility where collateral used to secure the facility has a value that is sufficient to cover the carrying amount of the loan. Such security is perfected in all respects and has no prior encumbrances that could impair its value or otherwise prevent obtaining clear title.

1.4.17 **Grouping of accounts.** Means loans and advances to related companies and individuals are grouped together and recognized as a single borrowing in completing returns under this guideline; loans to a company or individual

are to be grouped together with loans to their associated companies and individuals. Associates are defined in Section 2 of the Banking Act.

- 1.4.18 **Overdraft** a loan which can be transacted without any specific repayment schedule but has a limit and an expiry date for repayment.

## **PART II: STATEMENT OF POLICY**

### **2.1 Purpose**

2.1.1 This guideline is intended to ensure that all assets are regularly evaluated using an objective internal grading system which is consistent with this guideline and that timely and adequate provisions and write offs are made to the provisions account in order to accurately reflect the true and fair financial condition of the institutions. It is also intended to encourage institutions to develop effective workout plans for problematic assets in accordance with this guideline.

2.1.2 This guideline is intended to ensure that institutions do not charge interest that is more than the principal owing at the time the loan becomes non-performing.

### **2.2 Scope**

This guideline applies to all assets held or reflected in an institution's books, including off balance sheet items.

### **2.3 Responsibility**

The Board of Directors of each institution shall be responsible for establishing:

2.3.1 an asset review system, which is consistent with this guideline, which accurately identifies risk, assures the adequacy of the provisions for non-performing assets, and properly reflects such results in the financial statements of the institution.

2.3.2 a system to ensure that interest accrued on non-performing loans and advances does not exceed the principal owing at the time the loan becomes non-performing.

In the exercise of its prerogatives as the highest policy making body of the institution, the Board of Directors of every institution shall prescribe in writing:

- a) a credit policy specifying the criteria and procedures in the evaluation, processing, approval, documentation, and disbursement of credits. Such policy should include the procedures for loan administration and recovery, the recording of transactions and maintenance of appropriate credit and document files. The levels of discretion given to approving executive officers or committees must be defined in such credit policy or in a separate resolution of the board of directors. The credit policy should also outline circumstances and conditions under which loans may be restructured.
- b) a system of reviewing the entire asset portfolio including contingent accounts or off balance sheet items and adequate provisioning for losses at periodic quarterly intervals. Such a review system should be made part of the credit policy mentioned.
- c) a system of review of each extension or renewal of credit, identifying, and classifying troubled credits as weaknesses become evident without waiting for the scheduled periodic review. Such review system should likewise be made part of the credit policy mentioned.
- d) a system for identifying loans and advances as when they become non-performing and the outstanding balance at the time.

### **PART III: SPECIFIC REQUIREMENTS FOR LOANS AND ADVANCES**

#### **3.1 Loan Review**

##### **(a) Objectives.**

Each institution's loan review function shall ensure that:

- The lending function conforms to a sound and written lending policy which has been adopted and approved by the board of directors;

- Management and the board of directors are adequately informed regarding portfolio risk;
- Problem accounts are properly identified on a timely manner and internally classified appropriately, in accordance with the classification criteria as given in this guideline as a minimum;
- Adequate level of provisions for potential loss are made and maintained at all times;

**(b) Frequency and Reporting**

The management of each institution shall ensure that a review of its loan portfolio is made at least on a monthly basis. Such reports shall provide sufficient information that will enable the board to deliberate and direct management to take timely and necessary remedial action within a specified time frame.

**3.2 Classification of Loans**

**(a) Criteria for Classification**

In the determination of the classification for loans and advances, performance will be the primary consideration. The performance will generally show the repayment capability of the borrower. An institution could develop and implement its own loan classification system based on internal risk rating methodologies, however at minimum loans shall be classified into the five categories using the criteria provided in this Guideline

Loans classified as sub-standard, doubtful and loss shall be considered as non-performing loans (NPLs).

- Normal
- Watch
- Sub-standard
- Doubtful
- Loss

Where an institution is using its own internal risk rating system there should be a proper process to map the internal rating to classification provided in this guideline.

**(b) Adverse Classification**

A significant departure from the primary source of repayment may warrant adverse classification even when a loan is current or is supported by an underlying collateral value. Reclassification may also be warranted if a delinquency has been technically cured by modification of terms, refinancing, or additional advances.

In cases where different classification grades may be assigned based on subjective criteria, the more severe classification should generally apply. Moreover, nothing contained in the classification definitions below shall preclude assigning a more severe grade when an analysis of a borrower's financial condition, ability, and willingness to repay justifies a more severe classification.

**(c) Central Bank's Classification**

Upon completion of an on-site examination, the Central Bank of Kenya will provide a list of reclassified accounts, some of which will be downgraded from categories earlier classified by the institution. No account from this list will be upgraded by the institution without sufficient justification.

It is a requirement that, before the quarterly and year-end accounts are finalized and published, institutions take into account the provisions recommended in the latest Central Bank inspection report. Where necessary, tripartite meetings may be held between the institution, Central Bank of Kenya and the external auditors.

### **3.3 Classification Categories**

**(a) Normal**

These are well-documented facilities granted to financially sound customers where no weaknesses exist. All such loans must be performing in accordance with the contractual terms and are expected to continue doing so. Loans in this category are normally fully protected by the current sound net worth and paying capacity of the borrower.

**Performance**

- (i) Term loans:
  - Up to date repayments;

- (ii) **Overdrafts:**  
Operates within limit and receiving sufficient credits each month to cover interest.
- (iii) **Bills Discounted**  
Bill not yet due
- (iv) **Off Balance Sheet items**  
Off balance sheet items that have not yet crystallised.

**(b) Watch**

Loans in this category may be currently protected and may not be past due but exhibit potential weaknesses which may, if not corrected, weaken the asset or inadequately protect the institution’s position at some future date. Examples of such weaknesses include, but are not limited to: inability to properly supervise the debt due to an inadequate loan agreement; deteriorating condition or control of collateral; deteriorating economic conditions or adverse trends in the borrower’s financial position which may, if not checked, jeopardize repayment capacity, risk potential is greater than when the loan was originally granted. This category should not be used as a compromise between Normal and Substandard.

**Performance**

(i) **Term Loans**

These are loans, which display one or all of the following characteristics:

- Principal or interest is due and unpaid for 30 to 90 days
- Interest payments are outstanding for 30 to 90 days or have been refinanced, or rolled over.
- For loans paid in installments:

<b>Mode of payment</b>	<b>Installments in Arrears</b>
Monthly	Less than 3 months
Quarterly	1 (not paid within 3 months)
Semi-annually	1 (not paid within 3 months)
Annually	1 (not paid within 3 months)

ii) Current accounts (overdrafts)

Current accounts (overdrafts) and other credit extensions are considered “Watch” when any of the conditions below exist:

- overdraft exceeds the customers approved limit for more than 30 to 90 consecutive days.
- the customer’s credit line has expired and has not been renewed for more than 30 to 90 days from the date of expiry.
- interest is due and unpaid for more than 30 to 90 days.
- the account has been inactive for more than 30 to 90 days or credits are inadequate to meet all the outstanding interest during the period.
- the customer’s credit line has been extended administratively in line with the institution’s documented policy for more than 90 days from the date of expiry, on condition that, during the period of extension, it is performing as per contract terms.

(iii) Bills Discounted

Overdue for more than 30 to 90 days.

(iv) Off Balance Sheet items

Off balance sheet items that have crystallised and remain unpaid for up to 90 days.

An off-balance sheet item is said to have crystallised after occurrence or non-occurrence of anticipated events leading to existence of an asset or liability which was previously uncertain.

**(c) Substandard**

Loans in this category are not adequately protected by the current sound net worth and paying capacity of the borrower. In essence, the primary sources of repayment are not sufficient to service the debt and the institution must look to secondary sources such as collateral, sale of fixed assets, refinancing or additional capital injections for repayment.

Any loan, which is past due for more than 90 days but less than 180 days shall be classified as Substandard, at a minimum.



## Performance

(i) Term loan

- Principal or interest is due and unpaid for more than 90 days to 180 days.
- Interest payments for more than 90 days to 180 days have been re-financed, or rolled-over into a new loan.
- Principal or interest is due and unpaid for more than 90 days to 180 days.
- For loans paid in installments: -

Mode of payment	Installments in Arrears
Monthly	Over 3 months to 6 months
Quarterly	2 (not paid within 3 months)
Semi-annually	1 (not paid within 6 months)
Annually	1(not paid within 6 months)

(ii) **Current accounts (overdrafts)**

Current accounts (overdrafts) and other credit extensions are considered “Sub Standard” when any of the following conditions exist:

- debt exceeds the customers approved limit for more than 90 days to 180 consecutive days.
- the customer’s credit line has expired for more than 90 days to 180 days.
- interest is due and unpaid for more than 90 days to 180 days.
- the account has been inactive for more than 90 days to 180 days and credits are insufficient to cover all the outstanding interest during the period.

(iii) **Bills Discounted**

A bill discounted is considered substandard when the bill is overdue and unpaid for over 90 days to 180 days.

(iv) **Off Balance Sheet Items**

Crystallised off balance sheet items that remain outstanding for over 90 days to 180 days.

**(d) Doubtful**

Loans in this category have all the weaknesses inherent in a substandard loan plus the added characteristic that the loan is not well secured. These weaknesses make collection in full, on the basis of currently existing facts, conditions, and value, highly questionable and improbable. The possibility of loss is high, but because of important and reasonably specific pending mitigating factors, the actual amount of loss cannot be fully determined. If pending events do not occur within 360 days and repayment must again be deferred pending further developments, a loss classification is warranted upon realization of securities held. A loan that is past due for more than 360 days may however retain a “doubtful” classification if it is backed by realisable security.

**Performance**

Any loan which is past due more than 180 days shall be classified as Doubtful at a minimum:

- (i) Term loan
- Principal or interest is due and unpaid for over 180 days.
  - For loans paid in installments: -

<b>Mode of payment</b>	<b>Installments in Arrears</b>
Monthly	Over 6 months but less than 12 months
Quarterly	3 (not paid within 3 months)
Semi-annually	2 (not paid within 3 months)
Annually	1(not paid within 9 months)

- (ii) Current accounts (overdrafts)
- Current accounts (overdrafts) and other credit extensions are considered “Doubtful” when any of the following conditions exist:
- Debt exceeds the customers approved limit for more than 180 days.
  - The customer’s credit line has expired for more than 180 days.
  - The account has been inactive for more than 180 days or credits are inadequate to meet all the outstanding interest during the period.
  - Interest is unpaid and due for more than 180 days.

- (iii) Bills Discounted

A bill discounted is considered doubtful when the bill is overdue for more than 180 days but not more than 360 days.

(iv) **Off Balance Sheet items**

Crystallised off balance sheet items that remain outstanding for over 180 days to 360 days.

Any loan, which is under doubtful category where the security has either been sold or discounted to zero value, shall be classified as loss unless the debt is in the process of being collected e.g. in due course or through legal action or any other means expected to result in repayment of the debt or in its restoration to current status.

(e) **Loss**

Loans, which are considered uncollectible or of such little value that their continuance recognition as bankable assets is not warranted shall be classified Loss. Losses shall be taken in the period in which they are identified.

(i) Term loan

- Principal or interest is due and unpaid for over 360 days.
- For loans paid in installments: -

<b>Mode of payment</b>	<b>Installments in Arrears</b>
Monthly	12 or more
Quarterly	4 or more
Semi-annually	2 (not paid within 5 months)
Annually	1 (not paid within 11 months)

(ii) Current accounts (overdrafts)

Current accounts (overdrafts) and other credit extensions are considered “Loss” when any of the following conditions exist:

- Debt exceeds the customers approved limit for more than 360 days.
- The customer’s credit line has expired for more than 360 days.
- The account has been inactive for more than 360 days or credits are inadequate to meet all the outstanding interest during the period.
- Interest is unpaid and due for more than 360 days.

(iii) Bills Discounted

A bill discounted is considered loss when the bill is overdue for more than 360 days.

(iv) Off Balance Sheet items

Crystallised off balance sheet items that remain outstanding for more than 360 days.

**(f) Classification of Multiple facilities**

If an institution has granted multiple facilities to a single borrower, and any one of them is non-performing, then the institution shall evaluate every other loan to that borrower and where necessary place such loans on non-performing status. Provisions will be made against that facility to fairly state the bank's financial position. Apportionment of joint collateral should be prorated for purposes of provisioning based on current exposure, unless the institution has formulated an alternative acceptable allocation mechanism of the collateral value to the individual non performing facility.

**3.4 Re-classification of Non-Performing Loans and Advances**

3.4.1 A facility in the **Substandard** category will normally continue to be classified Substandard unless all past due principal and interest is repaid in full, in which case it may be upgraded to '**Watch**' classification.

3.4.2 A facility in the Doubtful category will normally continue to be classified Doubtful unless all past due principal and interest is repaid in full, in which case it may revert to '**Watch**' classification.

A facility which meets the above condition and has been classified as **Watch** may be reclassified **Normal** if a sustained record of performance is maintained for a period of six (6) months.

No provisions for non-performing loans may be written back unless the accounts have been upgraded strictly on the basis of the criteria under clause 3.4.

**3.5 Classification of Renegotiated Loans and advances**

3.5.1 A renegotiated loan and advance in the normal and watch categories will normally continue to be classified as normal or watch as the case may be unless the loans have exhibited weaknesses which may weaken the assets or inadequately protect the institution's position at some future date. Examples of such weaknesses include, but are not limited to:

Inability to properly supervise the debt due to an inadequate loan agreement.

- a) Deteriorating condition or control of collateral.
- b) Deteriorating economic conditions or adverse trends in the borrower's financial position which may, if not checked, jeopardize repayment capacity, and
- c) Risk potential is greater than when the loan was originally granted.

For normal and watch loan categories to be renegotiated, the customer must provide sufficient justification and evidence that he/she has enough income to support the new repayment schedule. In reviewing the terms and conditions of the facility, an institution must guard against granting 'evergreen' facilities which may be used as conduits to hide non-performing facilities.

3.5.2 A renegotiated loan and advance in the Substandard category will normally continue to be classified **substandard** unless:

- (i) all past due principal and interest is repaid in full at the time of renegotiation, in which case it may revert to '**Watch**' classification or
- (ii) a sustained record of performance under a realistic repayment program has been maintained. A sustained record of performance means that all principal and interest payments are made according to the modified repayment schedule.

A renegotiated loan which meets condition (i) above may be reclassified as **Normal** if a sustained record of performance is maintained for six (6) months from the date of renegotiation.

A renegotiated loan in the **Sub-standard** category, which meets condition (ii) above may be classified as '**Watch**' if the sustained record is maintained for at least six (6) months from the date of renegotiated date.

It may however qualify for '**Normal**' classification if the sustained record is maintained for at least twelve (12) months from the renegotiated date. If after a formal restructuring a loan deteriorates, it must revert to a non-performing classification status and be classified accordingly.

3.5.3 A renegotiated loan in the **Doubtful** category will normally continue to be classified **Doubtful** unless:

- (i) all past due principal and interest is repaid in full at the time of renegotiation, in which case it may revert to '**Watch**' classification or
- (ii) a sustained record of performance under a realistic repayment program has been maintained. A sustained record of performance means that all principal and interest payments are made according to the modified repayment schedule.

A renegotiated loan which meets condition (i) above may be reclassified **Normal** if a sustained record of performance is maintained for a period of six (6) months from the date of renegotiation.

A renegotiated loan in the '**Doubtful**' category, which meets condition (ii) above can be classified as '**Watch**' if the sustained record of performance is maintained for at least twelve (12) months from the date of renegotiation. It may however qualify for '**Normal**' classification if the sustained record of performance is maintained for at least eighteen (18) months from the renegotiated date. If after a formal restructuring, a loan deteriorates it must revert to a non-performing classification status and be classified accordingly.

### 3.6 **Provisioning Requirements**

#### (a) **Suspension of Interest**

When a loan is classified to non-performing category, an institution should either cease the accrual of interest or continue to accrue interest suspended in accordance with the criteria set out in this guideline and should not be treated as income. Interest in suspense shall be taken into account in the computation of provisions for non-performing loans.

#### (b) **Minimum provisioning allocations.**

In determining the amount of potential loss in specific loans or in the aggregate loan portfolio, all relevant factors shall be considered including, but not limited to: historical loan loss experience, current economic conditions, delinquency trends, the effectiveness of the institution's lending policies and

collection procedures, and the timeliness and accuracy of its loan review function.

The following minimum percentage amounts for provisioning are to be maintained according to assigned classifications. Where reliable information suggests that losses are likely to be more than these minimum amounts, larger provisions shall be made.

- i) for loans classified “**Normal**” 1%
- ii) for loans classified “**Watch**” 3%
- iii) for loans classified “**Substandard**” 20%
- iv) for loans classified “**Doubtful**” 100%
- v) for loans classified “**Loss**” 100%

In the case of the first two categories the above percentages shall be applied against the gross balance of a loan regardless of whether the loan is analysed individually or as part of a pool of loans. For nonperforming categories the percentages will be applied to the net balances after deduction of realisable value of security and interest in suspense.

#### **(c) Accounting treatment for provisions for loan losses**

If impairment charges computed under International Financial Reporting Standard (IFRS) are lower than provisions required under this guideline, the excess provisions shall be treated as an appropriation of retained earnings and not expenses in determining profit and loss. Similarly any credits resulting from the reduction of such amounts results in an increase in retained earnings and are not included in the determination of profits or loss.

Where the impairment charges computed under IFRS are higher than provisions required under this guideline, the impairment charges will be considered adequate for purposes of this guideline.

### **3.7 Treatment of Collateral**

#### **(a) General**

Classification ratings of loans do not depend on the amount or quality of collateral pledged. Collateral is regarded as a secondary source of repayment, and therefore is only used in assessing the amount of loan loss provision required for non-performing loans. This is especially true where the validity, value and ability to realize collateral is subject to significant doubt.

**(b) Perfection of Securities**

Where securities are obtained, they should be perfected in all respects, namely:

- Duly charged and registered.
- Adequately insured.
- Valued by a registered valuer.
- Perfected in all other areas specified in the letter of offer.

**(c) Valuation of Securities**

For the purpose of determining the value of security in accounts, security should be valued by a registered valuer on a reasonable and regular basis. This should be clearly stated in the institutions credit policy. Examiners may discount the value of securities depending on the prevailing circumstances of each case. If the Central Bank of Kenya deems it necessary, it may require the institution to have a valuation carried out by another valuer registered by the Institution of Surveyors of Kenya, at the institution's expense.

For the purpose of this guideline the value of chattels mortgage and guarantees that are not supported by tangible assets and will not be considered, while debentures will be considered at 50% of the realisable market value based on the latest valuation or the book values as per the latest audited financial statements. Examiners may discount the value of securities further depending on the circumstances of each case.

**(d) Discounting of Securities**

For the non-performing loans, the discounted value of collaterals shall be deducted from the loan balance before making provisions. The period allowable for deductions of discounted value of collaterals shall be for a maximum of five years from the period the loan becomes non-performing. Institutions will be expected to progressively discount the forced sale value of securities over the five-year period at a discount rate of 20% p.a. However, for the purpose of reporting to Central Bank, institutions will be required to discount their securities at a rate of 5% every quarter. For purposes of discounting, the security value will be based on the forced sale value when the loan becomes non-performing and any future appreciation in value should not affect the discount amount. For all forms of collaterals, the discounted value of securities may be deducted if transferability of title is certain and an active market



exists. An “active market” means that a bona fide sale (willing buyer/willing seller) can be achieved within a reasonable period. The effective date for starting discounting of securities shall be the date on which the underlying loan becoming non-performing.

### 3.8 **Examiner’s review**

The board of directors shall maintain adequate records supporting its evaluation of potential loan losses and the entries made to ensure adequacy of the provision for loan losses. Such records shall be available for examiners to assess management’s loss estimation procedures, the reliability of the information on which estimates are based, and the adequacy of the provision for loan losses. If the provision for loan losses is determined to be inadequate, adjusting entries will be required.

### 3.9 **Write-Off of Loan/Advances**

An institution should write off a loan or a portion of a loan from its balance sheet when the institution loses control of the contractual rights over the loan or when all or part of a loan is deemed uncollectible or there is no realistic prospect of recovery. This normally evident at a stage where-

- a) The institution loses control of the contractual rights that comprise the loan or part of the loan as determined by a court of law.
- b) All forms of securities or collateral have been called, realized, but proceeds failed to cover the entire facility outstanding.
- c) The institution is not able to collect or there is no longer reasonable assurance that the institution will collect all amounts due according to the contractual terms of the loan/advances agreement.
- d) The borrower becomes bankrupt
- e) Where efforts to collect debt are abandoned for any other reason.

Write off of facilities classified as loss should be done within 180 days of their being classified as loss if there are no recoveries within this period.

All credit policies should adequately detail the write-off procedures in order to minimise potential abuse. The ultimate authority for approval of write-offs rests with the board of directors and the memorandum accounts should be periodically audited.

#### **PART IV: OTHER ASSETS**

Apart from the loans and advances portfolio, institutions may have other assets such as deposits with institutions under statutory management and liquidation, investments in associates, subsidiaries and joint ventures and sundry debtors which may be subject to loss or diminution in value. Institutions should regularly review the other assets and make necessary provisions as need arises.

Provisions should be made where an actual loss of an asset occurs or when the recoverable amount of the asset is less than its carrying value. Provisions so made should not be lumped together with provisions for loans and advances on the CBK BS (M) but should be included under other provisions.

#### **PART V: REQUIREMENTS ON LIMITATION OF INTEREST RECOVERABLE ON NON -PERFORMING LOANS AND ADVANCES**

- 5.1 An institution shall be limited in what it may recover from a debtor with respect to a non-performing loan to the maximum amount under clause 5.2.
- 5.2 The maximum amount referred to in clause 5.1 is the sum of the following;
  - (a) the principal owing when the loan become non-performing;
  - (b) interest, in accordance with the contract between the debtor and the institution, not exceeding the principal owing when the loan becomes non-performing; and
  - (c) expenses incurred in the recovery of any amount owed by the debtor.
- 5.3 If a loan becomes non-performing and then the debtor resumes payments on the loan and then the loan becomes non-performing again, the limitation under paragraphs (a) and (b) of clause 5.2 shall be determined with respect to the time the loan last became non-performing.
- 5.4 The requirements of Section 44A shall not apply to limit any interest under a court order accruing after the order is made.
- 5.5 The limitation of interest recoverable on non-performing loans shall apply with respect to loans made before section 44A came into operation and to loans that have become non-performing before the said section comes into operation. Provided that where a loan became non-performing before this requirement comes into operation the maximum amount shall be the sum of the following;

- (a) the principal and interest owing on the day these requirements come into operation; and
- (b) interest in accordance with the contract between the debtor and the institution accruing after the day these requirements come into operation, not exceeding the principal and interest owing on the day this requirements come into operation; and
- (c) expenses incurred in the recovery of any amounts owed by the debtor.

## **PART VI: REPORTING REQUIREMENTS**

Institutions shall submit to the Central Bank of Kenya at monthly intervals CBK/PR4-1 to CBK/PR4-5. The intervals for reporting may change from time to time as the Central Bank may require. The returns should be submitted by 10<sup>th</sup> day of the subsequent month.

## **PART VII: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS**

### **7.1 Remedial measures**

If an institution fails to comply with this guideline, the Central Bank may pursue any or all corrective sanctions and or actions as provided for under the Banking Act.

### **7.2 Administrative sanctions**

In addition to the use of Remedial measures noted in 7.1 above, the Central Bank may pursue any or all of the following administrative sanctions against an institution, its board of directors, or its officers:

- 1) Prohibition from engaging in any further foreign exchange activities;
- 2) Prohibition from declaring or paying dividends;
- 3) Prohibition from establishing new branches or facilities;
- 4) Prohibition from engaging in new activities or from expanding existing activities;
- 5) Suspension of access to Central Bank credit facilities;
- 6) Suspension of lending, investment, and credit granting operations;
- 7) Prohibition from acquiring, through purchase or lease, additional fixed assets;
- 8) Prohibition from accepting further deposits or other lines of credit;
- 9) Prohibition from declaring or paying bonuses, salary incentives, severance packages, management fees or other discretionary compensation to directors or officers.

## **PART VIII: EFFECTIVE DATE**

8.1 **Effective date:** The effective date of this guideline shall be 1<sup>st</sup> January, 2013

### **8.2 Supersedence**

This guideline supersedes and replaces Prudential Guideline No. CBK/PG/04 on Risk Classification of Assets and Provisioning issued by the Central Bank of Kenya on 1<sup>st</sup> May 2007.

### **Enquires:**

Enquiries on any aspect of these Guidelines should be referred to:

Director,

Banking Supervision Department

Central Bank of Kenya

P.O. Box 60000-00200

Nairobi

TEL. 2860000 e-mail: *fin@centralbank.go.ke*

CBK/PR4-1-2 AG001

**RISK CLASSIFICATION OF LOANS AND ADVANCES AND PROVISIONING**

INSTITUTION:  
 FINANCIAL YEAR:  
 START DATE:  
 END DATE:

Figures in Kshs '000'

GLOBAL		LOCAL CURRENCY ASSETS				FOREIGN CURRENCY ASSETS				GRAND TOTAL			
No.	Classification	A	B	C	D	E	F	G	H	I(A+E)	J(B+F)	K(C+G)	L(D+H)
		No. of Accounts	% of Total	Amount O/s	% of Total	No. of Accounts	% of Total	Amount O/s	% of Total	No. of Accounts	% of Total A/cs	Amount O/s	% of Total O/s
1	Normal									0		0	
2	Watch									0		0	
3	Substandard									0		0	
4	Doubtful									0		0	
5	Loss									0		0	
6	Total	0		0		0		0		0		0	
<b>Provisioning</b>													
7	Provisions held for normal accounts												-
8	Provisions required for normal (1% of 1)			0				0					-
9	Excess/(shortfall) in provisions held for normal a/cs(7-8)			0				0					-
10	Provisions held for watch accounts												-
11	Provisions required for watch (3% of 2)			0				0					-
12	Excess/(shortfall) in provisions held for watch accounts(10-11)			0				0					-
13	Qualifying discounted value of securities for sub-standard accounts							0					-
14	Interest in suspense for sub-standard accounts			0				0					-
15	Net sub-standard a/cs (3 -13-14)			0				0					-
16	Provisions held for substandard accounts												-
17	Provisions required for sub-standard accounts ( 20% of 15)			0				0					-
18	Excess/(shortfall) in provisions held for sub-std accounts(16-17)			0				0					-
19	Qualifying discounted value of securities for doubtful accounts												-
20	Interest in suspense for doubtful accounts			0				0					-
21	Net doubtful accounts (4 -19-20)			0				0					-
22	Provisions held for doubtful accounts												-
23	Provisions required for doubtful accounts ( 100% of 21)			0				0					-
24	Excess/(shortfall) in provisions held for doubtful accounts (22-23)			0				0					-
25	Interest in Suspense for loss accounts			0				0					-
26	Net Loss accounts (5-25)			0				0					-
27	Provisions held for loss a/cs			0				0					-
28	Provisions required for loss accounts(100% of 26)			0				0					-
29	Excess/(shortfall) in provisions held for loss accounts (27-28)			0				0					-
30	Total provisions held (7+10+16+24+27)			0				0					-
31	Total provisions required (8+11+17+23+28)			0				0					-
32	Total Excess/(Shortfall) in Provisions(30-31)			0				0					-

**AUTHORIZATION:**

We declare that this return, to the best of our knowledge and belief is correct.

Name of Compiling Officer: ..... Sign: ..... Date: .....  
 Name of authorizing officer (1): ..... Sign: ..... Date: .....  
 Name of authorizing officer (2): ..... Sign: ..... Date: .....

**LOANS AND ADVANCES PERFORMANCE REPORT**

Institution: \_\_\_\_\_  
 Financial Year: \_\_\_\_\_  
 Start Date: \_\_\_\_\_  
 End Date: \_\_\_\_\_

**A. LOANS**

NO.	PERIOD OF PAST DUE	LOCAL CURRENCY			FOREIGN CURRENCY			GRAND TOTAL			
		A	B	C	D	E	F	G	H	I	J
		No. of A/cs	Amount Shs'000'	% of Total	No. of A/cs	Amount Shs'000'	% of Total	No of Accounts	% of Total	Amount Shs'000'	% of Total
1	30 to 90 days				-	-		-		-	
2	More than 90 to 180 days.	-	-		-	-		-		-	
3	More than 180 days	-	-		-	-		-		-	
4	More than 180 days with no security value	-	-		-	-		-		-	
5	<b>Total past due</b>	-	-		-	-		-		-	
6	<b>UP-TO-DATE PERFORMING FACILITIES</b>										
7	<b>TOTAL (5+6)</b>										

**B. DISCOUNTED BILLS**

NO.	PERIOD OF PAST DUE	LOCAL CURRENCY			FOREIGN CURRENCY			GRAND TOTAL			
		A	B	C	D	E	F	G	H	I	J
		No. of A/cs	Amount Shs'000'	% of Total	No. of A/cs	Amount Shs'000'	% of Total	No of Accounts	% of Total	Amount Shs'000'	% of Total
1	30 to 90 days							-		-	
2	More than 90 to 180 days.	-	-		-	-		-		-	
3	More than 180 days	-	-		-	-		-		-	
4	More than 180 days with no security value	-	-		-	-		-		-	
5	<b>Total past due</b>	-	-		-	-		-		-	
6	<b>UP-TO-DATE PERFORMING FACILITIES</b>										
7	<b>TOTAL (5+6)</b>										

**C. OVERDRAFTS**

NO.	PERIOD OF PAST DUE	LOCAL CURRENCY			FOREIGN CURRENCY			GRAND TOTAL			
		A	B	C	D	E	F	G	H	I	J
		No. of A/cs	Amount Shs'000'	% of Total	No. of A/cs	Amount Shs'000'	% of Total	No of Accounts	% of Total	Amount Shs'000'	% of Total
1	Accounts in excess of approved limit for 30 to 90 consecutive days. Borrowing line has expired for 30 to 90 days. Interest is due and unpaid for 30 to 90 days. Account inactive for 30 to 90 days										
2	Exceeds approved limit for more than 90 to 180 consecutive days. Borrowing line has expired for more than 90 to 180 days. Interest is due and unpaid for more than 90 to 180 days. Account inactive for more than 90 to 180 days Deposits insufficient to cover interest										
3	Exceeds approved limit for over 180 days . Borrowing line expired for over 180 days. Account inactive for over 180 days .										
4	Account with permanent hard-core with no transactions The security value is zero.										
5	<b>Total past due</b>										
6	<b>ACCOUNTS OPERATING WITHIN LIMIT</b>										
7	<b>TOTAL (5+6)</b>										

**D. SUMMARY**

NO.	PERIOD OF PAST DUE	LOCAL CURRENCY			FOREIGN CURRENCY			GRAND TOTAL			
		A	B	C	D	E	F	G	H	I	J
		No. of A/cs	Amount Shs'000'	% of Total	No. of A/cs	Amount Shs'000'	% of Total	No of Accounts	% of Total	Amount Shs'000'	% of Total
1	Total past due (A5+B5+C5)										
2	Total up-to-date performing facilities (A6+B6+C6)										
3	<b>TOTAL LOANS AND ADVANCES</b>										

**AUTHORIZED SIGNATORY:**

Name of Compiling Officer: .....	Signature: .....	Date: .....
Name of authorizing officer (1): .....	Signature: .....	Date: .....
Name of authorizing officer (2): .....	Signature: .....	Date: .....



**CBK62/PR4-462001**

**ADVANCES, BILL DISCOUNTS AND OTHER FACILITIES TO STAFF MEMBERS, SHAREHOLDERS, DIRECTORS AND THEIR ASSOCIATES**

<b>Institution:</b>	
<b>Financial Year:</b>	
<b>Start Date:</b>	
<b>End Date:</b>	

**FORM CBK/PR4-4**

**Core Capital (shs) '000**  **Figures in Kshs '000'**

	Account		Director/Owner		Outstanding Balance			Security		Interest in Suspense	Specific Provisions Held	Net Outstanding Balance to Core Capital (%)	Classification Category
	Name	PIN NO.	Name	PIN NO.	On-Balance Sheet	Off-balance Sheet	Total	Nature	Value				
<b>Total Insider Loans</b>					-	-	-		-	-	-		
<b>Item N°</b>							-					0%	
							-					0%	
							-					0%	
							-					0%	
							-					0%	
							-					0%	
							-					0%	
							-					0%	
							-					0%	
							-					0%	
							-					0%	
							-					0%	

\*Indicate **TOTAL** credit facilities extended to staff members. For staff members who are directors, their credit facilities should be reported individually.

**AUTHORIZATION:**

We declare that this return, to the best of our knowledge and belief is correct.		
<b>Name of Compiling Officer:</b> .....	<b>Date</b> .....	
<b>Name of authorizing officer (1):</b> .....	<b>Date</b> .....	
<b>Name of authorizing officer (2):</b> .....	<b>Date</b> .....	





## COMPLETION INSTRUCTIONS

### FORM CBK/PR4-1: RISK CLASSIFICATION OF LOANS AND ADVANCES AND PROVISIONING

#### General

- This return should be completed strictly in accordance with the Prudential Guideline on Risk Classification of Loans and Advances and Provisioning.
  - The reporting institution should report loans and advances in local and foreign currency separately and the total amounts as provided for in the return.
  - The gross amounts for loans and advances should agree with or should be capable of being derived from the figures reported in other returns.
1. Enter in lines 1 to 5 the number of accounts, percentages, number of customers and the amounts in each of the categories of Normal Risk; Watch; Sub-standard; Doubtful and Loss: as per the risk classification of loans and advances and provisioning guideline provided.
  2. Enter in line 6 the gross loans and advances. (Sum of line 1 to 5).
  3. Enter in line 7 specific provisions held for normal accounts.
  4. Enter in line 8 the amounts of specific provisions required for normal accounts. The provisions required are 1% of the value of loans and advances in normal category.
  5. Enter in line 9 the difference between provisions held and provisions required for normal accounts (difference between line 7 and 8).
  6. Enter in line 10 specific provisions held for watch accounts.
  7. Enter in line 11 the amounts of specific provisions required for normal accounts. The provisions required are 3% of the value of loans and advances in watch category.
  8. Enter in line 12 the difference between provisions held and provisions required for watch accounts (difference between line 10 and 11)
  9. Enter in line 13 the qualifying discounted value of securities in substandard categories. The value of securities reported should be for those securities which are transferable and for which active market exists. In arriving at this aggregated figure, the value of securities for individual accounts should be limited to the loan outstanding.
  10. Enter in line 14 interest in suspense for substandard accounts.
  11. Enter in line 15 the net amount of substandard accounts.
  12. Enter in line 16 the specific provisions held for substandard accounts.
  13. Enter in line 17 the specific provisions required for substandard accounts. The provisions required are 20% of the value of loans and advances in substandard accounts after deducting interest in suspense and discounted value of securities.
  14. Enter in line 18 the difference between provisions held and provisions required for substandard accounts (difference between line 16 and 17).
  15. Enter the qualifying discounted value of securities for doubtful accounts. The value of securities reported should be for those securities which are transferable, and for which active market exists. In arriving at this aggregated figure, the value of securities for individual accounts should be limited to the loan outstanding.
  16. Enter in line 20 interest in suspense held for doubtful accounts.
  17. Enter in line 21 the net amount of doubtful accounts.
  18. Enter in line 22 the specific provisions held for doubtful accounts.
  19. Enter in line 23 the specific provisions required for doubtful accounts. The provisions required are 100% of the value of loans and advances in doubtful accounts after deducting interest in suspense and discounted value of securities.

20. Enter in line 24 the difference between provisions held and provisions required for doubtful accounts (difference between line 18 and 19).
21. Enter in line 25 interest in suspense for loss for accounts.
22. Enter in line 26 values of loss accounts net of interest in suspense.
23. Enter in line 27 specific provisions held for loss accounts.
24. Enter in line 28 the specific provisions required for loss accounts. The provisions required are 100% of the value of loans and advances in loss accounts after deducting interest in suspense.
25. Enter in line 29 the difference between provisions held and provisions required for loss accounts (difference between line 27 and 28).
26. Enter in line 30 the gross specific provisions held for normal, watch, substandard, doubtful and loss accounts.
27. Enter in line 31 gross provisions required for all categories as per the guideline.
28. Enter in line 32 the difference between gross provisions held and gross provisions required for all categories of the accounts (difference between line 30 and 31).

#### **FORM CBK/PR 4-2: LOANS AND ADVANCES PERFORMANCE REPORT**

Enter the number of accounts and amounts past due in the relevant spaces. The total figure in line D3 should agree with the total in line 6 of Form CBK/PR 4-1.

#### **FORM CBK/PR 4-3: ADVANCES, BILLS DISCOUNTED AND OTHER FACILITIES TO ANY PERSON OR CONNECTED GROUP EXCEEDING 25% OF CORE CAPITAL**

- (a) Connected group is defined as companies with common director(s)/shareholder(s).
- (b) List the accounts in each group to obtain a group total.
- (c) Other facilities include Guarantees, Letters of Credit, Acceptances, Bonds etc.
- (d) Core capital reported should be as computed under Guideline No. CBK/PG/03.

#### **FORM CBK/PR 4-4: ADVANCES, BILLS DISCOUNTED AND OTHER FACILITIES TO STAFF MEMBERS, SHAREHOLDERS, DIRECTORS AND THEIR ASSOCIATES**

- (a) Enter the total value of all borrowings by:
  - i) All staff members combined. In case of staff members who are directors, their credit facilities should be reported by individual name.
  - ii) Any shareholder who holds directly or indirectly or has a beneficial interest of more than 5% of the paid-up capital of the institution.
  - iii) The directors of the reporting institution.
  - iv) Any associate of any shareholder and/or director.
  - v) Any associate of the institution. An Associate is defined in Section 2(2) of the Banking Act.
- (b) Where two or more entities form part of a group, the total amount borrowed by the group should be indicated as follows:
  - i) Name of principal entity should be stated at the head of the list and

- ii) Other individual entities within the group should be listed in a descending order depending on the amount borrowed or outstanding balance.
- (c) Group all borrowings relating to a particular director or shareholder together quoting the name of the director or shareholder at the head of the list and quote in sequence the names of the borrowers.
- (a) Off-balance sheet items include guarantees, letters of credit, acceptances and bonds.
- (b) Core capital reported should be as computed under Guideline No. CBK/PG/03 and reported on PR 3.

#### **FORM CBK/PR 4-5: FIFTY LARGEST BORROWERS**

- Column 1: Enter the name of the entity and the Pin Number i.e. Company or individual. In the case of a company, list the directors. For the purpose of this return, lending to a group shall be aggregated and each company's/individual's facilities listed together with the respective directors. Consequently, where two or more entities form part of a group, the total amount borrowed by the group should be treated as a single borrowing for purposes of this return.
- Column 2: Enter the name and Personal Identification Number of the directors of the borrowing entity.
- Column 3: State the nature of lending viz.: loan, overdrafts, bills discounted etc.
- Column 4: Indicate the date when the facility was granted or renewed.
- Column 5: Enter the authorized limit.
- Column 6: Enter the outstanding balance of the on-balance items.
- Column 7: Enter the outstanding balances in respect of guarantees, letters of credit, acceptances, bonds etc.
- Column 10: Enter the type of security.
- Column 11: Enter the discounted value of security.
- Column 12: Enter the amount charged.
- Column 13: Enter the date when the security was last valued.
- Column 14: Enter the name of the firm, which valued the security.
- Column 15: For the non-performing advances, enter the total interest in suspense.
- Column 16: For the non-performing advances enter the specific provisions held.
- Column 17: Additional provisions required for advances classified under substandard, doubtful and loss categories to be calculated as on-balance sheet outstanding balance less discounted realizable value of security, interest in suspense and provisions held. Where the resultant sum is negative, additional provisions should be indicated as NIL.

# **GUIDELINE ON LIQUIDITY MANAGEMENT CBK/PG/05**

## **CONTENTS**

### **PART I: Preliminary**

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- 7.1 Effective Date
- 7.2 Supersedence

## **PART I: PRELIMINARY**

1.1 **Title:** Guideline on Liquidity Management

1.2 **Authorization:** This Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

1.3 **Application:** This Guideline shall apply to all institutions licensed under the Banking Act (Cap 488) to conduct business in Kenya.

1.4 **Definitions:**

- **Liquidity:** Is the ability of an institution to fund increase in assets and meet obligations as they fall due without incurring unacceptable losses.
- **Short Term Liabilities:** These are liabilities that have matured and those that are due to mature within 91 days and have cash flow implications.
- **Deposits:** For purposes of this Guideline, deposits are as defined under Section 2 of the Banking Act
- **Contingency Funding Plan (CFP)** is the compilation of policies, procedures and action plans for responding to severe disruptions to a bank's ability to fund some or all of its activities in a timely manner and at a reasonable cost.

Other terms used in this Guideline are as defined in the Banking Act.

## **PART II: STATEMENT OF POLICY**

2.1 **Purpose:**

The purpose of this Guideline is to:

- Ensure each institution maintains adequate level of liquidity to meet its obligations as they fall due.
- Provide guidance on compilation of liquidity returns.
- Ensure accuracy and uniformity in the computation of the liquidity ratio in the banking sector.
- Guide institutions in the formulation of liquidity management strategies, policies, procedures, management information systems, internal controls and contingency plans for unexpected distress situations.

- 2.2 **Scope:** This Guideline applies to an institution's compliance with statutory liquidity requirements and management of liquidity.
- 2.3 **Responsibility:** It is the responsibility of the board of directors of each institution to implement and maintain a liquidity management strategy and policies that are appropriate for the operations of the institution to ensure that it has sufficient liquidity to meet its obligations as they fall due. The strategy and policies should be communicated to executive and senior management and all other appropriate staff members for execution.

Although the statutory prescribed minimum liquidity requirement is 20% of deposit liabilities, matured and short term liabilities, liquidity requirements vary from institution to institution depending on cash flow requirements. Each institution shall therefore establish a robust liquidity risk management framework that ensures it maintains sufficient liquidity, including a cushion of unencumbered, high quality liquid assets, to withstand a range of stress events, including those involving the loss or impairment of both unsecured and secured funding sources.

### **PART III: BACKGROUND**

The objective of liquidity management is to ensure that an institution is able to meet, in full, all its obligations/commitments as they fall due. An institution is required to hold adequate liquid assets to fund maturing claims for prudent business management. It is therefore important for management to not only measure liquidity on an on-going basis, but also to examine ways of how to fund liquidity requirements during distress situations.

### **PART IV: SPECIFIC REQUIREMENTS**

- 4.1 **Minimum Liquidity Ratio:** Under section 19 of the Banking Act, an institution shall maintain such minimum holding of liquid assets as the Central Bank may from time to time determine. Currently an institution is required to maintain a statutory minimum of twenty per cent (20%) of all its deposit liabilities, matured and short term liabilities in liquid assets.
- 4.2 **Liquidity Management:** In addition to complying with the minimum statutory requirements under section 19 of the Banking Act, the management of an institution should put in place mechanisms that will flag out potential funding problems in order to explore ways and means of raising additional funds of the right type and amount. Liquidity Management should, as a minimum, address the following:

#### **4.2.1 Liquidity Management Strategy**

This is a brief statement of an institution's longer term approach to liquidity, including management of its liquidity and maturity mismatch positions. This should be consistent with the institution's business lines and size of balance sheet.

#### **4.2.2 Management Structure and Information Systems**

An institution should have an adequate information system for measuring, monitoring, controlling and reporting liquidity requirements. This system should be integrated in the overall management information systems of the institution.

To supplement the management information system, an institution should have an appropriate management reporting structure to effectively execute the liquidity strategy, with the use of appropriate policies and procedures.

#### **4.2.3 Measuring and Monitoring Net Funding Requirements:**

An institution should have a process of assessing cash inflows against its outflows to identify the potential for any shortfall. This should incorporate funding requirements for both on and off-balance sheet items and in major foreign currencies traded by the institution both in terms of aggregate foreign currency needs and for each currency individually. Assumptions made in making cash flow projections should be clear and documented. They should be subject to frequent reviews to determine the validity of underlying factors. Less frequent, but more in-depth reviews should be carried out to re-examine and refine institution's liquidity policies and practices in the light of its experience and developments in its business and economic environments.

In order to effectively monitor its liquidity risk, an institution is supposed to establish an Asset Liability Committee (ALCO) with the following roles:

- (i) management of the overall liquidity of the institution;
- (ii) the ALCO must report directly to the Board or in the case of a foreign incorporated bank, to senior management of the institution in the country;
- (iii) the ALCO must facilitate, coordinate, communicate and control balance sheet planning with regards to risks inherent in managing liquidity and convergences in interest rates; and
- (iv) the ALCO is responsible for ensuring that a bank's operations lies within the parameters set by its Board of Directors. However, the ALCO is not responsible for formulating the in-house liquidity risk management policy.

In determining the composition, size and various roles of the ALCO, the Board is required to consider the size of the institution, the risks inherent in the institution's operations and the organizational complexity.

#### **4.2.4 Contingency Funding Plan (CFP)**

An institution should have a formal Contingency Funding Plan (CFP) that clearly sets out the strategies for addressing liquidity shortfalls in emergency situations. A CFP should outline policies to manage a range of stress environments, establish clear lines of responsibility, include clear invocation and escalation procedures and be regularly tested and updated to ensure that it is operationally robust.



The plan should be commensurate with a bank's complexity, risk profile, scope of operations and role in the financial systems in which the bank operates. It should articulate available potential contingency funding sources and the amount of funds an institution estimates can be derived from these sources; clear escalation/prioritization procedures detailing when and how each of the actions can and should be activated; and the lead time needed to tap additional funds from each of the contingency sources.

CFPs should be reviewed and tested regularly to ensure their effectiveness and operational feasibility and should be consistent with institution's business continuity plans.

#### **4.2.5 Liquidity Stress Tests**

An institution should conduct stress tests on a regular basis for a variety of short-term and protracted institution-specific and market-wide stress scenarios (individually and in combination) to identify sources of potential liquidity strain and to ensure that current exposures remain in accordance with a bank's established liquidity requirement. An institution should use stress test outcomes to adjust its liquidity management strategies, policies, and positions and to develop effective contingency plans.

#### **4.2.6 Foreign Currency Liquidity Management**

Each institution should have a measurement, monitoring and control system for its liquidity positions in major currencies traded; both in terms of aggregate foreign currency needs and for each currency individually.

#### **4.2.7 Internal Controls for Liquidity Management**

An institution should have an adequate system of internal controls over its liquidity management process. There should be regular, independent reviews and evaluations of the effectiveness of the system.

The internal control system for liquidity should be integrated with the overall system of internal control and it should promote effective and efficient operations, reliable financial and regulatory reporting, and compliance with applicable laws, regulatory requirements and institution's own policies.

### **PART V: RETURNS AND COMPLETION INSTRUCTIONS**

An institution shall provide data on its liquidity in the prescribed format (Form CBK/PR5-2 {Liquidity statement}) and in accordance with the completion instructions attached, after each ten (10) working days period. The data should be submitted within five (5) working days after the reporting date.

In addition to the liquidity ratio data, an institution shall provide data on maturity analysis of its assets and liabilities in the prescribed format (Form CBK/PR5-1 {Maturity Analysis of Assets

and Liabilities}) on monthly basis and in accordance with the completion instructions attached. The return should be submitted by the 10<sup>th</sup> day of the subsequent month.

Maturity analysis of off-balance sheet items that have cash flow implications should also be analyzed in this return. The maturity time band will depend on the management judgment of when the commitments will be likely to be called or drawn down.

## **PART VI: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS**

### **6.1 Remedial Measures**

- 6.1.1 If an institution fails to comply with the provisions of section 19 of the Banking Act, the Central Bank of Kenya shall take action as per Banking Circular No. 14 of 2000 and Legal Notice No. 77 of 10th June, 1999.
- 6.1.2 If an institution is unable to fund its liquidity mismatch, it shall forthwith, in writing, report its inability to the Central Bank of Kenya, Bank Supervision Department, stating reasons for such failure and/or inability, and measures being taken to rectify the situation.
- 6.1.3 Institutions submitting late and/or inaccurate returns shall be penalized and officers held accountable and liable in accordance with the provisions of the Banking Act and CBK Prudential Guidelines.

### **6.2 Administrative Sanctions**

The conditions to be given shall generally cover management and control of liquidity exposures, and conduct of the concerned institution's business, but may specifically include the following:

- 6.2.1 Imposition of penalties under relevant sections of the Banking Act.
- 6.2.2 Suspension of lending activities and undertaking any new business.
- 6.2.3 Suspension from taking new deposits to retire maturing ones.
- 6.2.4 Recommending suspension from clearing house.
- 6.2.5 Prohibition of acquisition of additional non-core assets.
- 6.2.6 Prohibition from declaring dividends or paying bonuses, salary incentives, and other discretionary compensation to directors and/or officers of the institution.
- 6.2.7 Prohibition or suspension from any other activity (ies) that Central Bank perceives to be contributing to liquidity strain in the affected institution.

## **PART VII**

1. **Effective Date:** This Guideline takes effect from 1<sup>st</sup> January, 2013
2. **Supersedence:** This Guideline supersedes Prudential Regulation no. CBK/RG/05 on Liquidity Requirements issued on 1<sup>st</sup> January, 2006

### **ENQUIRIES**

Any enquiries should be addressed to the

Director,

Bank Supervision Department

Central Bank of Kenya

P.O. Box 60000 - 00200

**NAIROBI**

TEL. 2860000 e-mail: *fin@centralbank.go.ke*

**MATURITY ANALYSIS OF ASSETS AND LIABILITIES**

**CBK/PR 5-1**

Name of Institution.....

Period Ending.....

		1	2	3	4	5	6	7	8	9
<b>A</b>	<b>ASSETS</b>	Matured	Maturing in Less than 1 month	1 month Less than 3 months	3 months Less than 6 months	6 months Less than 1 year	1 year Less than 3 years	3 years Less than 5 years	Over 5 Years	Total
1	Cash reserves									
2	Balance with Central Bank of Kenya									
3	Balance due from local institutions & Bldg Societies									
4	Balance due from banks abroad									
5	Kenya government Treasury Bills									
6	Kenya Government Treasury Bonds									
7	Foreign government Treasury Bills and Bonds									
8	Other Investments									
9	Other foreign assets									
10	Local currency loans and advances (net)									
11	Foreign currency loans and advances (net)									
12	Fixed Assets (net)									

13	Balance due from group companies									
14	Other assets									
15	<b>TOTAL ASSETS</b>									
16	Off-balance sheet assets									
<b>B</b>	<b>LIABILITIES</b>									
1	Balance due to Central Bank of Kenya									
2	Balances due to local institutions & Bldg Societies									
3	Balance due to banks abroad									
4	Local currency deposits									
5	Local currency borrowings									
6	Foreign currency deposits									
7	Foreign currency borrowings									
8	Other foreign liabilities									
9	Balance due to group companies									
10	Other liabilities									
11	Capital and Reserves									
12	<b>TOTAL LIABILITIES</b>									
13	Off-balance sheet liabilities									
<b>C</b>	<b>NET POSITION ON-BALANCE SHEET ITEMS (A15-B12)</b>									
<b>D</b>	<b>NET POSITION OFF-BALANCE SHEET (ITEMS (A16-B13))</b>									

**AUTHORIZATION**

Name of Officer.....  
Designation.....  
Signature.....  
Date.....

**CONFIDENTIAL**  
**LIQUIDITY STATEMENT**

**CBK PR 5-2**

Name of Institution \_\_\_\_\_  
Reporting Date: \_\_\_\_\_

**NOTES ON COMPLETION**

- Forward the return within one week after reporting dates as at 10<sup>th</sup>, 20<sup>th</sup>; and last day of each month.

To: The Director, Bank Supervision Department  
Central Bank of Kenya, P.O. Box 60000-00200, Nairobi

**DECLARATION**

We declare that this return has been prepared from the books of the institution and that to the best of our knowledge and belief is correct.

Signed: \_\_\_\_\_  
CHIEF EXECUTIVE CHIEF ACCOUNTING OFFICER

Name of Institution.....  
Reporting Date.....

**1. NOTES AND COINS**

SHS'000'

- (a) Local \_\_\_\_\_
- (b) Foreign \_\_\_\_\_

---

**2. BALANCES WITH CENTRAL BANK OF KENYA**

(a) Balances with Central Bank \_\_\_\_\_

(b) Less: Borrowings from Central Bank \_\_\_\_\_

**3. BALANCES WITH DOMESTIC COMMERCIAL BANK**

(a) Balances with banks \_\_\_\_\_

Less:

(b) Time deposits with banks \_\_\_\_\_

(c) Balances due to banks \_\_\_\_\_

(d) Overdrafts and matured loans/advances \_\_\_\_\_

**4. BALANCES WITH BANKS ABROAD**

(a) Balances with banks abroad \_\_\_\_\_

Less:

(b) Time deposits with banks abroad \_\_\_\_\_

(c) Balances due to banks abroad \_\_\_\_\_

(d) Overdrafts and matured loans/advances  
from banks abroad \_\_\_\_\_

**5. BALANCES WITH FINANCIAL INSTITUTIONS**

(a) Balances with financial institutions \_\_\_\_\_

Less:

(b) Time deposits with financial institutions \_\_\_\_\_

(c) Balances due to financial institutions \_\_\_\_\_

(d) Matured loans/advances from financial institutions \_\_\_\_\_

**6. BALANCES WITH MORTGAGE FINANCE COMPANIES**

(a) Balances with mortgage finance companies \_\_\_\_\_

Less:

(b) Time deposits with mortgage finance companies \_\_\_\_\_

(c) Balances due to mortgage finance companies \_\_\_\_\_

(d) Matured loans/advances from mortgage companies \_\_\_\_\_

**7. BALANCES WITH BUILDING SOCIETIES**

(a) Balances with building societies \_\_\_\_\_

Less:

(b) Time deposits with building societies \_\_\_\_\_

(c) Balances due to building societies \_\_\_\_\_

(d) Matured loans/advances from building societies \_\_\_\_\_

**8. TREASURY BILLS** \_\_\_\_\_

**9. TREASURY BONDS** \_\_\_\_\_

**10. FOREIGN TREASURY BILLS & BONDS** \_\_\_\_\_

**11. NET LIQUID ASSETS (1-10)** \_\_\_\_\_

**12. DEPOSIT BALANCES** \_\_\_\_\_

(a) (i) Deposits from parastatals including accrued interest \_\_\_\_\_

(ii) Deposits from all other sources including Accrued interest \_\_\_\_\_

(iii) Total deposits \_\_\_\_\_

(b) Less:

(i) Balances due to banks \_\_\_\_\_

(ii) Balances due to financial institutions \_\_\_\_\_

(iii) Balances due to mortgage finance companies \_\_\_\_\_

(iv) Balances due to building societies \_\_\_\_\_

(v) Total deductions \_\_\_\_\_

(c) Net Deposit Liabilities \_\_\_\_\_

**13. OTHER LIABILITIES**

(a) Matured \_\_\_\_\_

(b) Maturing within 91 days \_\_\_\_\_

(c) Total Other Liabilities \_\_\_\_\_

**14. LIQUIDITY RATIO**

(a) Net Liquid Assets (1-10) \_\_\_\_\_

(b) Total Short term Liabilities 12(c) + 13(c) \_\_\_\_\_

(c) Ratio of (a)/(b) \_\_\_\_\_

**ANALYSIS OF BALANCES DUE/TO/FROM OTHER BANKING INSTITUTIONS**

**I. DOMESTIC INSTITUTIONS**

INSTITUTION	AMOUNT DUE TO	AMOUNT DUE FROM	NET
BANKS			
TOTAL			
FINANCIAL INSTITUTIONS	AMOUNT DUE TO	AMOUNT DUE FROM	
TOTAL			
MORTGAGE FINANCE	AMOUNT DUE TO	AMOUNT DUE FROM	



COMPANIES			
TOTAL			
BUILDING SOCIETIES	AMOUNT DUE TO	AMOUNT DUE FROM	
TOTAL			

**ANALYSIS OF BALANCES DUE TO/FROM OTHER BANKING INSTITUTIONS**  
**II. FOREIGN INSTITUTIONS**

INSTITUTION	AMOUNT DUE TO	AMOUNT DUE FROM	NET
BANKS			
TOTAL			
FINANCIAL INSTITUTIONS	AMOUNT DUE TO	AMOUNT DUE FROM	
TOTAL			
MORTGAGE FINANCE COMPANIES	AMOUNT DUE TO	AMOUNT DUE FROM	
TOTAL			
BUILDING SOCIETIES	AMOUNT DUE TO	AMOUNT DUE FROM	
TOTAL			

**INSTRUCTIONS FOR COMPLETION OF THE FORM ON MATURITY ANALYSIS OF ASSETS AND LIABILITIES – FORM CBK/PR5-1**

**GENERAL**

Assets and liabilities should be entered according to the remaining period to maturity.

**A. ASSETS**

**1. Cash Reserves**

Enter notes and coins (both local and foreign) held in the tills and vaults.

**2. Balances with Central Bank.**

Enter all credit balances with Central Bank including the mandatory cash reserve, repos purchase and credit balance in any other current accounts maintained with Central Bank. They should be reported gross of accrued interest.

**3. Balances due from Local Institutions and Building Societies**

Enter balances and placements with domestic institutions and building societies according to their remaining period to maturity. They should be reported gross of accrued interest.

**4. Balances due from banks abroad**

Enter balances and placements with foreign institutions according to their remaining maturity. They should include accrued interest.

**5. Kenya Government Treasury Bills**

These should be reported at amortized cost and should be entered according to their respective remaining period to maturity.

**6. Kenya Government Treasury Bonds**

These should be reported at amortized cost if held to maturity or at fair value if held for trading purposes and should be entered according to their respective remaining period to maturity or when payment is expected.

**7. Foreign Government Treasury Bills and Bonds**

These are securities issued by other sovereign governments, other than the Government of Kenya. These should be reported at amortized cost if held to maturity or at fair value if held for trading purposes and should be entered according to their respective remaining period to maturity or when payment is expected.

**8. Other investments**

Enter equity and other local currency investments according to their respective maturity dates. Equity investments should be entered in column 8.

**9. Other foreign assets**

Enter other foreign assets including foreign equity investments and bonds according to their respective period remaining to maturity or when they can be repaid.

**10. Local currency loans and advances**

Enter net outstanding local currency loans, bills discounted and other loans. Loans should be entered according to their respective period remaining to maturity. Overdrafts should be spread out and entered in the appropriate time bands according to their respective expiry dates. Enter bills discounted in the appropriate time bands according to their respective due dates. Non-performing loans, overdrafts and bills discounted should be entered in appropriate time bands when repayment can be realistically expected. Ordinarily this should exceed one year unless the recovery process has started and the exact date of repayment is known. All past due bills should be treated as non-performing.

**11. Foreign currency loans and advances**

Enter net outstanding foreign currency loans, bills discounted and any other foreign currency facility. Loans should be entered according to their respective period remaining to maturity. Enter bills discounted in the appropriate time bands according to their respective due dates. Non-performing loans and bills discounted should be entered in appropriate time bands when repayment can be realistically expected. Ordinarily this should exceed one year unless the recovery process has started and the exact date of repayment is known. All past due bills should be treated as non-performing.

**12. Fixed assets**

Enter the net figure under item 12. These should include prepaid operating lease rentals.

**13. Balances due from group companies**

Enter balances due from group companies in appropriate time bands according to when payment is expected.

**14. Other assets**

Enter components of other assets under the appropriate time bands when receipts are realistically expected.

**15. Total assets**

Enter the sum of items 1 to 14 for each time band.

**16. Off-Balance Sheet Assets**

Enter off-balance sheet assets that have cash flow implications. Maturity bands will depend on management judgment of when the commitments are likely to be drawn.

## **B. LIABILITIES**

### **1. Balances due to Central Bank of Kenya**

Enter balances due to Central Bank including repo sales in appropriate time bands according to the remaining period to maturity or when repayment is expected. They should be reported gross of interest accrued.

### **2. Balances due to local institutions and Building Societies**

Enter balances and deposits due to domestic institutions and building societies according to their remaining period to maturity and should be reported gross of interest accrued.

### **3. Balances due to banks abroad.**

Enter balances and deposits due to banks abroad according to their remaining period to maturity.

### **4. Local currency deposits**

Enter outstanding balances of local currency deposits including accrued interest in accordance with their respective remaining period to maturity. Demand account deposits should be entered under column 1. Call and seven days deposits should be entered under column 2, but if notice of withdrawal has been given, then enter the amount to be withdrawn under column 1. Savings accounts deposits should be entered under column 2.

### **5. Local currency borrowings**

Enter outstanding balances of local currency borrowings including accrued interest in accordance with their respective remaining period to maturity taking into account rollover commitments.

### **6. Foreign currency deposits**

Enter outstanding balances of foreign currency deposits including accrued interest in accordance with their respective remaining period to maturity. Demand account deposits should be entered under column 1. Call and seven days deposits should be entered under column 2, but if notice of withdrawal has been given, then enter the amount to be withdrawn under column 1. Savings accounts deposits should be entered under column 2.

**7. Foreign currency borrowings**

Enter outstanding balances of foreign currency borrowings including accrued interest in accordance with their respective remaining period to maturity taking into account rollover commitments.

**8. Other foreign liabilities**

Enter other foreign liabilities not specified elsewhere according to their respective period remaining to maturity or when repayment is expected.

**9. Balances due to group companies**

Enter balances due to group companies in appropriate time bands according to when repayment is expected.

**10. Other liabilities**

Enter components of other liabilities under the appropriate time bands when receipts are realistically expected.

**11. Capital and Reserves**

Enter appropriately recognizing that most of the components should ordinarily be entered in column 8.

**12. Total liabilities**

Enter the sum of items 1 to 11 for each time band.

**13. Off-Balance Sheet Liabilities**

Enter off-balance sheet liabilities that have cash flow implications Maturity bands will depend on management judgment of when the commitment are likely to be called up.

**COMPLETION INSTRUCTIONS FOR LIQUIDITY RETURN**

**FORM CBK/PR5-2**

**1. Notes and coins**

a) Local

Enter all notes and coins on the institution's premises (including mobile units) which are legal tender in Kenya.

b) Foreign

Enter the Kenyan shillings equivalent of all convertible foreign currencies held by the institution. CBK mean rates as on the reporting dates should be applied in converting foreign currencies into Kenya shillings.

**2. Balances with Central Bank of Kenya**

a) Balances with Central Bank

Enter all credit balances with the Central Bank, including the mandatory cash reserve and credit balance in any other accounts maintained with the Central Bank including balances held in Repo accounts in respect of purchases from CBK.

b) Borrowing from Central Bank

Enter all borrowings from the Central Bank; including accrued interest charged. Exclude balances due to CBK in respect of Repo sales to CBK.

All Central Bank balances should be reported as per institutions' ledger. Reconciliation between CBK statement balances and institution ledger will be submitted upon request by Central Bank of Kenya.

**3. Balances with Domestic Commercial Bank**

a) **Balances with banks**

Enter the total of all balances (credit current accounts balances, overnight, call and time) held at other domestic commercial banks excluding uncleared effects.

These balances should include accrued interest and should agree with the total analysed in the schedule attached to liquidity return.

b) **Time Deposits with Banks**

Enter the amount of time deposits including accrued interest entered in 3(a) above whose maturities exceed 91 days.

c) **Balances Due to banks**

Enter the total of balances due to commercial banks including accrued interest. This balance should agree with the total analyzed in the table attached to the liquidity return.

d) **Overdrafts and matured loans and advances from domestic banks**

Enter the total of all overdrafts and any other debit balances on current accounts, matured loans and advances including letters of credit, guarantees and bonds given by commercial banks.

**4. Balances with banks abroad**

a) **Balances with Banks Abroad**

Enter balances with banks abroad, including balances with correspondent banks and both related and unrelated foreign branches of the reporting institution. This should include accrued interest but should exclude un-cleared effects. They should also agree with the total analyzed in the attached table.

b) **Due to Banks Abroad**

Enter the total of debit balances on current and/or correspondent accounts due to banks abroad including matured installments of loans and advances and accrued interest. These should agree with the balance analyzed in the attached table.

**5. Balances with Financial Institutions**

a) **Balances with Financial Institutions**

Enter the total of all balances (overnight, call and time) placed with the institution, excluding un-cleared effects. This should include accrued interest; and should agree with the total analyzed in the table attached.

b) **Time Deposits with Financial Institutions**

Enter the amount of time deposits including accrued interest entered in 5(a) above whose maturities exceed 91 days.

c) **Balances due to Financial Institutions**

Enter the total of balances received from financial institutions including accrued interest. This balance should agree with the total analyzed in the table attached and should exclude balances with institutions with maturities period exceeding 91 days.

d) **Matured Loans and Advances Received from Financial Institutions**

Enter the total of matured loans and advances including guarantees, bills discounted, promissory notes and performance bonds received from financial institutions.

**6. Balances with Mortgage Finance Companies**

a) **Balances with Mortgage Finance Companies**

Enter the total of all balances (overnight, call and time deposits) placed with the institution, excluding un-cleared effects but including accrued interest.

b) **Time Deposits with Mortgage Finance Companies**

Enter the amount of time deposits including accrued interest included in line 6(a) above whose maturities exceed 91 days.

c) **Balances due to Mortgage Finance Companies**

Enter the total of all balances including accrued interest (overnight borrowings, and call placements) received from mortgage finance companies.

This balance should agree with the total analyzed in the table attached to the liquidity return.

d) **Matured loans and advances from Mortgage Finance Companies**

Enter the total of matured loans and advances including guarantees, bills discounted, promissory notes and performance bonds received from mortgage finance companies.

**7. Balances with Building Societies**

a) **Balances with Building Societies**

Enter the total of all balances (call and time deposits) placed with building societies, including accrued interest. This balance should agree with the total analyzed in the schedule attached to the return.

b) **Time Deposits with Building Societies**

Enter the amount of time deposits including accrued interest included in line 7(a) above whose maturities exceed 91 days.

c) **Balances Due to Building Societies**

Enter the total of all balances (call and time deposits, loans and advances) received from other building societies including accrued interest. This balance should agree with the total analyzed in the table attached to the liquidity return.

d) **Matured Loans and Advances from Building Societies**

Enter the total of matured loans and advances received from building societies.

All deposits/placements with institutions/building societies under liquidation should not be reported as part of liquid assets.

**8. Kenya Government Treasury Bills**

Enter the amortized cost of all Kenya Government Treasury Bills investments by the reporting institution, net of encumbered Treasury Bills. Encumbered Treasury Bills are



those pledged to secure any form of credit facility granted to the reporting institution. Treasury Bills held under repurchase agreements are encumbered and should not therefore be reported as part of liquid assets. Under the Repo agreement such treasury bills are to be held until maturity after which they are repurchased. Repo bills cannot therefore be negotiated/discounted during the tenure of the agreement.

**9. Kenya Government Treasury Bonds/ Bearer Bonds**

Enter the amortized cost or fair value of all treasury bonds/bearer bonds including government contractor bonds traded in the Nairobi Stock Exchange acquired by the reporting institution directly from the government and its issuing agents and those discounted from third parties.

Treasury bills and bonds pledged as security for the Intra-Day Liquidity Facility (ILF) shall be considered as part of liquid assets in the computation of liquidity ratio. However, in the event of failure to settle by the reporting institution, the ILF shall convert to an overnight facility (Lombard). The underlying pledged securities shall therefore become encumbered and cease to qualify for inclusion in liquidity computation.

**10. Foreign Government Treasury Bills and Bonds**

Enter the amortized cost or fair value of Treasury bills and bonds issued by other sovereign governments.

These may only be included if they are:

- Freely marketable or readily discountable,
- The country of origin should not have any foreign exchange restrictions or controls.

**11. Total Liquid Assets**

Enter the sum of items 1 to 10 above

**12. Total Deposit Liabilities**

a) Enter total deposits (Local and Foreign Currency) from all sources, including accrued interest, but excluding un-cleared effects.

b) **Less:**

i) **Balances Due to banks**

Enter the total of balances due to domestic and foreign commercial banks including accrued interest. This amount should agree with the sum of balances analyzed in the attached table.

ii) **Balances Due to Financial Institutions.**

Enter the total amount of balances due to both domestic and foreign financial institutions including accrued interest. This amount should agree with the sum of balances in the attached table.

- iii) **Balances Due to Mortgage Finance Companies.**  
Enter the total amount of balances due to both domestic and foreign mortgage finance companies including accrued interest. This amount should agree with the sum in the attached table.
- iv) **Balances Due to Building Societies**  
Enter the total amount of balances due to domestic and foreign building Societies including accrued interest. This amount should agree with the sum in the attached table.
- v) **Total Deductions**  
Enter the total of items b (i) to b (iv)
- c) **Net Deposit Liabilities:**  
Enter the net amount of item 12(a) (iii) less sum of 12 (b) (v)

**13. Other liabilities:**

- a) **Matured:** Enter the sum of all matured liabilities (Including crystallized off-balance sheet commitments) that have cash flow implications and are due for payment
- b) **Maturing Liabilities:** Enter the sum of all other liabilities maturing within three months from the reporting date.

**14. Liquidity Ratio**

- a) Total of items (1 - 10)
- b) Sum of Group 12 (c) + 13 (c)
- c) Ratio of [(a)/ (b)] x 100%

- 15.** The liquidity return (PR 5-2) should be completed as per the instructions contained in this guideline, and should be submitted within five (5) clear working days after reporting dates of 10th, 20th and the last day of each month.

# **GUIDELINE ON FOREIGN EXCHANGE EXPOSURE LIMITS CBK/PG/06**

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## **PART I: PRELIMINARY**

- 1.1. **Title** - Guideline on Foreign Exchange Exposure Limits
- 1.2. **Authorisation** - This Guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya (CBK) to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.
- 1.3. **Purpose** - This Guideline is intended to ensure that the potential risk of loss arising from foreign exchange rate fluctuations to a bank's capital base is within prudential limits.
- 1.4. **Definitions**
  - a) **“Foreign exchange business”** means any facility offered, business undertaken or transaction executed with any person involving a foreign currency inclusive of any account facility, credit extension, lending, issuance of guarantee, counter-guarantee, purchase or sale by means of cash, cheque, draft, transfer or any other instrument denominated in a foreign currency.
  - b) **“Foreign currency”** means a currency other than legal tender of Kenya.
  - c) **“Forward transaction”** or **“forward purchase”** or **“forward buy”** or **“forward sale”** means a transaction that is to be executed after more than two working days from the date the transaction is contracted or agreed.
  - d) **“Long position”** or **“long open position”** or **“overbought position”** of a financial institution in a foreign currency means the holding by the financial institution of that foreign currency for its own account in excess of all its contractual spot, same day value and forward transaction commitments in that foreign currency.

- e) **“Net open position”** of a financial institution in a foreign currency means the net sum of all its assets and liabilities inclusive of all its spot, same day value and forward transactions and its off balance sheet items in that foreign currency.
- f) **Overall foreign currency risk exposure** means the sum of all net balance and off-balance sheet assets or liabilities denominated in foreign currencies, expressed as a domestic currency equivalent amount at the spot mid-rate using the shorthand method of measurement.
- g) **Shorthand method means the procedure for measuring the foreign exchange risk exposure by:**
  - a. adding separately all short positions on one side and all long positions on the other side;
  - b. comparing the two totals; and
  - c. taking the larger of the two totals as the open position.
- h) **“Same day transaction”** or **“same day purchase”** or **“same day-buy”** or **“same day-sale”** means a transaction having same day value.
- i) **“Same day value”** means the transaction to which it is referred is to be executed on the very day it is contracted or agreed.
- j) **“Short position”** or **“short open position”** or **“oversold position”** of a financial institution in a foreign currency means the holding by the financial institution of that foreign currency for its own account is less than all its contractual spot, same day value and forward transaction commitments in that foreign currency.
- k) **“Spot transaction”** or **“spot purchase”** or **“spot buy”** or **“spot sale”** means a transaction having a spot value.
- l) **“Spot value”** means the transaction to which it is referred is to be executed two working days from the date it is contracted or agreed.
- m) **“Value date”** of a transaction means the date on which it is to be executed.

## **PART II: IMPLEMENTATION AND SPECIFIC REQUIREMENTS**

### **2.1. Limit on ‘overall’ foreign exchange risk exposure**

The overall foreign exchange risk exposure as measured using spot mid-rates and shorthand method shall not exceed 10% of the institution's core capital.

**2.2 Limit on “Single” currency foreign exchange risk exposure**

The foreign exchange risk exposure in any single currency, irrespective of short or long position, will be determined by the individual institution provided it remains within the overall exposure limit of 10% of its core capital.

**2.3. Limit on “intra-day” foreign exchange risk exposure.**

Intra-day foreign exchange risk exposures, both in single currencies and overall, shall be maintained within prudent limits as established by a bank's board of directors in a written policy covering foreign exchange risk exposure.

**2.4. Calculation of foreign exchange risk exposure**

Each bank shall calculate its single currency and overall foreign exchange risk exposure daily using the methodology required by CBK.

**2.5. Correction of excess foreign exchange risk exposures**

Each bank shall take every reasonable action to immediately correct any and all foreign exchange risk exposures which exceed the limits set forth in this guideline and in its board-adopted policy. Failure to correct any non-complying risk exposure by the closure of business on the following day may result in administrative sanctions as set forth in this guideline.

**2.6. Maintenance of supporting documentation**

Each bank shall maintain records which are sufficient to determine at all times its single currency and overall foreign exchange risk exposures. Each bank shall also maintain a daily record showing close-of-business foreign exchange risk exposures (both single currencies and overall) and a reconciliation of opening-to-closing positions.

**2.7 Market Manipulation**

In order to sustain the integrity of the financial exchange market, all institutions must avoid engaging in speculative foreign exchange transactions that tend to mislead the other participants in the market and must also avoid misuse of any privileged information. To the greatest extent possible, all foreign exchange transactions should be supported by the underlying commercial activity.

Market manipulation practices include insider dealing and deliberate attempts to interfere with the market's free and fair operations, which include but are not limited to:-

- Carrying out two or more concurrent or succeeding foreign exchange deals or transactions that has, or is likely to have, the effect of altering or maintaining the ruling exchange rate with the intention of influencing the decision of others to either participate in a deal or otherwise.

- Making a false or misleading impression of active forex trading through any of the available communication channels.
- Carrying out forex deals that do not involve an exchange of consideration or making fictitious deals that influence the ruling exchange rate or forex flows.
- Any other conduct that unduly influences the ruling exchange rate or forex flows.

## **PART III: CALCULATION OF FOREIGN EXCHANGE RISK EXPOSURE**

### **3.1. Calculation of Exposure on Net Open Position in a Single Currency**

The measurement of an institution's exposure in a single currency involves determining if the financial institution has a long or short open position in that particular currency, and how large this position is. The open position in a currency is the sum of the net spot position and the net forward position. These are explained below as follows:

#### **(a) Net Spot Position**

The spot position is simply the position which appears directly on the balance sheet. The net spot position is the difference between foreign currency assets and liabilities in a particular currency. This must also include all accrued income and accrued expenses.

#### **(b) Net Forward Position**

The net forward position represents all amounts to be received less all amounts to be paid in the future in a particular currency as a result of foreign exchange transactions which have already taken place. These transactions which are recorded as off-balance sheet items would include:

- (i) Spot transactions which are not yet settled.
- (ii) Forward foreign exchange transactions.
- (iii) Documentary credits, guarantees and similar commitments denominated in foreign currencies which are certain to be called upon and are likely to be irrevocable. In case of guarantees, this will arise after notice has been received by the bank.
- (iv) Currency futures and Swaps

All amounts to be received less all amounts to be paid in the future as a result of transactions in currency futures, and also the principal on currency swaps, must be measured and included in the net forward position.

### **3.2. Calculations of Overall Foreign Exchange Risk Exposure**

This involves measurement of risks inherent in an institution's mix of long and short positions in different currencies. Institutions will adopt the "shorthand method" for calculating the overall foreign exchange risk exposure or overall open position as follows:

- a) Calculate the net open position in each currency (as above).
- b) Arrive at the sum of all net short positions.
- c) Arrive at the sum of all net long positions.

Overall foreign exchange risk exposure or overall open position is the higher of (b) or (c).

## **PART IV: REPORTING INSTRUCTIONS**

### **4.1. General Instructions**

Institutions will complete on a daily basis, a return in the attached format (CBK/PR/6) and submit to the Central Bank by mid-day of the following day. The amounts reported will be the foreign currency amounts recorded in the reporting banking institution's books as at the close of business at the end of each day, adjusted where necessary for transactions not posted as at the reporting date.

Structural positions, i.e. foreign currency capital assets and liabilities such as investments in subsidiaries, premises, loan capital, e.t.c, that are of a fixed long-term nature, may be recorded by way of foot-notes to the return rather than in the body of the return.

Specified foreign currency details will be given in the return for those currencies with a total long or a total short position. Other unspecified currencies may be combined and reported in the row - "Others" of the return.

Amounts reported for each foreign currency, including forward transactions, will be translated into Kenya shillings (Kshs) at the midpoint of the indicative spot TT buying and selling exchange rates. The exchange rates to be used will be CBK Mean rates issued daily by the Central Bank of Kenya. The exchange rates used will be recorded in the row designated "Exchange Rate", on the return.

Forward foreign exchange rates are different from the spot rates and take into account the respective levels of interest rates. Nevertheless, the exposures will be measured by using the above-mentioned spot indicative exchange rates and not the forward rates.

### **4.2 Completion and Submission of Daily Return**



Notes on completion and submission of the daily return are annexed to this guideline.

## **PART V: CORRECTIVE MEASURES**

### **5.1. Remedial Measures**

If a bank fails to comply with this guideline in a manner that results, or threatens to result, in an unsafe or unsound condition, CBK may pursue any or all corrective actions as provided under section 33 and 34 of the Banking Act. However, before the sanctions are administered, the bank will be given opportunity to defend itself.

### **5.2. Administrative sanctions**

In addition to the use of corrective actions noted in 5.1 above, the Central Bank of Kenya may prohibit the non-compliant institution from engaging in any further foreign exchange activities or impose any sanctions deemed necessary.

### **5.3. Penalties for Violation of Guidelines**

Monetary penalties will be levied for violations of this guideline, as provided for in the Banking Act vide Legal Notice No.77 of 1999 under the Banking (Penalties) Regulations, 1999.

## **PART VI: EFFECTIVE DATE**

**6.1 Effective Date** - The effective date of this guideline shall be 1<sup>st</sup> January 2013.

**6.2 Supersedence** - This Guideline supersedes and replaces the Prudential Guideline on Foreign Exchange Exposure Limits, CBK/PG/06 issued by CBK on 1<sup>st</sup> January 2006 and the Banking Circular No.12 of 2011 dated 17<sup>th</sup> October 2011.

### **ENQUIRIES:**

Any enquiries on this guideline should be forwarded to:

The Director

Bank Supervision Department

Central Bank of Kenya

P.O. Box 60000 - 00200

**NAIROBI.**

TEL.2860000 e-mail: [fin@centralbank.go.ke](mailto:fin@centralbank.go.ke)

**FOREIGN EXCHANGE EXPOSURE RETURN**

**CBK/PR6**

**INSTITUTION.....**

**REPORTING DATE.....**

**SHS '000'**

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
		USD	GBP	EURO	JPY	CHF	ZAR	OTHERS	TOTALS
	CURRENCY TYPE								
	EXCHANGE RATE								
1.	FOREIGN CURENCY ASSETS								
1.1	Balance Sheet Items								
1.1.1	Cash and Balances with Banks Abroad								
1.1.2	Loans & Advances								
1.1.3	Investment in Govt. Securities								
1.1.4	Other Foreign Assets								
2.	Off-Balance Sheet Items								
2.1	Undelivered Spot Purchases								
2.2	Forward Purchases								
2.3	Other Off-balance items e.g. swaps and options								
3.	Total Foreign Assets (1.1.1 to 2.3)								
4.	FOREIGN CURRENCY LIABILITIES								
4.1	BALANCE Sheet Items								
4.1.1	Balance due to Banks abroad								
4.1.2	Deposits								
4.1.3	Loans & Advances								
4.1.4	Other Foreign Liabilities								
5.	Off-balance Sheet Items								
5.1	Undelivered Spot sales								
5.2	Forward Sales								
5.3	Other off-balance sheet items e.g. swaps and options								
6.	Total Foreign Liabilities								

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
		USD	GBP	EURO	JPY	CHF	ZAR	OTHERS	TOTALS
	(4.1.1 to 5.3)								
7.	NET OPEN POSITION (3 less 6)								
7.1	Long Position (where 3 less 6 is positive)								
7.2	Short Position (where 3 less 6 is negative)								
8.	SINGLE CURRENCY EXPOSURE								
8.1	Net open position as a %age of core capital								
9.	OVERALL FOREX EXPOSURE								
9.1	Exposure (higher Total of 7.1 or 7.2 above)								
9.2	Core Capital (as per CBK/PR3 Return)								
9.3	Exposure (9.1/9.2)%								
9.4	Allowable Exposure (%)								
9.5	Over/(Under) Exposure (9.3 less 9.4)								

- To be completed on a daily basis and submitted to the Central Bank of Kenya by mid-day of the following day.

**AUTHORIZATION**

NAME.....

DESIGNATION.....

SIGNATURE.....

DATE.....

## **COMPLETION INSTRUCTIONS: FOREIGN EXCHANGE EXPOSURE FORM CBK/PR6**

### **1. Foreign Currency Assets**

This refers to foreign currency assets recorded in the reporting banking institution's books.

#### **1.1 Balance Sheet Items:**

##### **1.1.1 Cash and Balances with Banks**

These are foreign currency notes and coins, balances with the Central Bank of Kenya and balances with the institution's own branches and correspondent banks.

##### **1.1.2 Loans and Advances**

These are bills discounted, loans and advances denominated in foreign currency. Loans and advances should be reported net of provisions.

##### **1.1.3 Investment in Foreign Government Securities**

This constitutes investment in foreign treasury bills and bonds issued by either foreign governments or other corporate entities. These should be reported either at fair value or amortized cost depending on the classification.

##### **1.1.4 Other Foreign Assets**

These are all other asset balances denominated in foreign currency not covered above.

### **2. Off-Balance Sheet Items**

These are foreign currency items such as forward contracts which entail an identifiable foreign currency commitment. Gross amounts of outstanding purchase contracts must be reported.

#### **2.1 Undelivered Spot Purchases**

Foreign exchange deals are generally settled two business days after they are made. During these two days the amount of the purchased currency to be received is recorded as off-balance sheet amounts. Undelivered spot transactions refer to all outstanding spot contracts written but not delivered.

#### **2.2 Forward Purchases**

A forward purchase is defined as one contracted for receipt beyond two business days from the reporting date. Forward purchases refer to the gross amounts of outstanding forwards, other than those to be delivered “spot”.

### 2.3 **Other Off-Balance Sheet Items**

This refers to items that involve foreign currency exposures not covered in the above categories such as options and swaps. If material, details should be given by way of footnotes.

## 3. **Total Foreign Assets**

This is the sum of lines 1.1.1 to 2.3

## 4. **Foreign Currency Liabilities**

This refers to foreign currency liabilities recorded in the reporting banking institution’s books.

### 4.1 **Balance Sheet Items**

#### 4.1.1 **Balances due to banks**

These are balances due to the Central Bank of Kenya, correspondent banks abroad and the institutions own branches.

#### 4.1.2 **Foreign Deposits**

These are deposits denominated in foreign currency. They should include interest accrued.

#### 4.1.3 **Foreign Loans and Advances**

These are loans, advances and bills discounted denominated in foreign currency.

#### 4.1.4 **Other Foreign Liabilities**

These are all other foreign liabilities denominated in foreign currency not covered above.

## 5. **Off-Balance Sheet Items**

These are foreign currency items such as forward contracts, which entail an identifiable foreign currency commitment. Gross amounts of outstanding sale contracts must be reported.

### 5.1 **Undelivered Spot Sales**

Foreign exchange deals are generally settled two business days after they are made. During these two days the amount of sold currency to be delivered is

recorded as off-balance sheet amounts. Undelivered spot transactions refer to all outstanding spot contracts written but not delivered.

## 5.2 **Forward Sales**

A forward sale is defined as one contracted for delivery beyond two business days from the reporting date. Forward sales refer to the gross amounts of outstanding forwards, other than those to be delivered “spot”.

## 5.3 **Other Off-Balance Sheet Items**

This refers to items that involve foreign currency exposures which are not covered above such as options and swaps. If material, details should be given by way of footnotes.

## 6. **Total Foreign Liabilities**

This is the sum of 4.1.1 to 5.3

## 7. **Net Open Positions**

This is calculated by subtracting Total Foreign Currency Liabilities (line 6) from Total Foreign Currency Assets (line 3) for each currency. A positive result indicates an overbought position (+) and should be indicated in Row 7.1 while a negative position (-) indicates an oversold position and should be indicated in Row 7.2. Whether the position is negative or positive, it is still an exposure. Therefore do not use negative or positive signs on rows 7.1 or 7.2. The entry for other currencies (“Others”), which are not individually specified should be divided to show the total for those currencies with net long positions and the total for those with net short positions separately.

## 8. **Single currency Risk Exposure**

### 8.1 **Net Open Position as a percentage of core capital**

This is calculated dividing the long or short position for each currency (line 7.1 or 7.2) by the core capital and multiplying by 100.

## 9. **Overall Foreign Exchange Risk Exposure**

### 9.1 **Exposure (Overall)**

This is the higher of (a) the sum of all net long positions in line 7.1 or (b) the sum of all net short positions recorded in line 7.2.

### 9.2 **Core Capital**

Core capital is as defined in the Banking Act and as reported in the latest submitted PR 3.

**9.3 Exposure as percentage of Core Capital**

This is arrived at dividing line 9.1 by 9.2 and multiplying by 100.

**9.4 Allowable Exposure**

The allowable limit is 10% of core capital of the institution. The limit is on the overall foreign exchange risk exposure for all currencies combined.

**9.5 Over Exposure/Under Exposure**

This is arrived at subtracting line 9.4 from line 9.3. Over-exposure means actual exposure is greater than the allowable exposure and the institution should address this matter. Under exposure means actual exposure is less than the allowable exposure and the institution need not address the matter.

**9.6 Submission of Daily Returns**

The daily returns in the format given in Form CBK/PR/6 duly signed by the reporting bank's authorized officials must be submitted to the Bank Supervision Department of the Central Bank of Kenya on a daily basis by mid-day of the following day.

# **GUIDELINES ON PROHIBITED BUSINESS CBK/PG/07**

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- 5.1. Effective Date
- 5.2. Supersedence



## PART I PRELIMINARY

1.1 **Title** – Guideline on Prohibited Business

1.2 **Authorisation** - This Guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

1.3 **Application**- All institutions licensed under the Banking Act (Cap. 488).

1.4 **Definition** - Terms used within this guideline are as defined in the Banking Act, or as defined below, or as reasonably implied by contextual usage.

1.4.1 **“Insider”** - means any officer, director, employee or shareholder, or their associates. However, for public quoted companies holders of 5% or more of shares are considered as insiders.

1.4.2 **“Reckless” means** –

- a) Transacting business beyond the limits set under the Banking Act or Central Bank of Kenya Act;
- b) Offering facilities contrary to any guidelines or regulations issued by the Central Bank;
- c) Failing to observe the institution’s own policies as approved by the Board of Directors; or
- d) Misuse of position or facilities of the institution for personal gain.

1.4.3 **“Fraudulent”** – means intentional deception, false and material representation, concealment or non-disclosure of a material fact or misleading conduct, device or contrivance that result in loss and injury to the institution with an intended gain to the officer of the institution or to a customer of the institution.

1.4.4 **“Large exposure”** - for the purpose of this guideline means all credit facilities granted to a person and his associates above 10% of an institution’s core capital.

## PART II STATEMENT OF POLICY

2.1 **Purpose** - This guideline is intended to prevent prohibited business practices as specified in Part III of the Banking Act and as restricted elsewhere in the Act.

2.2 **Scope** - This guideline applies to all transactions conducted by an institution and reflected on the balance sheet or reflected as off-balance sheet items. Notwithstanding the limits set forth in this guideline and the provisions of the Banking Act, institutions shall comply with sound banking practices and written policies, which have been adopted and approved by the institutions’ board of directors.

**2.3 Responsibility** - The board of directors of an institution shall be responsible for establishing appropriate policies and procedures which ensure that:

- (a) All business transactions made are fully compliant with the limitations set forth in Part III of the Banking Act and in this guideline, and,
- (b) All business decisions made are administered in accordance with prudent banking practices.

## **PART III SPECIFIC REQUIREMENTS**

### **3.1 Single Borrower Limits (Banking Act Section 10)**

3.1.1 An institution shall not grant to any person or permit to be outstanding any advance, credit facility or give any financial guarantee or incur any other liability on behalf of any person, so that the total value of the advances, credit facilities, financial guarantees and other liabilities in respect of that person at any time exceeds 25% of its core capital.

- a) The Central Bank of Kenya may authorize a mortgage finance company to give advances, credits, guarantees or incur liabilities whose values exceed 25% of the institution's core capital.
- b) The limit shall not apply to transactions with a public entity, transactions between banks or branches of a bank, or to the purchase of or advances made against clean or documentary bills of exchange or documents of title of goods entitling some person to payments outside Kenya for imports.

3.1.2 The term "person" includes that person and his associates. For this reason, facilities for the person and the associates shall be aggregated and the 25% of core capital rule shall apply to the aggregate amount. Where the association is as a result of common directorship, the loans need not to be grouped if the common director does not have a controlling interest in the associates.

3.1.3 Where a credit facility is non-performing, the outstanding balance should be net of provisions for purposes of determining the single borrower exposure.

### **3.2 Restrictions on Facilities to Insiders (Banking Act Section 11)**

#### **3.2.1 General Restrictions**

Sub-Sections 11(1) (a), (b), (c) and (d) of the Banking Act prohibit an institution from granting or permitting to be outstanding:

- a) Any advance or credit facility against the security of its own shares.
- b) Any advance or credit facility or give any financial guarantee or incur any other liability to or in favour of, or on behalf of any company (other than another institution) in which the

institution holds, directly or indirectly, or otherwise has a beneficial interest in more than 25% of the share capital of that company.

- c) Any unsecured advances in respect of any of its employees or their associates. However, facilities granted to staff members within schemes approved by the board, and are serviced by salary through a check-off system are allowed.
- d) Any advances, loan or credit facilities, which are unsecured, or advances, loans or credit facilities, which are not fully secured to:
  - i) Any of its officers or their associates.
  - ii) Any person of whom or of which any of its officers has an interest as an agent, director, manager or shareholder.
  - iii) Any person of whom or of which any of its officers is a guarantor.
- e) For purposes of this section, where facilities to insiders are secured by guarantees, these guarantees should be supported by tangible or other securities with proven market value that are duly charged and registered in favour of the institution.

### **3.2.2 Restrictions on Granting Facilities to Insiders on Preferential Terms**

- a) Sub-section 11(1)(e) of the Banking Act prohibits institutions from granting or from permitting to be outstanding any advance or credit facility to any of its directors or other person participating in the general management of the institution unless such advance, loan or credit facility:
  - i) Is approved by the full board of directors of the institution upon being satisfied that it is viable. An institution must ensure that all members of the Board are made aware of the facility before it is disbursed.
  - ii) Is made in the normal course of business and on terms similar to those offered to ordinary customers of the institution. The institution shall notify the Central Bank of every approval given pursuant to subparagraph (a) of this paragraph, within seven days of such approval, using form IF 12-4 annexed to Guideline No. CBK/PG/12.
- b) Loan facilities to Executive Directors and Chief Executives are to be treated and reported as insider lending facilities.
- c) Review of overdraft and re-scheduling of existing credit facilities should be treated as new facilities in compliance with (a) and (b) above.
- d) Loans and other facilities to staff members should be within schemes approved by the Board.

### **3.2.3 Restrictions on Aggregate Credit Limits to Insiders**

Sub-Sections 11(1) (f) and (g) of the Banking Act prohibit an institution from granting or permitting to be outstanding:

- a) Any advance or credit facility or financial guarantee or incurring any other liability to, or in favour of, or on behalf of, any one insider in excess of 20% of core capital of the institution;
- b) Any advance or credit facility or financial guarantee or any other liability to, or in favour of, or on behalf of all insiders amounting in aggregate to more than 100% of core capital of the institution.

### **3.2.4 Prohibition on Reckless and Fraudulent Activities**

- a) Sub-section 11(1) (h) of the Banking Act prohibits an institution from granting, advancing or from permitting to be outstanding any advance or credit facility or giving a guarantee or incurring any liability or entering into any contract or transaction or conducting its business or part thereof in a fraudulent or reckless manner or otherwise than in compliance with the provisions of the Banking Act.
- b) The above prohibitions (contained under section 11 of the Banking Act) are applicable whether or not the advance, loan or credit facility in question is granted to any person alone or with others.

### **3.3 Restriction on Large Exposures**

The aggregate credit facilities to all large exposures at any one time shall not exceed 5 times (500%) of the institution's core capital.

### **3.4. Restrictions on Trading and Investments (Banking Act Section 12)**

3.4.1 The bulk of funds held by an institution constitute depositors' funds. For this reason, it would be imprudent for an institution that has been licensed to carry on banking, financial or mortgage finance business to venture into trading, or investments that may be risky thereby jeopardizing depositors' funds. The Banking Act therefore prohibits an institution from:

- a) Engaging alone or with others in wholesale or retail trade in the course of satisfaction of a debt due to it.
- b) Acquiring or holding, directly or indirectly any part of the share capital of, or otherwise have a beneficial interest in any financial, commercial, agricultural,

industrial or other undertaking, where the value of the institution's interest would exceed in the aggregate 25% of the institution's core capital.

This provision is not applicable where:

- (i) such an undertaking is in satisfaction of a debt due. Such interests have to be disposed of within such time as the Central Bank may allow.
  - (ii) the shareholding is in a corporation established for the purpose of promoting development in Kenya and such shareholding has been approved by the Minister.
- c) Purchasing or acquiring or holding any land or any interest or right therein except as reasonably necessary for the purpose of conducting its business or holding or providing amenities for staff not exceeding prescribed limits. These conditions are subject to limits prescribed by the Central Bank of Kenya from time to time. Currently the prescribed limit for land and buildings is restricted to 20% of an institution's core capital. Acquiring and developing land should therefore be strictly within the specified limit. The institution is however, not prevented from:
- i) Letting part of any building, which it uses for conducting its business.
  - ii) Securing a debt on land and, in the event of default in payment of the debt, holding the land for so long as in the opinion of the Central Bank is needed for its realization or,
  - iii) Acquiring land for the purpose of its own development.

### **3.5. Restrictions on Ownership of Share Capital of an Institution (Banking Act Section 13)**

3.5.1 To diversify ownership of an institution for the purpose of prudent management; direct or indirect share-holding of an institution has been restricted to a maximum of 25% to any one person other than:

- a) another institution,
- b) the government of Kenya, or the Government of a foreign sovereign state,
- c) a state corporation within the meaning of the State Corporations Act, or,
- d) a foreign company, which is licensed to carry on the business of an institution in its country of incorporation.

3.5.2 No financial institution or mortgage finance company shall acquire or hold, directly or indirectly any part of the share capital of, or otherwise have beneficial interest in any bank.

3.5.3 An institution is required to disclose to the Central Bank the natural person(s) behind a nominee, corporate body or company.

3.5.4 A shareholder shall not transfer more than five percent of an institution's share capital to an individual or an entity except with the prior written approval of the Central Bank.

### **3.6 Restrictions on making advances for Purchase of Land (Banking Act Section 14)**

3.6.1 An institution is restricted from making advances or loans for the purchase, improvement or alteration of land so that the aggregate is in excess of 40% of the amount of its total deposit liabilities unless it is a mortgage finance company.

3.6.2 The Central Bank may however, authorize an institution to exceed the limit up to a maximum of 70%.

3.6.3 These provisions, shall however, not prevent an institution from accepting security over land for a loan or an advance made in good faith for any other purpose.

### **3.7 Imposition of charges and payment of interest (Banking Act Section 16A)**

3.7.1 No institution shall impose any form of charges on a savings, seven day call or fixed deposits account.

3.7.2 An institution shall, in respect of a saving account, pay interest accruing, or a return in the case of an institution carrying out business in accordance with Islamic law, to that account as long as the minimum balance is maintained.

3.7.3 An institution shall, in respect of a seven day call or fixed deposit account, pay interest accruing to the account on agreed contractual terms.

3.7.4 The interest in 3.7.2 or 3.7.3 may be forfeited if the deposit is uplifted before the maturity date.

### **3.8 Restrictions on deposit taking (Banking Act Section 16)**

No person other than an institution or a duly approved agency conducting banking business on behalf of an institution which holds a valid license shall invite or accept deposits in the course of carrying on a deposit – taking business.

### **3.9 Restriction on interest recovered on non-performing Loans (Banking Act Section 44A)**

Under Section 44A of the Banking Act, an institution shall be limited in what it may recover from a debtor with respect to non – performing loans to a maximum amount hereunder.

The maximum amount shall be the sum of the following:

- a) the principal owing when the loan becomes non-performing;
- b) interest, in accordance with the contract between the debtor and the institution, not exceeding the principal owing when the loan becomes non-performing; and,
- c) expenses incurred in the recovery of any amounts owed by the debtor.

### **3.10 Restriction on bank charges (Banking Act Section 44)**

No institution shall increase its rate of banking or other charges except with the prior approval of the Central Bank

### **3.11 Restrictions on Dividend payment (Banking Act Section 20)**

No institution incorporated in Kenya shall pay any dividends on its shares or make any form of distribution to its shareholders until all its capitalized expenditure (including preliminary expenses, share selling commission, brokerage, amount of losses incurred and items of expenditure not represented by tangible assets) has been written off and provisions for loans, advances and other assets have been made in accordance with the Banking Act.

### **3.12 Periodic Returns to the Central Bank of Kenya**

An institution must ensure that it submits the returns under this guideline at monthly intervals: The returns should be submitted by the 10<sup>th</sup> day of the following month. The intervals for reporting may change from time to time as the Central Bank may require.

- Advances, Bill Discounts and Other Facilities to any Person or Connected Group Exceeding 25% of Core Capital (Form CBK/PR 7-1).
- Restrictions on interest recovered on non-performing loans (Form CBK/PR 7-2).

## PART IV: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS

### 4.1 Remedial measures

When an institution contravenes any of the provisions of this guideline or is not in compliance with these guidelines then:

- a) All officers of the institution shall be liable jointly and severally to indemnify the institution against any loss arising in respect of the advance, loan or credit facility.
- b) In the case of an advance, loan or a facility to a person other than a director of the institution or a person participating in the general management of the institution, an officer shall not be so liable. Provided he or she shows that, through no act or omission on his or her part, he or she was not aware that the contravention was taking place, or he or she took all reasonable steps to prevent it taking place.
- c) The Central Bank may in the case of an advance, loan or credit facility to a director of the institution, direct the removal of such director from the Board of Directors of the institution.

The Central Bank may direct the suspension of any other officer or employee of the institution who sanctioned the advance, loan or credit facility. The institution shall comply with every direction of the Central Bank under this paragraph forthwith.

- d) Any director of an institution who defaults in the repayment of any advance or loan made to him by the institution for three consecutive months shall forth with be disqualified from holding office as such.

An institution which:

- a) Fails to comply with any direction of the Central Bank under subsection 4.1 (c) or,
- b) Permits a director who is disqualified by virtue of subsection 4.1 (d) to continue holding office as such shall be guilty of an offence and in addition to the penalties provided for under the Banking Act, shall be subject to the remedial action specified in (4.2) below.
- c) Where an offence under subsection (b) persists, the institution shall in addition to the penalty prescribed under sections 49 and 50 of the Banking Act, be liable to such penalty as may be prescribed for each day or part thereof during which the offence continues.



These are specified in the Legal Notice No. 77 of 1999.

#### 4.2 **Administrative sanctions**

In addition to the remedial measures available to it as given above in Part IV (4.1), the Central Bank of Kenya may impose any or all of the following administrative sanctions with regard to an institution that fails to comply with this guideline and against an institution, its board of directors, or its officers:

- i) Prohibition from engaging in any further foreign exchange activities.
- ii) Prohibition from declaring or paying dividends.
- iii) Prohibition from establishing new branches.
- iv) Prohibition from engaging in new activities or from expanding existing activities.
- v) Suspension of access to Central Bank credit facilities.
- vi) Suspension of lending, investment, and credit granting operations.
- vii) Prohibition from acquiring, through purchase or lease, additional fixed assets.
- viii) Prohibition from accepting further deposits or other lines of credit.
- viii) Prohibition from declaring or paying bonuses, salary incentives, severance packages, management fees or other discretionary compensation to directors or officers.

### **PART V: EFFECTIVE DATE**

**5.1 Effective date** - The effective date of this Guideline is 1<sup>st</sup> January 2013.

**5.2 Supersedence** - This Guideline supersedes Prudential Guideline No. CBK/PG/07 on Prohibited Business issued on 1<sup>st</sup> January 2006.

#### **ENQUIRIES:**

Enquiries on any aspect of these guidelines should be referred to:

The Director

Bank Supervision Department

Central Bank of Kenya

P. O. Box 60000- 00200

**NAIROBI**

TEL.2860000 e-mail: [fin@centralbank.go](mailto:fin@centralbank.go)





# **GUIDELINE ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM - CBK/PG/08**

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### **PART I: PRELIMINARY**

- 1.1 **Title** - Guideline on Anti-Money Laundering and Combating the Financing of Terrorism.
- 1.2 **Application** - All institutions licensed under the Banking Act (Cap.488) and their foreign branches and subsidiaries.
- 1.3 **Authorisation** - This Guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue Guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.
- 1.4 **Definition** – “**Money laundering**” means the act of a person who:
  - (i) engages, directly or indirectly, in a transaction that involves proceeds of any unlawful activity;
  - (ii) acquires, receives, possesses, disguises, transfers, converts, exchanges, carries, disposes, uses, removes from or brings into Kenya proceeds of any unlawful activity; or
  - (iii) conceals, disguises or impedes the establishment of the true nature, origin, location, movement, deposition, title of, rights with respect to, or ownership of, proceeds of any unlawful activity where –
    - a) as may be inferred from objective factual circumstances, the person knows or has reason to believe, that the property is proceeds from any unlawful activity, or
    - b) in respect of the conduct of a natural person, the person without reasonable excuse fails to take reasonable steps to ascertain whether or not the property is proceeds from any unlawful activity.

“**person**” means any natural or legal entity.

“**proceeds of crime**” proceeds of crime” means any property or economic advantage derived or realized, directly or indirectly, as a result of or in connection with an offence irrespective of the identity of the offender and includes, on a proportional basis, property into which any property derived or realized directly

from the offence was later successively converted, transformed or intermingled, as well as income, capital or other economic gains derived or realized from such property from the time the offence was committed;

A “**business relationship**” is any arrangement between the institution and a customer the purpose of which is to facilitate the carrying out of transactions between the parties on a frequent, habitual or regular basis, and where the monetary value of dealings in the course of the arrangement is not known or capable of being ascertained at the outset. The opening of an account with an institution should therefore be treated as forming a ‘business relationship’.

A “**correspondent banking relationship**” is an arrangement where one bank, the (“correspondent bank”) provides banking services to another bank (the “respondent bank”). Respondent banks may be provided with a wide range of services, including cash management, interest-bearing accounts in a variety of currencies, international wire transfers, cheque clearing, payable-through accounts and foreign exchange services.

A “**one off transaction**” means any transaction carried out other than in the course of a business relationship. For example, a single foreign currency transaction for a customer who does not have an account at the concerned institution constitutes a one off transaction.

“**Competent Authorities**” means (i) the home authority that should be involved for the understanding of group policies and controls at group-level and (ii) the host authorities that should be involved for the branches/subsidiaries.

“**Know your customer**” requirements consist of obtaining full particulars of the customer’s identity (which may need to be verified in certain circumstances) and a sound knowledge of the purpose for which the customer is seeking to establish a business relationship with an institution. This knowledge needs to be applied to all dealings initiated by the customer. The extent to which such dealings appear not to ‘fit’ this knowledge base will become the basis of an institution’s suspicion about the customer which should then be reported to the Central Bank in accordance with the provisions of the Guideline.

Other terms used within this Guideline are as defined in the Banking Act.

## **PART II: STATEMENT OF POLICY**

- 2.1 **Purpose** - The purpose of this Guideline is to provide guidance regarding the prevention, detection and the control of possible money laundering activities and terrorism financing.

2.2 **Scope** - This Guideline shall apply to all institutions licensed to transact business under the Banking Act. It highlights methods of prudent customer identification, record keeping, identification of suspicious activities and the need to report such activities to the appropriate authority for further investigation.

2.2.1 This Guideline is also applicable to the foreign branches and subsidiaries of institutions licensed to transact business under the Banking Act.

2.3 **Responsibility** - It is the responsibility of the Board of Directors and management of an institution to establish appropriate policies on anti-money laundering and combating the financing of terrorism (AML/CFT) procedures and to train staff to ensure adequate identification of customers, source of funds and the use of the said funds. Such policies should also ensure the effective prevention, detection and control of possible money laundering and terrorism financing.

### **PART III: BACKGROUND**

#### **3.1 What is Money Laundering?**

Money laundering is the process by which criminals attempt to conceal the illegal origin and illegitimate ownership of property and assets that are the fruits or proceeds of their criminal activities. If undertaken successfully, it also allows the criminals to present the proceeds of their crime as having originated from legitimate source thereby allowing them to maintain control over those proceeds and to dispose of them without hindrance, which ultimately is the goal of crime committed for profit.

Money laundering is a global phenomenon that affects all countries to varying degrees. By its very nature, it is a hidden activity. However, failure to prevent the laundering of the proceeds of crime permits criminals to benefit from their actions.

##### **3.1.1 Money Laundering Predicate Offence**

Money laundering predicate offence is the underlying criminal activity that generates proceeds, which when laundered, results in the offense of money laundering. Examples of predicate offences include human trafficking, robbery, fraud, corruption, bribery, insider trading and counterfeiting of goods.

### 3.1.2 The Need to Combat Money Laundering

There is growing recognition that it is essential for criminals to be prevented, whenever possible, from legitimizing the proceeds of their criminal activities by converting their “dirty” funds to “clean” funds.

The ability to launder the proceeds of criminal activity through the financial system is vital to the success of criminal operations. If they are to benefit from the proceeds of their activities, those involved need to exploit the facilities of the world’s financial sector businesses, which includes facilities in the country.

The long term success of any of the world’s financial sectors depends on attracting and retaining legitimately earned funds. Criminally earned money is invariably transient in nature. It damages reputation and deters honest investments. Institutions that become involved in money laundering risk prosecution, the loss of their good market reputation, and damaging the reputation of the country as a safe and reliable financial jurisdiction.

### 3.1.3 Stages of Money Laundering

Despite the variety of methods employed, the laundering process is accomplished in three stages. These stages, described below, may comprise numerous transactions by the launderers that could alert an institution of the criminal activity.

- (a) **Placement** – the physical disposal of the initial proceeds derived from illegal activity.
- (b) **Layering** – separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the audit trail and provide anonymity.
- (c) **Integration** – the provision of apparent legitimacy to criminally derived wealth. If the layering process has succeeded, an integration scheme places the laundered proceeds back into the economy in such a way that they re-enter the financial system appearing as normal business funds.

The three basic steps may occur as separate and distinct phases. Alternatively, they may occur simultaneously or, more commonly, they may overlap. How the basic steps are used depends on the available laundering mechanisms and the requirements of the criminal organizations.



### **3.1.4 Vulnerabilities**

Certain points of vulnerability have been identified in the laundering process which the money launderer finds difficult to avoid and where his activities are therefore more susceptible to being recognized, specifically: These are:

- entry of cash into the financial system;
- cross-border flows of cash; and
- transfers within and from the financial system.

## **3.2 What is Terrorism Financing?**

Terrorism financing is when a person by any means, directly or indirectly, unlawfully and willfully provides or collects funds with the intention that these funds will be used in full or in part to carry out a terrorist act by a terrorist organization or be linked to specific terrorist acts.

Terrorism financing not only poses a threat to the security of the country, but also can have a damaging impact on the stability, efficiency and transparency of the financial system. It poses a long term threat to development of the economy, by diverting money from productive uses to unproductive uses, while damaging the reputation of a country.

The main difference between money laundering and terrorism financing is that terrorism financing may come from legitimate sources as well as illegitimate sources. In contrast, money laundering only involves proceeds originating from illegitimate sources.

### **3.2.1 The United Nations International Convention for the Suppression of the Financing of Terrorism**

Kenya is a signatory to the United Nations International Convention for the Suppression of the Financing of Terrorism (1999). The Convention defines a terrorist act as an “act intended to cause death or serious bodily injury to a civilian, or any other person taking an active part in the hostilities in a situation of armed conflict when the purpose such act by its nature or context is to intimidate a population, or to compel a Government or an international organization to do or to abstain from doing any act”.

This convention is the most comprehensive international instrument for combating the financing of terrorism. It specifies various international treaties that deal with the different types of terrorist activities. The offences set out in all the said treaties are among the crimes that must be considered acts of terrorism.

### **3.2.2 The United Nations 1267 Sanctions Committee**

The United Nations 1267 Sanctions Committee was established on 15 October 1999 by the Security Council with the adoption of the Resolution 1267 for the purpose of overseeing the implementation of sanctions measures imposed on Taliban-controlled Afghanistan for its support of Osama bin Laden. The sanctions regime has been modified and strengthened by subsequent resolutions, to cover more than a dozen additional United Nations Security Council Resolutions so that the sanctions measures apply to designated individuals and entities associated with Al-Qaida wherever located.

On 17 June 2011, the Security Council unanimously adopted resolutions 1988 (2011) and 1989 (2011) as successor resolutions to resolution 1904 (2009). By adopting these resolutions, the Security Council split the Al-Qaida and Taliban sanctions regime. Resolution 1989 (2011) stipulates that the sanctions list maintained by the Security Council Committee established pursuant to resolution 1267 (1999) will henceforth be known as the “Al-Qaida Sanctions List” and include only names of those individuals, groups, undertakings and entities associated with Al-Qaida. The Security Council will review the current sanctions December 2012.

The cornerstone of the regime is a consolidated list of persons maintained by the Security Council. All nations are obliged to freeze bank accounts and other financial instruments controlled by, or used for the benefit of, anyone on the list.

### **3.2.3 1267 Return**

Institutions shall be required to put in place internal control measures which ensure the detection of persons and/or entities that have been designated by the UN Security Council 1267 Committee by accessing the UN website: (<http://www.un.org/Docs/sc/committees/1267/1267ListEng.htm>). Institutions shall further be required to submit the 1267 Return CBK/IF 9 (Refer to Appendix I) on a quarterly basis verifying that the persons or entities designated by the UN Security Council Committee form part of their customer database.

### **3.3 Proliferation Financing**

Proliferation financing refers to the act of providing funds or financial services which are used, wholly or partially for the manufacture, acquisition, possession, development, export, shipment, brokering, transport, transfer, stockpiling or use of nuclear, chemical or biological weapons and their means of delivery and related materials in contravention of national laws or, where applicable, international obligations.

In the recent past, proliferation financing has emerged as a common global security threat. It facilitates the movement and development of proliferation-sensitive items and can contribute to global instability and potentially catastrophic loss of life if weapons of mass destruction (WMD) are developed and deployed.

#### **3.3.1 Vulnerabilities**

Kenya is geographically located in close proximity to countries that are sources of the raw minerals that are key to development of weapons of mass destruction. Nairobi also serves as the financial hub for the East and Central Africa Region which may on occasion facilitate the sale and purchase of these raw minerals.

### **3.4 International Standard Setters**

#### **3.4.1 The United Nations**

The United Nations (UN) was the first international organization to undertake significant action to fight money laundering on a global basis. The UN has the ability to adopt international treaties or conventions that have the effect of law in a country once that country has signed, ratified and implemented the convention, depending upon the country's constitution and legal structure. In certain cases, the UN Security Council has the authority to bind all member countries through a Security Council Resolution, regardless of other action on the part of an individual country.

The international effort to fight money laundering can only be addressed effectively using a multinational law. Kenya is a signatory to several of the United Nations Conventions that aim to combat money laundering, terrorism financing and proliferation financing including:

- i. **The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention)**

- ii. **The International Convention against Transnational Organized Crime (the Palermo Convention)** requires member countries to criminalize money laundering and all the predicate offences of money laundering and establish regulatory and supervisory regimes to detect all forms of money laundering.
- iii. **The International Convention for the Suppression of the Financing of Terrorism** which UN member countries to criminalize terrorism, terrorist organizations and terrorist acts.
- iv. **United Nations Security Council Resolution 1373 and 1267** which oblige all UN member countries to criminalize actions relating to the financing of terrorism and requires member states to freeze the assets of the Taliban.

### **3.4.2 The Financial Action Task Force (FATF)**

The Financial Action Task Force (FATF) is an inter-governmental body which sets standards and develops and promotes policies to combat money laundering and terrorist financing and proliferation. FATF assesses member compliance with those standards, promotes global compliance with the standards, and identifies AML/CFT threats.

About 180 jurisdictions across the globe have directly endorsed the FATF recommendations. Kenya is a member of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) which is one of the FATF Associate Members.

## **PART IV ANTI - MONEY LAUNDERING LEGISLATION IN KENYA**

**4.1** This Guideline has been updated to take into account the requirements of the Proceeds of Crime and Anti-Money Laundering Act, 2009.

### **4.2 The Proceeds of Crime and Anti-Money Laundering Act 2009**

The Proceeds of Crime and Anti-Money Laundering Act 2009 came into effect on June 28, 2010. The Act:

- a) Criminalizes money laundering.
- b) Provides for both criminal and civil restraint, seizure and forfeiture.
- c) Places an obligation on financial institutions to;
  - (i) To monitor and report suspected money laundering activity
  - (ii) To verify customer identity (KYC).
  - (iii) To establish and maintain customer records.
  - (iv) To establish and maintain internal reporting procedures.

- d) Establishes the Financial Reporting Centre (Financial Intelligence Unit), the Asset Recovery Centre and the Criminal Assets Recovery Fund.
- e) Provides for procedures that facilitate international assistance with investigations and proceedings related to money laundering offences.

#### **4.2.1 What the Proceeds of Crime and Anti-Money Laundering Act 2009 requires**

#### **4.2.2 Offences**

**The Proceeds of Crime and Anti-Money Laundering Act, 2009** makes it an offence for any person to enter into an agreement or engage in any arrangement or transaction with anyone in connection with property that forms part of the proceeds of crime, whether that agreement, arrangement or transaction is legally enforceable or not and whose effect is to:

- conceal or disguise the nature, source, location, disposition, movement or ownership of the said property or,
- enable or assist any person who has committed or commits an offence, whether in Kenya or elsewhere to avoid prosecution; or,
- remove or diminish any property acquired directly, or indirectly, as a result of the commission of an offence.

#### **4.2.3 Acquisition**

Acquisition, use and possession of proceeds of crime knowing that such property forms part of the proceeds is an offence.

#### **4.2.4 Tipping off**

It is also an offence for anyone who knows or suspects that an investigation into money laundering has been, is being, or is about to be conducted to inform someone else of that fact thereby prejudicing the investigation.

#### **4.2.5 AML Obligations for Institutions**

Institutions are obligated by sections 44, 45, 46 and 47 of the Act, to:

- monitor and report suspected money laundering activity;
- verify customer identity;
- establish and maintain customer records;
- establish and maintain internal reporting procedures.

#### **4.2.6 Failure to Report**

It is an offence for an institution to fail to:

- monitor and report suspected money laundering activity;
- verify customer identity; and
- establish and maintain customer records.

#### **4.2.7 Immunity where actions are exercised in good faith**

The Act accords immunity or protection to institutions and officers in respect of obligations done under the Act in good faith such as reporting of suspicious transactions.

### **PART V SPECIFIC REQUIREMENTS**

5.1 **Specific Measures:** The Board of Directors of an institution operating in Kenya is expected to ensure that management:

- a) Establish adequate internal control measures to address potential money laundering and terrorist financing risks.
- b) Obtain, verify and maintain proper identification of customers wishing to open accounts or make transactions whether directly or through proxy.
- c) Obtain and maintain adequate records such as; copies or records of official identification documents like passports, identity cards; driving licenses or similar documents; statements of accounts, account files and business correspondence including the results of any inquiries to establish the background and purpose of any complex, unusual large transactions, for a minimum of seven years, regarding the sources of funds and details of transactions in order to:
  - (i) enable the identification of unusual or suspicious transactions, and
  - (ii) reconstruct individual transactions.
- d) Train staff on a regular basis in the prevention, detection and control of money laundering and the identification of suspicious transactions.
- e) Monitor and report any suspicious transactions or activities to the Central Bank of Kenya that may indicate money laundering or other attempts to conceal the true identity of customers or ownership of assets.

- f) Cooperate with national law enforcement agencies by taking appropriate measures which are consistent with the law where there are reasonable grounds for suspecting money laundering.
- g) While taking into account the sensitive nature of extra-territorial anti-money laundering laws and regulations, ensure that their overseas branches and subsidiaries are aware of the reporting requirements as directed by the Central Bank of Kenya with regard to suspicious transaction reporting and sanctions reporting.

## **5.2 Compliance by Foreign Branches and Subsidiaries**

Foreign branches and subsidiaries of institutions licensed pursuant to the Banking Act should endeavor to comply with this Guideline and where there is conflict between the Guideline and the regulatory requirements of the host country, the more stringent requirement should be adopted to the extent that is permitted by the host country's laws and regulations.

5.2.1 Institutions should pay special attention to foreign branches or subsidiaries operating in countries which have insufficiently implemented the internationally accepted AML/CFT measures.

5.2.2 In the event that, an institution's foreign branch or subsidiary is unable to observe the more stringent requirements, due to the prohibition of the host country's laws and regulations, the foreign branch or subsidiary should issue an exception report to the institution and the institution should inform the Central Bank of Kenya accordingly. In addition, the institution should place additional AML/CFT controls on the respective foreign branch or subsidiary and should map out a timeline for the foreign branch or subsidiary to comply with the requirements.

## **5.3 The Anti-Money Laundering Program**

Institutions should put in place effective anti-money laundering programs that address the risks posed by money laundering and terrorism financing. It should enhance the ability of the institution to identify, monitor, and deter persons from attempting to gain access to, or make use of the financial system.

5.3.1 The program should be documented and should establish clear responsibilities and accountabilities to ensure that policies, procedures and controls are introduced and maintained.

5.3.2 The program should amongst others address the following issues:

- a) Internal policies, procedures, and controls instituted that are based on the institution's money laundering and terrorism financing risk assessment.
- b) Designate an AML Compliance Officer and detail the role he /she will play in the day-to-day AML/CFT supervision of the institution.
- c) Provide for and document policies and procedures to perform independent testing/audit, to measure compliance with the relevant AML/CFT laws and regulations.
- d) Provide for, and document AML training for appropriate personnel.
- e) Provide for adequate screening policies and procedures to ensure high ethical and professional standards when hiring staff.

#### 5.4 Internal Controls, Policies and Procedures

5.4.1 Procedures and responsibilities for monitoring compliance with and effectiveness of anti-money laundering policies and procedures should be clearly laid down by institutions in the form of policy documents and internal procedural manuals.

5.4.2 Institutions should appoint a Compliance Officer to undertake this function and the officer should have the necessary authority to carry out the function.

- a) The Compliance officer will be the central point of contact with the Central Bank for anti-money laundering purposes.
- b) The institutions should provide the Compliance Officer with the necessary access to systems and records to enable the Officer fulfill his responsibilities.

5.4.3 The functions of the Compliance Officer shall be to amongst others:

- a) receive and vet suspicious activity reports from staff;
- b) file suspicious transaction reports with the Financial Reporting Centre(FRC);
- c) develop the institution's anti money laundering compliance programme;
- d) ensure that the anti-money laundering compliance programme is followed and enforced within the institution;
- e) coordinate training of staff in anti-money laundering awareness, detection methods; and



f) maintain close co-operation and liaison with the Central Bank.

5.4.4 Institutions should verify, on a regular basis, compliance with policies, procedures, and controls relating to money laundering activities, in order to ensure that the requirement to maintain such procedures has been discharged.

5.4.5 Each institution should institute specific “know your employee” controls designed to deter internal fraud and abuse of the institution which require employees to:

- a) Follow a code of ethics;
- b) Avoid and disclose conflicts of interest;
- c) Maintain good credit ratings;
- d) Adhere to policies on rotation of duties and mandatory vacations; and
- e) Require the use of employee identification cards for access to secure areas;

## **5.5 Risk Assessment**

Institutions shall undertake a Money Laundering and Financing of Terrorism Risk Assessment. The Assessment should provide the means for identifying the degree of potential money laundering and financing of terrorism risks associated with specific customers and transactions thereby allowing the institution to focus on customers and transactions that potentially pose a greater risk of money laundering and terrorism financing. In addition the risk assessment should enable institutions to assess, monitor, manage and mitigate the risks associated with money laundering.

The risk assessment conducted by institutions should enable that institution adopt a risk based approach towards managing and mitigating risks related to anti-money laundering and the financing of terrorism. Institutions are advised to undertake enhanced measures to manage and mitigate AML/CFT risks where higher risks are identified; correspondingly, where risks are lower, simplified measures may be permitted. Simplified measures may however not be undertaken whenever there is a suspicion of money laundering or terrorist financing.

Institutions should take into consideration the findings of the country’s National Money Laundering and Terrorism Risk Assessment.

5.5.1 When preparing a risk assessment, an institution should consider factors such as:

- a) The number and volume of transactions per customer,
- b) Nature of the customer relationships, and

- c) Whether, for example, the institution's interaction with customers is face-to-face or non-face-to-face such as electronic banking (for example, internet banking, and mobile banking).

5.5.2 The development of an AML risk assessment framework involves three steps:

- a) Identifying and assessing the money laundering and terrorism financing risks that may be associated with the institution's unique combination of products and services, customers, geographic locations and delivery channels.
- b) Conducting a detailed analysis of all available data to assess the level of risk within each high risk category; and,
- c) Determining whether the institution's AML compliance program is adequate and provides the necessary controls to mitigate the risks identified.

5.5.3 Institutions should update their risk assessment policies/programs at least every two years in order to take into account changes such as the entry of the institution into new markets and the introduction of new products and services.

#### **5.5.4 Risk Categories**

In undertaking a Risk Assessment, institutions shall amongst others take into account the following categories.

##### **a) Country Risk**

Institutions should identify domestic and international geographic locations that may pose a higher risk to its AML/CFT compliance program. Each case should be evaluated individually when assessing the risks associated with doing business, such as opening accounts or facilitating transactions, in certain geographic locations.

Factors that may result in a country or region posing a higher risk include:

- (i) Countries that are subject to sanctions, embargoes or similar measures issued by credible organizations such as the United Nations ("UN"), the Financial Action Task Force (FATF).

- (ii) Countries identified by credible sources as lacking appropriate AML/CFT laws, regulations and other measures.
- (iii) Countries identified by credible sources as providing funding or support for terrorist activities or that have designated terrorist organisations operating within them.

**b) Products/Services Risk**

Institutions should consider the potential money laundering and terrorism financing risks associated with each specific product or service prior to its introduction to the market. This risk assessment should be forwarded to CBK for review and consideration prior to the introductions to the market. Special attention should be paid to the risks associated with new or innovative products or services not specifically being offered by the institution, but which make use of the institution's services to deliver the product. Such products or services could include:

- i) Electronic funds payment services;
- ii) Electronic cash such as stored value cards or
- iii) Domestic and international funds transfers, payable upon proper identification (PUPID) transactions, and third-party payment processors;
- iv) Remittance activity;
- v) Automated clearing house (ACH) transactions;
- vi) Automated teller machines (ATMs);
- vii) Mobile Phone Financial Services;
- viii) Electronic banking;
- ix) Foreign exchange and funds transfers;
- x) Domestic and international private banking;
- xi) Trust and asset management services;
- xii) Monetary instruments;
- xiii) Foreign correspondent accounts, payable through accounts (PTAs) and foreign currency denominated accounts; and
- xiv) Lending activities, particularly loans secured by cash collateral and marketable securities.

**c) Customers/Entities Risk**

An institution shall determine, based on its own criteria, whether a particular customer poses a higher risk. Certain customers and entities may pose specific risks depending on the nature of the business, the occupation of the customer, or the nature of anticipated transaction activity. Some factors to consider include:

- a) Customers conducting their business relationship or transactions in unusual circumstances, such as:
  - (i) Significant and unexplained geographic distance between the institution and the location of the customer;
  - (ii) Frequent and unexplained movement of accounts to different institutions; and;
  - (iii) Frequent and unexplained movement of funds between institutions in various geographic locations.
- b) Customers whose structure or nature of the entity or relationship makes it difficult to identify the true owner or controlling interests.
- c) Foreign financial institutions, including banks and foreign money service providers such as forex bureaus, and money transmitters.
- d) Non-bank financial institutions such as money services businesses, casinos and brokers/dealers in securities, and dealers in precious metals, stones, real estate dealers.
- e) Publicly exposed persons (PEPs). Individuals who are or have been entrusted with prominent public functions (both foreign or local), for example, senior politicians, senior government officials, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs may involve reputational risks similar to those with PEPs.
- f) Resident and Non- resident aliens (NRAs) and accounts held by foreign individuals.
- g) Foreign corporations and domestic business entities, particularly offshore corporations such as domestic shell companies, private investment companies and international business corporations located in high-risk geographic locations.
- h) Cash-intensive businesses, including, for example, supermarkets, convenience stores, restaurants, retail stores, liquor stores, wholesale distributors

- i) Foreign and domestic non-governmental organizations and charities.
- j) Professional service providers.

The weight assigned to each of these risk categories (individually or in combination) in assessing the overall risk of potential money laundering may vary from one institution to another, depending on their respective circumstances. Consequently, an institution will have to make its own determination as to the risk weights to assign to the different risk.

### **5.5.5 Conducting a detailed analysis of all available data**

The second step of the risk assessment process entails a detailed analysis of the data obtained during the identification stage in order to assess the AML Risk. This stage involves obtaining quantitative data pertaining to the institution's activities, different weights are assigned to each product/service, customer/entity and geographical based on the following:

- The institution's ability to identify the customer.
- Number and volume of transactions.
- Past history

The weight assigned to each of these risk categories (individually or in combination) in assessing the overall risk of potential money laundering may vary from one institution to another, depending on their respective circumstances. Consequently, institutions will have to make their own determination as to the risk weights to assign to the different types of risk.

### **5.5.6 Building a risk-based AML Program**

The third step is the process of building a risk-based AML program which adequately addresses the concerns identified in the risk assessment. This includes establishing appropriate policies and procedures to monitor and control the various risks with particular emphasis placed on those risk categories classified as "high risk".

## **5.6 Customer Due Diligence**

### **5.6.1 Know your Customer Requirements**

The need for institutions to know their customers is vital for the prevention of money laundering and underpins all other activities.

When a business relationship is being established, the nature of the business that the customer expects to conduct with the institution should be ascertained at the outset to show what might be expected as normal activity. In order to be able to judge whether a transaction is or is not suspicious, institutions need to have a clear understanding of the legitimate business of their customers.

### **5.6.2 Customer Identification and Verification**

In all circumstances, any business entity operating within the financial sector requires basic information on its customers. The nature and extent of this information will vary according to the type of business. It shall also depend on whether the business is being introduced by a financial intermediary and the type of customer involved.

An institution should establish to its satisfaction that it is dealing with a person that actually exists. It should identify those persons who are empowered to undertake the transactions, whether on their own behalf or on behalf of others.

When a business relationship is being established, the nature of business that the customer expects to conduct with the institution concerned should be ascertained, so as to determine what might be expected as the customer's normal activity levels. In order to judge whether a transaction is or is not suspicious, an institution needs to have a clear understanding of the pattern of its customer's business as its relationship.

### **5.6.3 When Identity Must Be Verified**

An institution must identify its customer in the following circumstances:

- (a) When establishing initial business relations.
- (b) When undertaking occasional or one-off transactions.
- (c) When there is cause to be suspicious.
- (d) When there is doubt about veracity or adequacy of previously obtained customer information.

### **5.6.4 Anonymous Accounts and Numbered Accounts**

No institution shall open and/or maintain anonymous accounts or accounts in fictitious names. All numbered accounts should undergo the same identification and verification process as regular accounts.

### 5.6.5 Customer Due Diligence Measures

Customer Due Diligence (CDD) measures are to be undertaken by institutions with the following objectives:

- a) To identify the customer and verify that customer's identity using reliable, independent source documents, data or information.
- b) To identify the beneficial owner, and take reasonable measures to verify the identity of the beneficial owner, such that the institution is satisfied that it knows who the beneficial owner is. Enhanced due diligence measures shall be applied to persons and entities that present a higher risk to the institution. For legal persons and arrangements, institutions are required to understand the ownership and control structure of the customer.
- c) Understand and, as appropriate, obtain information on the purpose and intended nature of the business relationship.
- d) Conduct on going due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including where necessary the source of funds.

#### 5.6.5.1 Face to Face Customers

- a) **For personal accounts or transactions:**

An institution shall take measures to satisfy itself as to the true identity of any applicant seeking to enter into a business relationship with it, or to carry out a transaction or series of transactions with it, by requiring the applicant to produce an official record for the purposes of establishing the true identity of the applicant. At a minimum the mandatory requirements;

- (i) **In the case of an individual:**

- A birth certificate; or
- Passport; or
- National identity card; or
- Drivers licence

Additional due diligence measures that may be used to verify the identity of the customer include:

- a) Address of current residence verified by a referee, a utility bill i.e. electricity or water bill, etc.;

- b) Verified employment and/or source(s) of income; and
- c) Where applicable, written confirmation from customer's prior bank attesting to customer's identity and history of account relationship (bank referee).
- d) For accounts with more than one party and where one of the parties has identified the others, written confirmation must be obtained to the effect that the first party has known the other(s) personally for at least 12 months.

**(ii) For minors' accounts**

**At a minimum the requirements are as follows;**

- a) Nationality and date of birth evidenced by birth certificate of the minor, and;
- b) National passport, driving license or national identity document and certified copy thereof; of legal parent or guardian at a minimum;

**Additional measures that may be used to verify the identity of the minor include:**

- a) Verified address of current residence of minor and also of legal parent or guardian. The verification should be done by a referee or via the production of utility bills i.e. electricity and water bills.
- b) Declaration of source of funds or income from the parent/guardian.

**(iii) For accounts or transactions corporate, partnerships, sole traders and other legal entities:**

**At a minimum the requirements are as follows;**

- a) Evidence of registration or incorporation – A Certified copy of Certificate of Registration or Certificate of Incorporation, and Partnership Deed, Memorandum and Articles of Association or other similar documentation evidencing legal status should be provided;



- b) Certified copy of Board Resolution stating authority to open accounts, transact business, and borrow funds, and designating persons having signatory authority thereof;
- c) In the case of a government department a letter from the accounting officer;

**Additional measures that may be used for verification**

- d) Verify the identity and address of the chairman of the Board of Directors, the Managing Director, or the general partner and at least one limited partner for partnerships, or the principal owner for sole traders, etc;
- e) Audited financial statements (last full year at minimum although, last three years preferred) for corporation; for partnerships, sole traders, un-audited statements may be substituted upon prior written approval of a senior management official of bank; formation statement and PIN registration. An exemption may be considered for new sole proprietorship business and partnerships in the production of audited accounts or un-audited accounts as there may be practical difficulties in obtaining financial statements from them.
- f) Where applicable, written confirmation from customer's prior bank if any attesting to customer's identity and history of account relationship.

**iv) Un-incorporated Businesses/Partnerships**

- a) Where the applicant is an un-incorporated business or a partnership whose partners/controllers are not known to the institution, the identity of at least two partners/controllers and/or signatories to the mandate should be verified initially, in line with the requirements for personal customers. When signatories to the mandate change, care should be taken to ensure that the identity of at least two of the current signatories has been verified. For established businesses, a copy of the latest financial report and accounts (audited where applicable) should be obtained.
- b) A visit to the place of business might also be made to confirm the true nature of the business activities.

- c) The nature of the partnership or business should be ascertained to ensure that it has a legitimate purpose. In cases where a formal partnership arrangement exists, a mandate from the partnership.
- d) Authorising the opening of an account and conferring authority on those who will operate it should be obtained.

**v) Trustees of Occupational Pension Schemes**

For the Trustees of Occupational Pension Schemes, satisfactory verification of identity can be based on the inspection of formal documents concerning the Trust which confirm the names of the current Trustees and their addresses for correspondence. Verification can also be based on extracts from Public Registers, or references from Professional Advisors or Investment Managers. Individual verification of each Trustee would not normally be required.

### **5.6.6 Enhanced Customer Due Diligence Measures**

Enhanced due diligence measures shall be applied to persons and entities that present a higher risk to the institution. This can broadly be addressed with the following measures:

- Obtain further information to establish the customer's identity.
- Apply extra measures to check documents supplied by a credit of financial institution.
- Obtain senior management approval for the new business relationship or transaction.
- Establish the persons/entity's source of funds.
- Carry out ongoing monitoring of the business relationship.

### **5.6.7 Non Face-To-Face Verification**

#### **5.6.7.1 Telephone mobile and Internet Banking**

The rapid growth in telephone, mobile and internet banking has added a new dimension to banking risks including the verification of identity, unlicensed deposit taking and tax evasion and opens up new mechanisms for fraud and money laundering because its use is unregulated. Any mechanism which avoids face-to-face contact between an institution and the customer inevitably poses challenges for customer identification and can provide additional opportunities for criminals to gain access to the banking system.

- 5.6.7.2 Any bank offering telephone banking, mobile banking and /or internet banking should implement procedures to identify and authenticate the customer and should ensure that there is sufficient communication to confirm address and personal identity in accordance with the details set out in paragraphs 5.6.7.3 to 5.6.7.8 below.
- 5.6.7.3 The procedures adopted should confirm the identity as robustly as those for face-to-face verification and reasonable steps should be taken to avoid single or multiple fictitious applications or substitution (impersonation) fraud for the purpose of money laundering.
- 5.6.7.4 As with face-to-face verification, the procedures to check identity must serve two purposes:
- They must ensure that a person bearing the name of the applicant exists and lives at the address provided; and
  - That the applicant is that person.
- 5.6.7.5 There are a number of checks and measures which, when undertaken successfully, will give the institution a reasonable degree of assurance as to the authenticity of the applicant where there is no face-to-face contact. Some of the more widely used checks are listed below in paragraphs 5.6.7.7 and 5.6.7.8. The list of checks is not definitive and it is for each institution to decide upon which checks to employ. Institutions should assess the money laundering risk posed by the postal, telephone and mobile banking products they offer and devise their verification of identity procedures with due regard to that risk.
- 5.6.7.6 For all accounts and products offering third party transfer and money transmission facilities, evidence of personal identity and address verification should be undertaken through a combination of checks, examples of which are set out below in paragraph 5.6.7.7 and 5.6.7.8 For non-transferable investment products of accounts, where the money invested can only be returned to the original investor, the procedures set out in the paragraphs below can be followed, although further verification checks will need to be undertaken if the customer migrates to another account or product that provides money transmission facilities and therefore constitutes a higher money laundering risk.
- 5.6.7.7 Some of the best means of verifying address are:

Requesting sight of a recent utility bill, local authority tax bill, institution statement (to guard against forged or counterfeit documents, care should be taken to check that the documents offered are originals); or checking a local telephone directory (for businesses).

5.6.7.8 In addition, satisfactory evidence of personal identity can be obtained by a number of means, some of which are set out below:

- Use of a computerised system, for internal or external application database checks, to check for any inconsistencies in the information provided – particularly those containing known fictitious application/fraud information (accommodation, addresses, aliases, etc.);
- Telephone contact with the applicant on an independently verified home or business number;
- With the customer's consent, employer's personnel department confirms employment by verbal confirmation on a listed number; or
- Salaries details appearing on recent bank statements;
- Care should be taken to ensure that the same supporting documentation is obtained from Internet customers as for other postal/telephone/mobile banking customers;
- Institutions should consider regular monitoring of accounts opened on the Internet. Unusual transactions should be investigated and reported if found to be suspicious.

## **5.6.8 Wire Transfers**

5.6.8.1 Institutions should ensure that information accompanying both domestic and cross-border wire transfers should always contain the following information:

- a) the name of the originator;
- b) the originator account number where such an account is used to process the transaction;
- c) the originator's address, or national identity number, or date and place of birth;
- d) the name of the beneficiary; and
- e) the beneficiary account number where such an account is used to process the transaction.
- f) In the absence of an account number, a unique transaction reference number should be included which makes it possible to trace the transaction.

**5.6.8.2 The requirements in 5.6.8.1 apply to institutions in circumstances where the institution is acting as:**

- a) **The ordering financial institution;** This is where the institution initiates the wire transfer and transfers the funds upon receiving the request for a wire transfer from the customer.
- b) **The beneficiary financial institution;** This is where the institution receives the wire transfer from the ordering institution directly or through an intermediary institution and makes the funds available to the beneficiary identified by the sender as the receiver of the requested wire transfer.

5.6.8.3 Wire transfers to and from persons or entities that are designated under the United Nations Security Council 1267 (1999) and/or other United Nations resolutions relating to the prevention of terrorism and terrorist financing are prohibited.

**5.6.9 Reliance on Third Parties**

Institutions may rely on third parties to perform elements of CDD measures set out in part 5.6.5.1 to 5.6.7 of this Guideline, provided that they meet the criteria set out below.

The term third parties means other financial institutions or designated non-financial businesses or persons (DNFBPs) that are supervised or monitored by competent authorities.

It should be noted that where reliance on third parties to perform elements of CDD measures is permitted, the ultimate responsibility for CDD measures remains with the institution that is relying on the third party.

- a) An institution relying on a third party should immediately obtain the necessary information concerning the relevant elements of CDD measures set out in 5.6.5.1 to 5.6.7 of this Guideline.
- b) Institutions should take adequate steps to satisfy themselves that copies of identification data and other relevant documentation relating to the CDD requirements will be made available from the third party upon request without delay.

- c) Each institution should ensure that that the third party is regulated, supervised or monitored by a competent authority and has measures in place for compliance with, CDD and record-keeping requirements in line with international best practice.
- d) There are instances where an institution may be relying on a third party that is based out of Kenya in another country. The institution should assess the AML/CFT risks that the country poses and the adequacy of CDD measures adopted by financial institutions in that country.

**5.6.10 Where an institution is unable to fully comply with the customer due diligence requirements set out in this Guideline, it :**

- a) Should not open the account, commence the business relation or perform or undertake the transaction; or,
- b) In the event where the institution has already commenced the business relationship terminate the business relationship; and,
- c) File a suspicious transaction report in accordance with this Guideline.

**5.7 Non Kenyan Residents**

For prospective non Kenyan resident customers who wish to open accounts without face-to-face contact, it will not be practical to seek sight of a passport or national identity card. There are a number of alternative measures that can be taken:

- Branches, subsidiaries, head offices, representative offices or correspondent banks in the prospective customer's home country may be used to confirm identity or as an agent to check personal verification and address details;
- Where the institution has no group presence or correspondent relationship in the country of residence, a copy of the passport authenticated by an attorney, notary or consulate could be obtained; or
- An account opening reference can be sought from a reputable credit or financial institution in the applicant's home country. Verification details should be requested covering true name or names used, current permanent address, date of birth and verification of signature.

**5.8 Legitimacy of Funds and Transactions**

The following types of information will be considered the minimum acceptable for determining the legitimacy of funds and transactions:

- 5.8.1 For large, frequent or unusual cash deposits or withdrawals - written statement from the customer confirming that the nature of his/her business activities normally and reasonably generates substantial amounts of cash;
- 5.8.2 For large, frequent or unusual currency exchanges - written statement from the customer confirming the reason and need for acquired currencies;
- 5.8.3 For multiple or nominee accounts, or similar or related transactions - written statement from the customer confirming the reason and need for multiple or nominee accounts, or similar or related transactions;
- 5.8.4 For large, frequent or unusual transfers or payments of funds - appropriate documentation as to the identity of the recipient (or sender) of the transferred or paid funds, and the reason underlying the transfer or payment;
- 5.8.5 For large or unusual investments or requests for advice or services - written statement from the customer confirming that the investments or advice or services being requested are bona fide and consistent with the goals and objectives of the customer's reasonable and normal business activities;
- 5.8.6 For large or unusual foreign transactions - written confirmation from the customer indicating the nature, reason and appropriate details of the foreign transactions sufficient to determine the legitimacy of such transactions.
- 5.8.7 Institutions should set up policies setting limits on the maximum cash transaction amounts non-customers can undertake with them.

## **5.9 Politically Exposed Person (PEPs)**

A Politically Exposed Person means a person who has been entrusted with a prominent public function in (i) Kenya and (ii) a foreign country, and include;

- a) Members of the Cabinet;
- b) Senior executives of a state owned corporation;
- c) An important political party official;
- d) Senior military officials and other members of the disciplined forces;
- e) Members of the Judiciary;
- f) Senior State Officers,
- g) Persons who have been entrusted with a prominent function by an international organization who serve as members of senior management i.e. directors, deputy directors or board members.
- h) Senior Public Offices; and

- i) Any immediate family member or close business associate of a person referred to under the categories a) to h).

Where a customer has been found to be a Politically Exposed Person, institutions will be required to take the following measures;

- a) Obtain approval from senior management to transact/establish the relationship with that person.
- b) Take adequate measures to establish the source of wealth and the source of funds which are involved in the proposed business relationship of transaction.
  - obtain information on immediate family members or close associates of the PEP who may be having transaction authority over the account;
  - determine the purpose of the account and the expected volume and nature of account activity; and
  - review public sources of information for example the internet, company registries.
- c) Once the account has been established, conduct enhanced on-going monitoring of the relationship.

In the event that that a customer subsequently becomes a Politically Exposed Person after having initially established a relationship with a financial institution, the institution is to carry out steps a) to c) above immediately it is made aware that a customer is a Politically Exposed Person.

## **5.10 Correspondent Banking**

In Kenya, international banks provide correspondent banking services to local commercial banks. However, increasingly a number of the top tier domestic banks are also providing correspondent banking services.

5.10.1 An institution which intends to establish a correspondent banking relationship either as the correspondent bank or the respondent bank shall undertake the following steps before establishing a business relationship:

- a) Gather sufficient information about the correspondent bank regarding the nature of its business activities;



- b) Determine from available information the reputation of the correspondent bank institution and the quality of its supervision;
- c) Determine the quality of anti-money laundering regulation in the correspondent bank's jurisdiction or country of domicile;
- d) Assess the correspondent bank's anti-money laundering controls;
- e) Obtain approval from senior management before establishing a new correspondent banking relationship;
- f) In respect to the correspondent bank's customers, be assured that it verifies the identity of its customers and conducts on-going monitoring.
- g) Verify the ownership and management structures of the correspondent bank including whether a publicly exposed person has ownership or control of the bank.

#### **5.10.2 Shell Banks**

- a) Institutions are prohibited from opening an account or entering into a correspondent banking relationship with a shell bank.
- b) Before entering into a correspondent banking relationship with another bank, an institution should ensure that the bank does not permit their accounts to be used by shell banks.

#### **5.11 New Innovations/Technology**

- a) Institutions shall conduct a money laundering and terrorism financing risk assessment so as to assess money laundering and terrorism financing risks in relation to:
  - (i) New products and new business practices, including new delivery mechanisms; and
  - (ii) New or developing technologies for both new and pre-existing products.

- b) Institutions should ensure that a money laundering and terrorism financing risk assessment is conducted **prior** to the introduction of a new product, new business practice or new technology for both new and pre-existing products.

## **5.12 Money Value Transfer Services**

Institutions that offer money value transfer services as a product should ensure that the providers of (MVTs) are:

- a) Licensed or registered by the relevant authorities;
- b) Subject to effective systems for monitoring and ensuring compliance with AML/CFT measures;
- c) Have AML/CFT programmes in place; and
- d) Regularly monitor the AML/CFT programmes for compliance.

## **5.13 On-going Monitoring of Transactions**

On-going monitoring of account activity and transactions should be conducted on a risk-sensitive basis. Institutions can only effectively control and reduce their risk if they have an understanding of normal and reasonable activity of their customers. This enables them to have the means of identifying transactions which fall outside the regular pattern of an accounts activity. This can be done by establishing limits for a particular class or category of accounts particular attention should be paid to transactions that exceed these limits.

## **5.14 Transparency and Beneficial Ownership of Legal Persons and Arrangements**

5.14.1 Institutions should ensure that they are able to identify, verify the natural persons behind legal persons and arrangements. In addition, institutions are required to understand the nature of business, ownership and control structure when performing CDD measures in relation to customers that are legal persons or legal arrangements. The objective of undertaking this function would be to identify the natural persons exercising control and ownership in the legal person or arrangement. Information that may be obtained from customers to assist institutions in this function includes the following;

- a) Certificate of Incorporation
- b) Partnership agreement
- c) Deed of Trust

- d) Memorandum and Articles of Association
- e) Official returns showing registered office and if different the principal place of business
- f) Names of the relevant persons having senior management position in the legal person or trustees of the legal arrangement
- g) Names of the trustee, beneficiaries or any other natural person exercising ultimate effective control over the trust.
- h) Any other documentation from a reliable independent source proving the name, form and current existence of the customer.

The relevant identification data may be obtained from a public register, from the customer or other reliable sources.

- 5.14.2 Where a person is purporting to act on behalf of another person whether as a nominee or otherwise, the institution should ensure that it is able to identify and verify that person.

## **5.15 Reporting of Suspicious Activities or Transactions**

If an institution becomes aware of suspicious activities or transactions which indicate possible money laundering or terrorism financing, the institution shall ensure that it is reported to the Financial Reporting Centre (FRC) immediately and in any event within seven days of the date of the transaction or occurrence of the activity that is considered suspicious.

### **5.15.1 Nature of the Information to be disclosed**

Sufficient information should be disclosed which indicates the nature of and reason for the suspicion. Where the institution has additional supporting documentation that should also be made available.

### **5.15.2 Termination of a Business Relationship Following a Disclosure**

If, following a disclosure, an institution, exercising its commercial judgment wishes to terminate the relationship with the customer, it is recommended that before taking this step, the reporting institution should liaise with the Central Bank to ensure that the termination does not in any way “tip-off” the customer or prejudice possible investigation.

### **5.15.3 The Suspicious Transaction Report**

The Suspicious Transaction Report shall provide sufficient details, regarding the activities or transactions so that authorities can properly investigate and, if warranted, take appropriate action. See Appendix 1 attached to this guideline for a sample list of suspicious activities.

### **5.15.4 Failure to Report Suspicious Transaction Reports**

Institutions are reminded that failure to report suspicious transactions may invite remedial action.

## **5.16 Tipping Off**

Institutions which obtain or become aware of information which is suspicious or indicates possible money laundering activities should not disclose such information to the customer but shall, report it to the Central Bank as required by this Guideline.

## **5.17 Record Keeping**

5.17.1 Institutions must ensure that they maintain and keep records of all transactions for a minimum period of seven years from the date of the relevant business or transaction was completed or following the termination of an account or business relationship.

5.17.2 Institutions must ensure that they keep all records obtained through CDD measures such as copies or records of official documents like passports, identification cards or similar documents, account files and business correspondence including the results of any analysis undertaken such as inquiries to establish the background and purpose of complex, unusual, large transactions for a period of at least seven years.

5.17.3 Where the transaction involves a negotiable instrument other than currency, the name of the drawer of the instrument, the name of the institution on which it was drawn, the name of the payee (if any), the amount and date of the instrument, the number (if any) of the instrument and details of any endorsements appearing on the instrument should be retained.

5.17.4 The record keeping requirements under this guideline are made without prejudice to any other records required to be kept by or under any other

written law, the transaction records should be made available to competent authorities where required on a timely basis.

## **PART VI: REMEDIAL MEASURES**

Central Bank may pursue any or all remedial actions provided under sections 33, 33A, 34 and 55 of the Banking Act.

## **PART VI: EFFECTIVE DATE**

- 7.1 **Effective Date** - The effective date of these guidelines shall be 1<sup>st</sup> January 2013.
- 7.2 **Supersedence** - This guideline supersedes the Guideline on the Proceeds of Crime and Money Laundering (Prevention) issued on 1st January, 2006.

## **ENQUIRIES**

Enquiries on any aspect of this guideline should be referred to:

Director,

Bank Supervision Department

Central Bank of Kenya

P.O. Box 60000 - 00200

**NAIROBI**

TEL. 2860000 e-mail: [fin@centralbank.go.ke](mailto:fin@centralbank.go.ke)

**FORM NO. CBK/IF 8**

**Suspicious Activities or Transactions Report (SATR)**

Submit to: Director, Financial Institutions Supervision, Central Bank of Kenya Always complete entire report, attach additional pages if necessary to explain situation fully,

1. Tick appropriate box a. Initial Report  b. Correct Report   
c. Supplemental Report

**Part I. Information About Institution Submitting This Report**

2. Name of Institution  
3. Address of Head Office  
4. Address of Branch(es) where activity/transaction occurred  
5. Account number(s) affected, if any:

**Part II Information about Person or Entity Engaging In Suspicious Activities or Transactions**

6. Surname (or Name of Entity)  
7. First Name  
8. Middle/Name  
9. Address  
10. Date of Incorporation (DDMMYY): ...../...../.....  
11. Nat. Identity No.....  
12. Occupation or Business:  
13. Identity verified by: a. Passport ..... b. National ID card .....  
c. Other..... d. Incorporation Number .....  
e. Date & Place Issued .....
14. Relationship to this Financial Institution (tick all that apply)
- a. Accountant
  - b. Agent
  - c. Appraiser
  - d. Attorney
  - e. Borrower
  - f. Broker
  - g. Depositor
  - h. Director
  - i. Employee
  - j. Officer
  - k. Shareholder
  - l. Other .....

- 15. Is suspect affiliated with this institution? a. Yes b. No If no, specify  
c. Resigned d. Suspended e. Terminated
- 16. Date of Resignation, Suspension, Termination (DDMMYY) ...../...../.....
- 17. Admission/Confession: a. Yes b. No.

**PART III Information About Suspicious Activity or Transaction**

- 18. Date of suspicious activity or transaction (DDMMYY) ...../...../.....
- 19. Amount involved Kshs.....
- 20. General description of suspicion transaction:
  - a. Cash deposit(s)
  - b. Cash exchange (s)
  - c. Cash payment(s)
  - d. Cash withdrawal(s)
  - e. Deposit from abroad
  - f. Transfer to abroad
  - g. Transfer to domestic bank
  - h. Transfer from domestic bank
- 21. Has suspicious activity or transaction had material impact on or otherwise adversely affected the financial soundness of this institution? a. Yes b. No. If yes, describe impact
- 22. Has financial institution’s insurer been notified a. Yes b. No. If yes, when & how?
- 23. Has any law enforcement authority already been notified in any manner? If so, indicate following: a. Authority..... b. Specific person notified:  
.....
- c. How notified ..... d. Details provided .....

**PART IV Information About Compliance Officer**

- 24. Name: .....
- 25. Position/Title in this institution  
.....
- 26. Signature ..... Date.....





**Suspicious Activities**

The following types of activities or transactions may indicate possible money laundering activities (*list is not exhaustive*):

1. Account activity (e.g. large, frequent or unusual deposits, withdrawals, payments or exchanges of cash, foreign currency or negotiable instruments) which is not consistent with or reasonably related to the customer's normal business activities or financial standing;
2. Use of multiple or nominee accounts, or similar or related transactions which are not consistent with the customer's normal business activities, financial standing, or indicated reasons thereof;
3. Consolidation of multiple smaller accounts at several institutions within same locality prior to request for onward transmission of funds elsewhere;
4. Reluctance to provide reasonable information and documentation when opening an account or in connection with a requested transaction, investment or advice or service, or the providing of information which is unreasonably difficult or expensive to verify;
5. Transactions or account activity, including transfers of funds abroad or use of foreign travel and trade-related instruments, where the use or involvement of funds is not consistent with the customer's normal business activities, financial standing, or indicated reasons thereof, or where the destination country is a known or suspected tax haven or drug trafficking country;
6. Requests by a customer to provide/arrange/participate in credit facilities where the source of the customer's contribution is unclear, not consistent with normal business activities or financial standing, or involves real property;
7. Matching of cash deposits/withdrawals with payments or transfers out/in;
8. Deposits of large third-party cheques endorsed in favour of customer;
9. Large or unusual activity in dormant/inactive accounts;
10. Deposit of cash by means of numbered credit slips so that the total of each deposit is unremarkable but the total of all the credits is large;
11. Customers who open numerous accounts and pay in amounts of cash to each of them in

circumstances in which the total of credit would be a large amount;

12. Company accounts whose transactions, both deposits and withdrawals are dominated by cash rather than the forms of transactions normally associated with commercial operations (e.g. cheques, letters of credit, bills of exchange, etc.)
13. Customers who wish to maintain a number of trustee or clients' accounts which do not appear consistent with type of business, and transactions which involve nominee names;
14. Customers who seek to exchange large quantities or low denomination notes for those of higher denomination;
15. Request to borrow against assets held by the bank or a third party, where the origin of the assets is not known or is inconsistent with the customer's standing.

# **GUIDELINE ON APPOINTMENT, DUTIES AND RESPONSIBILITIES OF EXTERNAL AUDITORS CBK/PG/09**

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### **PART I: Preliminary**

- 1.1 Title
- 1.2 Authorisation
- 1.3 Application
- 1.4 Definition

### **PART II: Statement of Policy**

- 2.1 Introduction
- 2.2 Purpose
- 2.3 Scope
- 2.4 Responsibility
- 2.5 Audit Partner and/or Manager Rotation

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- 3.1 Approval of Appointment
- 3.2 Duties and Responsibilities

### **PART IV: Ineligible Activities of Registered Public Accounting Firms**

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### **PART VI: Change of a Registered Public Accounting Firm**

### **PART VII: Remedial Actions**

### **PART VIII: Effective Date**

- 5.1 Effective Date
- 5.2 Supersedence

## **PART 1: PRELIMINARY**

- 1.1 Title** – Guideline on Appointment, Duties and Responsibilities of External Auditors.
- 1.2 Authorisation** - This guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.
- 1.3 Application** – All institutions licensed under the Banking Act (Cap.488).
- 1.4 Definition** – The terms ‘external auditor’ or ‘Auditor’ means a registered public accounting firm. These terms are used interchangeably.

Other terms used within this Guideline are as defined in the Banking Act.

## **PART II: STATEMENT OF POLICY**

- 2.1 Introduction** - This guideline sets out minimum requirements regarding the appointment, duties and responsibilities of external auditors of institutions. While the preparation and integrity of financial statements are the responsibility of the board and senior management of commercial banks, assurance of a properly conducted audit serves to provide an independent view of the financial statements’ reliability. Such assurance would depend significantly on the exercise of appropriate due diligence by commercial banks in the selection and engagement of auditors.
- 2.2 Purpose** - The need for Central Bank’s approval of the registered public accounting firm arises out of the desire to ensure that the registered public accounting firm appointed by the institutions has achieved acceptable standards of both competence and independence to enhance the supervisory role of the Central Bank. This guideline is therefore intended to:
- Require and assist the external auditors of institutions to discharge its functions more effectively. Every institution shall advise its registered accounting public firm to use this guideline in conjunction with Sections 24, 25 and 26 of the Banking Act.
  - Ensure that external auditors of institutions have acceptable standards of competence and independence;
  - Enforce international best practices in carrying out audits of institutions;
  - Assist in promoting confidence in the financial system by ensuring that qualified auditors are appointed by institutions to audit and report on their operations and financial statements;
  - Promote transparency and accuracy in reporting by institutions to enhance market discipline; and

- Safeguard depositors' funds by requiring institutions to be subjected to effective external audits.

**2.3 Scope** - This guideline applies to the appointment, duties and responsibilities of a registered public accounting firm.

**2.4 Responsibility** – It is the responsibility of the board of directors to ensure that the institution's shareholders appoint a registered public accounting firm annually in accordance with this guideline and other applicable laws.

It is also the responsibility of the board of directors of institutions to ensure that the institution's external auditors are given right to access at all times the institution's books of accounts, computer systems, vouchers, financial records, securities and all other relevant records in order to facilitate their work.

**2.5 Audit Partner and/or Manager Rotation** - A registered public accounting firm shall ensure that the lead audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit and the audit manager or officer leading the audit team, do not perform audit services for an institution for more than five (5) consecutive financial years.

The lead and reviewing audit partners and/or audit manager who have been rotated off the audit of an institution may resume the role only after a lapse of three (3) years from the last audit engagement with the institution.

## **PART III: SPECIFIC REQUIREMENTS**

### **3.1 Approval of Appointment**

#### **3.1.1 Approval Procedures**

- a) The nomination and subsequent appointment of a registered public accounting firm by an institution does not take effect unless written approval has been obtained from Central Bank of Kenya as required under Section 24(1) of the Banking Act. Institutions have to apply to the Central Bank for approval of a newly appointed registered public accounting firm prior to commencement of any audit work by the registered public accounting firm.
- b) All applications for approval of newly appointed external auditors should be received by the Central Bank by 30<sup>th</sup> June of each year and prior to the commencement of the interim

- audit. The application will be accompanied by the extract of the Annual General Meeting (AGM) resolution approving the appointment of the external auditor.
- c) On an annual basis, where there is no change in the registered audit firm, an institution shall notify CBK of the reappointment of the existing audit firm within fifteen days of reappointment by submitting the Annual General meeting Resolution reappointing the audit firm together with the valid annual licence for the audit firm from the Institute of Certified Public Accountants of Kenya.
- d) Where there is a change in the lead or reviewing partner or audit manager, the institution shall inform the Central Bank of the change at least 30 days before the change takes effect. The notice of change of audit partner and/or audit manager shall be accompanied by the following:
- Name, qualifications, experience and detailed CV of the new audit partner and/or audit manager.
  - Details of the audit partner's/manager's experience in auditing banks and other financial institutions, including a list of major audit assignments over the last three (3) years.
  - Confirmation that the audit partner or manager are not holding past due loans in the institution.
  - Copy of the practicing certificates of the audit partner/manager issued by the Institute of Certified Public Accountants of Kenya (ICPAK).
  - Certification that the audit partner/manager has no pending administrative or criminal case or any record of disciplinary action taken against them for unprofessional conduct by the Institute of Certified Public Accountants of Kenya and the decision for such disciplinary action has not been reversed.
  - Any other information considered necessary in support of the application.
- e) The Central Bank shall, within 30 days of receipt of information on change in audit partner and/or audit manager, review and respond to the institution.
- f) The firm should keep the Central Bank informed of any changes in partnerships, audit managers, disciplinary actions against the firm or its partners, etc. within 30 days of the event.

### **3.1.2 Information Required for Application**

- a) The application for the approval of a newly appointed registered public accounting firm should contain the following information:

- i) Name of the registered public accounting firm.
- ii) Names, qualifications, experience and detailed CVs for each partner and the number of professional staff.
- iii) Physical and postal address of the local office. In case of an international firm, full details of the head office.
- iv) Details of the partner in charge of the institution.
- v) Name, qualifications and experience of the manager who will be directly engaged in the audit of the institution.
- vi) Details of the audit firm's experience in auditing banks and other financial institutions, including a list of major audit assignments over the last three (3) years.
- vii) Details of any existing business relationship between the partner in-charge of the audit and the institution.
- viii) Confirmation that neither the firm, nor the partners or staff involved in the audit of financial institutions, are holding past due loans in the institution.
- ix) Copy of the practicing certificates of the partners in the firm issued by Institute of Certified Public Accountants of Kenya (ICPAK).
- x) Copy of the valid annual license for the audit firm from the Institute of Certified Public Accountants of Kenya.
- xi) A declaration under oath that the audit firm or the lead audit partner has no pending administrative or criminal case and has not been convicted of or has been an accomplice in any offence involving corruption, fraud, tax evasion, money laundering, other economic and financial crimes.
- xii) Certification that the audit firm does not have any record of disciplinary action taken against them for unprofessional conduct by the Institute of Certified Public Accountants of Kenya (ICPAK) and the decision for such disciplinary action has not been reversed.
- xiii) Any other information considered necessary in support of the application.

### **3.1.3 Evaluation**

- a) In assessing the application, the Central Bank will have to be satisfied that:
  - i. The registered public accounting firm is not disqualified in terms of Section 24(7) of the Banking Act.

- ii. The firm or any of its partners do not operate an account or has not been granted any type of facilities in the institution, except in the normal course of business and at an arms-length. The facility has been approved by the full board.
  - iii. The firm or its partners do not represent directly or indirectly the interests of the shareholders or directors of the institution in any business ventures.
  - iv. The partners of the firm do not have any business association with the shareholders or directors of the institution except in public quoted companies.
  - v. The registered public accounting firm has adequate resources, capacity and ability to perform its duties with professional competence and due care in accordance with approved professional auditing standards and applicable legal and regulatory requirements.
  - vi. Where the firm or its partners have been subject to any disciplinary action by any professional body, clearance has been obtained from that body.
  - vii. The audit fees from an institution shall not exceed 10% of the total gross income of the firm.
  - viii. There has been no element of misconduct in the performance of the registered public accounting firm's duties in other firms whether in its auditing, accounting, secretarial, trustee nominee services or otherwise.
  - ix. The firm maintains adequate quality control measures.
- b) The Central Bank may verify any information submitted by the registered public accounting firm for the purpose of the approval.

## **3.2 Duties and Responsibilities**

### **3.2.1 Principal Responsibilities**

Traditionally, the principal role of the registered public accounting firm is to express an opinion as to whether:

- a) All the necessary information and explanations for the audit have been obtained.
- b) Proper books of accounts have been kept and maintained by the institution.



- c) The accounts dealt with in the report are in agreement with the books of accounts and are in conformity with the International Financial Reporting Standards.
- d) The financial statements derived from the books of accounts give a “true and fair view” of the financial affairs and results of the institution.
- e) The institution has adhered to the Banking Act and the attendant regulations and prudential guidelines issued by the Central Bank of Kenya.

### **3.2.2 Scope of Audit Engagement**

- The scope of the audit engagement shall have regard to the institution’s financial reporting risk areas.
- The audit programme and audit plan must at least include specific procedures to test the institution’s internal controls over financial reporting in relation to the loan and investment portfolios. These procedures should include a review and validation of management’s processes for determining the adequacy of provisions for loan impairments and values ascribed to financial instruments. The procedures should be adequate to enable the auditor to form a view as to whether management’s processes are based on a comprehensive, adequately documented and consistently applied analysis of the banking institution’s loan and investment portfolios.
- The audit scope and plan should similarly address any other area identified by the board which presents a significant financial reporting risk to the institution.
- As an extension of the financial statement audit, the scope of the audit engagement should include recommendations to management for improving internal controls to ensure the fair presentation of financial statements. The issues raised and recommendations made by the auditor should be deliberated by the institution’s board in a timely manner with appropriate remedial actions identified and followed through.

### **3.2.3 Reports to Audit Committees**

Each registered public accounting firm that performs for any institution any audit shall report to the audit committee of the institution:-

- a) All critical accounting policies and practices used or to be used;
- b) All alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the institution, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and

- c) Other material written communications between the registered public accounting firm and the management of the institution, such as any management letter or schedule of unadjusted differences.

### **3.2.4 Additional Responsibilities**

In order to enhance the supervisory role of the Central Bank, the registered public accounting firm may also be required under Section 24(3) to:-

- a) Submit such additional information in relation to its audit as the Central Bank may consider necessary, from time to time.
- b) Carry out any other special investigation.
- c) Submit a report on any of the matters referred to in (a) and (b). The institution concerned shall remunerate the registered public accounting firm in respect of the discharge of all or any of such additional duties.

### **3.2.5 Information to be submitted to the Central Bank**

- a) Section 24(4) of the Banking Act stipulates that the registered public accounting firm shall immediately report to the Central Bank if:
  - i. There has been a serious breach of or non-compliance with the provisions of the Banking Act, the Central Bank of Kenya Act or guidelines or other matters prescribed by the Central Bank;
  - ii. Any criminal offence involving fraud or dishonesty has been committed by the institution or by any of its officers or employees;
  - iii. Losses have been incurred which reduce the core capital of the institution by fifty per cent (50%) or more;
  - iv. Serious irregularities have occurred which may jeopardize the security of depositors or creditors of the institution; or
  - v. It is unable to confirm that the claims of the depositors and creditors of the institution are capable of being met out of the assets of the institution.
- b) To submit to Central Bank a copy of the Interim Audit Management report.
- c) The registered public accounting firm in addition is required to submit directly to Central Bank no later than three (3) months after the financial year end:
  - i. Certified copies of the BSM-A, PR4-1A, PR21 and PR3-A returns confirming that they are in agreement with the institutions audited books of accounts.
  - ii. A copy of the final audit management letter.

- iii. A confirmation that adequate provisions for loans and advances have been made. The registered public accounting firm must base their calculation for the required provisions for loans and advances debts as a minimum, on the Guideline CBK/PG/04 on “Risk Classification of Assets and Provisioning”, and relevant Prudential Returns and Completion Instructions.
- iv. Information that indicates a material breach of the institution’s own policies, Articles of Association and Memorandum of Association.

## **PART IV: INELIGIBLE ACTIVITIES OF REGISTERED PUBLIC ACCOUNTING FIRMS**

### **4.1 Incoming Registered public accounting firm**

A registered public accounting firm shall not be approved to audit an institution if the firm or its partners are involved directly or indirectly with the institution in other non audit services including:-

- i. Book-keeping or other services related to the accounting records or financial statements of the audit client;
- ii. Financial information systems design and implementation;
- iii. Appraisal or valuation services, fairness opinions or contribution-in-kind reports;
- iv. Actuarial services;
- v. Internal audit outsourcing services;
- vi. Management functions or human resources (including head hunting services);
- vii. Broker or dealer, investment adviser, or investment banking services;
- viii. Legal services and expert services unrelated to the audit; and
- ix. Any other service that the Central Bank may specify as not permissible.

An existing audit firm, audit partners or audit manager, already engaged by an institution, which gets involved directly or indirectly with the institution in any of the above non audit services is subject to disqualification by the Central Bank from auditing the institution.

An audit firm, audit partners or audit managers, who have offered any of the above non audit services to an institution, can only be allowed to audit the institution if three (3) years have lapsed from when they ceased offering the services.

## **PART V: DISQUALIFICATION OF AN APPOINTED REGISTERED PUBLIC ACCOUNTING FIRM**

- a) An approved registered public accounting firm shall be disqualified from auditing an institution if the firm or its partners or associates:-

- i. are involved in the matters specified in Section 24 (7) of the Banking Act.
  - ii. have been granted any type of facility by the institution outside the normal course of business and not at an arm's length by that institution.
  - iii. represents directly or indirectly the interest of the shareholders or directors of the institution in any business venture.
  - iv. have any business interest in association with the shareholders or directors of the institution.
  - v. refuse or fail to satisfactorily undertake additional duties as required by the Central Bank under Section 24 (3) of the Banking Act.
  - vi. fail to report the matters specified in Section 24 (4) of the Banking Act.
  - vii. become involved in matters specified in Section 24 (7) of the Banking Act.
  - viii. do not give a written notice to the Central Bank of the matters specified in Section 25 (2) of the Banking Act.
  - ix. fail to comply with the guidelines and regulations issued by the Central Bank from time to time.
  - x. fail to furnish to the Central Bank details on changes of partnership, audit managers, disciplinary actions against the firm or partners or any other pertinent information.
  - xi. fails to meet the approval criteria set by Central Bank.
- b) If a registered public accounting firm of an institution fails to comply with the requirements of this Guideline, the Central Bank may disqualify the firm from auditing an institution.
- c) Any other information that casts doubt on the integrity and conduct of the firm or any of its partners may also be used for purposes of disqualification.

## **PART VI: CHANGE OF A REGISTERED PUBLIC ACCOUNTING FIRM**

No institution shall remove or change its registered public accounting firm except with the prior written approval of the Central Bank. In considering the proposed change, Central Bank shall obtain a written representation from the outgoing firm. Any institution aggrieved by a decision of the Central Bank to disallow the change of a registered public accounting firm, may under Section 25(3) of the Banking Act appeal to the Minister for Finance within 14 days. The decision of the Minister for Finance shall be final.

## **PART VII: REMEDIAL ACTIONS**

If an institution fails to comply with this guideline, the Central Bank may pursue any or all remedial actions provided under sections 33, 33A, 34 and 55 of the Banking Act.

## **PART VIII: EFFECTIVE DATE**

- 5.1 **Effective date** - The effective date of this guideline shall be 1<sup>st</sup> January 2013.
- 5.2 **Supersedence** – This guideline supersedes and replaces Prudential Guideline on Appointment, Duties and Responsibilities of External Auditors, CBK/RG/09 of 1<sup>st</sup> January 2006.

### **Enquiries**

Enquiries on any aspect of these guidelines should be referred to:-

The Director

Bank Supervision Department

Central Bank of Kenya

P. O. Box 60000 - 00200

**NAIROBI**

TEL. 2860000

E-mail: *fin@centralbank.go.ke*

# **GUIDELINE ON PUBLICATION OF FINANCIAL STATEMENTS AND OTHER DISCLOSURES CBK/PG/10**

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- 1.2 Authorisation
- 1.3 Application

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- 4.2 Administrative Sanctions

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## **PART I: PRELIMINARY**

**1.1 Title** - Guideline on Publication of Financial Statements and Other Disclosures.

**1.2 Authorisation** - This Guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

**1.3 Application** - All institutions licensed under the Banking Act.

## **PART II: STATEMENT OF POLICY**

**2.1 Purpose**- This guideline is intended to enhance market discipline in the banking and financial sector in general. As a custodian of public funds, institutions have the responsibility to safeguard their integrity and credibility in order to maintain public confidence.

It is under these considerations that institutions are required to periodically publish their financial statements and other disclosures in order to avail timely information to all stakeholders. This would also encourage institutions to enhance prudent management of their affairs and exercise self- regulation.

**2.2 Responsibility** - The board of directors of each institution shall be responsible for the adherence and compliance with the provisions of this guideline. This is consistent with the board of directors' responsibility to ensure that the financial statements are drawn up so as to give a true and fair view of the state of affairs and of the results of the institution.

## **PART III: SPECIFIC REQUIREMENTS**

**3.1** Institutions should present a statement of financial position that groups assets and liabilities by nature, listed in an order that reflects the relative liquidity of the groups of assets and liabilities. Similarly, a statement of comprehensive income should reflect income and expenses grouped by nature, quantifying the principal types of income and expenses.

**3.2 Audited Financial Statements and Other Disclosures** - All institutions licensed and operating in Kenya shall be required, within three months of the end of every financial year, to publish in a newspaper of nationwide circulation, between Mondays and Fridays excluding public holidays, a copy of their audited statement of financial position showing its assets and liabilities, statement of comprehensive income covering its activities and any other information prescribed by Central Bank of Kenya. The financial statements and other disclosures so

published must fully conform to the format prescribed by the Central Bank of Kenya from time to time.

All the audited financial statements and other disclosures to be published should first be submitted to the Central Bank of Kenya for clearance at least two weeks before publication. The financial statements must be signed by the Chief Executive Officer and at least one director of the institution. The reports forwarded to the Central Bank of Kenya for clearance must provide detailed reconciliations for any differences between them and the CBK (BSM), PR4-1, PR21, PR3 and any other return relating to the financial year end cut-off date which had earlier been forwarded.

Institutions shall also submit within three months of the end of every financial year audited financial statements in the Central Bank's prescribed format i.e. CBK-BSM (A), PR4-1A, PR21A, PR3A and any other prescribed returns to the Central Bank of Kenya. The returns should be certified by the external auditors of the institution. The Management Letter of the institution should also be submitted not later than 31<sup>st</sup> March of every year.

- 3.3 Un-audited Financial Statements and Other Disclosures** - Every institution shall cause a copy of un-audited financial statements to be published in a newspaper of nationwide circulation, between Mondays and Fridays excluding public holidays, in the format prescribed by the Central Bank of Kenya from time to time. In order to facilitate comparisons, the prescribed formats shall be similar to those used to publish audited financial statements.

The un-audited financial statements shall be published at quarterly intervals in accordance with the following programme:

<b>Period ending</b>	<b>Publication Deadline</b>
31 <sup>st</sup> March	<b>31<sup>st</sup> May</b>
30 <sup>th</sup> June	<b>31<sup>st</sup> August</b>
30 <sup>th</sup> September	<b>30<sup>th</sup> November</b>

The publication for the period ending 31<sup>st</sup> December should follow the process described under clause 3.2 on Audited Financial Statements.

All the quarterly financial statements and other disclosures to be published should first be submitted to the Central Bank of Kenya for clearance at least two weeks before publication. The financial statements must be signed by the Chief Executive Officer and at least one director of the institution. The reports forwarded to the Central Bank of Kenya for clearance must provide detailed reconciliations for any differences between the disclosures and the CBK-BS



(M), PR4-1, PR21, PR3 and other prudential returns relating to the same cut-off date which had earlier been forwarded.

### **3.4 Continued Access to Financial Statements and Other Disclosures**

To ensure continuous access of institutions' financial statements and other disclosures by the public, institutions shall include a note in their quarterly publications in the newspapers stating that their financial statements and other disclosures are available on their website, together with the address of the websites. The institutions should also disclose the physical address of its head office where the financial statements and other disclosures can be accessed.

### **3.5 Qualitative Disclosures**

Public disclosure of reliable and timely information by banks enable users of that information to make an accurate assessment of a bank's financial condition and performance, business activities, risk profile and risk management practices. However, disclosure alone does not necessarily result in transparency. To achieve transparency, a bank must provide timely, accurate, relevant and sufficient disclosures of qualitative and quantitative information that enables users to make proper assessment of the institution's activities and risk profile.

At minimum the following broad categories of information should be disclosed in clear terms and appropriate detail to help achieve a satisfactory level of bank transparency. These are:

- financial performance;
- financial position (including capital, solvency and liquidity);
- risk management strategies and practices;
- risk exposures (including credit risk, market risk, liquidity risk, and operational, legal and other risks);
- aggregate exposure to related parties and transactions with related parties;
- all material entities in the group structure;
- accounting policies; and
- basic business, management and corporate governance information.

The scope and content of information provided and the level of disaggregation and detail should be commensurate with the size and nature of a bank's operations.

Where information on any of the above categories is not part of the published disclosures, institutions are required to prepare and update the disclosures on a quarterly basis, forward to CBK for clearance together with the disclosures for quarterly publication and upload them in their websites on the same link as the published disclosures for reference by interested parties.

## **PART IV: CORRECTIVE MEASURES**

- 4.1 Remedial measures** - if an institution fails to comply with this guideline, the Central Bank may pursue any or all corrective actions as provided under Sections 33, 34 and 55 of the Banking Act.
- 4.2 Administrative sanctions** - in addition to the use of corrective actions noted in paragraph 1 above, the Central Bank may pursue any or all of the following administrative sanctions against an institution, its board of directors, or its officers:
- 4.2.1 Prohibition from declaring or paying dividends;
  - 4.2.2 Prohibition from establishing new places of business;
  - 4.3.3 Prohibition from engaging in new activities or from expanding existing activities; and
  - 4.3.4 Prohibition from declaring or paying bonuses, salary incentives, or other discretionary compensation to directors or officers.

## **PART V: EFFECTIVE DATE**

- 5.1 Effective date** - The effective date of this guideline shall be 1<sup>st</sup> January 2013.
- 5.2 Supersedence** – This guideline supersedes and replaces Guideline on Publication of Financial Statements and Other Disclosures, CBK/PG/10 of 1<sup>st</sup> January 2006.

### **Enquires**

Any enquiries on this Guideline should be forwarded to:

Director

Bank Supervision Department

Central Bank of Kenya

P. O. Box 60000 - 00200

NAIROBI

TEL...2860000

E-mail: [fin@centralbank.go.ke](mailto:fin@centralbank.go.ke)

NAME OF INSTITUTION.....

**AUDITED FINANCIAL STATEMENTS AND OTHER DISCLOSURES CBK/PR 10-1(A)**

		Bank		Group Consolidated	
<b>1</b>	<b>STATEMENT OF FINANCIAL POSITION AS AT</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>
		<b>Previous Year</b>	<b>This Year</b>	<b>Previous Year</b>	<b>This Year</b>
		<b>Shs.'000'</b>	<b>Shs.'000'</b>	<b>Shs.'000'</b>	<b>Shs.'000'</b>
<b>A</b>	<b>ASSETS</b>	<b>(Audited)</b>	<b>(Audited)</b>	<b>(Audited)</b>	<b>(Audited)</b>
1	Cash (both local and foreign)				
2	Balances with Central Bank of Kenya				
3	Kenya Government and other securities held for dealing purposes				
4	Financial Assets at fair value through profit and loss				
5	Investment Securities: (a) Held to Maturity: a. Kenya Government securities b. Other securities  (b) Available for sale: a. Kenya Government securities b. Other securities				
6	Deposits and balances due from local banking institutions				
7	Deposits and balances due from banking institutions abroad				
8	Tax recoverable				
9	Loans and advances to customers (net)				
10	Balances due from banking institutions in the group				
11	Investments in associates				
12	Investment in subsidiary companies				
13	Investments in joint ventures				
14	Investment properties				
15	Property, plant and equipment				
16	Prepaid lease rentals				

		<b>Bank</b>		<b>Group Consolidated</b>	
<b>1</b>	<b>STATEMENT OF FINANCIAL POSITION AS AT</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>
		<b>Previous Year</b>	<b>This Year</b>	<b>Previous Year</b>	<b>This Year</b>
		<b>Shs.'000'</b>	<b>Shs.'000'</b>	<b>Shs.'000'</b>	<b>Shs.'000'</b>
<b>A</b>	<b>ASSETS</b>	<b>(Audited)</b>	<b>(Audited)</b>	<b>(Audited)</b>	<b>(Audited)</b>
17	Intangible assets				
18	Deferred tax asset				
19	Retirement benefit assets				
20	Other assets				
21	<b>TOTAL ASSETS</b>				
<b>B.</b>	<b>LIABILITIES</b>				
22	Balances due to Central Bank of Kenya				
23	Customer deposits				
24	Deposits and balances due to local banking institutions				
25	Deposits and balances due to banking institutions abroad				
26	Other money market deposits				
27	Borrowed funds				
28	Balances due to banking institutions in the group				
29	Tax payable				
30	Dividends payable				
31	Deferred tax liability				
32	Retirement benefit liability				
33	Other liabilities				
34	<b>TOTAL LIABILITIES</b>				
<b>C</b>	<b>SHAREHOLDER'S FUNDS</b>				
35	Paid up/Assigned capital				
36	Share premium (discount)				
37	Revaluation reserve				
38	Retained earnings/Accumulated losses				
39	Statutory loan loss reserve				
40	Other Reserves				
41	Proposed dividends				
42	Capital grants				
<b>43</b>	<b>TOTAL SHAREHOLDER'S FUNDS</b>				

		Bank		Group Consolidated	
1	STATEMENT OF FINANCIAL POSITION AS AT	31 <sup>st</sup> Dec	31 <sup>st</sup> Dec	31 <sup>st</sup> Dec	31 <sup>st</sup> Dec
		Previous Year	This Year	Previous Year	This Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
<b>A</b>	<b>ASSETS</b>	(Audited)	(Audited)	(Audited)	(Audited)
<b>44</b>	<b>TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS</b>				

**AUDITED FINANCIAL STATEMENTS AND OTHER DISCLOSURES CBK/PR 10-2(A)**

		Bank		Group Consolidated	
11	STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD ENDED	31 <sup>st</sup> Dec	31 <sup>st</sup> Dec	31 <sup>st</sup> Dec	31 <sup>st</sup> Dec
		Previous Year	This Year	Previous Year	This Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
<b>1</b>	<b>INTEREST INCOME</b>	(Audited)	(Audited)	(Audited)	(Audited)
	1.1 Loans and advances				
	1.2 Government Securities				
	1.3 Deposits and placements with banking institutions				
	1.4 Other interest income				
	1.5 Total Interest income				
<b>2</b>	<b>INTEREST EXPENSES</b>				
	2.1 Customer deposits				
	2.2 Deposits and placements from banking institutions				
	2.3 Other Interest Expenses				
	2.4 Total Interest Expenses				
<b>3</b>	<b>NET INTEREST INCOME/(LOSS)</b>				
<b>4</b>	<b>OTHER OPERATING INCOME</b>				
	4.1 Fees and commissions on loans and advances				
	4.2 Other fees and commissions				
	4.3 Foreign exchange trading income (loss)				
	4.4 Dividend Income				
	4.5 Other income				

			<b>Bank</b>		<b>Group Consolidated</b>	
	<b>11</b>	<b>STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD ENDED</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>
			<b>Previous Year</b>	<b>This Year</b>	<b>Previous Year</b>	<b>This Year</b>
			<b>Shs.'000'</b>	<b>Shs.'000'</b>	<b>Shs.'000'</b>	<b>Shs.'000'</b>
<b>1</b>		<b>INTEREST INCOME</b>	<b>(Audited)</b>	<b>(Audited)</b>	<b>(Audited)</b>	<b>(Audited)</b>
	4.6	Total Other Operating Income				
<b>5</b>		<b>TOTAL OPERATING INCOME</b>				
<b>6</b>		<b>OPERATING EXPENSES</b>				
	6.1	Loan loss provision				
	6.2	Staff costs				
	6.3	Directors' emoluments				
	6.4	Rental Charges				
	6.5	Depreciation charge on property and equipment				
	6.6	Amortisation charges				
	6.7	Other operating expenses				
	6.8	Total Operating Expenses				
7		Profit/(loss) before tax and exceptional items				
8		Exceptional items				
<b>9</b>		<b>Profit/(Loss) after exceptional items</b>				
10		Current tax				
11		Deferred tax				
<b>12</b>		<b>Profit/(loss) after tax and exceptional items</b>				
<b>13</b>		<b>Other Comprehensive Income:</b>				
	13.1	Gains/(Losses) from translating the financial statements of foreign operations				
	13.2	Fair value changes in available-for-sale financial assets				
	13.4	Revaluation Surplus on property, Plant and Equipment				
	13.5	Share of other comprehensive income of associates				
	13.6	Income tax relating to components of other comprehensive income				
14		<b>Other comprehensive income for the year net of tax</b>				
15		<b>Total comprehensive income for the year</b>				

**AUDITED FINANCIAL STATEMENTS AND OTHER DISCLOSURES CBK/PR 10-3(A)**

	111	OTHER DISCLOSURES	Bank		Group Consolidated	
			31 <sup>st</sup> Dec	31 <sup>st</sup> Dec	31 <sup>st</sup> Dec	31 <sup>st</sup> Dec
			Previous Year	This Year	Previous Year	This Year
			Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
1	NON-PERFORMING LOANS AND ADVANCES		(Audited)	(Audited)	(Audited)	(Audited)
	a)	Gross non-performing loans and advances				
		Less				
	b)	Interest in suspense				
	c)	Total Non-performing loans and advances (a-b)				
		Less				
	d)	Loan loss provisions				
	e)	Net Non-performing loans (e-d)				
	f)	Discounted Value of Securities				
	g)	Net NPLs Exposure (e-f)				
2	Insider Loans and Advances					
	a)	Directors, shareholders and associates				
	b)	Employees				
3	Off-Balance Sheet Items					
	a)	Letters of credit, guarantees, acceptances				
	b)	Forwards, swaps, and options				
	c)	Other contingent liabilities				
	d)	Total Contingent Liabilities				
4	Capital Strength					
	a)	Core capital				
	b)	Minimum statutory capital				
	c)	Excess/(Deficiency)				
	d)	Supplementary capital				
	e)	Total capital (a + d)				
	f)	Total risk weighted assets				
	g)	Core capital/total deposit liabilities				
	h)	Minimum statutory ratio				
	i)	Excess/(Deficiency)				

			<b>Bank</b>		<b>Group Consolidated</b>	
	<b>111</b>	<b>OTHER DISCLOSURES</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>	<b>31<sup>st</sup> Dec</b>
			<b>Previous Year</b>	<b>This Year</b>	<b>Previous Year</b>	<b>This Year</b>
			<b>Shs.'000'</b>	<b>Shs.'000'</b>	<b>Shs.'000'</b>	<b>Shs.'000'</b>
	l)	Core capital/total risk weighted assets				
	k)	Minimum Statutory ratio				
	i)	Excess/(Deficiency) (j-k)				
	m)	Total capital/total risk weighted assets				
	n)	Minimum statutory ratio				
	o)	Excess/(Deficiency)(m-n)				
<b>5</b>	<b>Liquidity</b>					
	a)	Liquidity Ratio				
	b)	Minimum statutory ratio				
	c)	Excess/(Deficiency) (a-b)				

These financial statements are extracts from the books of the institution as audited by..... and received unqualified/qualified opinion.

The complete set of audited financial statements, statutory and qualitative disclosures can be accessed on the Institution's website ----- . They may also be accessed at the institutions head office located at ----- (physical address).

Signed.....

**CHIEF EXECUTIVE OFFICER**

Signed.....

**CHAIRMAN**



NAME OF INSTITUTION.....

**QUARTERLY FINANCIAL STATEMENTS AND OTHER DISCLOSURES**

**CBK/PR 10-1**

		Bank					Group Consolidated		
1	STATEMENT OF FINANCIAL POSITION AS AT	Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Current Year	Same Quarter	Previous year	Current Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
A	ASSETS	Unaudited	Audited	Unaudited	Unaudited	Unaudited	Unaudited	Audited	Unaudited
1	Cash (both local and foreign)								
2	Balances with Central Bank of Kenya								
3	Kenya Government and other securities held for dealing purposes								
4	Financial Assets at fair value through profit and loss								
5	Investment Securities: a). Held to Maturity: a. Kenya Government securities b. Other securities  b). Available for sale: a. Kenya Government securities b. Other securities								
6	Deposits and balances due from local banking institutions								
7	Deposits and balances due from banking institutions abroad								

		Bank					Group Consolidated		
1	STATEMENT OF FINANCIAL POSITION AS AT	Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Current Year	Same Quarter	Previous year	Current Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
A	ASSETS	Unaudited	Audited	Unaudited	Unaudited	Unaudited	Unaudited	Audited	Unaudited
8	Tax recoverable								
9	Loans and advances to customers (net)								
10	Balances due from banking institutions in the group								
11	Investments in associates								
12	Investments in subsidiary companies								
13	Investments in joint ventures								
14	Investment properties								
15	Property, plant and equipment								
16	Prepaid lease rentals								
17	Intangible assets								
18	Deferred tax assets								
19	Retirement benefit assets								
20	Other assets								
21	TOTAL ASSETS								
B	LIABILITIES								
22	Balances due to Central Bank of Kenya								
23	Customer deposits								
24	Deposits and balances due to local banking institutions								
25	Deposits and balances due to								

		Bank					Group Consolidated		
1	STATEMENT OF FINANCIAL POSITION AS AT	Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Current Year	Same Quarter	Previous year	Current Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
A	ASSETS	Unaudited	Audited	Unaudited	Unaudited	Unaudited	Unaudited	Audited	Unaudited
	foreign banking institutions								
26	Other money market deposits								
27	Borrowed funds								
28	Balances due to banking institutions in the group								
29	Tax payable								
30	Dividends payable								
31	Deferred tax liability								
32	Retirement benefit liability								
33	Other liabilities								
34	TOTAL LIABILITIES								
C	SHAREHOLDERS' FUNDS								
35	Paid up/Assigned capital								
36	Share premium/(discount)								
37	Revaluation reserves								
38	Retained earnings/Accumulated losses								
39	Statutory loan loss reserve								
40	Other Reserves								
41	Proposed dividends								
42	Capital grants								
43	TOTAL SHAREHOLDERS' FUNDS								

		Bank					Group Consolidated		
1	STATEMENT OF FINANCIAL POSITION AS AT	Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Current Year	Same Quarter	Previous year	Current Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
A	ASSETS	Unaudited	Audited	Unaudited	Unaudited	Unaudited	Unaudited	Audited	Unaudited
44	TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS								

NAME OF INSTITUTION.....

QUARTERLY FINANCIAL STATEMENTS AND OTHER DISCLOSURES CBK/PR 10-2

		Bank					Group Consolidated		
11	STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD ENDED	Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Current Year	Same Quarter	Previous year	Current Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
		Unaudited	Audited	Unaudited	Unaudited	Unaudited	Unaudited	Audited	Unaudited
1	INTEREST INCOME								
1.1	Loans and advances								
1.2	Government securities								
1.3	Deposits and placements with banking institutions								
1.4	Other interest income								

		Bank					Group Consolidated		
11	STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD ENDED	Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Current Year	Same Quarter	Previous year	Current Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
		Unaudited	Audited	Unaudited	Unaudited	Unaudited	Unaudited	Audited	Unaudited
	1.5	Total Interest income							
<b>2</b>	<b>INTEREST EXPENSES</b>								
	2.1	Customer deposits							
	2.2	Deposits and placements from banking institutions							
	2.3	Other interest expenses							
	2.4	Total Interest Expenses							
<b>3</b>	<b>NET INTEREST INCOME/ (LOSS)</b>								
<b>4</b>	<b>NON-OPERATING INCOME</b>								
	4.1	Fees and commissions on loans and advances							
	4.2	Other fees and commissions							
	4.3	Foreign exchange trading income (loss)							
	4.4.	Dividend income							
	4.5	Other income							
	4.6	Total Non-Interest Income							
<b>5.</b>	<b>TOTAL OPERATING INCOME</b>								
<b>6</b>	<b>OTHER OPERATING EXPENSES</b>								
	6.1	Loan loss provision							
	6.2	Staff costs							

		Bank					Group Consolidated		
11	STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD ENDED	Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Current Year	Same Quarter	Previous year	Current Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
		Unaudited	Audited	Unaudited	Unaudited	Unaudited	Unaudited	Audited	Unaudited
6.3	Directors' emoluments								
6.4	Rental charges								
6.5	Depreciation charge on property and equipment								
6.6	Amortisation charges								
6.7	Other operating expenses								
6.8	Total Other Operating Expenses								
7	Profit/(loss) before tax and exceptional items								
8	Exceptional items								
9	Profit/(loss) after exceptional items								
10	Current tax								
11	Deferred tax								
12	Profit/(Loss) after tax and exceptional items								
13	<b>Other Comprehensive Income:</b>								
13.1	Gains/(Losses) from translating the financial statements of foreign operations								
13.2	Fair value changes in available -for-sale financial assets								
13.4	Revaluation Surplus on Property, plant and equipment ion								

		Bank					Group Consolidated		
11	STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD ENDED	Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Current Year	Same Quarter	Previous year	Current Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
		Unaudited	Audited	Unaudited	Unaudited	Unaudited	Unaudited	Audited	Unaudited
13.5	Share of other comprehensive income of associates								
13.6	Income tax relating to components of other comprehensive income								
14	<b>Other comprehensive income for the year net of tax</b>								
15	<b>Total comprehensive income for the year</b>								

NAME OF INSTITUTION.....

**QUARTERLY FINANCIAL STATEMENTS AND OTHER DISCLOSURES CBK/PR 10-3**

		Bank					Group Consolidated		
OTHER DISCLOSURES		Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Same Quarter	Previous year	Current Year	Current Year
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'
		Unaudited	Audited	Unaudited	Unaudited	Unaudited	Audited	Unaudited	Unaudited
1	<b>NON-PERFORMING LOANS AND ADVANCES</b>								
	a) Gross non-performing loans								

		Bank					Group Consolidated			
OTHER DISCLOSURES		Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter	
		Same Quarter	Previous year	Current Year	Current Year	Same Quarter	Previous year	Current Year	Current Year	
		Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'	
		Unaudited	Audited	Unaudited	Unaudited	Unaudited	Audited	Unaudited	Unaudited	
	and advances									
	Less:									
	b) Interest in suspense									
	c) Total Non-performing loans and advances (a-b)									
	Less									
	d) Loan loss provisions									
	e) Net non-performing loans (c-d)									
	f) Discounted value of securities									
	g) Net NPLs Exposure (e-f)									
<b>2</b>	<b>Insider Loans and Advances</b>									
	a) Directors, shareholders and associates									
	b) Employees									
	c) Total insider loans, advances and other facilities									
<b>3</b>	<b>Off-balance sheet items</b>									
	a) Letters of credit, guarantees, acceptances									
	b) Forwards, swaps, and options									
	c) Other contingent liabilities									
	d) Total Contingent liabilities									
<b>4</b>	<b>Capital strength</b>									



		Bank					Group Consolidated			
OTHER DISCLOSURES		Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter	
		Same Quarter	Previous year	Current Year	Current Year	Same Quarter	Previous year	Current Year	Current Year	
		Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	Shs.'000'	
		Unaudited	Audited	Unaudited	Unaudited	Unaudited	Audited	Unaudited	Unaudited	
a)	Core capital									
b)	Minimum statutory capital									
c)	Excess (deficiency)									
d)	Supplementary capital									
e)	Total capital (a + d)									
f)	Total risk weighted assets									
g)	Core capital/total deposit liabilities									
h)	Minimum statutory ratio									
i)	Excess (Deficiency) (j-k)									
j)	Core capital/total risk weighted assets									
k)	Minimum statutory ratio									
l)	Excess (deficiency) (j-k)									
m)	Total capital/total risk weighted assets									
n)	Minimum statutory ratio									
o)	Excess (deficiency) (m-n)									
<b>5</b>	<b>Liquidity</b>									
a)	Liquidity ratio									
b)	Minimum Statutory ratio									
c)	Excess/Deficiency) (a-d)									

		Bank					Group Consolidated		
OTHER DISCLOSURES		Previous year	31 <sup>st</sup> Dec	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	Previous year	31 <sup>st</sup> Dec	Current Quarter
		Same Quarter	Previous year	Current Year	Current Year	Same Quarter	Previous year	Current Year	Current Year
		Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'	Shs. '000'
		Unaudited	Audited	Unaudited	Unaudited	Unaudited	Audited	Unaudited	Unaudited

These financial statements are extracts from the books of the institution. The complete set of quarterly financial statements, statutory and qualitative disclosures can be accessed on the institutions website -----.  
They may also be accessed at the institutions head office located at ----- (physical address).

Signed.....

Signed.....

**CHIEF EXECUTIVE OFFICER**

**CHAIRMAN**

## **NOTES FOR COMPLETION OF FINANCIAL STATEMENTS AND OTHER DISCLOSURES: CBK/PG10**

### **GENERAL**

- These completion instructions are issued to ensure uniformity of reporting by all institutions.
- No asset or liability stated in the statement of financial position should be offset by deduction of another liability or asset except inter-branch balances and items in transit or where a legal right of set-off exists.
- The financial statements should be prepared in accordance with the International Financial Reporting Standards (IFRS).
- All figures should be shown in thousands of Kenya shillings.
- All the rows should be published irrespective of whether the institution has a figure to report or not.

### **I. STATEMENT OF FINANCIAL POSITION**

#### **A. ASSETS**

##### **1. Cash balances**

Notes and coins (both local and foreign) held in the tills and vaults.

##### **2. Balances with Central Bank of Kenya**

These include:

- Balances held with the Central Bank of Kenya, including cash held for cash reserve ratio purposes; and
- Repo purchases from the Central Bank of Kenya, which constitute amounts lent to CBK against government securities.

##### **3. Kenya Government and other securities held for dealing purposes**

These include Government and other marketable securities held for dealing purposes. Institutions hold these securities with the intention of reselling them in the short-term.

They include Treasury Bonds bought at Nairobi Stock Exchange, Corporate bonds and commercial paper which can be sold in active market.

**4. Financial assets at fair value through profit and loss**

These are financial assets acquired principally for the purpose of selling in the near term or if it is part of a portfolio of financial assets that are managed together, there is evidence of a recent actual pattern of short-term profit-taking. These include listed treasury bonds, corporate bonds and equity instruments.

**5. Investment Securities:**

**a) Held to Maturity:**

- a. Kenya Government securities
- b. Other securities

These are government securities and other securities (both local and foreign) with fixed or determinable payments and fixed maturities that an institution's management has the positive intention and ability to hold to maturity.

**b) Available for sale:**

- a. Kenya Government securities
- b. Other securities

These are government securities and other securities (both local and foreign) that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

**6. Deposits and balances due from local banking institutions**

These include:

- Placements by the reporting institution with other institutions including inter-bank placements. Placements with collapsed institutions should be disclosed among "other assets" net of provisions held, if any.
- All loans and advances granted to other institutions and building societies.
- All credit balances in current accounts held with other institutions.

**7. Deposits and balances due from foreign banking institutions**

These include:

- Placements by the reporting institution with other institutions including inter-bank placements overseas. Placements with collapsed institutions should be disclosed among “other assets” net of provisions held, if any.

All loans and advances granted to other overseas institutions and building societies.

- All credit balances in current accounts held with other institutions.
- Banking institutions include building societies.

## **8. Tax Recoverable**

This is tax that is recoverable as a result of overpayment of tax in the previous periods.

## **9. Loans and Advances to Customers (Net)**

These are term loans, overdrafts, bills discounted and hire purchase. The balance to be reported is net of provisions and interest in suspense. These also include commercial paper and corporate bonds, with fixed or determined payment and maturities.

## **10. Balances due from banking institutions in the group**

These are amounts due from group companies conducting banking business.

## **11. Investments in Associates**

These are equity investments by the reporting institution in other companies where it has significant influence and which is neither a subsidiary nor a joint venture of the institution.

## **12. Investments in Subsidiary Companies**

These include equity investments by the reporting institution in its subsidiaries.

## **13. Investments in Joint Ventures**

These are investments by the reporting institution in joint ventures.

## **14. Investment Properties**

Investment Properties are defined in IAS 40 as a property (land or a building or part of a building or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for: -

- (a) Use in the production or supply of goods or services or for administrative purposes;  
or
- (b) Sale in the ordinary course of business.

**15. Properties, Plant and Equipment**

Comprise all the immovable and other fixed assets of the reporting institution. These are to be reported net of accumulated depreciation. They include:

- Staff houses.
- Furniture, fixtures and fittings.
- Motor vehicles.
- Office equipment including computer equipment.
- Land and buildings including leasehold land classified as finance lease (excludes leasehold land classified as operating lease and investment property).
- Others not specified elsewhere including foreclosed assets.

**16. Prepaid lease rentals**

These relate to the cost of the leasehold land classified as operating lease net of accumulated amortised amount.

**17. Intangible assets**

Include all intangible assets such as goodwill, computer software, royalties, copyrights etc.

**18. Deferred Tax Asset**

These are taxes recoverable in future periods in respect of:

- Deductible temporary difference.
- The carry forward of unused tax losses.
- The carry forward of unused tax credits.

**19. Retirement Benefit Asset**

These are staff retirement benefit assets computed as per IAS 19.

**20. Other assets**

These include assets which do not fall in any category already disclosed including amounts due from other group companies other than banks.

**21. Assets Total**

This is the total of items 1 to 20 above.

**B. LIABILITIES**

**22. Balances due to Central Bank of Kenya**

These include:

- Overnight loans and advances from Central Bank; and
- Reverse REPO sales to the Central Bank against government securities.

**23. Customer Deposits**

These include all funds received from public bodies, parastatals, private enterprises, individuals and other non-profit making institutions, both resident and non-resident in Kenya. They include current account balances, fixed/call deposits, and savings account balances, margins on letters of credit or any other deposit by whatever name both in local and foreign currencies whether matured or not.

**24. Deposits and balances due to local banking institutions**

These include deposits due to commercial banks, financial institutions, mortgage finance companies and building societies domiciles in Kenya. All inter-bank borrowings should be reported here.

**25. Deposits and balances due to foreign banking institutions**

These include deposits due to commercial banks, financial institutions, mortgage finance companies and building societies domiciled abroad (overseas).

**26. Other Money Market Deposits**

These include deposits/financial instruments from the money market, which have not been disclosed in any other category.

**27. Borrowed Funds**

These include term borrowings from the Central Bank of Kenya, commercial banks both in Kenya and overseas, companies, donor agencies and other lending agencies both in Kenya and overseas. Special loan facilities covering funds received through special arrangements between the Kenya government and other foreign governments or donor agencies, such as EIB Loans, for onward lending or distribution to specified sectors of the economy should be entered here. Shareholders' loans whose original maturities are below 5 years should be classified as borrowed funds.

**28. Balances due to banking institutions in the group**

These include amounts owed to banking institutions in the group.

**29. Tax Payable**

This relates to tax liability computed but not yet paid.

**30. Dividends Payable**

These are dividends that have been declared and approved at annual general meeting but not yet paid.

**31. Deferred Tax Liability**

These are taxes payable in future periods in respect of taxable temporary differences.

**32. Retirement Benefit Liability**

This is the retirement benefits liability as accounted for under IAS 19.

**33. Other Liabilities**

These include all other liabilities not specified elsewhere e.g.

- Items in transit.
- Amount due to other group companies other than banks.

**34. Total Liabilities**

This is the total of items 22 to 33 above.



## **C. SHAREHOLDERS' EQUITY**

### **35. Paid up/Assigned Capital**

This is the nominal value of ordinary and preference shares issued and fully paid by the shareholders or capital assigned to Kenyan Branch (es) by foreign parent companies.

### **36. Share premium/(discount)**

This is the difference between the nominal price and the purchase price of ordinary and preference shares, which is not refundable.

### **37. Revaluation Reserve**

These are revaluation surpluses/losses arising from revaluation of fixed assets.

### **38. Retained Earnings/Accumulated Losses**

These are undistributed profits or losses brought forward over the years. They should also include unrealised gains/losses.

### **39. Statutory Loan Loss Reserve**

These are provisions that have been appropriated from retained earnings (revenue reserves). This will only apply if provisions computed under Risk Classification of Assets and Provisioning Guideline is in excess of impairment losses computed under the relevant International Financial Reporting Standards.

### **40. Other Reserves**

These include such reserves as fair value gains on available for sale investment securities.

### **41. Proposed Dividends**

These are dividends that have been proposed by the Board but have not been ratified at the annual general meeting.

### **42. Capital Grants**

These are grants to the institution, which are not callable.

### **43. Total Shareholders' Funds**

This is the sum of items 35 to 42 above.

## **II STATEMENT OF COMPREHENSIVE INCOME**

### **1. INTEREST INCOME**

#### **1.1 Loans and advances**

This covers interest income and discounts on loans and advances including bills and notes discounted/purchased and interest on commercial paper and corporate bonds. Interest income should not include interest on non-performing loans and this should exclude fees, commissions and penalties on loans and advances.

#### **1.2 Government securities**

This covers interest and discounts earned on all Government securities.

#### **1.3 Deposits and placements with banking institutions**

This includes all interest earned on placements and overnight lending to commercial banks, financial institutions, mortgage finance companies and building societies. Also include interest earned on current accounts held the institutions with other commercial banks, mortgage finance companies and building societies. Interest on placements with collapsed institutions, should be suspended and not recognized as income.

#### **1.4 Other interest income**

This represents other interest income not captured above including interest income on repos. Interest income doubtful of recovery should not be recognized.

#### **1.5 Total Interest Income**

Total for items Nos.1.1-1.4 above.

### **2. INTEREST EXPENSES**

#### **2.1 Customer deposits**

Consists of interest expenses on all categories of deposits, both local and foreign, excluding interest on borrowed funds.

## **2.2 Deposits and placements from banking institutions**

Includes interest on borrowed funds plus interest on money market borrowings, both from domestic and overseas markets.

## **2.3 Other interest expenses**

Consists of all other interest expenses on borrowings other than those specified in 2.1 and 2.2 above.

## **2.4 Total Interest Expenses**

Total for item Nos. 2.1-2.3 above.

## **3. NET INTEREST INCOME/(LOSS)**

Deduct item No. 2.4 from item 1.5 above

## **4. OTHER OPERATING INCOME**

### **4.1 Fees and commission income on loans and advances**

This includes all charges and commissions relating to lending e.g. appraisal fees, commitment fees, administration fees etc

### **4.2 Other Fees and commission income**

This includes all charges and commissions relating to account operations (e.g. ledger fees), fees received from managing other institutions/group companies, commissions earned (e.g. charges on standing orders, safe-deposit facilities and ATMs) etc.

### **4.3 Foreign exchange trading income/(loss)**

Consists of the gain (loss) arising from the purchase and sale of foreign currency. Also include gains/loss arising from the revaluation or conversion of foreign currency balances.

### **4.4 Dividend income**

This income is earned from shareholding in other firms.

#### 4.5 **Other income**

This is all other income not specified elsewhere above. This income should arise from normal banking business operations.

#### 4.6 **Total Other Operating Income**

This is the total of items Nos. 4.1-4.5 above.

### 5. **TOTAL OPERATING INCOME**

Aggregate item 3 and 4.6

### 6. **OPERATING EXPENSES**

#### 6.1 **Loan loss provision**

Enter the loan loss charge for the current period. Recoveries from a loan, which had been written off, should be reported under other income.

#### 6.2 **Staff costs**

These are staff salaries and other staff benefits excluding the executive directors.

#### 6.3 **Directors' emoluments**

These are compensations, salaries and benefits to the executive directors and non-executive directors for running the institution for the period.

#### 6.4 **Rental charges**

These are rental charges by the institution in the normal course of its business.

#### 6.5. **Depreciation charge on property and equipment**

This is depreciation charge on property and equipment for the period.

#### 6.6 **Amortization charges**

Amortization charge on prepaid lease rentals, capital grants and intangible assets.

**6.7 Other operating expenses**

Includes all other expenses arising from normal banking business operations that have not been specified elsewhere. When finalizing the annual report and financial statements, any significant item (i.e. more than 10% of the value of items in this category) should be disclosed separately.

**6.8 Total Operating Expenses**

This is the sum of items 6.1-6.7

**7. PROFIT/(LOSS) BEFORE TAX AND EXCEPTIONAL ITEMS**

Enter the difference between item 5 and 6.8 above.

**8. EXCEPTIONAL ITEMS**

Income or expenses that arise from events or transactions that are clearly distinct from ordinary banking activities of the institution and therefore are not expected to recur frequently or regularly.

**9. PROFIT/ (LOSS) AFTER EXCEPTIONAL ITEMS**

Enter sum of item on line 8 and item on line 7 above.

**10. Current tax**

Enter the corporate tax charge for the period.

**11. Deferred tax**

Enter the deferred tax charge.

**12. PROFIT/(LOSS) AFTER TAX AND EXCEPTIONAL ITEMS**

Enter the sum of items on lines 9, 10 and 11 above. If item 9 is a profit, subtract items 10 and 11.

**13. Other Comprehensive Income**

Includes unrealised gains or losses on foreign currency translations, fair value changes in available-for-sale financial assets, revaluation surplus on property, plant and equipment revaluations, gains or losses from translating the financial statements of foreign

operations and pension liabilities. Prior to 2009 when IAS 1 was amended, these were disclosed as separate components of shareholders equity on the statement of financial position.

### III OTHER DISCLOSURES

#### 1. NON-PERFORMING LOANS AND ADVANCES

**a) Gross Non-Performing Loans**

Enter the gross aggregate of substandard, doubtful and loss accounts inclusive of interest in suspense.

**b) Interest in suspense**

Enter the aggregate of interest in suspense for substandard, doubtful and loss accounts.

**c) Total non-performing loans net of interest in suspense**

Enter the difference between (a) and (b) above.

**d) Loan loss provisions**

Enter the aggregate of loan loss provisions made for substandard, doubtful and loss accounts computed as per Prudential Guideline on Risk classification of Assets and Provisioning, CBK/PG/04.

**e) Net Non-Performing Loans (c-d)**

Enter the difference between items (c) and (d) above.

**f) Discounted Value of Securities**

Enter the discounted value of securities held against substandard and doubtful accounts. However, for an individual non-performing debt, if the discounted value of security is more than the debt amount net of interest in suspense and the provisions, then enter the net amount of the debt. The value of securities should be compiled as per the CBK Prudential Guideline on Risk Classification of Assets and Provisioning, CBK/PG/04.

**g) Net NPLs Exposure (e-f)**

Enter the difference between (e) and (f) above. Note that where the Discounted Value of Securities is less than the NPL exposure, an explanatory note should be provided to the Central Bank when the disclosures are being submitted for approval before publication.

**2. INSIDER LOANS, ADVANCES AND OTHER FACILITIES**

**(a) Directors, Shareholders and Associates**

- On-balance sheet
- Off-balance sheet

These are loans and advances including off-balance sheet items to Directors, Significant Shareholders and their associates as per section 2 of the Banking Act.

**(b) Employees**

Enter loans and advances to employees.

**(c) Total Insider Loans**

Enter the aggregate of 2(a) and 2(b).

**3. OFF- BALANCE SHEET ITEMS**

**a) Letters of Credit, Guarantees and Commitments**

Enter Letters of Credit, Guarantees, Commitments etc. This should exclude off-balance sheet items to insiders.

**b) Enter amounts for Forward Contracts, Swaps and Options**

**c) Other Contingent Items**

Enter other items not covered under 3(a) and 3(b) above.

**d) Total Contingent Items**

Enter aggregate of items on lines 3(a), 3(b) and 3(c) above.

#### **4. CAPITAL STRENGTH**

The following risk-based capital items should be computed as stipulated in the Capital Adequacy Prudential Guideline, CBK/PG/03.

- a) Core Capital
- b) Supplementary Capital
- c) Total Capital
- d) Total Risk Weighted Assets
- e) Core capital/Total deposit liabilities
- f) Core capital/Total risk weighted assets
- g) Total capital/Total risk weighted assets

#### **5. LIQUIDITY**

The liquidity ratio should be computed as stipulated in Liquidity Management Prudential Guideline, CBK/PG/05

- (a) Net Liquid Assets/Total short-term liabilities
- (b) Minimum Statutory Ratio
- (c) Excess/Deficiency (a-b)



**GUIDELINE ON OPENING OF NEW PLACE OF BUSINESS, CLOSING EXISTING PLACE OF BUSINESS OR CHANGING LOCATION OF PLACE OF BUSINESS  
CBK/PG/11**

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**PART I Preliminary**

- 1.1. Title
- 1.2. Authorization
- 1.3. Application
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**PART II Statement of Policy**

- 2.1. Purpose
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**PART III Application Procedures**

**PART IV Minimum Standards for Banking Premises**

**PART V Commencement of Operation**

**PART VI Opening of a Branch outside Kenya**

**PART VII Conduct of limited Banking Services through another Institution located outside Kenya.**

**PART VIII Closure of Place of Business**

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**PART X Effective Date**

**PART XI Application Forms**

**APPENDICES**

- CBK/IF 11-1 Application Forms to open new place of business.
- CBK/IF 11-2 Questionnaire for approval to commence operations at a branch
- CBK/IF 11-3 Application form to close or relocate an existing place of business.
- CBK/IF 11-4 Number of Operational ATMs
- CBK/IF 11-5 Sales Centres

## **PART I PRELIMINARY**

- 1.1 **Title** – Guideline on Opening of New Place of Business, Closing Existing Place of Business or Changing Location of Place of Business.
- 1.2. **Authorization** - This Guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.
- 1.3. **Application** - All institutions licensed under the Banking Act (Cap 488).
- 1.4 **Definitions** –.

“branch” means any permanent premises, other than its head office, at which an institution transacts business in or outside Kenya;

“place of business” means any premises, other than the head office, including a branch, an agency or a mobile unit, or such other premises as may, from time to time, be prescribed by the Central Bank, at which an institution transacts banking or financial business in Kenya and which is open to the public.

“sales centres” means an institution’s place of business responsible to a branch, which the institution uses to carry out the following permissible activities: Distribution and collection of account opening and loan forms, information on product offering, marketing, and training of field officers, customer queries and any other activity which CBK may from time to time prescribe.

Other terms used within this Guideline are as defined in the Banking Act.

## **PART II STATEMENT OF POLICY**

- 2.1. **Purpose** - This guideline has been issued to assist institutions applying to open new places of business, close the existing places of business or change location of business in Kenya. It shall also assist institutions applying to open or close foreign branches.
- 2.2. **Scope** - This guideline provides clear regulatory requirement that should be fulfilled prior to an institution being granted an approval to open, close or change location of an existing place of business.
- 2.3. **Responsibility** - The Board of Directors of institutions are required to decide on the policy and strategy for setting up new branches taking into account the yearly business plan, potential for business at the new locations for opening of branches, profitability of the proposed branches, the robustness of the internal control system, redeployment of

staff where surplus manpower has been identified and for extending prompt and cost-effective customer service to the customers.

It is the responsibility of the Board of Directors of institutions to ensure that the institution complies with this guideline.

### **PART III APPLICATION PROCEDURES**

#### **3.1 Establishment of Place of Business in Kenya**

Every institution should apply to the Central Bank of Kenya, P.O. Box 60000, Nairobi, using the appropriate forms entitled “Application by an institution to open or close or change location of a place of business”.

#### **3.2 Establishment of a Branch outside Kenya**

Every institution should apply to the Central Bank of Kenya, P.O. Box 60000, Nairobi, using the appropriate forms entitled “Application by an institution to open or close or change location of a place of business”.

3.3 The forms for completion have been prepared as part of this Guideline and hard copies may be obtained from the Bank Supervision Department, Central Bank of Kenya or may be accessed on the CBK website at [www.centralbank.go.ke](http://www.centralbank.go.ke). All applications duly completed together with the necessary attachments specified in Part III of this guideline should be submitted to: The Director, Bank Supervision Department, Central Bank of Kenya, P.O. Box 60000, Nairobi.

#### **3.4 Opening or Relocating of a New Place of Business:**

Institutions will be required to submit the following information, in support of their applications for opening new place of business or relocating a place of business:

- a) Board approved business plan.
- b) Summary report showing performance of the institution for the last two years.
- c) Organization structure for the proposed place of business.
- d) A detailed feasibility study of the future operations and development of the new place of business for a minimum of three years from the date of this application including projections of:
  - i. deposit mobilization and interest payable stating separately the proposed major sources of deposits;
  - ii. advances to be made and interest receivable, stating intended sectoral lending;

- iii. investments to be made and earnings, stating policy and categories of business to be financed;
  - iv. operating expenses including rents, salaries, employee benefits, directors' remuneration;
  - v. liquid and cash reserve assets;
  - vi. capital structure;
  - vii. provisions for loans and advances;
  - viii. fixed assets, including business premises;
  - ix. other income, including commissions, discounts, etc.
  - x. net operating profit/loss.
  - xi. Interest rate sensitivity analysis of the projections submitted or other similar analyses of the extent to which the forecasts will change when interest rates vary (the assumptions underlying the projections and the sensitivity analysis should be stated).
- e) Statistical and other data which may have been collected in respect of the area in which the applicant intends to serve including population of the area, schemes of agriculture, business, industrial development, etc. and existing banking facilities.
- f) A schedule of all the preliminary expenses.
- g) A bankers cheque for the fees payable to the Central Bank of Kenya, to cover application fees as specified in the Banking (fees) Regulation (Currently fees payable is shs.5,000/= for each branch).

Upon receipt of this application, CBK will appraise the application. The institution may be requested to submit additional information as CBK may deem necessary.

In considering an application for a new branch, the Central Bank shall require that the institution meets the requirements of the Banking Act and Prudential Guidelines. In addition, the Central Bank will consider the most recent performance indicators and condition of the institution and whether such an institution is not under any administrative or remedial sanctions. Where an institution does not meet the requirements, the Central Bank may at its own discretion, recommend an approval if otherwise satisfied, that it will be in the public interest to do so.

Where CBK is satisfied that all requirements have been met by the institution, CBK may within 30 days from the date of submission of the complete application approve the application with or without conditions and communicate its approval to the institution in writing. Where the Central Bank declines to approve the application or any part thereof the CBK may within 30 days from the date of submission of the complete application communicate its refusal to the institution in writing and shall state the reason for its refusal.

An institution whose application has been declined may resubmit the application upon fulfilment of the conditions communicated by the Central Bank.

### 3.5 Other Requirements

- 3.5.1 The license of a place of business, branch or a subsidiary, which fails to commence operations within one year of the Central Bank's approval, shall be considered to have lapsed. The institution shall thereafter be required to submit a fresh request if they so wish to open the place of business, branch or in the future.
- 3.5.2 Change of business hours - All institutions should ensure that customers are informed of any intended changes in business hours, in any of their places of business, thirty days in advance to avoid inconvenience to them. The institutions are also required to notify CBK of the intended change at least 10 working days before the change is effected.

### 3.6 Notifications

The Central Bank should be notified on opening of the following places of business:

**Installation of Automated Teller Machines (ATMs):** The institutions shall submit to the Central Bank quarterly statistics on their ATM network within 10 days of the end of every quarter in the format shown in form CBK/IF 11-4.

**Sales Centres:** The institutions shall submit to the Central Bank quarterly statistics (CBK/IF 11-5) on their Sales Centres within 10 days of the end of every quarter.

### 3.7 Places of Business Not Covered in this Guideline

- 3.7.1 Opening, Closing or Relocating of Agencies is subject to the requirements as prescribed in the Guideline for Agent Banking CBK/PG/15.
- 3.7.2 Mobile banking units, which comprise the under listed, are excluded from the normal approval requirements in order to facilitate or give institutions more flexibility in meeting their customer needs:
- a. Banking services carried out in vehicles in different locations.
  - b. Instances where bank officers visit customers outside the bank premises and transact business with them.
  - c. Banking services carried out by a mobile unit on a few days of the week (not on all working days) in a permanent place with staff attached to a branch of the bank visiting the mobile unit to transact business.
  - d. Banking services carried out at temporary outlets operated at public places such as temples, schools, carnivals, exhibitions, conferences and streets.

## **PART IV MINIMUM STANDARDS FOR BANKING PREMISES**

This section is intended to outline the minimum health, safety and physical security standards to be observed at all times by existing institutions in their branches.

### **4.1 PREMISES**

The following requirements should be fulfilled before a licensed institution commences operations:

#### **4.1.1 Title Deeds/Lease Agreements**

A title deed or a signed lease agreement whichever is applicable, of the premises should be obtained. The terms of the lease should be long enough to allow for the economical use of the permanent improvements and in any case not less than 5 years. A copy of the registered lease should be forwarded to CBK within thirty days after CBK approval to commence operations. In the event that registration of the lease takes longer than the stipulated thirty days, the institution should notify the Central Bank immediately.

#### **4.1.2 Approvals by Relevant Authorities**

- a) Permission to build, erect, or alter the premises should be obtained from the local authority where necessary, together with their approval after the work has been carried out.
- b) An occupational certificate from the Health Authority relating to water, sewerage, staff working/rest areas, sanitation, customers' area etc. should be obtained where necessary.
- c) An installation certificate and agreement from the security firm regarding physical security of premises should be obtained.
- d) Approval of Kenya Power and Lighting Company for the wiring of premises.

#### **4.1.3 Banking Hall**

In determining the adequacy of the banking hall, the institution should take into account the type of business to be undertaken in the premises and the projected business growth especially in the number and type of accounts.

#### **4.1.4 Staff Operating Area**

The office space for the staff should be adequate for staff and should leave room for expansion in the immediate future. The workplace should not be so overcrowded as to cause risk of injury to the health of the employees. The space allowed for each individual employee should be reasonable and as a guiding principle should not be less than 350

cubic feet. Sufficient and suitable sanitary conveniences for employees should be provided, maintained and kept clean.

#### 4.1.5 **Ventilation**

Effective and suitable provision should be made for securing and maintaining circulation of fresh air in every part of the premises.

#### 4.1.6 **Strong room**

The custom-built strong room (**Safe/Vault**) should be conveniently situated. It should not border with the outside walls and should have adequate space to cater for the needs of the Institution. In cases where the strong room does not border outside walls, the institution should have additional protection e.g the inclusion of a metal plate on the walls.

The doors should be of fireproof material and under the control of more than one person. The duplicate keys should be stored off the premises.

Where a free-standing safe is in use, in place of a custom- built strong room, it should be fire proof. The access to the safe and the room should be under the control of more than one person. The safe itself should be located inside a windowless room secured by a heavy duty lock door of fire resistant material.

#### 4.1.7 **Record Room/Stationery Store**

Critical records pertaining to customer information should be kept in fire proof cabinets. The room should also be fitted with smoke detectors.

#### 4.1.8 **Cash Loading Bay**

Where premises are owned by the institution, provision must be made for a loading bay. Cash loading/unloading area should be protected from public view and access. There should be an arrangement with the police or private security firm for protection of cash-in transit. The provisions will apply even in rented premises where possible.

#### 4.1.9 **Security guards**

Adequate security guards should be posted at the premises at all times day and night. There should be a guard posted at the main entrance to the banking hall during business hours.

#### 4.1.10 **Cashier's Tills**

Access to the cashiers' tills should be restricted to cashiers during working hours.

#### **4.1.11 Alarm System**

There should be an alarm system installed in the premises which should be connected to the police and security firm. The alarm system should be installed with adequate switches in the cashiers' cubicles and the manager's offices. The alarm system should incorporate motion sensors to cover the staff operating areas, computer room and strong room.

Its panel should be obscured from public view, with a low buzzer noise level to indicate alarm with a light to show the source of the alarm. To prevent false alarms being sent to the Police, panic buttons should be configured to be pressed twice before an external alarm system can be sent. The alarm remote signals facility should provide a means of confirming the soundness of the radio communication link at least once every 48 hours.

Security guards should preferably be equipped with remote control buttons or a break glass near their station to enable them activate the alarm when necessary.

Management should ensure that the alarm system is tested at least quarterly outside banking hours and an up-to-date record of such maintenance kept.

Management should install closed circuit television network with facility for CCTV recording.

Wiring of the alarm system should be in its own conduits or trucking to protect from other interferences that may result in false alarms.

It is advisable to install fire alarm system to incorporate smoke/heat detectors in areas, which are not in continuous use. The fire alarm system must have proper maintenance schedule and be connected via the Radio Alarm System to the Fire Brigade.

#### **4.1.12 Emergency Plan**

Every institution must have a well-documented Emergency Plan. The plan should contain details of what is required of staff in case of an emergency. The Emergency Drills should stipulate who is to be alerted, which calls to make e.g. Ambulance, Fire Brigade, Police, Health Care providers. The plan should state clearly the escape routes, which should be conspicuously displayed. The plan should also indicate an assembly point for roll call.

The Drill should be done periodically and all staff involved. Fire extinguishers should be installed at vantage points within the premises.



#### 4.1.13 Server Room

The server room where applicable, should be located in a secure area within the premises. Access to the computer room should be restricted only to the authorized personnel. There should be passwords to operate the computer. Duplicate/back up magnetic tapes or discs should be stored in fire proof safes off the premises.

#### 4.1.14 Safe Deposit Lockers

Safe deposit lockers where provided should be housed in a separate strong room. Customers should be provided with sufficient and suitable verification space.

#### 4.1.15 Security Officer(s)

Institutions are encouraged to recruit their own security officer(s) who should be thoroughly vetted, to:-

- i) Monitor performance of security guards.
- ii) Oversee general operations.
- iii) Liaise with regional/county security officers and police on security matters.
- iv) Liaise with security firm on the maintenance of alarm system.
- v) Deal with cases of fraud/robbery in liaison with Banking Fraud Investigation Unit of CBK.
- vi) Monitor CCTV recording and ensure periodic testing of the systems to confirm good working order.

#### 4.1.16 Insurance

The institution should obtain adequate covers for the following policies from licensed insurance companies.

- a) Fire and other perils.
- b) Burglary and theft.
- c) Public liability.
- d) Fidelity.
- e) Workmen's compensation.
- f) Cash and valuables in transit.
- g) Cash and valuables in premises.
- h) Motor vehicles in premises.
- i) Other assets (e.g. computer).
- j) Employers' liability.

## **PART V COMMENCEMENT OF OPERATIONS**

### **5.1 Approval of New Branches**

Thirty days prior to proposed commencement of operations at a branch, an institution should seek approval from CBK using the application form attached to this guideline titled “Application Form To Open a New Place of Business”. Fourteen days prior to commencement of operations at a branch, an institution shall send to CBK the following information:

- (i) Completed questionnaire (Form CBK/IF/02) together with all required certificates and documents.
- (ii) A copy of the letter from the CBK in which approval was granted for the specified branch.
- (iii) Branch license fee as prescribed in the Banking Act.
- (iv) Proposed date of commencement of operations.
- (v) Proposed business hours for the branch.

Institutions should approach CBK for a branch license only after finalization of details regarding the location i.e. execution of tenancy/lease agreement for the proposed branch. Institutions are advised that the Central Bank will not carry out inspection of premises prior to opening of branch premises.

Once the Central Bank is satisfied that the institution has met the requirements for the branch premises as indicated in the minimum guidelines for branches, it will grant approval to the institution to commence operations.

The Central Bank may at its own discretion and from time to time carry out inspection of new branches prior to granting approval for commencement of operations.

## **PART VI OPENING OF A BRANCH OUTSIDE KENYA:**

This refers to institutions intending to open branches outside of Kenya and excludes subsidiaries of institutions intending to open branches in their countries of operation.

In considering an application to open a branch outside Kenya, an institution should submit to the Central Bank:

- a. Amount required from Kenya immediately and projections for the next three years.
- b. Board Resolution approving the opening of the branch outside Kenya

- c. Copy of management agreement, if any.
- d. A brief on the economic conditions of the host country and business plan for the proposed branch.
- e. A schedule of expected income and expenditure and Projected Balance Sheet for the next three years.

Prior to granting an approval to open a branch, a letter of no objection shall be obtained from the host regulator.

## **PART VII: CONDUCT OF LIMITED BANKING SERVICES THROUGH ANOTHER INSTITUTION LOCATED OUTSIDE KENYA,**

This refers to institutions intending to provide limited banking services to its customers through another institution located outside Kenya, while the customers are outside Kenya.

### **7.1 Permissible Limited Banking Services**

The following services may be provided by the institution located outside Kenya and as may be specifically agreed between it and the institution.

- i) Cash deposit and cash withdrawal.
- ii) Balance enquiry.
- iii) Customer Service/Call Center enquiries and assistance.
- iv) Any other activity as the Central Bank may prescribe.

7.2 In considering an application to provide limited banking services to its customers, an institution should apply formally to the Central Bank notifying the Bank of their said intention. Alongside the application letter, the Applicant should submit:

- (a) Board Resolution approving the provision of limited banking services through another institution outside Kenya.
- (b) Letter of no objection from the host Regulator.
- (c) A copy of the duly executed Service Level Agreement between the two institutions.
- (d) Risk assessment report detailing risks associated with the provision of these services including the mitigating measures to be adopted in order to control the risks identified, in accordance with risk management policies currently in force and this Guideline. The risk assessment should incorporate AML/CFT risks.
- (e) Due diligence report on the partner institution.

(f) The banking services to be provided by the partner institution and the limits to which they will be subject.

(g) The list of charges or fees applicable for each service which are payable to the institution by the customers.

7.3 There should be dispute resolution mechanism in place between the institutions involved in the provision of limited banking services.

## **PART VIII: CLOSURE OF PLACE OF BUSINESS**

8.1 In deciding on the approval to authorize the closure of a place of business, the Central Bank seeks to be satisfied that:

a) The public interest that was being served in the area the institution currently operates from will not be jeopardized by the closure.

b) Alternative financial services that were being provided by the institution at current place of business are available in the locality.

c) The previous projections supplied by the institution which initially indicated the current location as being lucrative shall be taken into account while appraising the request.

8.2 In deciding on the approval to authorise the closure of a branch or a subsidiary, the Central Bank of Kenya seeks to be satisfied that:

a) The financial performance of the branch or subsidiary and its future outlook;

b) Country risk assessment as submitted by the institution;

c) Opinion of the host country supervisor;

d) Financial and reputational impact that it may have on the institution.

Once the approval has been granted by the Central Bank to close a particular place of business here in Kenya, the institution shall give six months' notice to the public of its intention to do so'. Similarly, in the case of a branch or subsidiary outside Kenya, the institution shall give six months' notice to the public of its intention to do so once approval has been granted by the Central Bank of Kenya.

In the case of a foreign branch and subsidiary, the Central Bank of Kenya should be notified six months prior to the intended closure of the foreign branch/subsidiary.

Institutions should complete CBK/IF 11-3 when applying to close or relocate an existing place of business.

## **PART IX CORRECTIVE MEASURES**

- 9.1. **Remedial measures** - If an institution fails to comply with this guideline, the Central Bank may pursue any or all corrective actions as provided under Sections 33, 34 and 55 of the Banking Act.
- 9.2. **Penalty** – The Central Bank may close a place of business and impose a penalty on an institution in case it comes to the knowledge of the Central Bank that an institution is operating an unauthorized place of business.

## **PART X EFFECTIVE DATE**

- 10.1. **Effective Date:** The effective date of this guideline shall be 1<sup>st</sup> January 2013.
- 10.2 **Supersedence:** This Guideline supersedes and replaces Guideline on Opening New Places of Business, Closing Existing Places of Business and Changing Location of Places of Business of 1<sup>st</sup> January 2006.

### **Enquires**

Enquiries on any aspect of this regulation should be referred to:

The Director, Bank Supervision Department

Central Bank of Kenya

P.O. Box 60000 - 00200

**NAIROBI**

**PART XI: APPLICATION FORMS**

**CBK/IF 11- I APPLICATIONS BY AN INSTITUTION TO OPEN A NEW BRANCH**

*(To be completed and submitted with every application)*

**APPLICATION BY AN INSTITUTION TO OPEN A NEW BRANCH**

1. Name of the Institution .....
  2. Names/locations of existing branches and dates of establishment.....
  3. a) Name of the proposed location of business .....
  - b) Postal address and telephone number(s) .....
  - c) Physical address:- L.R.NO. .... Building ..... Street .....
  - Town .....
  4. a) Chief Operating officers of the Proposed New Place of Business
  - b) Number and designation of non-management staff.....
  5. Business hours .....
  6. Will the new place of business be:-
    - a) Self-owned? .....Yes/No\* ..... If yes, cost of purchase or construction .....
    - b) Leased? ..... Yes/No\* ..... If yes, terms of lease .....
  7. Proposed date of commencing operations .....
  8. Do you plan to change the status of the proposed place of business? ..... Yes/No\* ..... If yes, state proposed type of status and when .....
  9. In case of a subsidiary and the location of the new place of business will be outside Kenya;
    - a) Provide names of the joint shareholders, nationality, address and their respective percentage shareholding.....
    - i) Authorised capital.....
    - ii) Paid-up/assigned capital .....
  10. Name of Managing Director/Chief Executive .....
- Signature ..... Date .....

**\*Delete whichever is not applicable**

## **NOTES ON THE COMPLETION OF THE APPLICATION FORM TO OPEN NEW PLACE OF BUSINESS**

These notes are intended to give further guidance to the completion of the application form. Items on the form where guidance is deemed necessary are:-

### **1. Item Number 3(b) and (c) Postal and Physical Address.**

These details should be submitted to the Central Bank of Kenya as soon as they are known.

### **2. Item Number 4: Particulars of Officers**

The term 'officers' refers to:

- (a) the officer in charge of the place of business;
- (b) the assistant officer in charge of the place of business; all the section heads.

Information requested under item 4(b) on non-management staff is total number in each grade (i.e. cleaners, clerks and secretaries).

**CBK IF 11-2 QUESTIONNAIRE FOR APPROVAL TO COMMENCE OPERATIONS AT A BRANCH**

	YES	NO	COMMENTS
<b>TITLE DEED/LEASE AGREEMENT</b>			
<b>(a) Title Deed</b>			
Is the institution registered as the owners of the premises? Attach a copy of the title deed.			
<b>(b) Lease Agreement</b>			
Attach a signed copy of the lease agreement.			
Is the lease registered?			
What is the duration of the lease and is it long enough to allow for economical use of the permanent improvement?			
Attach the landlord's approval for interior design/alteration obtained and other conditions satisfied?			
<b>APPROVAL BY LOCAL AUTHORITY</b>			
Attach the approvals for the following, if applicable:-			
a) Design or architectural plans approval			
b) Occupation certificate			
c) Local authority licences.			
<b>APPROVAL BY OTHER RELEVANT AUTHORITIES</b>			
Have the following been obtained where necessary, if so attach evidence of the same:-			
Security firm – regarding physical security of staff, premises and assets.			
Attach:			
a) signed guarding contracts,			
b) signed CCTV contracts (i.e. leased or maintenance),			
c) alarm contract etc.			
Are there security guards at the premises at all times-day and night?			
Approval by K.P. & L. Co. For electrical wiring of the premises.			
<b>BANKING HALL</b>			
Does the Banking Hall suit the type of business to be undertaken in the premises?			
<b>STAFF OPERATING AREA</b>			
Is space allowed for each individual employee equal to or more than 350 cubic feet?			
Are sufficient and suitable sanitary conveniences for employees provided and kept clean?			



	YES	NO	COMMENTS
<b>VENTILATION</b>			
Is ventilation adequate for security and circulation of fresh air in the premises?			
<b>LIGHTING</b>			
Is there sufficient and suitable lighting in every part of the premises?			
<b>DISPLAYS</b>			
Are the following displayed?			
a) Approved business hours			
b) Audited accounts			
c) Current Banking licence			
d) Banking Tariffs			
e) Names of Senior Officers			
f) Certificate of contribution from DPF			
<b>OUTER DOORS/WALL/WINDOWS</b>			
Do the outer doors and windows meet reasonable security scrutiny e.g. if made of wood, is it reinforced, does it have dual control and backed by alarm system and a guard? Are windows and glass walls reinforced with metal grills or made of anti-burglar/bullet proof glass?			
<b>STRONGROOM (SAFE/VAULT) OR FREE STANDING SAFE</b>			
Is there a strong room or a free standing safe in the branch?			
If a strong room:			
Are the duplicate keys stored off the premises?			
Is there dual control for entry			
If a free standing safe, is it fire proof?			
If the room where is the safe is kept under the control of more than one person?			
Is the safe in a window less room and secured by a heavy duty lock door of fire resistant material?			
<b>CASH LOADING/UNLOADING AREA</b>			
Is it protected from public view and access?			
Is cash in transit protected by policy/security firm? If so, attach signed copies of the contract			
<b>ALARM SYSTEM</b>			
Is there an alarm system installed in the premises?			
Is it connected to policy/security firm?			
As a guiding principle, alarm switches should be located in the strong room, cashiers' cubicles and the branch manager's office			

	YES	NO	COMMENTS
<b>EMERGENCY PLAN</b>			
Is there an emergency plan?			
Is it documented?			
Are there fire extinguishers at appropriated places?			
<b>SERVERS</b>			
Is the server located in a secure area/room?			
Is the access to the server room restricted?			
Are back-ups made and stored outside the premises?			
<b>INSURANCE</b>			
Attach insurance certificates indicating that the new branch has been insured against:			
a) Fire			
b) Burglary and theft			
c) Public liability			
d) Fidelity			
e) Cash and valuable in premises			
f) Motor vehicles in premises			
g) Other assets			
h) Employers' liability			
i) Work Injury Benefit ACT (WIBA)			
Is the issuing insurance firm licensed with the insurance regulatory authority?			
Is the insurance company connected in any way with the institutions:-			
o Directors			
o Management and			
o Shareholders with more than 5% of the institution's shares?			
Are there other insurances that are required to be taken under the lease agreement? i.e. glass windows			
If yes have the covers been taken.			
<b>DOCUMENTATION</b>			
Does the branch have copies of the policy manuals approved by the board of directors, covering at least staff, training, fixed assets, deposits, lending, loan classification, bad provisions/write-offs, investment, management information systems, budgeting and variance analysis			
Are the policy documents availed to all staff members and are they updated regularly on any changes?			

## DECLARATION

I, the undersigned, being an officer of the institution, declare that to the best of my knowledge and belief, the information contained herein is complete and accurate.

Chief Executive Officer (Name) .....

Signature ..... Date.....

**WITNESSED BEFORE ME:**

**SIGNED..... (Witness)**

**COMMISSIONER FOR OATHS/ MAGISTRATE**

Name.....

Signature.....

Address .....  
.....  
.....

**CBK/IF 11-3 APPLICATION BY AN INSTITUTION TO CLOSE OR RELOCATE AN EXISTING PLACE OF BUSINESS**

**PART I**

- 1. Name of the Institution .....
- 2. Names/locations of existing branches and dates of establishment  
.....
- 3. Type of current place of business to be closed or relocated (i.e. branch, sub-branch, agency or mobile unit etc.)  
.....  
.....

**PART II**

**In case of relocation:**

- 4. a) Name of the proposed location of business if already identified  
.....
- b) Postal address and telephone number(s) .....

- c) Physical address:-
    - L.R. NO. .... Building .....
    - Street..... Town .....
  - d) State reasons for relocation .....
5. Is the new place of business:-
- c) Self-owned? .....Yes/No\* .... If yes, cost of purchase or construction .....
  - d) Leased? ..... Yes/No ..... If yes, terms of lease .....
6. Proposed date of commencing operations .....
7. Do you plan to change the status of the proposed place of business? .....  
yes/No\*..... If yes, state proposed type of status and when .....
8. In case of a subsidiary and the location of the new place of business will be outside Kenya; Provide names of the joint shareholders, nationality, address and their respective percentage shareholding.....

**PART III**

9. **In case of closure:**
- a) Location of current place of business proposed to be closed .....
  - b) Indicate profitability of the branch in the last three years .....
  - c) Proposed action plan on existing customers of the branch .....
  - d) Proposed action plan on current branch employees .....
  - e) Are there any banking facilities provided in the vicinity? If so state by whom .....

10. Name of Managing Director/Chief Executive .....

Signature.....Date.....

**\*Delete whichever not applicable**

**CBK/IF 11 - 4: NUMBER OF OPERATIONAL ATMS**

**Name of Institution:** .....

**Quarter End Date:** .....

Location of ATM	Town	County	Date Opened	Branch Responsible

**CBK/IF 11-5 NUMBER OF OPERATIONAL SALES CENTRES**

**Name of Institution:** .....

**Financial Year:** .....

**Quarter Start Date:** .....

**Quarter End Date:** .....

	Name assigned to Sales Centre	Postal and physical address	County	Date Opened	Branch Responsible	Services Offered at Sales Centre
1.						
2.						
3.						
4.						
5.						

# **GUIDELINE ON ACQUISITIONS, MERGERS, AMALGAMATIONS, TRANSFERS OF ASSETS AND LIABILITIES CBK/PG/12**

## **CONTENTS**

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### **PART II Statement of Policy**

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- CBK/IF 12-3. Particulars of Directors (C)
- CBK/IF 12-4. Particulars of Directors' Loans (D)
- CBK/IF 12-5. Particulars of Branches (E).

## **PART I: PRELIMINARY**

- 1.1. **Title** - Guideline on acquisitions, mergers, amalgamations, and transfer of assets and liabilities.
- 1.2. **Authorisation** - This guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system
- 1.3. **Application** - All institutions licensed under the Banking Act (Cap.488).
- 1.4. **Definitions** - Terms used within this guideline are as defined in the Banking Act, as further defined below, or as reasonably implied by contextual usage.
  - 1.4.1 **Acquisition** – The purchase by one institution licensed under the Banking Act (Cap. 488) of another, for cash, an exchange of shares, or a combination of both. The process is also referred to as a **takeover**.
  - 1.4.2 **Amalgamation** – The union or fusion of two institutions licensed under the Banking Act (Cap. 488).
  - 1.4.3 **Amalgamating or merging institutions** - the institutions contemplating effecting an amalgamation or merger.
  - 1.4.4 **Merger** – The fusion of two or more institutions licensed under the Banking Act (Cap. 488).
  - 1.4.5 **Partial transfer of assets and liabilities** - The transfer of limited assets and liabilities as specified in the merger / amalgamation agreement, of the transferor institution to the receiving institution.
  - 1.4.6 **Receiving institution** - the institution to which assets and liabilities are transferred through a transaction effected under this Guideline.
  - 1.4.7 **Resulting institution** - the institution resulting from a merger or an amalgamation effected under this Guideline.
  - 1.4.8 **Transfer of assets and liabilities** – The transfer of all the assets and liabilities of the transferor institution to the receiving institution.
  - 1.4.9 **Transferor institution** - the institution which transfers its assets and liabilities to a receiving institution.

## **PART II: STATEMENT OF POLICY**

- 2.1. **Purpose** - This guideline has been prepared pursuant to section 9 and section 13(4) of the Banking Act to assist institutions intending to undertake an acquisition, merge or amalgamate, transfer assets and liabilities and/or facilitate transfer of significant shareholding.



- 2.2. **Scope** – This guideline shall be applicable to all institutions licensed to conduct business in Kenya under the Banking Act (Cap.488). It specifies application procedures and sets out the minimum conditions that should be fulfilled by merging or amalgamating institutions or institutions involved in an acquisition. It also stipulates the forms to accompany applications for transfer of significant shareholding.
- 2.3. **Responsibility** – It shall be the responsibility of the shareholders and directors of the institutions intending to acquire, merge, amalgamate and/or transfer of assets and liabilities to ensure that the provisions of these guidelines are adhered to by the institutions.

### **PART III: SPECIFIC REQUIREMENTS**

#### **3.1. Application Procedures**

- 3.1.1 All institutions intending to acquire, merge/amalgamate or transfer assets and liabilities should write to the Director, Bank Supervision Department, Central Bank of Kenya, P.O. Box 60000 - 00200 Nairobi, providing advance notification at least 30 days prior to the proposed acquisition, merger or transfer. This notification must be accompanied with the required information specified in Section 3.1.3 below.
- 3.1.2 Merging or amalgamating institutions should first seek approval from the Central Bank of Kenya for the name under which they intend to use in case of change of name. They should then ascertain with the Registrar of Companies that the selected name is available and is appropriately reserved for their use.
- 3.1.3 Acquiring, merging or amalgamating institutions should submit a due diligence report signed by directors of the institutions involved. The report should at a minimum contain the following:
- a) An extract of minutes of the general meeting of the shareholders of each of the institutions involved passing the resolutions to acquire, merge or amalgamate and the terms and conditions of the relevant agreement. Also attach a copy of the resolution of the board of directors of all the participating companies approving the proposed merger or amalgamation.
  - b) Latest audited accounts for all the institutions involved in the acquisition merger/amalgamation. A copy of consolidated accounts of the institution's duly certified by an independent firm of auditors as at the date of application for approval. The certified accounts should meet CBK minimum disclosure requirements.
  - c) Memorandum and Articles of Association of merging/ amalgamating institutions or institutions involved in an acquisition.
  - d) A statement of the nature and objectives of the acquisition, merger/amalgamation.
  - e) A copy of the proposed agreement for the acquisition, merger /amalgamation.

- f) Financial projections for the first three years of operation after acquisition, merger/ amalgamation together with respective assumptions.
- g) Proposed details of the method of valuation and the name of the valuer.
- h) Proposed organisation structure of the resulting institution.
- i) Proposed details of senior management (A) - as per form CBK/IF 12-1.
- j) Proposed shareholding structure (B) - as per form CBK/IF 12-2.
- k) Proposed board of directors (C) - as per form CBK/IF 12-3.
- l) Particulars of Directors Loans\* (D) - as per form CBK/IF 12-4.
- m) Proposed branch network (E) - as per form CBK/IF 12-5.
- n) Proposed staff rationalization program. This should take into account the following:
  - i) The management structure of the resulting institution will need to be agreed upon, properly structured and where necessary job descriptions amended.
  - ii) The provisions of the trade union agreement, if any, will need to be complied with. This may require advance negotiations with the union.
  - iii) In respect of non-unionized staff the accumulated leave and other benefits will need to be computed and possibly transferred to the resulting institution.
  - iv) An appraisal of the staff requirements will need to be done. Recruitment of additional staff in specialized areas will need to be considered.
  - v) Staff pension scheme/provident fund schemes will need to be in compliance with the relevant laws and guidelines.
  - vi) Any expatriate staff on work permits will require the transfer of their work permits to the new entity.
  - vii) Contracts of employment will need to be transferred to the new entity or fresh ones drawn out.
  - viii) Salary scales, benefits and remuneration structure will need to be carefully reviewed and harmonized to avoid any inconsistencies.
  - ix) Staff training programs will need to be reviewed and consolidated.
  - x) New personnel policies will need to be agreed upon.
  - o) Anticipated tax implications of the merger.

- p) Operational contingencies and marketing plan.
- q) Business strategy to be adopted.
- r) ICT strategy and system software to be adopted.
- s) Legal due diligence covering all areas of any legal concerns that may face the resulting institution. This should include current litigations and anticipated litigation.

3.1.4 Institutions intending to acquire or merge will have to furnish the CBK with a letter of no objection/approval from the Competition Authority of Kenya.

### **3.2. Approval Procedures and Assessment Criteria**

The Central Bank of Kenya shall not approve the acquisition, merger amalgamation or transfer unless satisfied that:

- 3.2.1 The acquisition, merger or amalgamation shall be in public interest.
- 3.2.2 The business the applicant proposes to conduct is that of an institution under the Banking Act.
- 3.2.3 The acquisition, merger or amalgamation will be viable.
- 3.2.4 The corporate affiliation or new group structure does not expose the institution to undue risk or hinder effective supervision.
- 3.2.5 That the institution has from the outset adequate financial, managerial and organizational resources to handle the acquisition/merger.
- 3.2.6 The reputation of the proposed acquirer, mainly its integrity and professional competence.
- 3.2.7 The financial soundness of the proposed acquirer.
- 3.2.8 Every person proposed as a director or an officer in the new organisation complies with “Fit and Proper” criteria in accordance with the Schedule of the Banking Act.
- 3.2.9 In case of a transfer of assets and liabilities referred to, such transfer is to another institution or person approved by the Central Bank of Kenya for the purpose of the transfer.
- 3.2.10 The resulting institution, or in the case of such transfer of assets and liabilities, the bank or person taking over such assets and liabilities, shall have the same rights and be subject to the same obligations as those applicable prior to the merger/amalgamation or transfer.

3.2.11 All agreements, appointments, transactions and documents entered into, made, drawn up or executed with, by, or in favour of any of merged/amalgamated institutions and in force immediately prior to the merger/amalgamation or transfer shall remain in force and effect and shall be construed for all purposes as if they had been entered into, made, drawn up or executed with or in favour of the resulting institution.

3.2.12 The resulting institution shall be in compliance with the Banking Act, Central Bank of Kenya Act, and any guidelines issued there under and/or other applicable statutory requirements.

## **PART IV POST ACQUISITION, MERGER/AMALGAMATION REQUIREMENTS**

### **4. 1 Permits, licenses and other approvals**

4.1.1 Banking license in the name of the new entity will be required.

4.1.2 Likewise, all other licenses, permits and approvals will need to be obtained in the name of the new entity.

4.1.3 Membership of various trade associations and other similar bodies will have to be in the name of the new entity.

4.1.4 For rented premises, the landlord's consent may be necessary.

### **5.1 Banking and Finance Facilities**

5.1.1 All facilities enjoyed by the merging/amalgamating companies, including correspondent banking facilities will need to be transferred to the new entity.

5.1.2 Any hire purchase or finance leases will need to be assigned or transferred.

### **5.2. Maintenance of Records**

5.2.1 It is essential to ensure that the right accounting systems and procedures are in place. Expert advice may be required to ensure proper consolidation of the different accounts and systems used.

5.2.2 Books of the entity being absorbed will need to be closed.

5.2.3 Closure and/or transfer of all bank accounts, income tax file, PAYE file, and others.

5.2.4 Review/consolidation of policy and procedures manual.

### 5.3. Miscellaneous Requirements

The following requirements in so far as they are applicable, will need to be attended to:

- 5.3.1 Consolidation of insurance.
- 5.3.2 Transfer of lease agreements in respect of all rented premises, including premises occupied by staff.
- 5.3.3 Transfer of all electricity, water and telephone accounts.
- 5.3.4 Transfer of credit facilities from various suppliers to the new entity.

## PART VI: EFFECTIVE DATE

- 6.1 **Effective date:** The effective date of this guideline shall be 1<sup>st</sup> January 2013.
- 6.2 **Supersedence** - This Guideline supersedes and replaces the Guideline on mergers, amalgamations, and transfer of assets and liabilities (CBK/PG/12) issued at 1st January 2006

## ENQUIRIES

Enquiries on any aspect of this guideline should be referred to:

**The Director,**  
Bank Supervision Department  
Central Bank of Kenya  
P.O. Box 60000 - 00200  
**NAIROBI**  
TEL. 2860000 e-mail: *fin@centralbank.go.ke*













# **GUIDELINE ON ENFORCEMENT OF BANKING LAWS AND REGULATIONS - CBK/PG/13**

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### **PART III Effective Date**

- 3.1. Effective Date
- 3.2 Supersedence

### **Legal Notice No. 77/99 on Assessment of Monetary Penalties**

## **PART I: PRELIMINARY**

- 1.1 **Title:** Guideline on Enforcement of Banking Laws and Regulations
- 1.2 **Authorisation** - This Guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.
- 1.3 **Purpose** - This Guideline is intended to provide information and guidance to the banking industry on the approach the Central Bank will take in issuing prompt supervisory directives and corrective orders to institutions. Supervisory enforcement actions, contained herein have attempted to set forth the banking practices, conditions, and violations of law giving rise to the particular problems or weaknesses identified, ordinarily through on-site examinations. Supervisory enforcement actions are also to be used to provide an outline of specific corrective/remedial measures, including appropriate time frames and goals for achievement of compliance. Specific courses of enforcement action which may be considered for use by the Central Bank of Kenya will be communicated to each individual institution as and when the need arises.
- 1.4 **Definition** - Terms used in this Guideline are as defined in the Banking Act.

## **PART II: IMPLEMENTATION AND SPECIFIC REQUIREMENTS**

The following actions will be taken if, ordinarily, the management of institutions subject to such actions has demonstrated a disregard for safe and sound banking practices and/or the lack of willingness or ability to correct weaknesses or problems on their own. It should be noted that the enforcement actions contained herein are not exhaustive and CBK is at liberty to prescribe any remedial action that it considers appropriate in light of the lapses/violations being addressed.

### **2.1 Board Resolutions**

The Central Bank may require an institution to pass Board Resolutions which are acceptable commitments or responses from institutions that exhibit supervisory concerns, where such actions clearly evidence a board's commitment to effect prompt correction of weaknesses or violations. Such resolutions should indicate the time frame within which compliance will be attained.

### **2.2 Commitment Letter**

This is a letter from the Central Bank to an institution's board of directors outlining specific corrective actions to be undertaken by the bank management which should be accepted and signed by the bank's directors indicating their commitment to comply with

the specific recommendations. The concerns raised will have been identified whether through on-site inspection or off-site surveillance. The signed original letter should be returned to the Supervision Department within 30 days and a copy be retained with the institution's official records.

### 2.3 Memorandum of Understanding

This is a written agreement initiated by the Central Bank of Kenya setting forth specific corrective/remedial actions to be undertaken by an institution's board of directors. Failure to comply within a specified time frame by the board of directors could result in subsequent action of a legal nature. The weaknesses in need of correction will also have been identified either through on-site or off-site supervision.

### 2.4 Issuance of Directives

The following corrective actions are authorized by Section 33(1) of The Banking Act if the Central Bank of Kenya has reason to believe that:

- a) the business of an institution is being conducted in a manner contrary to or not in compliance with the requirements of the Act or of any guideline made there under or in any manner detrimental to or not in the best interest of its depositors or members of the public; or
- b) an institution, any of its officers or other person participating in the general management of the institution is engaged in any practice likely to occasion a contravention of any of the provisions of the Act or any regulations made there under, the Central Bank of Kenya may:
  - i. **give advice** and make recommendations to the institution with regard to the conduct of its business generally;
  - ii. **issue directions** regarding measures to be taken to improve the management or business methods or to secure or improve compliance with the Act, regulations or other written law or regulations;
  - iii. **issue directions**, in the case of Section 33 (1) (b), to an institution, officer or other person **to cease such practice**;
  - iv. **appoint a person** to advise and assist the institution generally or for the purposes of implementing any directions under (i) and (ii) above and such person's advice shall have the same force and effect as a direction and shall be deemed to be a direction of the Central Bank of Kenya.

However, prior to the above action, notice of intention shall be served on the institution or the officer as the case may be, to show cause why such a direction should not be issued.

## **2.5 Removal of Officers and Denial of Corporate Approvals**

The following corrective actions are authorized by Section 33A of The Banking Act and may be issued where an auditor's report, under Section 24 (4) or an inspection report under Part VII of the Banking Act reveals that an institution conducts its business in a manner contrary to the provisions of the Act or any regulations made there under or in any manner detrimental to or not in the best interests of its depositors or members of the public:

- a) restrict, suspend or prohibit the payment of dividends;
- b) prohibit the conversion of any profits into capital;
- c) direct the suspension or removal of any officer involved in such conduct;
- d) require the institution to reconstitute its board of directors;
- e) withhold branch or other corporate approvals.

## **2.6 CBK Intervention in the management of an institution**

Corrective actions are authorized under the provisions of Section 34 of The Banking Act by the Central Bank if:

- a) the institution fails to meet any financial obligation, when it falls due, including an obligation to pay any depositor;
- b) a petition is filed, or a resolution proposed, for the winding up of the institution or if any receiver or receiver and manager or similar officer is appointed;
- c) the auditor makes a report to Central Bank of Kenya under the provisions of subsection (4) of section 24; or
- d) the Central Bank of Kenya discovers or becomes aware of any fact or circumstance which warrants the exercise of the relevant power in the interests of the institution or its depositors or other creditors.
- e) if the institution is significantly undercapitalized; or

- f) if the institution fails:
  - (i) to submit a capital restoration plan or a plan to resolve all deficiencies as directed under Section 33A; or
  - (ii) to add more capital, and it fails, neglects or refuses to comply with an order or to implement a plan of correction.

The following corrective actions may be taken:

- i) **appoint a person (Manager)** to assume the management, control and conduct of the affairs and business of an institution to the exclusion of its board of directors;
- ii) **remove any officer or employee** who has caused or contributed to any contravention of the Act or any regulations made there under or to any deterioration in the financial stability of the institution or has been guilty of conduct detrimental to the interests of depositors or other creditors;
- iii) **appoint a competent person** to its board of directors to hold office as a director who shall not be capable of being removed from office without the approval of Central Bank of Kenya; and
- iv) **revoke or cancel any existing power of attorney**, mandate, appointment or other authority by the institution in favour of any officer or employee or any other person.
- v) **restrict the institution** from engaging in new foreign exchange business;
- vi) **prohibit the institution** from engaging in new off-balance sheet transactions; and
- vii) **prohibit the institution** from engaging any new agents or direct the institution to terminate any agency arrangement.

## 2.7 Removal of Directors and Officers and Levying of Penalties

Where an institution contravenes any of the provisions of the Banking Act , the Central Bank may impose any of the following conditions/actions:

- a) Joint and several liabilities of officers to indemnify the institution against any loss arising in respect of an advance, loan or credit facility in contravention of this section;

- b) Direct the removal of a director and/or direct the suspension of any officer or employee who sanctioned the advance, loan or credit facility.
- c) Levy penalties as provided for by legal notice No. 77/99 pursuant to section 55(2) of the Banking Act.
- d) Non-compliance may also result in enforcement action being taken pursuant to the provisions of the Banking Act.

## 2.8 **Revocation of Banking License**

Pursuant to the provisions of Section 6 of the Banking Act, the Central Bank may, by not less than 28 days' notice in writing to the institution, revoke the license of an institution if the institution:

- a) Ceases to carry on business in Kenya or goes into liquidation or is wound up or is otherwise dissolved; or
- b) Fails to comply with the Banking Act, the Central Bank of Kenya Act, or other rules, regulations, orders or directions issued under those Acts or any condition of its license.

As a practical matter, the revocation of an institution's license should be immediately followed by closure and the initiation of liquidation proceedings.

## 2.9 **Termination of Deposit Protection**

Pursuant to the provisions of Section 38(5) of the Banking Act, where it appears to the Deposit Protection Fund Board (Now Kenya Deposit Insurance Corporation (KDIC) that the affairs of an institution are being conducted in a manner detrimental to its own interest or to the interests of its depositors, the Board may:

- a) Increase the contributions (to the KDIC) of that institution; or
- b) Terminate the protection of its deposits.

2.10 In addition to the above listed measures and or sanctions, the Central Bank may take such enforcement and or corrective action as it deems necessary and as provided for under Central Bank's Guideline on Prompt Corrective Action Guideline (CBK/PG/21)

## 2.11 **Legal Notice No. 77/99**

This guideline should be read together with Legal Notice No. 77 of 1999.



### **PART III EFFECTIVE DATE**

- 3.1. **Effective Date** - The effective date of this guideline shall be 1<sup>st</sup> January 2013
- 3.2. **Supersedence** - This Guideline supersedes and replaces the Guideline on Enforcement of Banking Laws and Regulations issued at 1<sup>st</sup> January 2006.

### **ENQUIRIES**

Enquiries on any aspect of the guideline should be referred to:

The Director  
Bank Supervision Department  
Central Bank of Kenya  
P.O. Box 60000 - 00200  
**NAIROBI**  
TEL.2860000 e-mail: *fin@centralbank.go.ke*

## **LEGAL NOTICE NO.77/99**

IN EXERCISE of the powers conferred by section 55(2) of the Banking Act the Minister for Finance makes the following Regulations:

### **THE BANKING (PENALTIES) REGULATIONS, 1999**

1. These Regulations may be cited as the Banking (Penalties) Regulations 1999 and shall apply to all banks and other institutions licensed under the Act to conduct business in Kenya.
2. (a) Any institution or other person who fails or refuses to comply with any directions given by the Central Bank under the Act shall be liable to a penalty not exceeding one million shillings in the case of an institution, or one hundred thousand shillings in the case of a natural person.  
  
(b) The Minister may prescribe additional penalties not exceeding ten thousand shilling in each case for each day or part thereof during which such failure or refusal continues.
3. (1) The following shall constitute specific violations by an institution of the directions given by the Central Bank which shall be subject to assessment of monetary penalties under these Regulations:
  - a) Loans, advances or other credit facilities granted by the institution to any person in excess of 25% of the institution's core capital;
  - b) Outstanding unsecured advances to any of the institution's employees or their associates;
  - c) Outstanding advances, loans or credit facilities which are unsecured or not fully secured:
    - i. to any of its officers or their associates; or
    - ii. to any person of whom or of which any of its officers has an interest as an agent, principal, director, manager or shareholder; or
    - iii. to any person of whom or of which any of its officers is a guarantor.
  - d) Outstanding advance, loan or credit facility to any of its directors or other person participating in the general management of the institution which:
    - i. has not been approved by the full board of directors of the institution upon being satisfied that it is viable;
    - ii. has not been made in the normal course of business and on terms similar to those offered to ordinary customers of the institution; and

- iii. has not been reported to the Central Bank within seven days thereof as being approved under (i) above.
  - e) An aggregate of credit facilities to any one of the institution's shareholders, directors, officers or employees which is in excess of twenty percent of the institution's core capital;
  - f) The aggregate of loans, advances and other credit facilities to shareholders, directors, officers and employees in excess of one hundred percent of the institution's core capital.
  - g) Failure of the institution to:
    - i. exhibit its annual audited accounts, throughout each year, in a conspicuous place in every office and branch in Kenya; or
    - ii. publish its annual audited accounts in a national newspaper within the number of months of the end of each financial year as prescribed under the minimum disclosure requirements prescribed from time to time by the Central Bank.
  - h) Failure of the institution to submit, not later than three months after the end of its financial year, to the Central Bank its annual audited accounts and a copy of the auditor's report in the prescribed form.
  - i) Failure of the institution to furnish, at such time and in such manner as the Central Bank may direct, such information in accurate and complete manner as the Central Bank may require to properly discharge its functions under the Act.
- (2) Monetary penalties on non-compliance with other directions not covered herein above may be levied by the Central Bank.
- 4 (a) The Central Bank, after reviewing all available information and determining the existence of the contravention or violations of one or more of the provisions referred to herein, shall notify the institution in writing advising it of its findings and its decision to assess the penalties.
- (b) A notification under (a) above shall advise the institution of a reasonable time frame within which the violation shall be rectified.
5. Following the notification and expiration of the time frame designated in (4) above, or sooner if advised by the institution of the correction of the violation, the Director of Bank Supervision of the Central Bank shall instruct the institution, in writing, as to the

amount of monetary penalties assessed and the manner in which such monies shall be paid to the Central Bank.

6.
  - (a) Where the Central Bank is not satisfied, either by evidence provided by the institution or information obtained by the Central Bank, that the violation has been rectified as directed, the daily monetary penalty prescribed in Regulation 2(b) shall continue to accrue.
  - (b) Once the Central Bank is fully satisfied that the violation has been rectified, the daily penalty shall cease to accrue and the institution shall be assessed the aggregate penalty.

# **GUIDELINE ON BUSINESS CONTINUITY MANAGEMENT CBK/PG/14**

## **PART I Preliminary**

- 1.1 Title
- 1.2 Authorization
- 1.3 Application
- 1.4 Definitions

## **PART II Statement of Policy**

- 2.1 Purpose
- 2.2 Scope
- 2.3 Responsibility

## **PART III Specific Requirements**

- 3.1 Boards and Senior Management
- 3.2 Business Continuity Management Team

## **PART IV Remedial Measures**

- 4.1 Remedial Measures

## **PART V Effective Date**

- 5.1 Effective Date

## **PART I: PRELIMINARY**

- 1.1 **Title** – Guideline on Business Continuity Management (BCM).
- 1.2 **Authorization** – This Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking system.
- 1.3 **Application** – This Guideline applies to all institutions licensed under the Banking Act (Cap. 488).
- 1.4 **Definitions** – The terms used in this Guideline shall be taken to have the meaning as assigned to them hereunder. Other terms used in the guidelines are as defined in the Banking Act.
  - 1.4.1 **‘Alternate Site’** means a site held in readiness for use in the event of a major disruption that maintains an institution’s’ business continuity.
  - 1.4.2 **‘Business Continuity’** is a state of continued, uninterrupted operation of a business.
  - 1.4.3 **‘Business Continuity Management’** is a holistic business approach that includes policies, standards, frameworks and procedures for ensuring that specific operations can be maintained or recovered in a timely fashion in the event of disruption. Its purpose is to minimize the operations, financial, legal, reputational and other material consequences arising from disruption.
  - 1.4.4 **‘Business Continuity Plan’** means a comprehensive, documented plan of action that sets out procedures and establishes the processes and systems necessary to continue or restore the operation of an institution in the event of a disruption.
  - 1.4.5 **‘Business Impact Analysis’** means the process of identifying, and measuring (quantitatively and qualitatively) the business impact loss of business processes in the event of a disruption. It is used to identify recovery priorities, recovery resource requirements and essential staff and to help shape the business continuity plan. All impacts should be measured on financial, regulatory, legal and reputational damage basis.
  - 1.4.6 **‘Call Tree’** means a system that enables a list of person/roles organizations to be contracted as part of an information/communication plan.
  - 1.4.7 **‘Communication Protocols’** means an established procedure for communication that is agreed in advance between two or more parties internal or external to an institution. Such procedure also includes the nature of the information that should be

shared with internal and external parties and how certain types of information should be shared with internal and external parties.

- 1.4.8 **‘Critical Services’** means any activity, function, process or service, the loss of which would be material to the continued operation of an institution.
- 1.4.9 **‘Crisis’** an event, occurrence and/or perception that threatens the operations, staff, shareholder value, stakeholders, brand, reputation, trust and/or strategic/business goals of an institution.
- 1.4.10 **‘Crisis Management Team’** means a team consisting of key executives, key role players (i.e. legal counsel, facilities manager, disaster recovery coordinator), and the appropriate business owners of critical functions who are responsible for recovery operations during a crisis. Evaluation of capability, training, testing of Crisis Management teams maturity level must be documented.
- 1.4.11 **‘Disaster’** means a sudden, unplanned catastrophic event that compromises an institution’s ability to provide critical functions, processes, or services for some unacceptable period of time, causing unacceptable damage or loss.
- 1.4.12 **‘Emergency Response Team’** means any organization that is responsible for responding to hazards to the general population (e.g. fire brigades, police services, hospitals)
- 1.4.13 **‘Exercising’** means the process through which business continuity plans are tested, rehearsed in a controlled environment using team members and staff.
- 1.4.14 **‘Major operational disruption’** means high impact disruption of normal business operations, affecting a large geographic area and adjacent communities that are economically integrated to it.
- 1.4.15 **‘Operational Risk’** means the risk of loss from inadequate or failed internal processes, people and systems or from external events.
- 1.4.16 **‘Recovery’** means the rebuilding of a specific business operation following a disruption to a level sufficient to meet outstanding business obligations.
- 1.4.17 **‘Recovery Objective’** means a predefined goal for recovering specific business operations and supporting systems to a specified level of service (recovery level) within a defined period following a disruption. (recovery time).

- 1.4.18 **‘Recovery Time’ (RT)** means the duration of time required to resume a specified business operation. It has two components, the duration of time from activation of the business continuity plan and the recovery of business operations.
- 1.4.19 **‘Recovery Point Objective’ (RPO)** describes a point in time to which data, must be restored from backup storage for normal operations to resume if a computer, system, or network goes down as a result of a disruption.
- 1.4.20 **‘Resilience’** means the ability of an institution, network, activity, process or financial system to absorb the impact of a major operational disruption and continues to maintain critical operations or services.
- 1.4.21 **‘Risk Assessment’** means the probability and impact of specific threats being realised.
- 1.4.22 **‘Single point of failure** unique source of a service, activity, and/or process where, there is no alternative and whose loss could lead to the failure of a critical function.

## **PART II: STATEMENT OF POLICY**

### **2.1 Purpose**

This Guideline outlines the minimum requirements that institutions should implement to ensure that business operations are not adversely affected in the event of a disruption. It is envisaged that by implementing this Guideline, institutions will both reduce the likelihood and impact of operational disruption and ensure business continuity in order to maintain public trust and confidence in the financial system.

### **2.2 Scope**

This Guideline sets the minimum requirements for establishing sound and effective business continuity management practices by institutions.

### **2.3 Responsibility**

The responsibility for business continuity management ultimately rests with the board of directors and the senior management of an institution. They are expected to formulate business continuity policy, procedures, guidelines and set minimum standards for an institution. All of these must be documented and available for review by an external auditor and the Central Bank of Kenya.



## PART III SPECIFIC REQUIREMENTS

### 3.1 Board of Directors and Senior Management

#### 3.1.1 *Major duties and responsibilities*

An institution's board and senior management are responsible for the development, implementation and maintenance of policies that ensure the resilience and continuity of an institution, in the event of major operational disruptions. The board fulfills its business continuity planning responsibilities by setting policy, prioritizing critical business functions, allocating sufficient resources and personnel, providing oversight, approving the Business Continuity Plan (BCP), reviewing test results and ensuring maintenance of the current plan. These responsibilities include but are not limited to the following: -

##### 3.1.1.1 **Ensure that business continuity planning forms an integral part of the overall risk management of an institution and that business continuity processes are documented and embedded in an organization's operations.**

The board of directors and senior management are required to:

- a) Ensure a documented Policy on BCM is put in place.
- b) Define the roles, responsibilities and authority to act in the event of a major disruption, namely:
  - i. At the organizational level, overall management of the business continuity function on a day-to day basis should be assigned to a Business Continuity Management Team. The selection of the Team should be contingent upon the nature of business activities, size, complexity, and geographical location of an institution.

The basic composition of the Business Continuity Management Team should at a minimum constitute the following;

1. Co-coordinator (drawn from the senior management).
  2. Functional Department Heads.
  3. Line Managers.
  4. Risk Management Officer.
- ii. In the event that an institution opts to outsource the business continuity function, it should ensure that accountability for business

continuity management ultimately rests with the board of directors and senior management.

- iii. In cases where institutions share a disaster recovery site, there must be service level agreements in place that clearly outline the terms that govern these arrangements between the parties.
- iv. In cases where recovery sites are outsourced to a vendor or supplier, a signed contract must exist with service level agreements that support such an arrangement.
- v. In outsourced solutions that are syndicated, care must be taken not to syndicate services between banks where they have normal business functions close or adjacent to each other i.e. a bank back office operation in Nairobi which is next to or a few blocks away from another bank and uses the same vendor should not have syndicated solutions utilizing the same syndicated infrastructure. For the above, dedicated options should be taken to ensure recovery in the event of a city wide incident.
- vi. Office, data centre or server room recovery must not be in the same building or close to the normal business operation.
- vii. Distance from the normal business and recovery facility will depend on individual needs but it is proposed that if a bank has its head office or back office function within the city limits, they should have their recovery facilities outside of the city centre. If the recovery site is within the city centre then the Head office or back office function should be located outside the city limits. Care should be taken to look at other factors such as a second power grid and telecommunications infrastructure i.e. a power outage of the normal business functions should not be able to affect the recovery facility.
- viii. Recovery facilities must include all the necessary backup power generation and supply (Generator, UPS and adequate fuel supply).
- ix. Utilization of alternate sites for recovery within the same organization must be at an adequate distance from the operation based on above criteria. If the alternate site is utilized for normal and recovery operations a documented and tested plan must be in place to support such an arrangement.

- x. Recovery solutions must be based on Business Impact Assessment (BIA) information.
  - xi. Documented pre and post-test reports are to be completed for all recovery testing.
- c) Ensure that employees are trained and made aware of their roles in the implementation of the Business Continuity Plan.
  - d) Ensure that sufficient human and financial resources are made available to provide support for Business Continuity Management.
  - e) Ensure that the business continuity plans not only consider the business process and technical aspects, but also recognize and addresses the human element. The overriding consideration in formulating an institution's business continuity plan should be for the preservation of human life.

#### 3.1.1.2 **Establish a framework for crisis management**

Establish a Crisis Management Team, consisting of key executives and functional heads of critical operational areas who will be responsible for dealing with crisis management and business continuity during a crisis. This will require the institution to re-prioritize and re-allocate resources in order to expedite recovery. The roles and responsibilities of each individual member/team should be clearly defined. Institutions must take into account all relevant potential scenarios that could result in a crisis for the bank. The term crisis denotes a threatening situation that calls for critical decisions and cannot be handled with or with ordinary management tools and decision making powers. The following are examples of crisis management situations.

- Accident like events such as fires or explosions.
- Terrorist attacks and sabotage.
- Natural disasters such as floods and earth quakes.
- Mass absence of personnel due to a pandemic.
- Failure of building technology or energy supply.
- Failure of external suppliers (outsourcing) such as information providers.
- Failure of communication systems or Telecommunication providers.
- Failure of IT systems or infrastructure hardware or software.

#### **Crisis management recommended best practice**

- A detailed crisis management plan should be in place.
- The crisis management plan contains instructions on how to respond in event of casualties and fatalities. The plan should stipulate that priority is to attend to casualties and fatalities.
- Adjustments to crisis management plan should be made when threats change significantly.

- The senior management team knows who is in the crisis management team and has approved their selection.
- The senior management team understands the crisis management teams terms of reference.
- The crisis management team is responsible for managing all critical internal issues to resolution.
- The core crisis management team may be supplemented by preselected and trained specialists according to incident type scale and severity.
- At least 70% of the crisis management team should have been involved in tests and crisis management incidents in the preceding 12 months.
- Once activated the crisis management team has full authority for all decisions including powers to spend during the crisis.
- The primary command centre to support the crisis management team should be fully equipped with necessary facilities e.g. telephones, computers and printers.
- If the command centre is inaccessible the crisis management team may be accommodated in an alternative primary or secondary location.

#### **3.1.1.3 Establish a framework for review and monitoring by the Board of Directors and Senior Management**

- a) Business Continuity Plans should be reviewed and approved by the Board of Directors on an annual basis. Some information such as contact details should be reviewed on a monthly or quarterly basis.

However, certain events may trigger the need for an immediate review of the BCP.

These include significant changes in the following;

- i. Business strategy and risk appetite of an institution.
  - ii. Restructuring of an institution, either through expansion or through a merger or acquisition.
  - iii. Key technology and telecommunications.
  - iv. Service providers.
  - v. Regulatory and legislative requirements.
  - vi. Composition and size of staff.
- b) An institution's business continuity plan should be subject to an independent review on an annual basis and the findings reported to the board of directors on a timely basis. This is through assurance and business continuity management audits conducted at a predetermined frequency.

#### **3.1.1.4 Ensure compliance with all Prudential Guidelines and all other regulatory and legal requirements related to Business Continuity Management**

An institution should comply with the Banking Act, Prudential Guidelines and all other applicable laws and regulations which fall under jurisdiction of other regulatory authorities.

### **3.2 Business Continuity Management Team**

The major roles and responsibilities of the Business Continuity Management Team should be as follows;

#### **3.2.1 To develop and approve a business continuity management process and plan.**

An institution's business continuity plan should be developed along the following five levels which reflect the business continuity management life cycle;

- i. **Strategic level;** Examine the organizational framework taking note of the key business stakeholders, legislative and regulatory requirements in relation to business continuity.
- ii. **Process level;** - Develop resumption strategies for business processes and activities.
- iii. **Resource Recovery;** Ensure the deployment of appropriate resources to ensure appropriate continuity across all business processes and activities.
- iv. **Awareness and Education;** develop a business continuity culture through assessment of business continuity awareness campaigns. Ensure that the BCM Management Team is trained and that appropriate skills are in place.
- v. **Testing, Maintenance, Measurement and Audit;** Ensure reliability of the business continuity plan of an organization through independent review and testing.

#### **3.2.2 Ensure that the Business Continuity Plan (BCP) is updated to reflect the changes in an institution's risk profile**

The Business Continuity Management Team should ensure that the (BCP) business continuity plan is reviewed annually, though the frequency may be modified to take into account changes in the business strategy, business processes, personnel, location or technology and changes in the external business environment.

**3.2.3 Ensure the implementation of the business continuity plan by periodically conducting a business impact analysis, (at least once a year) an enterprise – wide risk assessment, risk management and risk monitoring to identify the mission critical activities and potential for major disruptions.**

Business Impact Analysis(BIA's) must be signed off by department or functional heads through a formal functional process stipulating that they understand, accept and verify BIA's are correct.

**3.2.3.1 Business Impact Analysis (BIA)**

Major operational disruptions pose a substantial risk to the continued operation of an institution. The extent to which an institution incorporates the risk of a major operational disruption in its business continuity plan is dependent upon its risk profile.

Business impact analysis forms the foundation upon which the business continuity plan is developed. It identifies critical business functions and operations that need to be recovered on a priority basis and establishes appropriate recovery objectives for those operations. It should be completed in advance of a risk assessment in order to identify the urgent functions upon which a risk assessment should be focused. At a minimum a business impact analysis is expected to;

- i. Provide an understanding of an institution's most critical objectives, the priority, and the timeframes for resumption of each (recovery objective and recovery time).
- ii. Provide information about resource requirements over time to enable each business function within the organization achieve continuity or resumption of activity within the established timeframes. It should at a minimum identify;
  - a. Staff numbers and key skills.
  - b. Data applications and systems.
  - c. Facilities including alternative location needs, backup strategy policy and schedule.
  - d. Vendors/suppliers of various services.
  - e. Constraints.
  - f. Mission Critical Activities (MCA's) or tasks that need to be recorded to ensure continuity of the process and business.
  - g. Dependencies on people, systems, processes, internal and external parties.
  - h. Recovery Time Objective (RTO) and Recovery Point Objective (RPO) for every MCA or business.
  - i. Systems impact assessment.
  - j. Location.
  - k. Department unit owners, system information, commissioning dates.

- l. Technical person responsible.
  - m. RTO, RPO and dependences.
- iii. Provide a list of recovery options for each business process.

#### **Methods and techniques**

A combination of the following tools and techniques may be used to carry out Business Impact Analysis;

- (i) Questionnaires.
- (ii) Interviews.
- (iii) Workshops.

Generally a combination of all the above methods should provide an adequate source of information from which to base the Business Continuity Plan. All relevant information should be stored for reference for at least one year or until the next BIA.

#### **3.2.3.2 Risk Assessment**

A risk assessment examines the most urgent business functions identified during business impact analysis. It looks at the probability and impact of a variety of specific threats that could cause a business disruption. A risk assessment is at a minimum expected to achieve the following;

- i. Identify unacceptable concentrations of risk and what are known as 'single points of failure'.
- ii. Identify internal and external threats that could cause a disruption and assess their probability and impact.
- .iii. Prioritize threats according to the institution.
- iv. Provide information for a risk control management strategy and an action plan for risks to be addressed.
- v. Mitigation of risks through a documented remediation plan.

#### **Methods and Techniques**

The methods and techniques to be used to provide a risk assessment include;

- a. Insurance statistics.
- b. Published disaster frequency statistics.
- c. Scoring systems for impact and probability.
- d. Gap analysis.
- e. Stress testing.

### 3.2.3.3 Recovery objectives

Institutions should develop recovery objectives that reflect the risk they represent to the operation of the financial system. Institutions should factor in interdependency risks when developing their recovery objectives. Consequently, institution's business continuity management team should:

- a) Make an assessment of the risks they pose to the financial sector based on critical services they provide and their significance to the financial system.
- b) Identify those business functions and operations to be recovered on a priority basis and establish recovery objectives.
- c) Establish recovery objectives proportional to the risk they pose to the financial system.

When evaluating whether an institution's business continuity plan can accommodate major operational disruptions an institution should review the adequacy of recovery arrangements in areas such as;

- i. The alternate site should be sufficiently remote from the main branch of an institution.
- ii The alternate site should be sufficiently equipped with the necessary equipment, data and to maintain critical operations and services for a sufficient time period. An inventory of assets (backup tapes, communication links, operating systems, hardware) needed for offsite recovery should be generated.
- iii. The business continuity plan should address staff requirements and reallocation to the alternate site in the event of a major disruption. A detailed list of tasks for offsite recovery should be made available to all concerned staff.

3.2.4 Report on the status of business continuity management to the board and senior management on a regular basis, highlighting where there are identified gaps. This is through implementation status reports, incident reports, testing results and related plans for strengthening the business continuity plan. Institutions should also report activation/invocation of their BCP's to the Central Bank of Kenya within 24 hours of the activation/invocation.

### 3.2.5 Facilitate testing of plans to ensure that crisis and recovery teams are aware of their roles and responsibilities in the event of a disruption

Testing the ability of an institution to recover critical operations is an essential component of effective business continuity management.



Though emphasis is made on testing technical recovery, the key element to be examined is human resource, ensuring that skills, knowledge, management and decision making ability is assessed. An institution should ensure that;

- a) Testing of the overall business continuity management of an institution should at a minimum be conducted at least once a year.

The frequency of testing should be dependent upon the nature, size, risks and complexity of the institution. The amount of tests should depend on the criticality of the business process.

- b) The frequency of testing for key functional areas is determined by how critical they are to an institution and any material changes to an institution's internal and external environment.
- c) There are measures for the quality of planning, competency of staff and effectiveness of the business continuity plan.
- d) There is organizational awareness of emergency procedures and team members and staffs are familiar with their roles, accountability, responsibilities and authority in response to an incident.
- e) All technological, logistical and administration aspects of the business continuity plan have been tested.
- f) The recovery of infrastructure including command centres and off site work area is assured.
- g) The opportunity to identify shortcomings and improvements to the institution's business continuity readiness is a continuous process.
- h) The availability and relocation of staff is assessed.
- i) Documentation of testing results for the board of directors, senior management, auditors and regulators.

### **Methods and techniques**

Management should develop a test plan for each BCP testing method used. An institution is expected to employ various methods of exercising including but not limited to the following;

- a. Technical tests.
- b. Desktop /Orientation/walkthroughs.
- c. Live runs.
- d. Simulations.
- e. Integrated tests for departments that are dependent on each other and also stress testing of recovery facilities.

3.2.6 Ensure that the institution's response to a disruption is communicated internally and externally to applicable parties. External communication to the media should only be through the external communications teams and approved by senior management or the board.

#### 3.2.6.1 **Communication**

Institutions should include in their business continuity plans procedures for communicating within their institution and with relevant external parties in the event of major disruptions. The communication procedures for an institution should:

- a) Ensure that there is a clear plan identifying staff, for communicating internally (within the organization) and externally (to the public) stakeholders.
- b) Establish communication protocols clearly outlining the chain of command from the board of directors, chief executive, and senior management; Develop a directory for all recovery team members including the crisis management and emergency management teams, local emergency response organisations and critical service providers.
- c) Ensure that the directory/contact lists are made available to all team members.
- d) Address obstacles that may arise due to failure in primary communications systems (electricity, mobile phone network, road network). Ensure that the institution has set up alternative modes of communication.
- e) Ensure regular updating and testing of call trees at least quarterly.
- f) Ensure that copies of business continuity plans are disseminated to the relevant personnel.

#### 3.2.6.2 **Cross-Border Communication**

Increased globalization of business processes has implications on the impact of a major operational disruption, which can extend across national borders. In this regard, institutions are expected to put in place procedures for communications with financial authorities in other jurisdictions in the event of a major operational disruption. Cross border communications mechanisms for institutions should:

- a) Take into account the implication of disruption of its business operations in one jurisdiction that significantly affect a subsidiary, branch or correspondent operations in other jurisdictions.
- b) Establish communication procedures for sharing information, views and assessments among authorities based in different jurisdictions and at different levels.
- c) Establish a directory of contacts for the various non-domestic financial authorities, supervisory bodies, treasuries, risk management/business continuity specialists.
- d) Ensure contact details are kept up to date on at least a quarterly basis.

#### **PART IV REMEDIAL MEASURES**

4.1 Remedial measures– Central Bank may pursue any or all remedial actions as provided in Sections 33,33A, 34 and 55 of the Banking Act.

#### **PART V. EFFECTIVE DATE**

**5.1 Effective date:** The effective date of this guideline shall be 1<sup>st</sup> January 2013.

**5.2 Supersedence** - This Guideline supersedes and replaces the guideline on Business Continuity Management CBK/PG/14 issued in March 2008.

**ENQUIRIES** – Any enquires on this Guideline should be addressed to:

The Director

Bank Supervision Department

Central Bank of Kenya

P.O. Box 60000-00200

**NAIROBI**

TEL. 2860000 e-mail: *fin@centralbank.go.ke*

## **GUIDELINE ON AGENT BANKING - CBK/PG/15**

### **PART I PRELIMINARY**

1.1 **Title** – Agent Banking Guideline.

1.2 **Authorization** - This Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

1.3 **Application** - This Guideline applies to institutions and their duly appointed agents.

#### **1.4 Definitions**

“**Agent**” means an entity contracted by an institution to provide services of the institution on behalf of the institution, in such manner as may be prescribed by this guideline.

“**Institution**” means a bank, financial institution or mortgage finance company as defined under the Banking Act.

“**Outlet**” means an agent’s place of business directly responsible to the Head Office, used for carrying out a commercial activity of the agent but does not include a mobile unit.

“**Real time**” means the electronic processing of transactional data instantaneously upon data entry or receipt of a command.

Other terms used in this Guideline are as defined in the Banking Act.

#### **1.5 Purpose**

The purpose of this Guideline is;

- i) To provide for agent banking as a delivery channel for offering banking services in a cost effective manner.
- ii) To outline activities which can be carried out by an agent and to provide a framework for offering agent banking services.
- iii) To serve as a set of minimum standards of data & network security, customer protection and risk management to be adhered to in the conduct of agent banking.

## **1.6 Statement of Policy**

- i) To increase the financial services outreach and to promote financial inclusion to the un-banked and under-banked population without risking the safety and soundness of the banking system.
- ii) To encourage institutions to use, in the conduct of agent banking business, equipment which are interoperable to leverage on the available technology and in the long run reduce the cost of equipment purchase, installation and maintenance. The overarching objective of interoperability is to reduce the cost of financial services and foster financial inclusion, reach and depth.

## **1.7 Scope**

This Guideline applies to the conduct of agent banking business.

## **1.8 Responsibility**

The Board of Directors of each institution shall be responsible for formulating policies, procedures and guidelines which ensure that;

- i) Credible agents are identified.
- ii) Risks associated with agent banking are properly identified, documented and mitigated.
- iii) The activities of agents are constantly monitored to ensure compliance with the Banking Act, this Guideline and the agency contract.

It is the responsibility of the Board of Directors of each institution to ensure compliance with this Guideline.

## **PART II REGULATION AND APPROVAL PROCESS**

### **1.9 Approval of agent prior to commencement of agent banking business**

1.9.1 Every institution seeking to conduct banking business through an agent shall apply and obtain the approval of the Central Bank prior to commencing agent banking business.

1.9.2 The approval for agent banking business is a two stage process, namely;

- i) Agent network approval, and
- ii) Specific agent approval.

1.9.3 An application for agent network approval shall be made only once when an institution decides to engage in agent banking business.

1.9.4 An application for specific agent approval is on annual basis and is renewable.

1.9.5 An application for agent network approval may be submitted to the Central Bank simultaneously with an application for specific agent approval. The two applications are however distinct and should be made in the form and manner specified under this Guideline.

## **2.0 Application for agent network approval**

2.0.1 The applicant will complete “Application for the approval of agent network” form together with the supporting documents in the First Schedule. The form(s) for completion have been prepared as part of this Guideline and hard copies may be obtained from the Bank Supervision Department, Central Bank of Kenya or may be accessed on [www.centralbank.go.ke](http://www.centralbank.go.ke).

2.0.2 The application duly completed including the information specified in this Part should be submitted to the Director, Bank Supervision Department, Central Bank of Kenya, P.O. Box 60000-00200, Nairobi, with the appropriate application fees and a bankers cheque of Kshs. 5,000/= per application payable to the Central Bank of Kenya.

## **2.1 Information required for agent network approval**

2.1.1 Every applicant seeking to engage in agent banking business shall, on a one off basis, submit the following information to the Central Bank;

- i) The proposed number of proposed agents per county over a three year period.
- ii) Agent due Diligence Policy and Procedures.
- iii) The services to be provided through agents.
- iv) A copy of the draft standard agency contract detailing amongst other things. The items specified in clause 4.5 of this guideline.
- v) The policies and procedures applicable to the provision of services through agents, as well as a description of the technology to be used.

- vi) A risk assessment report of the operations to be performed through the agents including the mitigating measures to be adopted in order to control the risks identified, in accordance with risk management policies currently in force and this Guideline.
- vii) Internal audit report regarding the adaptation of internal controls performed in readiness for agent banking business.
- viii) Anti-money Laundering/Countering of Financing of Terrorism (AML/CFT) policies and procedures.
- ix) Agent operational policies and procedures.

2.1.2 In addition to the above information, the applicant shall submit;

- i) The institution's delivery channel strategy and how agents fit in this strategy.
- ii) A feasibility study of the global view of future operations and development of the agent business for a minimum period of three years from the date of the application including:
  - a) The geographical and economic service areas of the proposed agents.
  - b) Total population and economically active population of the areas where they will operate.
  - c) Analysis of the relevant market over the past two (2) years, along with an estimate of the proposed agents' volumes/transactions in the institution's delivery channel strategy.
  - d) Description of the agent management structure to be used by the institution.
  - e) Financial projections on the share of the proposed agents in the institution's business.
- iii) A business strategy for agent banking.

## **2.2 Processing of Application for agent network approval**

2.2.1 Upon receipt of the application form together with the required documents, the Central Bank of Kenya will appraise the application.

2.2.2 The institution may be requested to submit such additional information as the Central Bank may deem necessary.

### **2.3 Approval of agent network**

2.3.1 Where the Central Bank is satisfied that all application requirements have been met by an institution, the Central Bank may approve the application with or without conditions. This approval shall be communicated to the institution in writing within thirty days from the date of submission of the complete application.

2.3.2 Where the Central Bank declines to approve the application or any part thereof, the Central Bank may within thirty days from the date of the application communicate its refusal to the institution in writing and shall state the reasons for its refusal.

2.3.3 The Central Bank may in the communication set out the conditions to be complied with by the institution before the application can be resubmitted to the Central Bank for approval.

### **2.4 Application for the approval of specific agents**

2.4.1 Where an institution seeks to appoint specific entities as agents pursuant to the approval granted under Clause 2.5.1, the institution shall apply to the Central Bank for the approval of the specific agents.

2.4.2 The application shall be accompanied by the following information:

- i) The names of the proposed agents.
- ii) Physical locations, GPS co-ordinates, postal addresses and telephone numbers of the proposed agents.
- iii) A description of the commercial activities the proposed agents have been carrying on for the last twelve months immediately preceding the date of the application.
- iv) Any variation in the terms and conditions of the standard contract which is specific to a particular agent.
- v) The banking services to be provided by each agent and the limits to which they will be subject.



- vi) A declaration by the Chief Executive Officer of the institution or a duly designated senior officer confirming that the institution has carried out the suitability assessment of the proposed agents and they have been found to have met the minimum qualifications set out in this Guideline. The Declaration shall be made in accordance with the Second Schedule.
- vii) A bankers cheque of Kshs. 1,000/= per agent or outlet payable to the Central Bank of Kenya, being the approval fees.

2.4.3 An institution may in one application apply for the approval of several entities as its agents and may make one declaration for all the entities as regards their suitability assessment. Institutions are encouraged to make applications for the approval of agents in bulk.

2.4.4 An institution may however at any time in the course of the year apply for the approval of a specific agent.

2.4.5 The application and agent information shall be set out in Form (2a) and Form 2(b) of the First Schedule.

## **2.5 Central Bank approval of specific agents**

2.5.1 Upon receipt of the complete application and all information required together with the approval fees, the Central Bank may within thirty days from the date of receipt of the complete application process either approve the specified agent with or without conditions or may decline to approve any agent for reasons to be stated and communicated to the applicant.

2.5.2 Where the Central Bank approves any agent the Central Bank shall issue an approval letter to the applicant institution permitting the entity to provide, on behalf of the institution, banking services specified in the letter.

2.5.3 Where the Central Bank rejects an application for the approval of any specific agent, the Central Bank shall communicate its rejection to the institution within thirty days from the date of the application and shall state the reasons for its rejection.

2.5.4 The Central Bank may impose conditions to be complied with by the institution before its application can be resubmitted for approval.

2.5.5 An application which has been rejected by the Central Bank may be resubmitted for approval once the institution complies with all conditions imposed by the Central Bank for the approval of the application.

2.5.6 The Central Bank may approve an application which has previously been rejected if the Central Bank is satisfied that the institution has complied with all conditions imposed by the Central Bank for the approval of the application.

2.5.7 An agent approval granted by the Central Bank shall be valid for one year but is renewable.

## **2.6 Annual renewal of specific agent approval**

2.6.1 An institution may by an application to the Central Bank renew the approval of a specific agent.

2.6.2 The application shall be in Forms 2(a) and (b) of the First Schedule and shall be accompanied by any changes to the information submitted to the Central Bank under Clause 2.4.2 of this Guideline together with annual renewal fees of Kshs. 1,000/= per agent, or outlet. The declaration required under Clause 2.4.2(vi) of this Guideline is not necessary for an application to renew a specific agent approval.

2.6.3 The annual renewal fees shall be paid within three months before the end of the current financial year. The financial year for agent banking business shall be the same as that of the institution.

2.6.4 Any institution that fails to pay the annual renewal fees within the prescribed period shall pay double the annual renewal fees, if payment is made within ninety days after the end of the financial year.

2.6.5 If an institution fails to pay the prescribed fees within ninety days after the end of the financial year, its agent renewal application shall be declined.

## **PART III ASSESSMENT OF AGENTS**

### **2.7 Suitability Assessment of an agent**

2.7.1 An institution shall, before seeking the Central Bank's approval of an entity to be contracted as an agent vet and satisfy itself as to the suitability of the entity and shall establish that;

- i) The entity has a well established commercial activity which has been operational for at least twelve months immediately preceding the date of suitability assessment for the agent.

- ii) The entity has not been classified as a deficient, doubtful or non-performing borrower in the financial system under the rules in force at the time the agent contract is to be signed. That status must be maintained for the duration of the contract.
- iii) The entity possesses appropriate physical infrastructure and human resources to be able to provide the services with the necessary degree of security.
- iv) The prescribed form is set out in Form 3 of the First Schedule to this Guideline.

2.7.2 Any entity that seeks to be appointed as an agent by an institution shall furnish the institution with the following information as applicable;

- (i) The name of the entity proposed to be an agent;
- (ii) The certificate of incorporation or certificate of registration of the business name of the entity where applicable;
- (iii) A description of the commercial activity the entity has been carrying on for the last twelve months immediately preceding the date of the application;
- (iv) Valid business license or permit for any lawful commercial activity carried on by the entity for at least twelve months prior to the date of the application;
- (v) Bank statements for the last two years where applicable;
- (vi) Certified financial affairs in the case of partnerships;
- (vii) A certificate of good conduct in the case of sole proprietors or partnerships;
- (viii) Physical location, GPS co-ordinates, postal address and telephone numbers of the entity and its working hours,
- (ix) Evidence of availability of funds to cover agent operations including deposits and withdrawals by customers.
- (x) Any other information as the institution may request.

2.7.3 The institution shall keep confidential and in safe custody the information provided under this Part and shall produce it as and when the Central Bank directs its production.

2.7.4 The institution shall endeavour to obtain accurate information from the entity and its officers or employees and shall not represent to the Central Bank that it was misled by the entity or its officers.

2.7.5 Any entity which or whose proprietors, partners, officers or employees furnish an institution with false or inaccurate information under this Part shall be disqualified forthwith from conducting agent banking business.

2.7.6 Every institution shall sensitize its agents on the provisions of this Guideline and the obligation to comply with its requirements.

## **2.8 Moral and professional suitability of sole proprietors, partners and two officers of a corporate entity.**

2.8.1 Prior to engaging an entity as an agent, an institution shall assess the moral, business and professional suitability of the sole proprietor or partners of an entity proposed to be appointed as an agent.

2.8.2 In the case of a corporate entity, the institution shall assess the moral, business and professional suitability of the Chief Executive Officer and the officer in charge of or responsible for agent banking operations of the entity.

2.8.3 The persons mentioned in Clauses 2.8.1 and 2.8.2 shall, for the purpose of suitability assessment, furnish the institution with a duly completed appraisal form. The prescribed form is set out in the Form 4 of the First Schedule to this Guideline.

2.8.4 An institution may at any time, in addition to the persons to be vetted under this Part, require a director, shareholder, partner, manager or any other officer or employee of an entity to be vetted in accordance with this Guideline, if in the opinion of the institution, his or her vetting is necessary for the purposes of agent banking business or operations. All suitability assessment requirements under this Part shall apply to such person with such modification as the circumstances may require.

2.8.5 In assessing the suitability of a corporate entity, sole proprietor, partners or two officers of a corporate entity, the institution shall have regard to inter alia:

- i) Negative information in possession of credit reference bureaus or gathered from other sources. In the case of information being obtained from a credit reference bureau, it shall be the responsibility of the corporate entity, sole proprietor, partner or officer of the corporate entity to obtain the information directly from the credit reference bureau in accordance with Regulation 15(a)(i) and (iii) of the Banking (Credit Reference Bureau) Regulations, 2008.

- ii) Any criminal record in matters relating to finance, fraud, honesty or integrity.
- iii) Reputation (based on references from at least two people of good social standing hailing from the same locality as the person and who has known the person for at least three years).
- iv) Business or work experience.
- v) Sources of funds.
- vi) The business track record of the entity in the last three years where applicable.
- vii) Any other matter which negatively or positively impacts on the person.

2.8.6 Any entity which or whose proprietors, partners or officers have been vetted by the Central Bank under any other written law is exempted from vetting under this Guideline

2.8.7 Reference to “proprietor” or “partner” under this Guideline shall, in respect of other unincorporated entities include reference to persons and their titles as they are known or referred to under those unincorporated entities.

## **PART IV AGENCY CONTRACT AND PERMISSIBLE ACTIVITIES**

### **2.9 Establishment of agency relationship**

2.9.1 An institution may conduct banking business through an agent.

2.9.2 An institution shall enter into a written contract with an entity for the provision on its behalf of any of the banking services specified in this Guideline.

2.9.3 Any contract entered into between an institution and an agent shall comply with this Guideline and any other law in force.

### **3.0 Who can be an Agent**

An agent can either be an entity running a commercial activity or non-commercial activity.

3.0.1 An agent running a commercial activity

- i) Shall possess a business licence or permit for any lawful commercial activity;
- ii) The commercial activity must have been carried on under a valid business licence or permit for at least twelve months immediately preceding the date of the application to become an agent.
- iii) The commercial activity must be ongoing.

3.0.2 Agent banking business shall not contravene any written law, the parent statute, memorandum and articles of association or other constitutive document or objects of the entity.

3.0.3 The following entities are eligible to act as banking agents

- i) Limited liability companies.
- ii) Sole proprietorships.
- iii) Partnerships.
- iv) Societies.
- v) Cooperative societies.
- vi) State corporations.
- vii) Trusts.
- viii) Public entities.
- ix) Faith-based organisations.
- x) Not-for-profit organizations.
- xi) Non-governmental organizations.
- xii) Educational institutions.
- xiii) Any other entity which the Central Bank may prescribe.

3.0.4 Any entity which is subject to any regulatory authority under any written law or is a public entity, shall obtain the consent of the regulatory authority or the appropriate oversight body or authority prior to being appointed an agent

### **3.1 Treatment of an entity and its outlets**

3.1.1 Any outlet of an entity whose operations or activities are managed, controlled, supervised or is subject to the direction of the Head Office of the entity and has no legal existence separate from that of the Head Office of the entity shall be deemed to be part of the entity for purposes of an application to be appointed as an agent. A branch of an entity shall be treated as its outlet.

3.1.2 Any act or omission of an outlet shall be deemed to be the act or omission of the entity.

3.1.3 An institution which seeks to contract an entity and its outlets as banking agents shall pay to the Central Bank Kshs. 1,000/= per outlet as agent approval fees. Annual renewal fees shall also be paid per outlet as per the Schedule on Fees.

3.1.4 Where an agent with outlets opens a new outlet, the institution shall, prior to the commencement of agent banking business in the new outlet, apply for approval by

the Central Bank and shall pay the prescribed agent approval fees of Kshs. 1,000/= per outlet.

3.1.5 The Central Bank, on receipt of the application may approve the outlet unconditionally or may call for such information as it may deem necessary before approving the outlet. Approval under this clause shall be communicated to the institution by the Central Bank within thirty days from the date of receipt of the complete application.

## **3.2 Permissible activities of an agent**

3.2.1 An agent may provide any of the following banking services as may be specifically agreed between it and the institution.

- i) Cash deposit and cash withdrawal.
- ii) Cash disbursement and cash repayment of loans.
- iii) Cash payment of bills.
- iv) Cash payment of retirement and social benefits.
- v) Cash payment of salaries.
- vi) Transfer of funds.
- vii) Balance enquiry.
- viii) Generation and issuance of mini bank statements.
- ix) Collection of documents in relation to account opening, loan application, credit and debit card application.
- x) Collection of debit and credit cards.
- xi) Agent mobile phone banking services.
- xii) Cheque book request.
- xiii) Cheque book collection by customers.
- xiv) Collection of bank mail/correspondence for customers.
- xv) Any other activity as the Central Bank may prescribe.

3.2.2 It is the responsibility of the institution to determine, based on agent risk assessment which services a particular agent should provide.

3.2.3 All monetary transactions conducted through an agent shall be in the local currency.

## **3.3 Prohibited activities**

3.3.1 An agent shall not;

- i) Operate or carry out an electronic transaction when there is communication failure in the system.

- ii) Carry out a transaction when a transactional receipt or acknowledgement cannot be generated.
- iii) Charge any fees directly to the customers.
- iv) Carry out agent banking business when, in the opinion of the institution the initial commercial activity has ceased or is significantly diminished. The commercial activity should be viable and able to financially support the agent banking business.
- v) Offer any type of guarantee in favour of any institution or customer.
- vi) Offer banking services on its own accord (provide on its own account banking services similar to those provided by it under an agency contract).
- vii) Continue with the agency business when it has a proven criminal record involving fraud, dishonesty, integrity or any other financial impropriety.
- viii) Provide, render or hold itself out to be providing or rendering any banking service which is not specifically permitted in the contract.
- ix) Open accounts, grant loans or carry out any appraisal function for purposes of opening an account or granting of a loan or any other facility except as may be permitted by any other written law to which the agent is subject.
- x) Undertake cheque deposit and encashment of cheques.
- xi) Transact in foreign currency.
- xii) Provide cash advances.
- xiii) Be run or managed by an institution's employee or its associate.

3.3.2 An institution may in the contract document specify other activities which the agent is prohibited from undertaking.

3.3.3 Anything done by an agent or sub-agent under the authority of any other written law shall not be deemed to have contravened the provisions of this Guideline merely because it is a prohibited activity or that it is inconsistent with a provision of this Guideline.

### **3.4 Mandatory provisions to be included in the contract**

3.4.1 Every contract between an institution and an agent shall contain as a minimum, the following information;

- i) The institution is wholly responsible and liable for all actions or omissions of the agent. This responsibility extends to actions of the agent even if not authorised in the contract so long as they relate to banking services or matters connected therewith.
- ii) Specific banking services to be rendered by the agent where applicable.



- iii) The rights, expectations, responsibilities and liabilities of both parties.
- iv) Measures to mitigate risks associated with agent banking services (limits, customer transactions, cash management, cash security, security of agent premises, insurance policies, etc).
- v) The Central Bank shall have free, full and timely access to the internal systems, documents, reports, records, staff and premises of the agent in so far as the agency banking business is concerned and shall exercise such powers as it may deem necessary.
- vi) AML/CFT requirements.
- vii) Duty by the agent to deliver transaction support documents.
- viii) A statement that all information or data that the agent collects in relation to agent banking services, whether from the customers, the institution or from other sources, is the property of the institution.
- ix) Adequate oversight safeguards for the institution to address instances of non-compliance by the agent with the stipulated obligations.
- x) Prohibition from charging the customer any fees.
- xi) Business hours of the agent.
- xii) Suitable limits on cash holding by the agent and also limits on individual customer payments and receipts.
- xiii) Confidentiality of customer and user information.
- xiv) Technical description of electronic devices.
- xv) Differentiation of services offered by one agent for different institutions.
- xvi) Remuneration for the agent.
- xvii) Specify that the agent shall at all times ensure safe-keeping of all relevant records, data, documents or files or alternately, such records, data, documents or files are shifted to the institution at regular pre-specified intervals for the institution's safe-keeping.

- xviii) A statement to the effect that employees of a banking agent shall not be treated as employees of the institution and their rights and duties shall be agreed upon between them and the agent.
- xix) A framework for changing the terms of the contract and stipulations for default and termination of the contract and in particular the circumstances under which an agent can terminate a contract.
- xx) A statement that the Central Bank can terminate the contract in the exercise of its powers under the Banking Act, this Guideline or any other law.
- xxi) A transition clause on the rights and obligations of the institution and the agent upon termination or cessation of the agency contract.

3.4.2 The institution and the agent may provide for other terms as they may consider necessary for the better carrying out of the agent banking business.

### **3.5 Termination of agency contract**

3.5.1 In addition to the provisions for termination of the agency contract as may be set out in the contract, an agency contract shall be terminated if an agent;

- i) Carries on agent banking business when the commercial activity has ceased.
- ii) Is guilty of a criminal offence involving fraud, dishonesty or other financial impropriety.
- iii) Sustains a financial loss or damage to such a degree which, in the opinion of the institution, makes it impossible for the agent to gain its financial soundness within three months from the date of the loss or damage.
- iv) Is being dissolved or wound up through court or otherwise.
- v) In case of a sole proprietor dies or becomes mentally incapacitated.
- vi) Transfers, relocates or closes its place of agent banking business without prior written consent of the institution.
- vii) Fails to hold or renew a valid business licence.
- viii) Violates any such provision of this Guideline as may, in the opinion of the institution warrant termination of the agency relationship.

- 3.5.2 Termination under Clause 3.5.1 of this Guideline may be initiated by the institution or the Central Bank. The institution shall ensure that an agent does not continue with agent banking business when it is affected by any of the provisions of Clause 3.5 of this Guideline.
- 3.5.3 Where an agency contract is terminated, the institution shall cause a notice of the termination to be published within the locality of the premises where the agent was operating or in any other way or manner as to inform the general public of the cessation of the agency contract.

## **PART V RESPONSIBILITIES**

### **3.6 Key Roles & Responsibilities of the Institution**

- 3.6.1 The ultimate responsibility for agent banking lies with the institution. The institution is wholly responsible and liable for all actions or omissions of the agent. This responsibility extends to actions of the agent even if not authorised in the contract so long as they relate to banking services or matters connected therewith.
- 3.6.2 The institution is expected to take an explicit, informed and documented strategic decision as to whether and how it is to provide agent banking services to its customers.
- 3.6.3 The institution shall maintain an effective system of internal control and overseeing agent's activities or functions.
- 3.6.4 The institution shall ensure that proper controls are incorporated into the system so that all relevant compliance issues are fully addressed, particularly the identification, assessment, monitoring and reporting on the institution's compliance risk.
- 3.6.5 The institution shall ensure that it has proper security control policies to safeguard the information, communication and technology systems and data from both internal and external threats.
- 3.6.6 The institution is also responsible for assessing the adequacy of controls of outsourced activities by taking appropriate direct or third party audits of the same as mandated under relevant outsourcing agreements
- 3.6.7 The institution needs to incorporate risk-based review of critical agent banking processes to ensure that the policies, rules, regulations and the operational guidelines are followed.

3.6.8 The institution shall provide agents with such operations manuals and risk management policy documents as are needed to ensure proper provision of services to customers.

### **3.7 Management of agent banking business**

3.7.1 The institution is responsible for developing and implementing agent banking strategy and for establishing an effective management oversight over agent banking services.

3.7.2 Effective management oversight encompasses the review and approval of the key aspects of the institution's security control programs and processes, and to implement security control policies and infrastructure.

3.7.3 Effective management oversight also includes a comprehensive process for managing risks associated with reliance on third parties.

3.7.4 The institution must ensure that the scope and coverage of the internal audit function has been expanded to be commensurate with the increased complexity and risks inherent in agent banking activities and the audit department is staffed with personnel having sufficient technical expertise to perform the expanded role of auditing agent where applicable.

3.7.5 It is incumbent upon the institution to take steps to ensure that it has updated and modified where necessary, its existing risk management policies and processes to cover its current or planned agent banking services.

3.7.6 The integration of agent banking applications with the main banking systems implies an integrated risk management approach for all banking activities.

3.7.7 The institution shall provide agents and sub-agents with sufficient training for them to adequately perform the operations and provide the services agreed upon, including training relating to the proper identification of customers, customer service, confidentiality of the information, banking secrecy, cash security, record keeping and financial education.

### **3.8 Risk Management**

- i) Institutions should pay special attention to credit risk, operational risk, legal risk, liquidity risk, reputation risk and compliance with rules for combating money laundering and financing of terrorism.
- ii) Proper assessment of agent's credit worthiness and proper limit structure for agent's various activities commensurate with this assessment should be in place.

- iii) All product programs, procedure manuals and customer limit structures should be devised keeping in mind the implications for operational risk and liquidity risk for agents.
- iv) Wireless or electronic banking related risks should be recognized, addressed and managed by institutions in a prudent manner according to the fundamental characteristics and challenges of electronic banking services.
- v) Technology risks regarding information and data security in wireless networks should be properly identified and mitigated.
- vi) A business continuity management plan should be developed to mitigate any significant disruption, discontinuity or gap in agents' functions.
- vii) The institution shall be responsible for putting in place appropriate product and operations manuals, accounting procedures and systems and for designing necessary forms/stationary to be used by the agents.
- viii) The institution shall have in place systems and personnel to adequately monitor and control agent banking operations in an ongoing basis.

### **3.9 Customer due diligence**

3.9.1 Institutions shall carry out customer due diligence to ensure that requirements of AML/CFT are not compromised.

3.9.2 The factors to consider include;

- i) KYC requirements.
- ii) Transactional limits per day, month and year (limits commensurate with customer's profile).
- iii) Maximum balance limits on debit and credit.
- iv) Minimum technological security requirements.
- v) Two factor authentication per customer per transaction.

3.9.3 Institutions shall comply with all applicable AML/CFT laws.

### **4.0 Agent due diligence**

- i) Efficient and thorough Agent Due Diligence (ADD) procedures must exist to mitigate risks.

- ii) Institutions are responsible for having clear, well documented Agent Due Diligence policy and procedures.
- iii) These procedures, at minimum, should contain methods of identifying potential agents, initial due diligence and regular due diligence checks to be performed at specified intervals and a list of early warning signals and corrective actions to ensure proactive agent management.
- iv) Agent Due Diligence should clearly specify roles and responsibilities of various functions in the institution with regard to agent management.
- v) Minimum agent selection criteria should be defined.
- vi) Institutions should ensure that agents are well established, enjoying good reputation and have the confidence of the populace in their areas of operation.
- vii) Institutions should ensure that proper AML/CFT monitoring processes exist for agent banking. The necessary actions to be taken by agents in this regard should be communicated to the agents. The agents' compliance should be monitored.

#### **4.1 Operational/transactional limits.**

- i) The institution shall establish limits for the provision of services agreed upon in conjunction with the agents.
- ii) The limits must be prudent and bear a relation to the volume of cash moved by the agent and the risks associated with the place of conducting agent banking business.
- iii) The said limits shall be set for each agent and where applicable, for each type of transaction.

### **PART VI AGENT OPERATIONS**

#### **4.2 Non-exclusivity**

- i) No contract between an institution and an agent shall be exclusive.
- ii) One agent may provide services to multiple institutions provided that the agent has separate agent banking contracts with each institution and provided further that the agent has the capacity to manage transactions for different institutions.
- iii) An institution seeking to contract an entity which has already been contracted by another institution to carry out agent banking shall assess the capacity of the entity to

manage transactions for different institutions. Due regard shall be taken to the space, technological capacity and adequacy of funds or float of the multi-banking agent.

### **4.3 Supervision of agents**

- i) The responsibility to monitor or supervise agent activities rests with the institution.
- ii) The institution must have information on the number and volume of transactions carried out for each type of service by each agent and monitor effective compliance with limits and other prudential measures established in each case.
- iii) The institution shall implement measures to control operating risk, including clause(s) in the contract establishing the liabilities of the agent vis-à-vis the institution.
- iv) Periodic physical visits by institution's staff or authorised persons are necessary to ensure that agents operate strictly within the requirements of the law, guidelines and the contract.
- v) Notwithstanding the responsibility imposed on institutions to monitor and supervise their agents, the Central Bank may at any time it deems fit exercise its regulatory and supervisory powers under section 27, 28 and 32 of the Banking Act and may request for such data or information and may carry out such inspection as it deems necessary.

### **4.4 Publication of list of agents and locations**

- 4.4.1 The institution shall publish an updated list of all its agents in its website and such other publications as it may deem appropriate. The publication containing the list of its agents shall be disseminated to all its branches and may also be disseminated to its agents.
- 4.4.2 The institution shall designate particular branches to be responsible for agents operating in their respective branch localities. Alternatively banks can develop and implement an effective system of monitoring agents.

### **4.5 Relocation, transfer and closure of agent premises**

- i) No agent shall relocate, transfer or close its agent banking premises without the prior written consent of the institution.
- ii) Notice of intention to relocate, transfer or close agent banking premises shall be served on the institution at least thirty days or such shorter or longer period as may be agreed in the contract.
- iii) Within thirty (30) calendar days prior to relocation or closure of agent premises, the institution shall apply to the Central Bank for approval and shall forward to the

Central Bank the name and other information of the agent seeking to relocate, transfer or close its premises. The application shall be in the prescribed form and in accordance with Form 5 of the First Schedule.

## **PART VII SETTLEMENT OF TRANSACTIONS AND THE TECHNOLOGY**

### **4.6 Real time transactions.**

4.6.1 All transactions involving deposit, withdrawal, payment or transfer of cash from or to an account shall be in real time.

4.6.2 Institutions shall ensure that agents are able to carry out real time transactions.

### **4.7 Minimum Technical requirements for the operating systems of the agent.**

4.7.1 To ensure that agent banking transactions are carried out with devices which are technically fit, institutions are required to ensure that the equipment is able to;

- i) Transmit transaction information in code.
- ii) Carry out electronic transactions on real time basis.
- iii) Allow handling under different user profiles for administration, maintenance and operation.
- iv) Reverse incomplete transactions due to error, system failure, power outage or other defects.
- v) Process or generate durable transactional documents or receipts. Electronic receipts or acknowledgements such as SMS acknowledgement are permissible.
- vi) Automatically log off an agent once the agent exhausts its daily cash limit or tries to perform an illegal or unauthorised transaction.
- vii) Generate an audit trail.

4.7.2 The institution shall at all times monitor the safety, security and efficiency of the equipment being used to prevent any tampering or manipulation by any person.

### **4.8 Data and Network security Concerns**

Institutions shall put in place systems that specifically and as a minimum address;

- i) Physical and logical security of infrastructure.
- ii) Availability of services.
- iii) Data confidentiality and integrity.
- iv) Encryption of PIN and electronic transactions.
- v) Customer accountability and non-repudiation on transactions.



- vi) Error messaging and exception handling.

#### **4.9 Third-Party Service Providers**

- i) An institution may enter into a written contract with a third party service provider for the provision of the following services in respect of its agent banking business;
  - a) Technology platform.
  - b) Agent selection.
  - c) Agent network management.
  - d) Agent training.
  - e) Equipment provision.
  - f) Equipment maintenance.
- ii) The provision of any of the services specified in Clause 4.9(i) does not constitute agent banking.
- iii) Any third party service provider who, apart from providing the services specified in Clause 4.9(i) seeks to provide or render agent banking services as specified in this Guideline shall enter into an agency contract with the institution for that purpose.
- iv) The institution shall remain liable for the agent banking business even where a third party service provider is contracted to provide the services specified in Clause 4.9(i) of this Guideline.

### **PART VIII ANTI-MONEY LAUNDERING AND COUNTERING OF FINANCING OF TERRORISM (AML/CFT)**

#### **5.0 AML/CFT requirements;**

- i) Institutions shall train Agents on Anti-Money Laundering (AML) and Combating of Financing of Terrorism (CFT) requirements.
- ii) Institutions should ensure that agents:
  - a) Identify customers with at least two factor authentication like IDs, PINs, passwords, ATM card, secret code or secret message while performing any transaction requiring identification.
  - b) Report within twenty four hours all suspicious activities that come to their knowledge.

- c) Transact agent banking business strictly as per the transactional limits prescribed by the institution.

In the fulfillment of AML/CFT requirements, institutions shall comply with the requirements of the Banking Act, Prudential Guidelines and Proceeds of Crime and Anti-Money Laundering Act, 2009.

## **PART IX CONSUMER PROTECTION**

### **5.1 Consumer protection measures.**

- 5.1.1 Appropriate consumer protection against risks of fraud, loss of privacy and loss of service is needed for establishing trust among consumers as trust is the single most necessary ingredient for growth of agent banking.
- 5.1.2 It is therefore necessary for institutions to put systems in place which provide sufficient protection and confidence to consumers of agent banking services.

### **5.2 Minimum requirements**

As a minimum, the following requirements must be complied with at all times.

- i) The institution shall possess mechanisms that enable its customers or users to appropriately identify the agent and it shall make information available about the services it provides through such agents.
- ii) The agents should issue receipts for all transactions. The institution should provide the equipment to generate a receipt or acknowledgement. Electronic receipts or acknowledgements are permissible.
- iii) Where an agent acts as a receiver and deliverer of documents, an acknowledgement should be provided for all documents received or delivered by the agent to or from the customer.
- iv) A channel for communication of customer complaint to the institution should be provided. The institution shall provide a dedicated customer care telephone line for lodging complaints by customers. The customers can also use this telephone line to verify with the institution, the authenticity and identity of the agent, its physical location and the validity of its agent banking business.

- v) The institution shall have a complaints redressal mechanism and shall ensure proper communication of its complaints redressal set up to the customers.
- vi) All customer complaints shall be addressed within a reasonable time and in any case not later than thirty days from the date of reporting or lodging the complaint. Institutions shall keep record of all customer complaints and the redress thereof.
- vii) The agent shall have signs, clearly visible to the public, indicating clearly that it is a provider of services of the institution with which it has an agency contract. The agent shall not represent to the public that it is a bank, financial institution or mortgage finance company.
- viii) Use of secure system that ensures customer information confidentiality.
- ix) The customer should be made aware of the fact that he or she is not supposed to store PIN and other critical information on mobile phones or share this with other parties including agents.
- x) An institution may establish contact centres to facilitate easy communication between a customer and the institution.

### **5.3 Disclosures**

#### **5.3.1 An agent shall disclose to the customers;**

- i) The name of the institution it is working for and shall display in a conspicuous place within the premises the institution's logo.
- ii) A list of banking services offered by the agent.
- iii) A notice to the effect that if the electronic system is down, no transaction shall be carried out.
- iv) A notice to the effect that services shall be provided subject to availability of funds.
- v) The list of charges or fees applicable for each service which are payable to the institution by the customers.
- vi) The dedicated telephone line through which customers can contact the institution.

- vii) The name, telephone numbers and location of the institution's branch to which the agent reports its agent activities.

5.3.2 These disclosures shall be displayed in a conspicuous place on agent premises.

5.3.3 An agent shall show on request by a customer a copy of the approval letter issued by the Central Bank, a copy of the appointment letter from the institution and the current license for the commercial activity being undertaken by the agent. These documents should therefore be readily available in the agent banking premises.

#### **5.4 Branding**

Institutions may choose to brand their agent network under any brand name. However use of protected words like bank, financial institution, financial intermediary or their derivatives or any other word suggesting that the agent is itself an institution is prohibited.

#### **5.5 Public Awareness and Sensitization**

Institutions shall carry out sensitization of their agents, sub-agents and customers about their agent banking business to the public. This shall be through public awareness campaigns, brochures and other programmes as the nature of the institution's products may require.

### **PART X REPORTING REQUIREMENTS AND CENTRAL BANK OVERSIGHT**

#### **5.6 Submission of data and statistical returns to the Central Bank.**

Every institution shall, at the end of every calendar month and not later than the 10th day of the next month, submit to the Central Bank as prescribed in the Fourth, Fifth and Sixth Schedules, data and other information on agent operations including information on;

- i) Nature, value, volume and geographical distribution of operations or transactions.
- ii) Incidents of fraud, theft or robbery.
- iii) Customer complaints.
- iv) Remedial measures taken to address customer complaints.

#### **5.7 Reporting**

The institution shall forward to the Central Bank not later than 31<sup>st</sup> March of each year and in the prescribed form set out in the Third Schedule, an annual report on its agent

banking operations including the names, number and other information on agent operations for the previous year.

## **5.8 Powers of the Central Bank over agents.**

5.8.1 In addition to any other power conferred on the Central Bank by the Banking Act, the Prudential Guidelines and any regulations, the Central Bank shall have power to;

- i) Request for any information from any agent or sub-agent at any time as the Central Bank may deem necessary;
- ii) Carry out impromptu or scheduled inspection of the books and premises of the agent.
- iii) Direct an agent or sub-agent to take such action or desist from such conduct as the Central Bank may find necessary;
- iv) Direct the termination of the agency contract and closure of the agency business as it may find necessary;
- v) Direct the institution to take such action or measures against or on behalf of the agent as the Central Bank may find appropriate;
- vi) Direct the institution to take such remedial action arising from the conduct of an agent or sub-agent as it may deem fit.

## **PART XI REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS**

### **5.9 Remedial measures**

If an institution or its agent fails to comply with this Guideline, the Central Bank may pursue any or all corrective actions against the institution as provided under Sections 33 and 34 of the Banking Act.

### **6.0 Administrative sanctions**

In addition to the use of Remedial measures noted in 5.9 above, the Central Bank may pursue any or all of the following administrative sanctions against an institution, its board of directors, officers, agents.

- i) Prohibition from engaging in any further agent banking business;
- ii) Prohibition from contracting new agents;

- iii) Revocation of agent approval;
- iv) Termination of agency contract;
- v) Withholding corporate approvals.

## **PART XII AMENDMENT OF THE GUIDELINE**

- 6.1** The Central Bank may at any time amend, delete, vary, add or change any provision of this Guideline and such amendment, deletion, variation, addition or change shall become effective from the date of notification to the institutions by the Central Bank.
- 6.2** Such notification may be effected through a circular, directive, notice, letter or other means communicating the intention of the Central Bank to the institutions generally.

## **EFFECTIVE DATE**

- 6.3 Effective date:** The effective date of this Guideline shall be 1<sup>st</sup> January 2013.
- 6.4 Supersedence** – This Guideline supersedes and replaces Prudential Guideline No. CBK/PG/15 on Agent banking issued in May 2010.

## **Enquires**

Enquiries on any aspect of this Guideline should be referred to:

Director

Bank Supervision Department

Central Bank of Kenya

P.O. Box 60000, 00200

Nairobi

**TEL. No. 2860000 e-mail: *fin@central***

**SCHEDULES**

**FIRST SCHEDULE**

**FORM 1: APPLICATION FOR THE APPROVAL OF AGENT NETWORK**

*(Ref: Clause 2.0)*

**PART I: GENERAL INFORMATION**

1. Name of institution .....
2. Contact information
  - a) Postal address and telephone numbers.....  
.....  
.....
  - b) Physical address: - L.R NO ..... Building .....  
Street .....  
County, District, Division, Town, City .....

**PART II: PROPOSED AGENT NETWORK INFORMATION**

3. Regional agent network information

	Names of the Counties	Number of agents
1.		
2.		
3.		
4.		

4. Services to be rendered through agents .....
5. Proposed date of commencing operations .....

Name: .....

*(Chief Executive Officer)*

Signed: .....

Dated at ..... this ..... day of..... 20.....

**Note: The first application must be accompanied by all the relevant documents and requirements here below, as detailed in Clauses 2.0.1 and 2.0.2 of the Guidelines.**

- a. Agent Due Diligence Policy and Procedures
- b. A copy of draft standard agency contract
- c. Policies and Procedures on the provision of services through Agents
- d. Risk Assessment Report on proposed Agent Operations

- e. Internal audit report
- f. AML/CFT policies and procedures
- g. Agent Policies and Procedures
- h. Feasibility Study
- i. Business and Delivery Channels Strategies
- j. Application fee: Bankers Cheque of KSh. 5000/= payable to the Central Bank of Kenya

**FORM 2(a): APPLICATION FOR APPROVAL OF SPECIFIC AGENT**  
(Ref: Clause 2.4)

**PART I: GENERAL INFORMATION**

1. Name of institution .....
2. Contact information
  - c) Postal address and telephone numbers.....  
.....  
.....
  - d) Physical address: - L.R NO ..... Building .....  
Street .....  
County, District, Division, Town, City .....

**PART II: AGENT INFORMATION**

3. Please provide the information required in Form 2(b)
4. If there is a variation in the standard contract specific to a particular agent, provide the details ...

Name: .....

*(Chief Executive Officer)*

Signed: .....

Dated at ..... this ..... Day of..... 20.....

**Note: This application must be accompanied by all the relevant documents and requirements here below, as detailed in Clause 2.4.2 of the Guidelines.**

- a. Declaration by Chief Executive Officer or duly designated senior officer confirming that the institution has carried out a suitability assessment of proposed agents and the persons required to be assessed. (ref. Second Schedule)
- b. Approval fee: Bankers Cheque of KSh. 1,000/= per agent payable to the Central Bank of Kenya.





**FORM 3: AGENT APPRAISAL FORM**

*{Ref: Clause2.7}*

1. Name of proposed Agent .....
2. Type of Business/ Commercial Activity (state the type of business activity being carried out by the entity) .....
3. Number of years the entity has conducted or carried out the commercial activity .....
4. Location of the place(s) of business .....
- a) Postal address and telephone numbers.....
- b) Physical address: - L.R NO ..... Building .....
- Street/ Village .....
- County, District, Division, Town, City .....
- c) GPS coordinates .....
5. Date of incorporation/ registration and certificate/ business permit number .....
6. Other Identification (PIN) number .....
7. Particulars of owner(s) (directors/ partners/ proprietors)

Name	Designation	Nationality	Date of Birth	ID. Number	Address

8. Number and Names of Related Business Outlets .....

9. Names of Banker(s)

.....

10. **DECLARATION**

I/ We, the undersigned, declare that to the best of our knowledge and belief, the information contained herein and any attachments is complete and accurate.

a) Owner (Proprietor/ Partner/ Director)

(Name and Designation).....

Signature..... Date.....

b) Owner (Partner/ Director) or Witness

(Name and Designation).....

Signature..... Date.....

**WITNESSED BEFORE ME:**

**SIGNED..... (Witness)**

**COMMISSIONER FOR OATHS/ MAGISTRATE**

**Note: This application must be accompanied by all the relevant documents and requirements here**

*below, as detailed in Clause 2.7.2 of the Guidelines.*

11. Provide the following supporting documentation:
  - a. Copy of Certificate of Incorporation, Certificate of Registration of business name.
  - b. A brief description of commercial activity for the last twelve months.
  - c. Copy of Valid Business Licence or permit for at least twelve months.
  - d. A certificate of good conduct in the case of a sole proprietor or partnership.
  - e. Evidence of availability of funds to cover agent operations.
  - f. Any other information the institution may require.

**FORM 4: AGENT APPRAISAL FORM FOR SOLE PROPRIETOR, PARTNER OR OFFICER OF CORPORATE ENTITY {Ref: Clause 2.8.3}**

**GENERAL INFORMATION**

- 1. Name of Proposed Agent .....
- 2. Type of Business/ Commercial Activity (state the type of business activity being carried out by the entity) .....

**PERSONAL INFORMATION**

- 3. Surname.....
- 4. Other Names.....
- 5. Previous Names (if any) by which you have been known:  
.....
- 6. Year and Place of birth: .....
- 7. Identification Card number and date of issue.....
- 8. Personal Identification Number .....
- 9. Postal address, code and telephone number(s).....
- 10. Physical address .....
- 11. Relationship with the entity.....
- 12. Educational Qualifications and Occupation .....
- 13. Business/ Work Experience .....
- 14. Name of Banker(s).....

15. Borrowings

Name of borrower	Name of lending institution	Type of loan	Date of loan	Amount of	Current Out- standing balance	Performance	Other Remarks

16. Are the funds obtained from money laundering activities or any other criminal act?

Yes/No

.....

Sources of Funds: .....

**ADDITIONAL INFORMATION**

17. Have you at any time been convicted of any criminal offence?

.....

If so, give particulars of the court in which you were convicted, the offence, the penalty imposed and the date of conviction .....

18. Have you ever been dismissed from any office or employment or been subject to disciplinary proceedings by any professional authority, body or persons?

.....

If so give particulars.....

19. Have you ever been held liable by a court, in any country, for any fraud or other misconduct?

.....

If so, give particulars.....

20. Indicate the names, addresses, telephone numbers and positions of two individuals of good standing who would be able to provide a reference on your personal and professional integrity. The referees must not be related to you, and should have known you for at least three (3) years and are hailing from the same locality as yourself.

i). .....

ii). .....

**21. DECLARATION**

I am aware that it is an offence to knowingly or recklessly provide any information, which is false or mis connection with an application for an agent banking approval in Kenya. I am also aware that omitting information intentionally or un-intentionally may lead to rejection of my application.

I certify that the information given above is complete and accurate to the best of my knowledge, and that the other facts relevant to this application of which the supervisory authority should be aware. I, also, undertake to notify known any changes material to the applications which arise while the application is under consideration.

Name: .....

Title in the Entity.....

Signed: .....

Dated at .....this..... Day of .....20.....

**WITNESSED BEFORE ME:**

**SIGNED..... (Witness)**

**COMMISSIONER FOR OATHS/ MAGISTRATE**

**Note: 1. This application must be accompanied by all the relevant documents and requirements here below.**

- a. Certificate of good conduct.
- b. Financial Affairs for last two years.
- c. Information obtained from Credit Reference Bureau.
- d. Curriculum vitae detailing educational qualifications, business and work experience.
- e. Copy of IDs or equivalent.

- f. Two passport size photos.
- g. Any other information the institution may request.

2. This Form may also be filled by any other person whom an institution seeks to vet in terms of Clause 2.8.3 of the Guideline

**FORM 5: RELOCATION OR CLOSURE OF AGENT PREMISES**

*{Ref: Clause 4.5}*

**PART I: GENERAL INFORMATION**

1. Name of institution .....
  
2. Contact information
  - a) Postal address and telephone numbers.....  
 .....  
 .....
  
  - b) Physical address: - L.R NO ..... Building .....  
 Street .....  
 County, District, Division, Town, City, Constituency .....
  
3. Previous branch responsible for the agent including its locations and addresses  
 .....



**PART II: RELOCATION OF AGENT**

- 4. Name of the agent(s) to be relocated  
.....
  
- 5. Location of the current place(s) of business
  - a) Postal address and telephone numbers.....
  
  - b) Physical address: - L.R NO ..... Building .....  
Street/ Village .....  
County, District, Division, Town, City, Constituency .....
  
  - c) GPS coordinates .....
  
  - d) Services currently offered by the agent.....
  
- 6. State reasons necessitating relocation of agent(s)  
.....
  
- 7. Proposed location(s) of the agent(s).....
  - a) Postal address and telephone numbers.....
  
  - b) Physical address: - L.R NO ..... Building .....  
Street/ Village .....  
County, District, Division, Town, City, Constituency .....
  
  - c) GPS coordinates .....
  
- 8. Is/Are the premise(s) suitable? Explain.....
  
- 9. Banking services to be provided by the agent relocating and limits it will be subject to  
.....
  
- 10. If there is a variation in the terms or conditions in the standard contract specific to the particular agent relocating, provide the details

.....  
11. Proposed date of commencing operations in the new location.....

12. Working Hours .....

13. Proposed branch responsible for the agent relocating including its location and addresses  
.....

**PART III: CLOSURE OF AGENT**

1. Current location of the agent(s) proposed to be closed -

a) Postal address and telephone numbers.....

b) Physical address: - L.R NO ..... Building .....  
Street/ Village .....  
County, District, Division, Town, City .....

c) GPS coordinates .....

d) Services currently offered by the agent.....

2. Specify type of closure, whether permanent or temporary.....

If temporary closure, specify the proposed dates for closure and opening

.....

3. State reasons necessitating closure of agency

.....

Name: .....

*(Chief Executive Officer)*

Signed: .....

Dated at ..... this ..... Day of..... 20.....

**SCHEDULE OF FEES**

{ Ref: Clause 3.1.3 }

<b>NO.</b>	<b>NATURE OF APPLICATION</b>	<b>FEES</b>
1.	Agent Network Approval	KSh. 5,000/= per application
2.	Specific Agent Approval	KSh. 1,000/= per agent/outlet
5	Agent annual renewal fees	KSh. 1,000/= per agent

**SECOND SCHEDULE**

*Clause 2.4.2(vi)*

**REPUBLIC OF KENYA**

**IN THE MATTER OF OATHS AND STATUTORY DECLARATIONS ACT**

**(Cap. 15)**

**STATUTORY DECLARATION**

I, ----- of ..... (*insert full name and postal address*) in the Republic of Kenya do hereby make oath and solemnly swear as follows:

1. THAT I am the deponent herein hence competent to swear this affidavit.
2. THAT I am the Chief Executive Officer of ..... (*insert the name of the institution*) (Hereinafter referred to as the institution).

Or

THAT I am a Senior Officer in charge of .....of .....(*insert the name of the institution*)(hereinafter referred to as the institution) and duly authorized to make this declaration on its behalf.

Or

3. THAT I am the holder of ..... (*Insert National Registration Card/Identification documentation details*).

4. THAT the institution seeks to contract the following entity (ies) as an agent(s) for the provision of banking services on behalf of the institution in accordance with the provisions of the Agent Banking Guidelines.
  
5. THAT the institution has carried out a thorough suitability assessment of the entity (ies) and confirms that the entity (ies) is/are credible and have met all requirements of the Guidelines on Agent Banking and will be able to satisfactorily provide agent banking services on behalf of the institution.
  
6. THAT the institution has also carried out a thorough suitability assessment of all persons who, under the Guidelines, are required to be assessed for moral and professional fitness and all have been found to be fit.
  
7. THAT what is deponed to herein is true to the best of my knowledge, information and belief.

**SWORN** at ..... **by the said** )  
 ..... (*Insert name of deponent*) ) .....  
**This**            **day of**            **20.....** )

**BEFORE ME** )  
 )

**A COMMISSIONER FOR OATHS**



**FOURTH SCHEDULE**

**NATURE, NUMBER, VALUE AND GEOGRAPHICAL DISTRIBUTION OF**

**TRANSACTIONS (Monthly)**

**Clause 5.6**

**Institution:** .....

**Financial Year:** .....

**Date:** .....

	County/Nature of Transactions	Number of Transactions							Value of Transactions (Kshs.)											
									Total											
1.	Cash Deposits																			
2.	Cash Withdrawals																			
3.	Cash Disbursement of Loans																			
4.	Cash Repayment of Loans																			
5.	Payment of Bills																			
6.	Payment of Retirement and Social Benefits																			
7.	Payment of Salaries																			
8.	Transfer of Funds																			
9.	Account balance enquiries																			
10.	Mini statement requests																			
11.	Collection of loan applications forms																			
12.	Collection of account opening application forms																			
13.	Collection of debit and credit card application forms																			
14.	Collection of debit and credit cards																			
15.	Other (Specify)																			



**FIFTH SCHEDULE**

*Clause 5.6*

**INCIDENTS OF FRAUD, THEFT OR ROBBERY (Monthly)**

**Institution:** .....

**Financial Year:** .....

**Start Date:** .....

**End Date:** .....

	<b>Nature of Fraud, theft or robbery (including attempts)</b>	<b>Name of agent affected</b>	<b>Physical Location of agent affected</b>	<b>No. of Incidents</b>	<b>Amount involved (KSh.)</b>	<b>Date(s) of Occurrence</b>	<b>Steps Taken</b>



**SIXTH SCHEDULE**

*Clause 5.6*

**CUSTOMER COMPLAINTS AND REMEDIAL ACTIONS (Monthly)**

**Institution:** .....

**Financial Year:** .....

**Start Date:** .....

**End Date:** .....

	<b>Nature of Complaint</b>	<b>Complainant Contact information)</b>	<b>Name of agent complained against</b>	<b>Physical location of the agent</b>	<b>Date of Occurrence</b>	<b>Remedial Actions</b>

# **GUIDELINE ON OUTSOURCING CBK/PG/16**

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- 5.1 Remedial Measures and Administrative Sanctions

### **PART VI: Effective Date**

- 6.1 Effective Date

## **PART I: Preliminary**

1.1. **Title** – Guideline on Outsourcing.

1.2 **Authorization** - This Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

1.3 **Application** – This Guideline applies to all institutions licensed under the Banking Act (cap 488) who desire to outsource aspects of their activities.

1.4 **Definitions** – The terms used in this Guideline are as defined in the Banking Act (Cap. 488). Other terms used in this guideline shall be taken to have the meaning assigned to them hereunder:

1.4.1 '**Outsourcing**' means the use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities on a continuing basis that would normally be undertaken by the institution itself, now or in the future.

1.4.2 “**Service provider**” refers to an entity that is undertaking the outsourced activity on behalf of the institution and includes a member of the group to which the institution belongs, unrelated company whether located in Kenya or outside.

1.4.3 “**Off shoring**” means outsourcing activities beyond national borders.

### 1.4.4 **Material Outsourcing**

Material outsourcing arrangements are those, which if disrupted, have the potential to significantly impact the business operations, reputation or profitability of the institution.

1.4.5 An institution should assess the degree of materiality in an outsourcing arrangement to the institution. Materiality of outsourcing would be based on:

- a) The level of importance of the activity being outsourced to the bank;
- b) The potential impact of the outsourcing on the institution on various parameters such as earnings, solvency, liquidity, funding and capital and risk profile;

- c) The likely impact on the institution's reputation and brand value, and ability to achieve its business objectives, strategy and plans, should the service provider fail to perform the service;
- d) The cost of the outsourcing as a proportion of total operating costs of the institution;
- e) The aggregate exposure to that particular service provider, in cases where the institution out sources various activities to the same service provider.
- f) An activity is considered material if it accounts for at least five percent (5%) of the institution's revenues or costs.

## **PART II: STATEMENT OF POLICY**

- 2.1 **Purpose** - This guideline is to provide guidance to institutions seeking to outsource material activities that form part of the financial service operations.
- 2.2 **Scope** – This guideline provides a clear guide to institutions on the conditions they must fulfill before and during an outsourcing arrangement.
- 2.3 **Responsibility** – It is the responsibility of an institution proposing to outsource, and those that have outsourced, any of their activities to ensure compliance with this Guideline.

## **PART III: Background**

- 3.1 While outsourcing can bring cost savings and other benefits, it may also increase the risk profile of an institution. Some of the key risks in outsourcing are Strategic Risk, Reputation Risk, Compliance Risk, Operational Risk, Exit Strategy Risk, Counterparty Risk, Country Risk, Contractual Risk, Access Risk Concentration and Systemic Risk.

The failure of a service provider in providing a specified service, a breach in security/confidentiality or non-compliance with legal and regulatory requirements by either the service provider or the outsourcing institution can lead to financial losses/reputational risk for the bank and could also lead to systemic risks within the entire banking system in the country. It would therefore be imperative for an institution outsourcing its activities to ensure effective management of the potential risks.

## **PART IV: SPECIFIC REQUIREMENTS**

### **4.1 Prohibitions**

4.1.1 No institution shall outsource material activities unless it has obtained approval from the Central Bank of Kenya for such purpose.

4.1.2 Institutions cannot outsource core management functions like:

- corporate planning,
- organization,
- management and control, and
- decision-making functions like determination of compliance with applicable laws and regulations, decision to grant loans and management of the institutions' investment portfolio.

4.1.3 Institutions will need to notify the Central Bank when outsourcing these non-material activities.

- Courier services.
- Mail.
- Printing services.
- Credit background checks, back ground investigations.
- Employment of contract or temporary staff.
- Any other activity the Central Bank may specify.

4.1.4 The following are examples of some services that when performed by a third party would be regarded as material outsourcing and would require approval from the Central Bank

- Information system management and maintenance (e.g data entry and processing, data centers, facilities management, end user support and help desks).
- Application processing (loan originations, credit cards).
- Claims administration (loan negotiations, loan processing, collateral management, and collection of bad debts).
- Business continuity and disaster recovery.
- Marketing and research.
- Cash movement.
- Provision of mobile financial services channels/technology.
- Document processing (e.g. cheques, credit card bill payments, bank statements and corporate payments).
- Professional services related to business activities of institution e.g. accounting and internal audit).
- Internal audit.
- KYC activities related to AML compliance.
- And any other activity the Central Bank may specify.

#### **4.1.5 The following activities will not be considered to be outsourcing for the purpose of this Outsourcing guideline**

- Use of common network infrastructure such as Visa/MasterCard.
- Market information services such as Bloomberg, Moody's, Standard and Poor.
- Clearing and settlement arrangements between institutions.
- Correspondent banking services.
- Credit reference bureau services.
- Statutory audit.
- Professional advisory services e.g. legal opinions.
- And any other activity the Central Bank of Kenya may specify.

#### **4.2 Legal obligations**

- 4.2.1 The outsourcing of any activity by an institution does not diminish its legal obligations. The board and senior management of the institutions retains the ultimate responsibility for the outsourced activity.
- 4.2.2 Institutions remain responsible for the actions of their service provider and the confidentiality of information pertaining to the customers that is available with the service provider. Therefore the institutions should retain ultimate control of the outsourced activity.
- 4.2.3 When an institution is performing due diligence in relation to outsourcing, it is imperative to consider all relevant laws, regulations, guidelines and conditions of approval, licensing or registration.

#### **4.3 Internal Controls and Standard of Care**

- 4.3.1 An institution should not engage in outsourcing that results in its internal control, business conduct or reputation being compromised or weakened.
- 4.3.2 An institution has to take steps to ensure that the service provider employs a high standard of care in performing the services as if the activity were not outsourced.
- 4.3.3 The institution also needs to maintain the capability and appropriate level of monitoring and control over outsourcing, such that in the event

of disruption or unexpected termination of the service, it remains able to conduct its business with integrity and competence.

#### **4.4 Customer Rights**

4.4.1 Outsourcing arrangements should not affect the rights of a customer against the institution, including the ability of the customer to obtain redress as applicable under relevant laws.

4.4.2 Where the customers are required to deal with the service providers in the process of dealing with the institution, the institution must reveal to their customers in the product brochures/agreements the role of the service provider and their obligations towards the customers.

#### **4.5 Risk Management Practices For Outsourced Financial Services**

##### **4.5.1 Outsourcing Policy**

An institution intending to outsource any of its financial activities should put in place a comprehensive outsourcing policy, approved by its Board, which incorporates, inter -alia;

- a) strategic goals, objectives and business needs of an institution in relation to outsourcing;
- b) clear definition of the range of activities that may be outsourced and those core activities which cannot be outsourced;
- c) steps that should be taken in evaluating whether a particular activity is appropriate for outsourcing;
- d) criteria for determining material outsourcing;
- e) processes for evaluating risks associated with an outsourced activity;
- f) criteria for evaluating outsourcing relationships (with service providers) including necessary controls and reporting processes on an ongoing basis;
- g) eligibility criteria for selecting service providers taking into account any relation, directly or indirectly, with the latter;
- h) issues addressing risk concentrations and risks arising from outsourcing multiple activities to the same service provider;
- i) steps that should be taken to ensure compliance with legal and regulatory requirements in both home and host countries; and
- j) contingency plan in case of business disruptions.

#### **4.5.2 Role of the Board**

The Board and Senior Management of an institution retain ultimate responsibility for effective management of risks arising from outsourcing. While an institution may delegate its day-to-day operational duties to the service provider, the responsibilities for effective due diligence, oversight and management of outsourcing and accountability for all outsourcing decisions, continue to rest with the institution, its board and senior management. The board or a committee delegated by it is responsible for:

- a) Approving a framework to evaluate the risks and materiality of all existing and prospective outsourcing and the policies that apply to such arrangements;
- b) Laying down appropriate approval authorities for outsourcing depending on risks and materiality;
- c) Undertaking regular review of outsourcing strategies and arrangements for their continued relevance, and safety and soundness; and
- d) Deciding on business activities of a material nature to be outsourced, and approving such arrangements.

#### **4.5.3 Role of Senior Management**

Senior management of an institution is responsible for the following are as related to outsourcing:

- a) Evaluating the risks and materiality of all existing and prospective outsourcing, based on the framework approved by the board;
- b) Developing and implementing sound and prudent outsourcing policies and procedures commensurate with the nature, scope and complexity of the outsourcing;
- c) Reviewing periodically the effectiveness of policies and procedures;
- d) Communicating information pertaining to material outsourcing risks to the board in a timely manner;
- e) Ensuring that contingency plans, based on realistic and probable disruptive scenarios, are in place and tested;
- f) Undertaking periodic review of outsourcing arrangements to identify new material outsourcing risks as they arise; and
- g) Ensuring that there is independent review and audit for compliance with set policies.

#### **4.5.4 Evaluation of the Risks**

To satisfy themselves that an outsourcing arrangement does not result in the internal control, business or reputation of an institution being



compromised or weakened, its board and senior management should be fully aware of and understand the risks in outsourcing and their impact on the institution. A framework for systemic risk evaluation should be established and it should include the following steps:

- a) Identification of the role of outsourcing in the overall business strategy and objectives of the institution, and its interaction with corporate strategic goals;
- b) Comprehensive due diligence on the nature, scope and complexity of the outsourcing to identify the key risks and risks mitigation strategies;
- c) Analysis of the impact of the arrangement on the overall risk profile of the institution, and whether there are adequate internal expertise and resources to mitigate the risks identified; and
- d) Analysis of risk-return on the potential benefits of outsourcing against the vulnerabilities that may arise, ranging from the impact of temporary disruption to that of an unexpected termination in the outsourcing, and whether for strategic and internal control reasons, the arrangement should be entered into.

Evaluation of outsourcing arrangements should be performed when an institution is planning to enter into outsourcing arrangements, as a part of the outsourcing approval and strategic planning or review processes of the institution.

The key risks in outsourcing that need to be addressed by institutions include:

- a) **Strategic Risk** – Every bank operates with some strategic long and short term goals. The service provider should relate to these goals. Strategic risk arises where the business practices of service providers are at odds with the short and long term objectives of the bank.
- b) **Reputation Risk** – Poor service from the service provider, its customer interaction not being consistent with the overall standards of the institution,
- c) **Compliance Risk** – Privacy, consumer and prudential laws not adequately complied with,
- d) **Operational Risk** – Arising due to technology failure, fraud, error, inadequate financial capacity to fulfill obligations and/or provide remedies,
- e) **Exit Strategy Risk** – This could arise from over-reliance on one firm, the loss of relevant skills in the institution itself preventing it from bringing the activity back in-house and contracts entered into wherein speedy exits would be prohibitively expensive,
- f) **Counterparty Risk** – Due to inappropriate credit assessments, which can diminish the quality of loans.

- g) **Country Risk** – Due to the political, social or legal climate creating added risk,
- h) **Contractual risk** – arising from whether or not the bank has the ability to enforce the contract, and
- i) **Concentration and Systemic Risk** – Due to lack of control of individual banks over a service provider, more so when overall banking industry has considerable exposure to one service provider.

#### **4.5.5 Evaluating the Capability of the Service Provider**

- 4.5.5.1** In considering or renewing an outsourcing arrangement, appropriate due diligence should be performed to assess the capability of the service provider to comply with obligations in the outsourcing agreement.
- 4.5.5.2** Due diligence should take into consideration qualitative and quantitative, financial, operational and reputational factors.
- 4.5.5.3** Institutions should consider whether the service providers' systems are compatible with their own and also whether their standards of performance including customer service are acceptable.
- 4.5.5.4** Where possible, institutions should obtain independent reviews and market feedback on the service provider to supplement their own due diligence findings.
- 4.5.5.5** The due diligence should involve an evaluation of all available information about the service provider, including but not limited to:-
  - a) Past experience and competence to implement and support the proposed activity over the contracted period;
  - b) Financial soundness and ability to service commitments even under adverse conditions;
  - c) Business reputation and culture, compliance, complaints and outstanding or potential litigation;
  - d) Security and internal control, audit coverage, reporting and monitoring environment, Business continuity management;
  - e) External factors like political, economic, social and legal environment of the jurisdiction in which the service provider operates and other events that may impact service performance.
  - f) Ensuring due diligence by service provider of its employees.

- 4.5.5.6** Due diligence undertaken during the initial evaluation process should be documented and re-performed periodically as part of the monitoring and control processes of outsourcing.
- 4.5.5.7** The due diligence process can vary depending on the nature of the outsourcing arrangement. For instance, reduced due diligence may be sufficient where no developments or changes have arisen to affect an existing outsourcing arrangements or where the outsourcing is to a member of the group.
- 4.5.5.8** An institution should ensure that the information used for due diligence evaluation is current and should not be more than 12 months old.
- 4.5.5.9** Institutions should at least on annual basis review the financial and operational conditions of the service provider to assess the ability to meet its outsourcing obligations. Such due diligence should highlight any deterioration or breach in standards, confidentiality, security or Business Continuity preparedness.

#### **4.5.6 The Outsourcing Agreement**

- 4.5.6.1** Outsourcing arrangements should be governed by a clearly written contract, the nature and detail of which should be appropriate to the materiality of the outsourced activity in relation to the ongoing business of the regulated entity.
- 4.5.6.2** A written contract is an important management tool and appropriate contractual provisions can reduce the risk of non-performance or disagreements regarding the scope, nature and quality of the service to be provided.
- 4.5.6.3** The terms and conditions governing the contract between the institution and the service provider should be carefully defined in written agreements and vetted by a competent authority on their legal effect and enforceability.
- 4.5.6.4** Every outsourcing agreement should address the risks and risk mitigation strategies identified at the risk evaluation and due diligence stages.
- 4.5.6.5** The agreement should be sufficiently flexible to allow the institution to retain an appropriate level of control over the outsourced activity and the right to intervene with appropriate measures to meet legal and regulatory obligations.
- 4.5.6.6** The agreement should also bring out the nature of legal relationship between the parties, that is, whether agent–principal or otherwise. Some of the key provisions of the contract include:

- a) The contract should clearly define what activities are going to be outsourced including appropriate service and performance standards.
- b) The institution must ensure it has the ability to access all books, records and information relevant to the outsourced activity in the service provider.
- c) The contract should provide for continuous monitoring and assessment by the institution of the service provider so that any necessary corrective measure can be taken immediately.
- d) A termination clause and minimum periods to execute a termination provision, if deemed necessary, should be included.
- e) Controls to ensure customer data confidentiality and service providers' liability in case of breach of security and leakage of confidential customer related information.
- f) Contingency plans to ensure business continuity.
- g) The contract should provide for the approval by the institution of the use of subcontractors by the service provider for all or part of an outsourced activity.
- h) Provide the institution with the right to conduct audits, on the service provider whether by its internal or external auditors, or by agents appointed to act on its behalf and to obtain copies of any audit or review reports and findings made on the service provider in conjunction with the services performed for the institution.
- i) A clause to allow the Central Bank or persons authorized by it to access the institution's documents, records of transactions, and other necessary information given to, stored or processed by the service provider within a reasonable time. The Agreement should further provide that in the event these are not made accessible to the Central Bank within a reasonable time, the Central Bank may pursue any or all of the remedial actions and administrative sanctions provided for under the Banking Act.
- j) A clause to recognize the right of the Central Bank to cause an inspection to be made of a service provider of a bank and its books and account by one or more of its officers or employees or other persons.
- k) There should be dispute resolution mechanism between parties involved in outsourcing contract.
- l) Details of pricing and fee structure of outsourcing contract should be provided

#### **4.5.7 Confidentiality and Security**

As public confidence in institutions is a cornerstone in the stability and reputation of the financial industry, it is vital that an institution satisfies itself that the service provider's security policies, procedures and controls will enable the institution to protect confidentiality and security of the customer information. An institution should take the following steps as minimum to ensure that the issue of customer confidentiality is addressed:-

- a) Access to customer information by staff of the service provider should be limited to those areas where the information is required in order to perform the outsourced function.
- b) The institution should ensure that the service provider is able to isolate and clearly identify the institution's customer information, documents, records and assets to protect the confidentiality of the information.
- c) The institution should review and monitor the security practices and control processes of the service provider on a regular basis and require the service provider to disclose security breaches.
- d) The institution should immediately notify CBK in the event of any breach of security and leakage of confidential customer related information. In these eventualities, the institution would be liable to its customers for any damage.

#### **4.5.8 Business Continuity Management**

An institution should ensure that its business continuity preparedness is not compromised by outsourcing. The institution should take steps to evaluate and satisfy itself that the interdependency risk arising from the outsourcing arrangement can be adequately mitigated such that the institution remains able to conduct its business with integrity and competence in the event of disruption, or unexpected termination of the outsourcing or liquidation of the service provider. The steps to ensure business continuity in outsourcing arrangements include:-

- a) The institution requiring its service providers to develop and establish a robust framework for documenting, maintaining and testing business continuity and recovery procedures. Institutions need to ensure that the service provider periodically tests the Business Continuity and Recovery Plan and may also consider occasional joint testing and recovery exercises with its service providers.
- b) In order to mitigate the risk of unexpected termination of the outsourcing agreement or liquidation of the service provider, institutions should retain an appropriate level of control over their outsourcing and the right to intervene with appropriate measures to continue its business operations in such cases without incurring prohibitive expenses

and without any break in the operations of the institution and its services to the customers.

- c) In establishing a viable contingency plan, institutions should consider the availability of alternative service providers or the possibility of bringing the outsourced activity back in-house in an emergency and the costs, time and resources that would be involved.
- d) Outsourcing often leads to the sharing of facilities operated by the service provider. The institution should ensure that service providers are able to isolate the institution's information, documents and records, and other assets. This is to ensure that in adverse conditions, all documents, records of transactions and information given to the service provider, and assets of the institution, can be removed from the possession of the service provider in order to continue its business operations, or deleted, destroyed or rendered unusable.

#### **4.5.9 Monitoring and Control of Outsourced Activities**

**4.5.9.1** The institution should have in place a management structure to monitor and control its outsourcing activities. Such a structure will vary depending on the nature, scope and complexity of the outsourced activities.

**4.5.9.2** As outsourcing relationships and interdependence increase in materiality and complexity, a more rigorous risk management approach should be adopted. An institution also has to be more proactive in its relationship with the service provider.

**4.5.9.3** An outsourcing arrangement which was previously not material may subsequently become material from incremental activities outsourced to the same service provider or an increase in volume or nature of the activity outsourced to the service provider. Material outsourcing risks may also arise when the service provider in a material outsourcing plans to sub-contract the service or makes significant changes to its sub-contracting arrangements.

**4.5.9.4** The institution should ensure that outsourcing agreements with the service providers contain provisions to address their monitoring and control of outsourced activities.

**4.5.9.5** A structure for effective monitoring and control of material outsourcing would comprise the following:

- a) A central record of all material outsourcing that is readily accessible for review by the board and senior management of the institution should be maintained. The records should be updated promptly and form part of the corporate governance reviews undertaken by the board and senior management of the institution.

- b) Regular audits by either the internal auditors or external auditors of the bank should assess the adequacy of the risk management practices adopted in overseeing and managing the outsourcing arrangement, the institution's compliance with its risk management framework and the requirements of these guidelines.
- c) Institutions should at least on an annual basis, review the financial and operational condition of the service provider to assess its ability to continue to meet its outsourcing obligations. Such due diligence reviews, which can be based on all available information about the service provider should highlight any deterioration or breach in performance standards, confidentiality and security, and in business continuity preparedness.

#### **4.6 Regulatory and supervisory requirements**

- 4.6.1** An institution should not enter into any outsourcing arrangement of a material function before getting approval from CBK.
- 4.6.2** Proposals to outsource material functions must be submitted to CBK in writing well in advance of the date on which it is intended that the outsourcing will commence.
- 4.6.3** An institution that has entered into or is planning material outsourcing, or is planning to vary any such outsourcing arrangements, should notify CBK of such arrangements.
- 4.6.4** The degree of detail of the proposal will depend on the functions that the bank proposes to outsource and the service provider to be used. The proposal should include details of:
  - the rationale for the outsourcing,
  - details relating to the proposed service provider,
  - Risk matrix identifying potential risks and how they will be mitigated.
  - draft outsourcing agreement between the parties involved, and
  - a description of the methods that the bank will employ to ensure that it retains its ability to control and monitor the outsourced functions.
- 4.6.5** Outsourcing, whether the service provider is located in Kenya or abroad should not impede or interfere with the ability of the institution to effectively oversee and manage its activities or impede the Central Bank in carrying out its regulatory and supervisory functions.

#### **4.7 Off-shore outsourcing of financial services**

- 4.7.1** The engagement of service providers in a foreign country exposes an institution to country risks including economic, social and political

Conditions and events in a foreign country that may adversely affect the institution.

- 4.7.2** These conditions and events could prevent the service provider from carrying out the terms of the outsourcing agreement with the institution.
- 4.7.3** To manage the country risk involved in off-shore outsourcing activities, the institution should take into account and closely monitor government policies as well as political, social, economic and legal conditions in countries where the service provider is based, during the risk assessment process and on a continuous basis, and establish sound procedures for dealing with country risk problems. This includes having appropriate contingency and exit strategies.
- 4.7.4** Off-shore outsourcing arrangements should only be entered into with parties operating in jurisdictions generally upholding confidentiality clauses and agreements. The governing law of the arrangement should also be clearly specified.
- 4.7.5** The activities outsourced outside Kenya should be conducted in a manner so as not to hinder efforts to supervise or reconstruct the Kenyan activities of the bank in a timely manner. Specifically, an institution should not outsource to jurisdictions where unfettered access to information by CBK or its authorized person, and the internal and external auditors of the bank, may be impeded by legal or administrative restrictions. CBK may communicate directly with the home or host regulator of the institution or the service provider, as the case may be, to seek confirmation relating to these matters.
- 4.7.6** A bank should seek CBK authority if any overseas authority were to seek access to its customer information.

#### **4.8 Outsourcing within a group/conglomerate**

The risk management practices expected to be adopted by an institution while outsourcing to a related party (i.e. a party within the Group/ Conglomerate) would be identical to those specified in clause 4.5 of this guideline. In addition before outsourcing to the group:

- The outsourcing institution should demonstrate that it can manage the risk involved.
- The outsourcing institution should be a member of a group that is subject to supervision on a consolidated basis in conformity with Basle Core Principles for Effective Banking Supervision.



#### **4.9 Inward sourcing**

For inward sourcing of material activities, an institution shall seek approval from the Central Bank. It shall detail the particulars of the services to be provided and furnish the following information:

- The functions to be performed by the service provider (local bank) should be detailed in the outsourcing agreement. The outsourcer remains ultimately responsible for the outsourcing agreement and the institution should not hold itself to be responsible for the outsourced activities.
- The copies of the outsourcing agreement between the institution and foreign entity should be made available to Central Bank.
- Risk matrix of the proposed arrangement identifying risks and mitigants.
- Approval from the host regulator of the foreign entity for the proposed outsourcing arrangement.

#### **4.10 Self-assessment of existing/proposed outsourcing arrangements**

Institutions are expected to conduct a self-assessment of their existing/proposed outsourcing arrangements, in the light of this guideline and rectify deficiencies/shortcomings if any observed in this regard.

#### **4.11 Reports to Central Bank**

All institutions will report to the Central Bank on an annual basis the activities they have outsourced. This report should be received by CBK by 15<sup>th</sup> January of every year. The report should detail the type of activity outsourced and the date the outsourcing arrangement commenced.

### **PART V: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS**

#### **5.1 Remedial measures**

Where any provision of this Guideline is breached or not observed, the Central Bank may pursue any or all of the remedial actions and administrative sanctions provided for under the Banking Act.

**Subject to the provisions of this guideline any institution which at the commencement of this guideline is carrying out an outsourced service which requires the approval of the Central Bank of Kenya shall within 12 months from the date of commencement of the guideline or within such longer period that the Central Bank may allow seek approval from the Central Bank of Kenya or cease to outsource such service.**

## **PART VI: EFFECTIVE DATE**

**6.1 Effective Date** - The effective date of this Guideline shall be 1<sup>st</sup> January 2013.

### **ENQUIRIES**

Enquiries on any aspect of this guideline should be referred to:

The Director,

Bank Supervision Department

Central Bank of Kenya

P. O. Box 60000 - 00200

NAIROBI

TEL.2860000 e-mail: [fin@centralbank.go.ke](mailto:fin@centralbank.go.ke)

# **GUIDELINE ON AUTHORIZATION OF REPRESENTATIVE OFFICES IN KENYA CBK/PG/17**

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## 8.1 Effective Date

### **PART I: PRELIMINARY**

#### **1.1. Title** – Guideline on Representative Office

**1.2 Authorization** - This Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

Section 43 of the Banking Act empowers the Central Bank to authorize a bank or financial institution incorporated outside Kenya which does not propose to transact banking or financial business in Kenya to establish a Representative Office in Kenya.

**1.3 Application** – This Guideline applies to foreign banks or financial institutions incorporated outside Kenya that have established or that intend to establish a Representative Office in Kenya as well as Representative Offices already established in Kenya by such foreign banks or financial institutions.

**1.4 Definitions** – The terms used in this Guideline are as defined in the Banking Act (Cap. 488). Other terms used in this guideline shall be taken to have the meaning assigned to them hereunder:

**1.4.1 “Applicant”** means the Head Office of the foreign bank or foreign financial institution applying to open a Representative Office in Kenya.

**1.4.2 “Foreign bank or foreign financial institution”** means the foreign bank or the foreign financial institution applying to, or authorized to open a Representative Office in Kenya.

**1.4.3 “Authority”** means the authority issued by the Central Bank of Kenya, allowing the Applicant/authorized institution to open and operate a Representative Office in Kenya.

**1.4.4 “Relevant Authority”** means the applicant’s supervisory authority in the applicant’s country of incorporation, or in the country in which the Applicant maintains its Head Office.

**1.4.5 “Representative Office”** means the Office in Kenya which represents a foreign bank or foreign financial institution.

## **PART II: STATEMENT OF POLICY**

### **2.1 Purpose**

**2.1.1** The purpose of this guideline is to provide information and guidance to foreign institutions seeking to secure an authority to open and operate a Representative Office in Kenya.

**2.1.2** The guideline is also intended to provide a broad framework, direction and guidance on the establishment, operation and closure of Representative Offices in Kenya.

### **2.2 Scope**

**2.2.1** This guideline provides direction to foreign institutions intending to open Representative Offices in Kenya on the conditions they must fulfill to be granted an authority to open and operate such an office.

**2.2.2** This Guideline applies to all Representative Offices in Kenya which have been authorized under the Banking Act.

### **2.3 Responsibility**

**2.3.1** It is the responsibility of a foreign institution proposing to establish a Representative Office in Kenya to ensure compliance with this Guideline.

**2.3.2** It is also the responsibility of authorized Representative Offices operating in Kenya to ensure compliance with this Guideline.

## **PART III: SPECIFIC REQUIREMENTS**

### **3.1 Prohibition**

**3.1.1** No foreign institution shall open or operate a Representative Office in Kenya unless it has obtained prior authority from the Central Bank of Kenya for such purpose.

**3.1.2** Every Representative Office authorized under the Banking Act shall conduct activities in accordance with the terms of the Authority granted to it under the Banking Act and this Guideline.

### **3.2 Authorization Requirements**

Authority shall not be granted to an Applicant to open and operate a Representative Office unless the Applicant meets the following conditions:

- 3.2.1 The Applicant should be an institution incorporated outside Kenya;
- 3.2.2 The Applicant should be authorized by the relevant supervisory authority in the country of origin to conduct the business of an institution;
- 3.2.3 The Applicant and/or the head office of the Applicant should be directly subject to the supervision and examination of the relevant authority in the country of origin as per the laws of that country;
- 3.2.4 The license of the Applicant in its country of origin should be valid as at the time of application;
- 3.2.5 The Applicant should have completed a period of no less than five (5) continuous years of conducting the business of an institution in the country of origin or the head office;
- 3.2.6 The relevant authority, to whose supervision the Applicant is subject , should exercise the required control on the banking and/or financial system in the country of incorporation of the Applicant;
- 3.2.7 The relevant authority should issue an approval or no-objection letter to the Foreign Financial Institution proposed opening of a Representative Office in Kenya;
- 3.2.8 The Applicant should undertake to fully comply with the laws, regulations, and guidelines applicable in Kenya and any directions or instructions issued by the Central Bank of Kenya;
- 3.2.9 The Applicant should undertake to share with the Central Bank (for examination) all relevant information relating to the proposed Representative Office as the Central Bank may require;
- 3.2.10 Every Applicant shall designate a Chief Representative Officer (CRO Designate) who shall manage the proposed Representative Office once approval is granted, and serve as the main liaison between the Central Bank and the Applicant. Prior to assumption of duties, the CRO Designate will be vetted by the Central Bank to determine whether or not the said nominee is fit and proper, as per the Central Bank's criteria, to serve in the proposed capacity; and

- 3.2.11 In deciding whether or not to grant or deny the Applicant Authority, the Central Bank may take into consideration any matters related to the financial position of any other party related to the Applicant.

## **PART IV: APPLICATION PROCEDURES**

### **4.1 Forwarding the Application:**

- 4.1.1** Foreign institutions wishing to obtain authority to open and operate a Representative Office in Kenya should write formally to the Central Bank notifying the Bank of their said intention. Alongside the notification letter, the Applicant should submit a completed “Application for Authority to Establish a Representative Office of a Foreign Bank or Financial Institution” Form CBK/RO 1-1 as well as “Fit and Proper” forms for the Designated Chief Representative Officer, proposed managers and senior officers for the proposed Representative Office (Form CBK/RO 1-2). The Applicant should also submit all additional documents as specified in Part 4.2 below. The forms for completion have been prepared as part of this Guideline and hard copies may be obtained from the Bank Supervision Department, Central Bank of Kenya or may be accessed on the Central Bank of Kenya website at [www.centralbank.go.ke](http://www.centralbank.go.ke).
- 4.1.2** All applications duly completed including the additional information specified in Part 4.2 below should then be submitted to the Director, Bank Supervision Department, Central Bank of Kenya, P.O. Box 60000-00200, Nairobi, with the prescribed application fee (currently Kshs 5,000 payable by bankers cheque in favour of the Central Bank of Kenya or by any other mode of payment the Central Bank may prescribe) as specified under the Fourth Schedule to the Banking Act (the Banking Fee Regulations) at least ninety (90) days prior to the proposed date of commencing operations.

### **4.2 Information Required**

The Applicant should submit the following documents together with the duly completed application form:

- 4.2.1** Notarized copy of the Certificate of Incorporation of the foreign institution proposing to open the Representative Office;
- 4.2.2** Notarized copy of the Articles and Memorandum of Association of the foreign institution proposing to open the Representative Office;
- 4.2.3** The names of the principal shareholders of the foreign institution and their respective percentage holdings;

- 4.2.4** A complete list of the Applicant’s Board of Directors and Chief Executive Officer;
- 4.2.5** A notarized extract of the minutes of the Applicant’s Board meeting passing the resolution to establish the proposed Representative Office in Kenya;
- 4.2.6** A statement identifying the kind of business intended to be conducted through the proposed Representative Office as well as the intended objectives of the Representative Office;
- 4.2.7** The name and full contact details of the relevant monetary or supervisory authority to whom the Applicant is subject;
- 4.2.8** A notarized copy of the Applicant’s valid licence to conduct banking business as issued by the home supervisor;
- 4.2.9** Certified copies of the statement of financial position and statement of comprehensive income for each of the three most years immediately preceding the date of the application;
- 4.2.10** If the applicant has links to or forms part of a larger group (either as parent company, subsidiary, joint venture or Associate Company) a detailed chart giving the entire group structure and respective shareholdings between members of the group;
- 4.2.11** A feasibility study of the future operations and development of the business for a minimum period of three years from the date of the application;
- 4.2.12** Proposed organisation structure for the Representative Office;
- 4.2.13** In respect of the CRO Designate and every proposed senior officer in the Representative Office, the following submissions are required:
- A notarized copy of the nominee’s valid passport (for foreign nationals).
  - A certified copy of a national identity card (for Kenyan citizens).
  - An up-to-date and detailed curriculum vitae.
  - Copies of the nominee’s academic and professional certificates; these should be duly *certified* where the issuing authority is located within the Republic of Kenya; certificates and other related documents issued by foreign authorities should be duly *notarized*.
  - Copies of any testimonials available duly certified or notarized as the case may be.
  - Names and full contact details of at least three independent personal referees who should have known the applicants for at least five years.
  - The curriculum vitae of the CRO Designate and every senior officer who is likely to take part in decision making at the Representative Office; these should be accompanied by copies of all supporting documents duly certified/notarized as the case may be.
- 4.2.14** A non-refundable application fee payable as specified in paragraph 4.1.3 above.



All submitted documents should be in the English language. Certified English translations should be provided for all submissions originally expressed in a language other than English. Translation certificates should be attached to the translated documents and should state, as a minimum:

- the name(s) and qualification(s) of the translator.
- that the translator understands the language in which the original versions of the documents in question have been prepared, and
- the translation is true, accurate, and correct to the best of the named translator's knowledge and ability.

The certificate should preferably be made under oath or notarized to provide assurance of its validity. The Central Bank reserves the right to request additional information, statements or documents as it shall deem necessary for purposes of determining an application.

### **4.3 Name of Representative Office**

**4.3.1** In processing an application by a foreign institution to open a Representative Office in Kenya, the Central Bank shall have the right to object to the name under which the prospective Representative Office proposes to operate in Kenya if the Central Bank deems such name to be inappropriate, ambiguous, potentially misleading or confusing to the public.

**4.3.2** Where the name proposed for a prospective Representative Office is deemed by the Central Bank to be inappropriate, ambiguous, potentially misleading or confusing to the public, the Central Bank shall notify the concerned foreign institution, in writing, of its objection to the name proposed and request that the foreign institution reconsider the said name.

**4.3.3** Where the Central Bank objects to a proposed name and requests an applicant institution to reconsider the name, the Central Bank shall not process the application in question any further unless and until the concerned institution has advised the Central Bank, in writing, of a revised name for the proposed Representative Office. The revised name submitted should be acceptable to the Central Bank, as advised by the Bank in writing.

**4.3.4** The Central Bank shall have the right to object to the name under which an authorized Representative Office operates if, in the opinion of the Central Bank, the concerned foreign institution undergoes such a fundamental change or changes in its status or in the nature of its business, that would

render the continued use of its existing name in Kenya misleading or confusing to the public.

- 4.3.5** The name by which a Representative Office of a foreign institution operates, as rendered in its Authority as issued by the Central Bank, cannot be changed without the prior written approval of the Central Bank.

#### **4.4 Processing of Application**

- 4.4.1** Upon receipt of an application in the prescribed Form together with the attachments, Central Bank of Kenya will appraise the application.
- 4.4.2** The Applicant may, if the need arises, be invited for an interview while the request for an authority to open and operate a Representative Office in Kenya is being assessed.

#### **4.5 Issuance or Denial of Approval –in-Principle**

- 4.5.1** Where the Central Bank of Kenya is satisfied that the necessary conditions stipulated in paragraph 4.2 above have been met, a letter of intent conveying approval-in-principle for the establishment of the proposed Representative Office will be issued to the Applicant.
- 4.5.2** The approval-in-principle shall constitute consent from the Central Bank to the Applicant to proceed and set up the proposed Representative Office by making all necessary arrangements in preparation for commencement of operations. These arrangements shall include identification of a suitable operating premises, information systems and staff.

#### **4.6 Proposed Operating Premises**

- 4.6.1** Upon identification and preparation of suitable operating premises, the Applicant shall invite the Central Bank to conduct an on-site inspection of the premises. This will be based on the inspection checklist, FORM CBK/RO 1-3.
- 4.6.2** Upon a satisfactory on-site inspection of the proposed premises, the Central Bank will advise the applicant in writing as to whether or not the proposed premises are suitable for the conduct of operations.
- 4.6.3** No Representative Office shall commence operations at its proposed operating premises prior to obtaining approval from the Central Bank.

**4.6.4** An institution authorized to operate a Representative Office in Kenya may, upon notifying the Central Bank in advance, and subject to such other directions as the Central Bank may issue, including payment of the prescribed fee, open more than one outlet in Kenya.

#### **4.7 Annual Authority Fees**

**4.7.1** Every Applicant shall, prior to issuance of the requested Authority to operate the proposed Representative Office, pay the requisite annual authority fee to the Central Bank as required under the Banking (Fees) Regulations specified in the Fourth Schedule to the Banking Act. The prescribed fee is payable in full in respect of every calendar year or part thereof in which the Authority remains in force. Issuance of initial authority to new applicants is subject to payment of the full annual fees prescribed. Existing Representative Offices are required to pay their annual fees at least 90 days prior to the commencement of the calendar year to which the fee pertains. In the event of non-payment, the Central Bank reserves the right to impose such conditions on the applicant or existing Representative Office as the Central Bank considers necessary, including the withholding of initial issuance or revocation of authority as the case may be.

#### **4.8 Issuance / Denial of Final Authority**

**4.8.1** Where the Central Bank of Kenya is satisfied that all the necessary requirements stipulated in this Guideline have been met, an Authority for the establishment of the proposed Representative Office will be issued to the Applicant, upon which the proposed Representative Office may commence operations.

**4.8.2** An authority to open and operate a Representative Office shall remain valid unless revoked by the Central Bank for reasons to be given to the affected institution in writing, or on voluntary request for revocation by the authorized institution.

**4.8.3** An authority to open and operate a Representative Office shall be considered to have lapsed if the Applicant fails to commence operations within one year of the Central Bank granting its approval.

**4.8.4** The Applicant shall be required to submit a fresh application if it wishes to establish a Representative Office at a future date.

- 4.8.5** Where the Central Bank of Kenya is not satisfied that all the necessary conditions have been met or for good cause to be shown in writing, a letter declining the establishment of a Representative Office will be issued to the Applicant.

## **PART V: REPRESENTATIVE OFFICE ACTIVITIES**

### **5.1 Permissible Activities**

A Representative Office may engage in the following activities:

- 5.1.1** Representing the foreign institution in marketing and liaison activities in Kenya.
- 5.1.2** Promoting its services in Kenya through marketing and liaison role.
- 5.1.3** Providing its Head Office with information regarding the economic developments in the country and region.
- 5.1.4** Providing its customers with information regarding the local market.
- 5.1.5** Providing information to any local party which intends to develop its activities in countries where the foreign institution operates in.
- 5.1.6** Providing its customers with banking, financial and other relevant advice but not deposit taking.
- 5.1.7** Providing its customers with the requisite documentation as required by the foreign institution to facilitate transactions, as well as providing document authentication and validation services.

### **5.2 Prohibited Activities**

A Representative Office operating in the country is prohibited from:

- 5.2.1** Conducting any business activities other than those mentioned in Clause 5.1 above;
- 5.2.2** Accepting deposits in any form whatsoever;
- 5.2.3** Opening accounts of any kind for clients;
- 5.2.4** Extending loans or advances to any party whatsoever;
- 5.2.5** Performing and/or participating in any other normal banking operations, such as issuing Letters of Guarantee, opening Letters of Credit, in its own name; and
- 5.2.6** Dealing in foreign currencies and securities.

### **5.3 Dealings with Resident Banks**

The Representative Office may open accounts in its name with banks operating in the country. Such accounts should however be used solely for the payment of its administrative expenses.

### **5.4 Other Obligations**

The foreign institution and its authorized Representative Office in the country shall ensure that they strictly adhere to the following:

- 5.4.1** Indicating clearly the expression “Representative Office” alongside the commercial name under which it conducts its business in Kenya as well as in all advertisements and official papers used by the Representative Office.
- 5.4.2** Management of its business by persons approved by the Central Bank.
- 5.4.3** Conducting the business activities mentioned in clause 5.1 above at appropriate premises, approved by the Central Bank.
- 5.4.4** Refraining from conducting any unauthorized business at the approved premises.
- 5.4.5** Not to relocate or close its premises without the prior written approval from the Central Bank.
- 5.4.6** Notify the Central Bank immediately of any principal changes relating to the status of the foreign institution.
- 5.4.7** Submit to the Central Bank, within ten days after the end of the every quarter, quarterly return (CBK/PR/RO/04) detailing activities undertaken by the Representative Office during the quarter.
- 5.4.8** Obtain such other relevant licenses or approvals from the concerned authorities to enable the Representative Office conduct its business. Such licenses or approvals should be restricted to conducting the business of Representative Offices only; the Representative Office should provide the Central Bank with copies of the same as soon as these are obtained from the concerned authorities.
- 5.4.9** Comply with all prevailing laws in the country.

### **5.5 Supervision**

The Central Bank shall have the right to examine the activities of the Representative Office whenever it so deems it necessary.

## **PART VI: CANCELLATION OR RESTRICTION OF AUTHORITY**

### **6.0 Cancelling, Restricting or Changing an Authority**

The Central Bank may at any time vary, restrict, revoke, withdraw or cancel an authority granted to a Representative Office:

- 6.1.1** upon a request by the foreign institution, after fulfilling such conditions as may be specified by the Central Bank for this purpose.
- 6.1.2** if the foreign institution or the Representative Office breaches any of the obligations herein on any of the terms of the authority.
- 6.1.3** if the Representative Office of foreign institution violates the provision of this Guideline or the provisions of the Banking Act or Central Bank of Kenya Act or any other Guideline, directive or Circular issued by the Central Bank or if it engages in illegal activities.
- 6.1.4** if the Central Bank is provided with false, misleading or inaccurate information by or on behalf of the foreign institution or the Representative Office.
- 6.1.5** if a winding up order or an order of liquidation is issued by the concerned judicial authority in the country of origin against the foreign institution or against any of its principal owners; or if a court receiver, liquidator or any other similar officer is appointed on its business in that country.
- 6.1.6** if the Representative Office does not commence operations within one year of the date of issuance of authority, or such longer period as may be prescribed by the Central Bank.
- 6.1.7** if the Representative Office suspends its operations for 3 consecutive months.

## **PART VII: REMEDIAL MEASURES**

### **7.1 Remedial measures**

Where any provision of this Guideline is breached or not observed, the Central Bank may pursue any or all of the remedial actions provided for under the Banking Act.

## **PART VIII: EFFECTIVE DATE**

**8.1 Effective Date** - The effective date of this Guideline shall be 1<sup>st</sup> January 2013.

## **ENQUIRIES**

Enquiries on any aspect of this guideline should be referred to:

The Director,

Bank Supervision Department

Central Bank of Kenya

P. O. Box 60000 - 00200

**NAIROBI**

TEL.2860000 e-mail: *fin@centralbank.go.ke*

**APPLICATION FOR AUTHORITY TO ESTABLISH A REPRESENTATIVE OFFICE OF A FOREIGN BANK OR FINANCIAL INSTITUTION**

- NB:** (a) Read the declaration on Section 16 below before completing this form.  
(b) In case the space provided is inadequate, use additional paper.  
(c) This form should be submitted, duly completed, accompanied by the complete set of documents prescribed under Paragraph 4.2 (*Information Required*) of the Guideline on Authorization of Representative Offices in Kenya (CBK PG/17).

**A. DETAILS OF PARENT INSTITUTION**

1. Name of the institution  
.....
2. Type of business  
.....
3. Full address  
.....
4. Date and country of incorporation  
.....
  - i. Branch offices  
.....
  - ii. Former name(s) by which the institution has been known  
.....
  - iii. Has the institution been denied authority by any supervisory body or Government to carry on any business activity in Kenya or elsewhere? If so, give particulars  
.....  
.....
  - iv. Is an inspector or other authorised officer of any Government Ministry, Department or Agency, Professional Association or other regulatory body investigating or has such an investigation ever previously taken place into the affairs of the institution? If so, give particulars  
.....  
.....  
.....



v. Has the institution been refused entry in Kenya or elsewhere to any professional body or trade association concerned with banking or financial activities or decided not to apply for entry after making an approach?.....If so, give particulars.....

5. Has the institution been put under receivership or made any compromise or arrangement with its creditors in the past or otherwise failed to satisfy creditors in full?..... If so, give particular.....

**B. DETAILS OF REPRESENTATIVE OFFICE IN KENYA**

6. Physical address of the office LR No. ....  
Building.....Street .....  
Town.....  
Postal address:  
.....  
Telephone Numbers: .....

7 (a) Names, designations and qualifications of the designated Chief Representative Officer for the Kenya office.....  
..  
.....  
.....  
.....  
.....  
.....  
.....  
.....

(c) Names, designations and qualifications of the senior officers to operate the Kenya office  
.....  
.....  
.....  
.....  
.....  
.....  
.....

(c) Number and designation of other staff

.....

8. Type of services to be offered by the Kenya Office  
.....  
.....

9. Do you plan to change the status of the proposed place of business? If yes, state purpose of proposed type of status and when.....

10. Proposed date of commencing operations.....

**11. DECLARATION BY CHIEF EXECUTIVE OFFICER/MANAGING DIRECTOR**

I am aware that it is an offence to knowingly or recklessly provide any information, which is false or misleading in connection with an application for an authority. I am also aware that omitting material information intentionally or intentionally shall be construed to be an offence and may lead to rejection of my application.

I certify that the information given above is complete and accurate to the best of my knowledge, and that there are no other facts relevant to this application of which the supervisory authority should be aware.

I undertake to inform the supervisory authority of any changes material to the applications which arise while the application is under consideration.

Name of Managing Director/Chief Executive Officer .....

Signature:.....Date.....

**CRITERIA FOR DETERMINING PROFESSIONAL AND MORAL SUITABILITY OF PERSONS IN CONTROL OF INSTITUTIONS LICENSED UNDER THE BANKING ACT**

- NB:**
- (a) Read the declaration on Section 6 below before completing this form.
  - (b) In case the spaces provided are inadequate, use additional paper.
  - (c) This form should be submitted as prescribed, duly completed, accompanied by the complete set of documents prescribed under Part IV (*Information Requirements*) of the Guideline on licensing (CBK PG/01).

1. THE INSTITUTION

Name .....

Type .....

Proposed position.....

2. PERSONAL INFORMATION

a) Surname .....

Other Names .....

b) Previous Names (if any) by which you have been known:

.....

.

.....

.

Reasons for change of names.....

c) Year and Place of birth:

.....

d) Nationality and how acquired.....

e) Personal Identification Number .....

f) i) Identification Card number and date of issue .....

ii) Passport number, place and date of issue.....

g) Postal Address: .....

h) Previous Postal Addresses (if any) .....

- i) Physical Address.....
- ii) Telephone numbers.....

i) Educational Qualifications .....

	Qualifications	Year Obtained	Institution	Examining Body	Grade Obtained

j) Professional Qualifications and years obtained  
.....

	Qualifications	Year Obtained	Institution	Examining Body	Grade Obtained

k) Name(s) of your bankers during the last 5 years  
.....  
.....  
.....  
.....  
.....

l) Responsibilities of proposed position

### 3. EMPLOYMENT/ BUSINESS RECORD

Period	Name of Employer/ Business and Address	Position Held & Dates	Responsibilities	Reasons for Leaving (where applicable)

### 4. DESCRIPTION OF YOUR PAST AND CURRENT ACTIVITIES IN KENYA AND ABROAD

#### 4.1 SHAREHOLDING (DIRECTLY OWNED OR THROUGH NOMINEES)

Company's Name	Date of Incorporation	Number of Shares held	% of Shareholding	Past Share - holding A	Past Share - holding B	Remarks
<p>A: Refers to date of closure or surrender of shares            B: Refers to reasons for closure or surrender</p>						

#### 4.2 DIRECTORSHIPS

Company's Name	Date of Incorporation	Executive or Non-executive	Position held in case of Executive	Past Directorships C	Past Directorships D	Remarks
<p>C: Refers to date of retirement / cessation            D: Refers to reasons for retirement / cessation</p>						

### 4.3 PROFESSIONAL BODIES

Name of body	Membership No.	Position Held (if any)	Position held in case of Executive	Past Membership		Remarks
				E	F	

E: Refers to date when membership ceased  
 F: Refers to reasons for cessation of membership

### 4.4 SOCIAL CLUBS

Club Name	Membership No	Position Held (if any)	Past Club Membership		Remarks
			G	H	

G: Refers to date of retirement, resignation or dismissal.  
 H: Refers to reasons for retirement, resignation or dismissal.

### 4.5 BORROWINGS

Name of Borrower*	Name of Lending Institution	Type of Facility	Amount Borrowed	Date of Offer	Terms of Facility	Security Offered	Value of Security	Current Outstanding Balance, KES	Remarks


*\*Applicant to indicate individual/personal as well as borrowings by associated private companies from lending institutions in which the applicant controls more than of 5% of equity.*

5.1 Have you or any entity with which you are associated as director, shareholder or manager, ever held or applied for a licence or equivalent authorization to carry on any business activity in any country? If so, give particulars. If any such application was rejected or withdrawn after it was made or any authorization revoked, give particulars.

.....  
 .....

5.2 Have you at any time been convicted of any criminal offence in any jurisdiction? If so, give particulars of the court in which you were convicted, the offence, the penalty imposed and the date of conviction

.....  
 .....  
 .....

5.3 Have you, or any entity with which you have been involved, been censured, disciplined, warned as to future conduct, or publicly criticized by any regulatory authority or any professional body in any country? If so give particulars.....

.....

5.4 Have you ever been disqualified, under any legislation or regulation from acting as a director or serving in a managerial capacity?

.....  
 .....

5.5 Have you, or has any entity with which you are, or have been associated as a director, shareholder or manager, been the subject of an investigation, in any country, by a government department or agency, professional association or other regulatory body? If so, give particulars.

.....  
 .....

5.6 Have you, in any country, ever been dismissed from any office or employment, or been asked to resign or resigned from employment or position of trust or fiduciary appointment, been subject to disciplinary proceedings by your employer or barred from entry of any profession or occupation because of

questions about your honesty and integrity? If so give particulars  
 .....

5.7 Have you ever been diagnosed as being mentally unfit or of unsound mind?.....

5.8 Have you failed to satisfy debt adjudged due and payable by you on order of court, in any country, or have you made any compromise arrangement with your creditors within the last 10 years? If so, give particulars.

5.9 Have you ever been declared bankrupt by a court in any country or has a bankruptcy petition ever been served on you? If so, give particulars.  
 .....  
 .....

5.10 Have you ever been held liable by a court, in any country, for any fraud or other misconduct? If so, give particulars  
 .....

5.11 Has any entity with which you were associated as a director, shareholder or manager in any country made any compromise or arrangement with its creditors, been wound up or otherwise ceased business either while you were associated with it or within one year after you ceased to be associated with it? If so, give particulars.....  
 .....

5.12 Are you presently, or do you, other than in a professional capacity, expect to be engaged in any litigation in any country? If so, give particulars.....  
 .....

5.13 Indicate the names, postal and e-mail addresses, telephone numbers and positions of at least three individuals of good standing who would be able to provide a reference on your personal and professional integrity. The referees must not be related to you, and should have known you for at least five years.

	Name of Referee	Postal Address	e-mail address	Tel no. (s)	Position (where applicable)	Relationship with applicant
1						
2						



3						

5.14 Is there any additional information which you consider relevant for the consideration of your suitability or otherwise for the position(s) held/to be held? The omission of material facts may represent the provision of misleading information.

.....

**N.B.** The information given in response to this questionnaire shall be kept confidential by the supervisory authorities, except in cases provided for by law.

**6. DECLARATION**

I am aware that it is an offence to knowingly or recklessly provide any information, which is false or misleading in connection with an application for a banking license. I am also aware that omitting material information intentionally or unintentionally shall be construed to be an offence and may lead to rejection of my application.

I certify that the information given above is complete and accurate to the best of my knowledge, and that there are no other facts relevant to this application of which the supervisory authority should be aware.

I undertake to inform the supervisory authority of any changes material to the applications which arise while the application is under consideration.

*NAME..... POSITION HELD .....*

*DATED..... AT..... THIS DAY OF.....*

**SIGNED.....**

**(Applicant)**

**(This declaration must be signed in the presence of the witness named below)**

**WITNESSED BEFORE ME:**

**COMMISSIONER FOR OATHS/MAGISTRATE**

**Name:** .....

**Signature**.....

**Address:** .....

**Date and Stamp**.....

**FORM CBK/RO 1-3**

**CHECKLIST FOR A PLACE OF BUSINESS OF A REPRESENTATIVE OFFICE**

	YES	NO	COMMENTS
<b>TITLE DEED/LEASE AGREEMENT</b>			
(a) Title Deed			
Is the institution registered as owners of the premises? Attach a copy of the title deed.			
(b) Lease Agreement			
Attach a signed copy of the lease agreement.			
Is the lease registered?			
What is the duration of the lease and is it long enough to allow for economical use of the permanent improvement?			
Attach the landlord's approval for interior design/alteration obtained and other conditions satisfied?			
<b>APPROVAL BY LOCAL AUTHORITY</b>			
Attach the approvals for the following, if applicable:-			
Design or architectural plans approval			
Occupation certificate			
Local authority licences.			
<b>APPROVAL BY OTHER RELEVANT AUTHORITIES</b>			
Have the following been obtained where necessary, if so attach evidence of the same:-			
Security firm – regarding physical security of staff, premises and assets.			
Attach:			
- signed guarding contracts,			
- signed CCTV contracts (i.e. leased or maintenance),			
- alarm contract etc.			
- Are there security guards at the premises at all times-day and night?			
Approval by K.P. & L. Co. for electrical wiring of the premises (Certificate).			
<b>STAFF OPERATING AREA</b>			
Is space allowed for each individual employee equal to or more than 350 cubic feet?			
Are sufficient and suitable sanitary conveniences for employees provided and kept clean?			
<b>VENTILATION</b>			
Is ventilation adequate for security and circulation of fresh			

	YES	NO	COMMENTS
air in the premises?			
<b>LIGHTING</b>			
Is there sufficient and suitable lighting in every part of the premises?			
<b>EMERGENCY PLAN</b>			
Is there an emergency plan?			
Is it documented?			
Are there fire extinguishers at appropriated places?			
<b>INSURANCE</b>			
Attach insurance certificates indicating that the new office has been insured against:			
(a) Fire			
(b) Burglary and theft			
(c) Public liability			
(d) Fidelity			
(e) Cash and valuable in premises			
(f) Motor vehicles in premises			
(g) Other assets – obtain a list of other assets and their values			
(h) Employers’ liability			
Is the issuing insurance firm licensed with the insurance regulatory authority?			
Is the insurance company connected in any way with the institutions:-			
o Directors			
o Management and			
o Shareholders with more than 5% of the institution’s shares?			
Are there other insurances that are required to be taken under the lease agreement? i.e. glass windows			
If yes have the covers been taken.			

QUARTERLY RETURN OF ACTIVITIES FOR REPRESENTATIVE OFFICES (RO) OF FOREIGN BANKING INSTITUTIONS IN KENYA		
<b>The Banking Act (Cap 488)</b> <i>(To be submitted to the Central Bank within 10 days following the end of the calendar quarter for every RO)</i>		
QUARTER ENDED		
START DATE		
END DATE		
No.	Item	Particulars
<b>Part A.</b>	<b>Background Information</b>	
1.	Name of Institution	
2.	Country of Incorporation	
3.	Home Licensing Authority/ Regulator	
4.	Postal Address of RO in Kenya	
5.	Physical Address in Kenya	
6.	Telephone /Fax No.	Tel: _____ Fax _____
7.	E-mail address	
8.	Chief Representative Officer (CRO)	Name: Passport No: Date of approval:
9.	Total no. of staff as at the end of the reporting period (Detail their names, nationalities and job titles)	
<b>Part B</b>	<b>Organizational changes / developments during current quarter:</b> <ul style="list-style-type: none"> <li>• <i>List any changes affecting the Group Structure , Equity Interests and Legal form,;</i></li> <li>• <i>Regulatory Approvals / Concerns Raised / Sanctions Imposed Against Representative Office in Kenya;</i></li> <li>• <i>Any relevant Regulatory Sanctions against Parent Institution either the Home Country / other Operating Jurisdictions that would impact the business of the Representative Office in Kenya.</i></li> <li>• <i>Visits and other activities/events facilitated by the Representative Office.</i></li> </ul>	

<b>QUARTERLY RETURN OF ACTIVITIES FOR REPRESENTATIVE OFFICES (RO) OF FOREIGN BANKING INSTITUTIONS IN KENYA</b>					
<b>The Banking Act (Cap 488)</b>					
<i>(To be submitted to the Central Bank within 10 days following the end of the calendar quarter for every RO)</i>					
<b>QUARTER ENDED</b>					
<b>START DATE</b>					
<b>END DATE</b>					
<b>No.</b>	<b>Item</b>	<b>Particulars</b>			
<b>Part C</b>	<b>Top 10 clients in Kenya (List all if less than 10) (Clients should be rated in terms of the value of business conducted through the Representative Office during the reporting period)</b>				
	1. 2. ↓ 10.				
	<i>(Use additional paper and attach in case the space provided is insufficient)</i>				
<b>Part D</b>	<b>Main areas of business being facilitated or promoted by the Representative Office in Kenya</b>	<b>Value of services in KShs</b>			
1.	Asset management services				
2.	Corporate Finance				
3.	Correspondent Banking				
4.	Private banking				
5.	Project Finance				
6.	Property Finance				
7.	Specialized Finance				
8.	Syndicated lending				
9.	Trade /Export finance				
10.	Mergers /Acquisitions				
11.	Credit assessments on the parent bank's customers in Kenya				
12.	Others <i>(Please specify)</i>				
	<b>Total</b>				
<b>Part E</b>	<b>Financial Details of the Representative Office in Kenya</b>				
1.	Details of the Representative Office's bankers, if any, in Kenya during the quarter		Name of Institution	Branch	Type of Facility Operated by RO
		a)			

**QUARTERLY RETURN OF ACTIVITIES FOR REPRESENTATIVE OFFICES (RO)  
OF FOREIGN BANKING INSTITUTIONS IN KENYA**

**The Banking Act (Cap 488)**

*(To be submitted to the Central Bank within 10 days following the end of the calendar quarter for every RO)*

<b>QUARTER ENDED</b>					
<b>START DATE</b>					
<b>END DATE</b>					
<b>No.</b>	<b>Item</b>	<b>Particulars</b>			
		b)			
		c)			

**QUARTERLY RETURN OF ACTIVITIES FOR REPRESENTATIVE OFFICES (RO) OF FOREIGN BANKING INSTITUTIONS IN KENYA**

**The Banking Act (Cap 488)**

*(To be submitted to the Central Bank within 10 days following the end of the calendar quarter for every RO)*

<b>QUARTER ENDED</b>	
<b>START DATE</b>	
<b>END DATE</b>	

<b>No.</b>	<b>Item</b>	<b>Particulars</b>
------------	-------------	--------------------

**NOTE:**

- a) The information given in this return shall be kept confidential by the supervisory authority, except in cases provided for by law.
- b) The Central Bank of Kenya reserves the right to seek further information from a Representative Office of a foreign banking institution in Kenya, or directly from the Home Office of the said Representative Office, and to confidentially share information with other supervisory authorities as authorized under the Banking Act (Cap 488).

**Part F (I): DECLARATION**

I, the undersigned, hereby declare as follows:

1. In respect of the prescribed return form CBK/PR/RO/01 hereby submitted :

- a) The Representative Office in Kenya of .....(name of institution) did not engage in any activities that would:
  - i. constitute banking or financial business as defined under the Banking Act (Cap 488);
  - ii. constitute criminal, money laundering or terrorist financing activity as defined under the Banking Act(Cap 488), the Proceeds of Crime and Money Laundering Act 2009 in Kenya and /or regulations there under;
  - iii. violate any other applicable law in Kenya governing the business of the said Representative Office;
- b) I am aware that it is an offence to knowingly or recklessly provide any information, which is false or misleading in connection with the activities of the Representative Office as specified in part 1(a) above;
- c) I am also aware that omitting material information intentionally or un-intentionally shall be construed as an offence and may lead to regulatory sanctions against me as Chief Representative Officer of the Representative Office specified in part 1(a) above, by the supervisory authority under the Banking Act (Cap 488);
- d) I certify that the information given above is complete and accurate to the best of my knowledge, and that there are no other facts relevant to this return of which the supervisory authority should be aware.

**Part F (II) : CERTIFICATION BY THE CHIEF REPRESENTATIVE OFFICER**

**Signed at....., this .....day of.....20.....**



# **GUIDELINE ON VOLUNTARY LIQUIDATION CBK/PG/18**

## **CONTENTS**

### **PART I Preliminary**

- 1.1. Title
- 1.2. Authorization
- 1.3. Application
- 1.4. Definitions

### **PART II Statement of Policy**

- 2.1. Purpose
- 2.2. Scope
- 2.3. Responsibility

### **PART III Specific Requirements**

- 3.1. Application and Approval procedures
- 3.2. Information Required

### **PART IV Remedial Measures**

### **PART V Effective Date**

## **PART I PRELIMINARY**

### **1.1 Title – Guideline on Voluntary Liquidations**

**1.2. Authorization** - This Guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

**1.3. Application** – This Guideline applies to all institutions licensed under the Banking Act (Cap 488).

**1.4. Definitions** – Terms used in this Guideline are as defined in the Banking Act.

“**Solvency**” means the ability of an institution to have enough assets to cover its liabilities and obligations.

## **PART II STATEMENT OF POLICY**

**2.1. Purpose** - This Guideline has been prepared pursuant to section 34A of the Banking Act to assist institutions intending to liquidate voluntarily.

**2.2. Scope** - This Guideline provides clear regulatory requirements that should be fulfilled prior to an institution being granted an approval to carry out voluntary liquidation.

**2.3. Responsibility** - It is the responsibility of the shareholders and the directors to ensure that the provisions of this guideline are adhered to by the institutions intending to voluntarily liquidate.

## **PART III SPECIFIC REQUIREMENTS**

### **3.1 Application and Approval Procedures**

**3.1.1.** Every institution seeking to voluntarily liquidate shall prior to commencing the voluntary winding up process apply and obtain the prior written approval of the Central Bank of Kenya. Institutions should submit their application using the Form CBK/PG/18-1 provided under this Guideline.

**3.1.2.** All applications duly completed together with the necessary attachments specified in section 3.2 of this Guideline should be submitted to: The Director, Bank Supervision Department, Central Bank of Kenya, P.O. Box 60000 – 00200,

Nairobi at least 21 days prior to the date appointed to commence voluntary winding up.

- 3.1.3.** Upon receipt of the application for voluntary winding up together with the attachments thereto, Central Bank of Kenya will appraise the application.
- 3.1.4** The Central Bank of Kenya will only approve an application submitted under this section if it satisfied as to the solvency of the institution. The institution's board of directors will have to submit to the Central Bank a declaration to the effect that they have made a full inquiry into the affairs of the institution, and that, having done so, they have formed the opinion that the institution will be able to pay its debts in full within such period not exceeding twelve months from the commencement of the winding up as may be specified in the declaration. Such a declaration must embody a statement of the institution's assets and liabilities as at the latest practicable date before the making of the declaration and must be signed by all members of the board.
- 3.1.5** An institution granted approval by the Central Bank to voluntarily liquidate shall have its licence revoked. From the date of receiving the approval of the Central Bank, an institution is to cease all its operations except such activities as are incidental to the orderly realization, conservation and preservation of its assets and settlement of its obligations.
- 3.1.6.** Upon receipt of Central Bank's approval to voluntarily wind up operations, the institution is required to send a notice of voluntary liquidation, by registered mail, to all its depositors, creditors and any persons otherwise entitled to the funds or property held by the institution as a trustee, lessor of a safe deposit box.
- 3.1.7** The notice should also be posted conspicuously on the premises of each office and branch of the institution and in addition thereto, the institution should publish the notice in at least two daily newspapers with national circulation.
- 3.1.8** A copy of the notice shall be submitted to the Central Bank of Kenya.
- 3.1.9** Every institution being voluntarily wound up shall be required to first discharge its liability to its depositors and thereafter rank all other creditors in accordance with the provisions of the Companies Act.
- 3.1.10** An approval granted by the Central Bank under this section shall not prejudice the rights of a depositor or other creditor of the institution to payment in full of a claim nor the right of the owner of funds or other property held by the institution to the return thereof.

**3.1.11** Any funds payable to a depositor or other creditor who has not claimed them must be dealt with as per the requirements of the Unclaimed Financial Assets Act No. 40 of 2011. This will also include any funds and property held by the liquidating institution that could not be returned to the owners. Any funds or property not claimed within the periods provided for under the Unclaimed Financial Assets Act, 2011 shall be presumed to be unclaimed property.

### **3.2. Information Required**

Every institution seeking to voluntarily wind up its operations should provide the following information and documentation to the Central Bank:

- (a) The resolution of the Board of Directors of the institution sanctioning the voluntary liquidation of the institution;
- (b) An extract of the minutes of shareholders meeting passing the resolution to voluntarily liquidate;
- (c) A detailed plan, including the relevant timeframes of the completion of voluntary liquidation in an orderly manner;
- (d) Confirmation from the directors, auditors and liquidators that the institution has ceased to carry on any banking business except in so far as may be required for the orderly winding up of the institution;
- (e) A balance sheet, as at the date of the commencement of the liquidation of the institution, submitted by the liquidator reflecting all existing assets and liabilities of the institution;
- (f) A certified listing of all unresolved, unsatisfied or un-discharged complaints or legal actions against the institution or instituted by the institution.
- (g) Quarterly financial reports of assets and liabilities to be furnished to Central Bank by the liquidator including any information that the Central Bank may require. The reports may also include schedules on paid claims, pending claims, and collected debts of the winding up institution.

## **PART IV: Remedial Measures**

**4.1** Where the Central Bank finds that the assets of an institution whose voluntary liquidation has been authorized under this Guideline shall not be sufficient for the full discharge of all the institution's obligations or that completion of the voluntary

liquidation is unduly delayed, it shall appoint the Kenya Deposit Insurance Corporation to take possession of the institution and commence proceedings on its compulsory liquidation.

- 4.2** The liability of shareholders of the institution for unpaid share capital of the institution shall continue until the end of the liquidation.
- 4.3** The Central Bank shall revoke the institution's licence once the liquidator has confirmed that the liquidation is complete and all required documentation has been received.

## **PART V: EFFECTIVE DATE**

The effective date of this Guideline shall be 1<sup>st</sup> January 2013

### **ENQUIRIES**

Enquiries on any aspect of this guideline should be referred to:

The Director,

Bank Supervision Department,

Central Bank of Kenya,

P.O. Box 60000 - 00200

NAIROBI.

TEL.2860000 e-mail: [fin@centralbank.go.ke](mailto:fin@centralbank.go.ke)

**FORM CBK/PG 18-1**

**APPLICATION FOR AN INSTITUTION TO LIQUIDATE VOLUNTARILY**

- 1. Name of the institution .....
- 2. Proposed date of commencement to liquidate voluntarily.....
- 3. Date of last license issued by the Central Bank of Kenya .....
- 4. Please provide full details for the reasons for opting to wind up operations.  
.....
- 5. Has the institution provided the Central Bank with all the required information as provided for under this guideline.....

**6. DECLARATION OF SOLVENCY**

We the Board of Directors, of....., being all the board members do solemnly and sincerely declare that we have made a full inquiry into the affairs of this institution, and that, having so done, we have formed the opinion that this institution will be able to pay its debts in full within a period of..... months from the commencement of the winding up, and we append a statement of the Company's assets and liabilities as at....., being the latest practicable date before the making of this declaration. And we make this solemn declaration, conscientiously believing the same to be true, and by virtue of the provisions of the Oaths and Statutory Declarations Act.

**7. DECLARATION**

We, the undersigned, declare that to the best of our knowledge and belief, the information contained herein and any attachments is complete and accurate.

- a) Chairman of the Board of Directors  
(Name).....  
Signature..... Date.....
- b) Director  
(Name).....  
Signature.....Date.....
- c) Director  
(Name).....

Signature.....Date.....

**WITNESSED BEFORE ME:**

**SIGNED..... (Witness)**

**COMMISSIONER FOR OATHS/ MAGISTRATE**

**Note: *This application must be accompanied by all the relevant documents and requirements here below, as detailed in Clause 3.2 of this Guideline. This Form must also be signed by all members of the Board of Directors.***

# **GUIDELINE ON CONSOLIDATED SUPERVISION CBK/PG/19**

## **CONTENTS**

### **PART I: Preliminary**

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- 1.2 Authorization
- 1.3 Application
- 1.4 Definitions

### **PART II: Statement of Policy**

- 2.1 Purpose
- 2.2 Scope

### **PART III: Reporting Requirements**

- 3.1 Annual Group Information Return
- 3.2 Institutions with Subsidiaries
- 3.3 Additional Reporting Requirements

### **PART IV: Prudential Requirements**

- 4.1 Capital Adequacy
- 4.2 Other Prudential Requirements

### **PART V: Remedial Measures and Administrative Sanctions**

- 5.1 Remedial Measures
- 5.2 Administrative Sanctions

### **PART VI: Effective Date**

- 6.1 Effective Date

### **Part VII: FORM CBK-PR19-1**



## **PART I: PRELIMINARY**

### **1.1 Title - Guideline on Consolidated Supervision**

### **1.2 Authorization**

1.2.1 The Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank to issue guidelines, advise and direct business of institutions for the general carrying out of the purposes and provisions of the Banking Act (Cap.488), and Sections 21, 27 and 28 of the Banking Act which place the following requirements upon institutions:

- Section 21 provides that The Central Bank may, at any time, issue directions to an institution requiring it to maintain such books, records or information, in addition to any books, records or information then already maintained by it, as the Central Bank may consider to be necessary.
- Section 27 provides that the Central Bank may require institutions to submit statistical and other returns on a periodic basis in addition to any other returns required by law.
- Section 28 provides that the Central Bank may require any institution to furnish to it, at such time and in such manner as it may direct, such information as the Central Bank may reasonably require for the proper discharge of its functions under the Act. Such information may include information relating to any company which is an associate or a holding company of the institution.

### **1.3. Application**

All institutions licensed under the Banking Act.

### **1.4. Definitions**

Terms used in this Guideline are as defined in the Banking Act and as further defined below:

1.4.1 “**the Act**” means The Banking Act, Chapter 488, Laws of Kenya;

1.4.2 “**Associate**” means

- (a) in relation to a company or other body corporate:
  - i. a subsidiary of its non-operating holding company;
  - ii. a holding company of its subsidiary;
  - iii. any person who controls the company or body corporate whether alone or with his associates or with other associates of it; and

(b) in relation to an individual:

- i. any member of his family. A person shall be deemed to be a member of a family if he is a parent, spouse, brother, sister, child, uncle, aunt, nephew, niece, stepfather, stepmother, stepchild or adopted child of the person concerned, and in case of an adopted child his adopter or adopters.
- ii. any company or other body corporate controlled directly or indirectly, by him whether alone or with his associates.

1.4.3 **“Banking group”** means a licensed institution and its subsidiaries, non operating holding company and subsidiaries of its non operating holding company.

1.4.4 **“Central Bank”** means the Central Bank of Kenya established by the Central Bank of Kenya Act;

1.4.5 **“Consolidated Supervision”** means an overall evaluation of an institution and the group to which it belongs, to ensure that all risk exposures are taken into account, whether the risks arise in the institution itself, or in a significant shareholder, subsidiary or associate of the institution.

1.4.6 **“Consolidated Financial Statements”** refers to the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

1.4.7 **“Control”** is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

1.4.8 **“Group”** refers to a parent and all its subsidiaries and associates.

1.4.9 **“Non-operating holding company”** means any company, other than an institution, that has approved control of an institution, whose activities are limited to: holding investments in subsidiaries; holding properties used by group members; raising funds to invest in, or to provide support to, subsidiaries; raising funds to conduct its own limited activities; investing funds on behalf of the group; conducting the banking activities required for its own limited functions; and providing administrative, risk management and financial services to support the efficient operation of the group.

1.4.10 **“Non-controlling interest”** is the equity in a subsidiary not attributable, directly or indirectly, to a parent.

1.4.11 “**Significant Shareholder**” means, a person other than the Government or a public entity that holds, directly or indirectly or otherwise has a beneficial interest in more than five percent of the share capital of an institution.

1.4.12 “**Subsidiary**” means an institution having more than half (50%) of its stock owned by another institution or an entity that is controlled by an institution or by a non-operating holding company. A subsidiary of a subsidiary is considered a subsidiary of the ultimate parent institution.

1.4.13 “**Parent**” means an entity that controls one or more entities.

## **PART II: STATEMENT OF POLICY**

### **2.1 Purpose**

2.1.1 The purpose of this guideline is:

- to establish reporting requirements for institutions with respect to their banking groups, associates, significant shareholders, and subsidiaries.
- to provide the Central Bank with a full understanding of the structure of such institutions and their associates, significant shareholders, and subsidiaries, as well as the business conducted by each entity in the group to which the institution belongs and the risk environment in which they operate in order to satisfy itself that the operations and affairs of such companies or persons are not detrimental to the safety and soundness of the institution concerned and are in compliance with the Act; and
- to ensure that institutions with subsidiaries or otherwise belonging to banking groups adhere to prudential requirements for capital adequacy, liquidity, single borrower limits and restrictions on facilities to insiders on both a consolidated and a solo basis.

2.2 **Scope** -This guideline applies to institutions as defined in the Banking Act.

## **PART III: REPORTING REQUIREMENTS**

### **3.1 Annual Group Information Return**

3.1.1 Institutions are required to provide the information set out in Part VII as at 31 December of each year with respect to associates, significant shareholders, and subsidiaries not later than 31 March of the following year.

### **3.2 Scope of consolidated financial statements**

- 3.2.1 Consolidated financial statements shall comprise all subsidiaries of the parent institution including those incorporated outside Kenya.
- 3.2.2. Control is presumed to exist when the parent institution, directly or indirectly through subsidiaries, owns more than half of the voting power of an entity unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control.

### **3.3 Consolidation procedures and reporting**

- 3.3.1 An institution having any subsidiaries shall submit a copy of the audited consolidated financial statements within three months of the end of the financial year.
- 3.3.2 The consolidated financial statements should be prepared in accordance with the applicable International Financial Reporting Standards and/or standards prescribed by the regulator of the parent entity.
- 3.3.3 The financial statements of the parent institution and its subsidiaries shall be prepared as of the same date. When the end of the reporting period of the parent is different from that of a subsidiary, the subsidiary should prepare, for consolidation purposes, additional financial statements as of the same date as the financial statements of the parent.
- 3.3.4 The consolidated financial statements should include consolidated balance sheet, consolidated statement of profit and loss, statement of cash flow, principal accounting policies and notes on accounts. The group accounts should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to do so, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.
- 3.3.5 An institution having any subsidiaries shall submit the following reports on both a solo and consolidated basis:
- a) Return CBK/PR3: Capital to Risk Weighted Assets;
  - b) Return CBK/PR4-3: Advances, bills discounted and other facilities to any person or connected group exceeding 25 Percent of Core Capital;
  - c) Return CBK/PR4-4: Advances, bills discounted and other facilities to staff members, shareholders, directors and their associates;
  - d) Large Exposures;
  - e) Liquidity Ratios;

- f) Exposures to related parties and
- g) Lending limits.

### **3.4 Additional Reporting Requirements**

- 3.4.1 The Central Bank shall, if it deems necessary, require an institution to submit a copy of the latest annual audited financial statements of any or all associates, significant shareholders, and subsidiaries, not later than (30<sup>th</sup> March) of the year following the financial year to which such audited financial statements refer.
- 3.4.2 The Central Bank shall, if it deems necessary require the institution to provide updated information with respect to any or all significant shareholders in the form set out in Second Schedule to the Guideline on Licensing of New Institutions (CBK/PG/01).
- 3.4.3 In addition to the reporting specified in this guideline, the Central Bank may require institutions to submit any information in respect of their associates, significant shareholders and subsidiaries in order that the Central Bank may be satisfied that the operations and affairs of such companies or persons are not detrimental to the safety and soundness of the institution concerned and are in compliance with the Act.
- 3.4.4 The Central Bank may determine which entities are to be included in the consolidation for the purposes of meeting the requirements of this guideline, and may require for supervisory purposes consolidated financial information, including a partial consolidation of the institution and such subsidiaries and associates of the bank within or outside Kenya as the Central Bank may specify, which may differ from the consolidation required under International Financial Reporting Standards.

## **PART IV: PRUDENTIAL REQUIREMENTS**

### **4.1 Capital Adequacy**

- 4.1.1 When the Central Bank determines that an institution has insufficient capital to shield against the risks arising from its group relationships, pursuant to Section 18 of the Act and the Capital Adequacy Guideline, the Central Bank shall require higher minimum capital ratios for the institution.

4.1.2 Members of the banking group are required to maintain the capital adequacy ratios prescribed by their respective regulators and ensure minimum capital requirements are complied with on a solo and consolidated basis. In case of any shortfall in the capital adequacy ratio of any of the subsidiaries, the parent should maintain capital in addition to its own regulatory requirements to cover the shortfall.

4.1.3 **Large Exposures:** - As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, the institutions in a banking group should, in addition to adherence to prudential limits on solo basis, also adhere to Single & Group borrower exposure limits on a consolidated basis.

4.1.4 **Liquidity Ratios:** - The existing liquidity requirements applicable to institutions on a solo basis are extended to the banking group as well. If the related entities in the group are banking institutions, liquidity position will be monitored on a consolidated basis after netting out intra-group transactions and exposures. If the related entities in the banking group are heterogeneous comprising non-banking entities, compliance would be restricted to the banking entities on a consolidated basis. In respect of non-banking financial entities within bank groups, each should comply with its solo liquidity requirements.

4.1.5 **Market Risk Exposure:** - Institutions should ensure that potential risk of loss arising from price risk, interest rate risk or foreign exchange rate fluctuations to the institution's capital base are within group tolerance level and prudential limits. The limits applicable to institution on a solo basis such as the foreign exchange risk exposure (net open forex exposure), single currency and intra-day foreign exchange exposure, are also extended to the banking group.

4.1.6 **Cross Border Visits:** - CBK may from time to time where it deems necessary and in coordination with the host supervisor, visit the foreign offices / operations of a member of the banking group. The location and frequency will be determined by the risk profile and systemic importance of the foreign operations.

## 4.2 Other Prudential Standards

4.2.1 If an institution with subsidiaries exceeds the single borrower limits and restrictions on facilities to insiders on a consolidated basis, the Central Bank shall in recognition of the risks and pursuant to Section 18 of the Act and the Capital Adequacy Guideline prescribe such higher capital adequacy requirements for that institution as may be required to ensure compliance with the prudential limits on a consolidated basis.

## **PART V: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS**

### **5.1 Remedial measures**

If an institution fails to comply with this guideline, the Central Bank may pursue any or all corrective sanctions and or actions as provided for under the Act.

### **5.2 Administrative sanctions**

In addition to the use of Remedial measures noted in 5.1 above, the Central Bank may pursue any or all of the following administrative sanctions against an institution, its board of directors and its officers:

- a) Prohibition from engaging in any further foreign exchange activities;
- b) Prohibition from declaring or paying dividends;
- c) Prohibition from establishing new branches, subsidiaries, agents or introducing new products;
- d) Prohibition from engaging in new activities or from expanding existing activities;
- e) Suspension of access to Central Bank credit facilities;
- f) Suspension of lending, investment, and credit granting operations;
- g) Prohibition from acquiring, through purchase or lease, additional fixed assets;
- h) Prohibition from accepting further deposits or other lines of credit;
- i) Prohibition from declaring or paying bonuses, salary incentives, severance packages, management fees or other discretionary compensation to directors or officers.
- j) Limit the range of activities the consolidated group may conduct and the locations in which such activities can be conducted (including the closing of foreign offices). If it is determined that:
  - i. The safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed;
  - ii. The supervision by other supervisors is not adequate relative to the risk the activities present.
  - iii. The exercise of effective supervision on a consolidated basis is hindered.

## **PART VI: EFFECTIVE DATE**

**6.1 Effective date:** The effective date of this Guideline shall be 1<sup>st</sup> January 2013.

**Enquires**

Enquiries on any aspect of these Guidelines should be referred to:

**The Director,  
Bank Supervision Department  
Central Bank of Kenya  
P.O. Box 60000-00200  
Nairobi  
TEL. 2860000  
e-mail: *fin@centralbank.go.ke***



**Part VII: FORM CBK-PR19-1**

**Annual Information Report**

**Subsidiaries, Associates, and Significant Shareholders**

**INSTITUTION:** .....

Pursuant to section 28 of the Banking Act and the Guideline on Consolidated Supervision (CBK/PG/19), each financial institution is required to submit by March 31 each year the following information as at December 31 of the preceding year:

1. A chart or series of charts which shows the relationship between the financial institution and its subsidiary companies, associates, and significant shareholders, together with a brief outline of the nature of business, types of products or range of services and locations of principal places of business for each such company or person.
2. A list of significant shareholders, directors and officers for each subsidiary, associate, and significant shareholders of the institution.
3. The name and contact details of the authority or body responsible for regulation and supervision, if applicable, of each subsidiary, associate and significant shareholder of the institution.
4. The name and contact details of the external auditors for each subsidiary, associate and significant shareholder of the institution.
5. A chart of the group management structure, if applicable, which clearly indicates the way in which senior management responsibilities (including the names and job titles) are allocated.

# **GUIDELINE ON STRESS TESTING CBK/PG/20**

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### **PART VII Effective Date**

## PART I: PRELIMINARY

- 1.1 **Title** - Guideline on stress testing.
- 1.2 **Authorization** - This Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.
- 1.3 **Application** - This Guideline applies to all institutions licensed under the Banking Act (cap 488).
- 1.4 **Definitions** – the terms used in this guideline are as defined in the Banking Act (cap 488). Other terms used in this guideline shall be taken to have the meaning assigned to them hereunder.

“**Stress Testing**” is a risk management technique used to evaluate the potential effect on an institution’s financial condition of a specific event and/or movement in a set of financial variables. The traditional focus of stress testing relates to the exceptional but plausible events.

“**Credit Risk**” is the risk that a counter party (for example, individuals, corporations, sovereign governments), fails to meet their obligations. Many different types of obligations are covered (from simple personal overdrafts to complex derivative transactions).

“**Exposure at default**” (**EAD**) it is defined as the gross exposure under a credit facility upon the default of an obligor

“**Probability of default**” (**PD**) it is the probability a borrower will default over a one year time horizon

“**Loss Given Default**” (**LGD**). it is the extent of credit loss when a borrower defaults. It is defined as (1 minus recovery rate)

“**Market Risk**” is the risk to an institution’s financial condition resulting from adverse movements in market variables, such as prices or interest rates.

“**Interest Rate Risk**” is the risk to an institution’s earnings and capital arising from adverse movements in interest rates.

“**Repricing Risk**” repricing risk arises due to pricing mismatches between assets and liabilities of a bank. Assets may be priced at fixed rates while liabilities may be on floating rate. If the rate of change in interest for fixed assets is not the same with that for liabilities, then repricing risk will result.

**“Yield curve Risk”** arises when unanticipated shifts in the yield curve have an adverse effect on bank’s income and capital.

**“Basis Risk”** arises when assets and liabilities are priced using different market outcomes. Assets may be priced off the interbank rate while liabilities may be priced off Treasury bill rate. If there is change in the spread between the interbank and T bill rate a bank will be subject to a basis risk.

**“Liquidity Risk”** is the ability to fund increases in assets and meet obligations as they fall due.

## **PART II: STATEMENT OF POLICY**

- 2.1. **Purpose** - The purpose of this guideline is to provide institutions with minimum requirements for developing stress testing mechanisms as a part of their overall risk management systems and frameworks.
- 2.2. **Scope** – Stress tests cover a range of methodologies and their complexity can vary, ranging from simple sensitivity tests, which are aimed at assessing the impact of severe macroeconomic stress event on measures like earnings and capital.
- 2.3. **Responsibility**  
Stress testing requirements are an integral component of an institution’s business planning and risk management framework. Therefore, it is the responsibility of senior management and the board to ensure appropriate stress tests are incorporated in its strategic plans. Senior management should establish the Stress Testing framework and maintain an effective oversight in the process by agreeing on the assumptions and reviewing the results.

## **PART III: ROLE OF BOARD AND SENIOR MANAGEMENT**

- 3.1. The Board has ultimate responsibility for the overall stress testing and should be aware of the key findings of the stress test. The board must ensure that its senior management has in place a fit for purpose stress testing program that is enterprise wide and that management has adopted policies requiring use of stress testing as a management tool.
- 3.2. The management has a critical role in implementing stress testing in the institution’s risk management. This calls for taking ownership of the overall framework, identifying potential stress scenarios, taking remedial measures or actions (where warranted), given the institution’s risk appetite and business strategy. Remedial measures or actions are imperative since much of the value in stress testing is derived from internal discussion of which stress scenarios imply the greatest vulnerability.

## **PART IV: INTRODUCTION**

### **4.1. Overview and Objective of the Guideline**

The primary objective of the “Guideline on Stress Testing’ (the Guideline) is to reinforce the importance of stress testing as a risk management tool. The guideline provides guidance and principles on the critical areas pertaining to stress testing as well as specific requirements that are expected of institutions.

### **4.2. Principles for Banks**

- 4.2.1. Stress testing should form an integral part of the overall governance and risk management culture of the bank. Stress testing should be actionable, with the results from stress testing analysis impacting decision making at the appropriate management level, including strategic business decisions of the board and senior management. Board and senior management involvement in the stress testing programme is essential for its effective operation.
- 4.2.2. A bank should operate a stress testing programme that promotes risk identification and control; provides a complementary risk perspective to other risk management tools; improves on capital and liquidity management; and enhances internal and external communication.
- 4.2.3. Stress testing programmes should take account of views from across the organization and should cover a range of perspectives and techniques.
- 4.2.4. A bank should have written policies and procedures governing the stress testing programme. The operation of the programme should be appropriately documented.
- 4.2.5. A bank should have a suitably robust infrastructure in place, which is sufficiently flexible to accommodate different and possibly changing stress tests at an appropriate level of granularity.
- 4.2.6. A bank should regularly maintain and update its stress testing framework. The effectiveness of the stress testing programme, as well as the robustness of major individual components, should be assessed regularly and independently.
- 4.2.7. Stress tests should cover a range of risks and business areas, including at firm-wide level. A bank should be able to integrate effectively, in a meaningful fashion, across the range of stress testing activities to deliver a complete picture of the firm-wide risk.
- 4.2.8. Stress testing programmes should cover a range of scenarios, including forward-looking scenarios, and aim to take into account system-wide interactions and feedback effects.
- 4.2.9. As part of an overall stress testing programme, a bank should aim to take account of simultaneous pressures in funding and asset markets, and the impact of a reduction on market liquidity on exposure valuation.
- 4.2.10. The effectiveness of risk mitigating techniques should be systematically challenged.

## **PART V: APPROACH TO STRESS TESTS BY INSTITUTIONS**

### **5.1. Coverage and Risk Factors**

5.1.1 Stress tests should be designed to take into account large movements in the risk factors. Stress tests should reflect exceptional but plausible events and take into account new concentrations of risks that may emerge, contagion effect and failure of hedging techniques. Exceptional events would be fairly rare and have a large magnitude or impact on the portfolio to be stress tested. Plausible events cannot be too extreme that no entity could withstand such a shock or have zero probability of occurring.

5.1.2 In addition, institutions also need to derive the risk drivers of these material risks as this would assist in understanding the underlying factors that affect the risks and determine the appropriate remedial measures. The number of risk factors to be stressed will depend on the complexity of the portfolio and the risks faced by the institutions. Nevertheless, licensed institutions should be able to justify their choice of factors stressed.

5.1.3 Among the risk factors that institutions should consider when constructing the stress tests would be:

- Macroeconomic factors (interest rates, foreign exchange rates, inflation, GDP growth, unemployment rate, asset prices);
- Geographical and political factors (health of other economies, vulnerabilities to external events, contagion effects);
- Financial market conditions (liquidity);
- Concentration risks (borrowers, industries, regions);
- Borrower risk characteristics that would affect obligor risks and increase the default probabilities (for example, borrower type, demographics, industry);
- Transaction risk characteristics (product, collateral type, loan to value ratio, guarantees); and
- Other category of risks such as operational risk.

The stress tests should also reflect the specific risk characteristics of the institutions including events such as mergers or strategic acquisitions.

### **5.2 Frequency**

5.2.1. The frequency of stress testing should be determined in accordance with the nature of the risks which the institutions are exposed to and the types of tests performed. Thus,

stress tests may be run on a daily, weekly, monthly, quarterly or yearly basis, depending on the nature of the portfolio and risks as well as circumstances.

- 5.2.2. Stress tests should be produced regularly enough to take account of changing market conditions and the institution's changing risk profile. Generally, the trading portfolio would be subject to more frequent stress testing. Similarly, in times of greater volatility and unstable market conditions, more stress testing would be conducted.
- 5.2.3. However under specific circumstances, ad-hoc stress tests may also be required to assess the impact of observed deterioration which licensed institutions had not taken into account or to assess the impact of similar stress across the industry.

### **5.3 Magnitude of Shock**

- 5.3.1. Institutions may vary the level of stress to assess its vulnerability under different scenarios. Accordingly, institutions would need to determine the magnitude of shocks to be administered.
- 5.3.2. Selecting the worst movement in the previous one-year period may not be optimal as the period may not include any stressful event. The time interval should include at least one business cycle (appropriate to the portfolio).
- 5.3.3. The magnitude of the shock used should be greater than the conservative estimate of potential losses over the business cycle. It is more than the adverse market movement (point of worst movement) relevant to the long-term risk profile of the specific portfolio.
- 5.3.4. The shocks should have some reference to but not be bound by historical events nor be so large that the exercise becomes purely hypothetical. The scenarios should be forward looking and also have some relevance to the current events or circumstances.

### **5.4 Stress Testing Methodologies**

#### **5.4.1 Stress Testing For Credit Risk**

- Credit risk is measured by measuring potential losses that are dependent on the obligor's ability and willingness to repay credit. There is no single indicator for credit risk since it cannot be measured directly. Hence, it is measured indirectly through the credit risk drivers *namely Exposure, Probability of Default (PD), Loss Given Default (LGD) and Maturity*.
- Credit stress tests measures the impact on the institution's asset quality and financial position arising from the impairment of the borrowers' creditworthiness during stress condition. Stress test by definition measures the effect of only large moves (shocks) in risk factors that would affect the obligor's business operations and income. For stress test purposes, such shocks should be 'exceptional but plausible'. *As elaborated earlier, there are two approaches to decide on the appropriate magnitude of shock; the shocks that actually occurred during historical stress episodes and shocks based on subjective*

*judgment. When using historical episodes, the size of the shock can be based on the most adverse movement in the risk factor during the period of the stress event.*

- Similar to the measurement of credit risk under normal conditions, credit risk under stress condition could stem from both on- and off-balance sheet activities and, for banks, from both the banking and trading books.

#### 5.4.2 Stress Testing For Market Risk

Stress testing should, as far as possible, be conducted on an institution-wide basis, and should take into account the effect of unusual changes in prices or volatilities, market liquidity, changes in historical correlations and assumptions in stressed market conditions, the vulnerability to historically worst case scenarios and the default of a large counter-party.

##### i) Interest Rate Risk

- Interest rate risk is the exposure of a licensed institution's financial condition to adverse movements in interest rates arising from four main sources namely repricing risk, basis risk and yield curve risk.
- Institutions can apply risk measurement techniques such as gap analysis, duration analyses, income simulation or other interest rate risk model in performing stress test for the banking and trading books.
  - The main step in performing the stress test is to specify the nature of the shocks to be applied. For interest rate risk, the simplest forms of shock are a parallel shift in the yield curve, a change in slope of the yield curve and a change in the spread between different interest rates with the same time horizon. **Parallel shifts in the yield curve** - stress the extreme movement in interest across the maturity spectrum, for example, the effects on the licensed institution's profitability of a 200 or 300 basis-point (bp) shifts in the interest rates.
- At the very basic level, institutions can apply gap analysis to measure the level of interest rate risk exposure in the banking book. The gap in each time band can be multiplied by various scaling factors to calculate the sensitivity of income to changes in interest rates. For example, the average interest rate or yield on assets and liabilities in each time band can be calculated and applied to the gap as a way of scaling the change in net interest income.

##### ii) Foreign Exchange Risk

- Foreign exchange risk is the risk that exchange rate changes can affect the value of a institution's assets and liabilities, as well as off-balance sheet items. It can be direct that is, where the licensed institution takes or holds a position in foreign currency or indirect that is, where a foreign position taken by one of the institution's borrowers or counterparties may affect their creditworthiness.



- The most commonly used measure of foreign exchange is the institution's net open position and the net open position in each currency can be stressed against variations in the exchange rate of a particular currency.
- If the overwhelming majority of foreign exchange exposure is in one currency, institutions may use either the net open position by currency or the aggregated net open position. The latter may be necessary if a breakdown by currency is not available.
- Institutions are also subject to indirect foreign exchange risk, that is, foreign exchange risk incurred by the institution's borrowers that can be transmitted to the institutions through credit risk. In order to assess the indirect foreign exchange risk, it is necessary to stress the major borrowers of the institutions and then estimate the impact on the loan portfolio.
- The basic type of shock to be used in all stress tests is a shock to the exchange rate itself. Depending on their relevance to the institutions, one or more exchange rates will have to be shocked either separately (sensitivity analysis) or simultaneously (scenario analysis).
- Institutions should incorporate past experience of financial crisis where the domestic currency suffered sharp depreciation into the stress test in order to assess the impact of the current portfolio.
- The following is a common scenario that institutions can take into consideration when performing stress testing for foreign exchange risk:
  - *Adverse changes in exchange rates between major currencies* – this estimates the impact on the licensed institution's net open position on major currencies. In addition, institutions may assess the impact of such changes on their major customers with substantial foreign exchange exposures.

#### 5.4.3 Stress Test for Liquidity Risk

- There are two types of liquidity risk namely asset liquidity risk and funding liquidity risk. Asset liquidity risk refers to the inability to conduct a transaction at current market prices because of the size of the transaction. Funding liquidity risk refers to the inability to access sufficient funds to meet payment obligations in a timely manner.
- In many cases of bank failure, illiquidity occurs after the institutions have become insolvent. Thus, the lack of adequate funding liquidity is considered to be a key sign that the institutions are in serious financial difficulties.
- Commonly, institutions face liquidity pressures from imbalances between the maturity dates on their assets and liabilities, where cash inflows from assets may not match the cash outflows to cover liabilities.
- Interest rate changes can also lead to liquidity problems where high interest rates may cause liquidity withdrawals as depositors seek higher returns elsewhere.
- Institutions should include the following scenarios when performing liquidity stress test:
  - *Liquidity crisis* - assess the adequacy of its short-term liquidity to meet crisis situations such as significant deposit outflows. In assessing the impact on the institution's funding and cash flow projections, institutions may adopt behavioral

assumptions for borrowers and depositors such as increase in depositor withdrawal rate.

- *Credit tightening* - stress the impact of credit and counterparty lines tightening and estimate and anticipate alternative funding costs and sources in a difficult market environment due to the downgrading of an institution’s rating. Then determine how it would affect the current business and the pricing and competitiveness of future business.

## 5.5 Reporting of Stress Test Results to the Central Bank of Kenya

It is expected that institutions will conduct several different stress tests in terms of scenarios and frequency. However, the reporting to Central Bank will be required for two scenarios only that is, the **latest** stress test conducted by the institutions using an **exceptional but plausible event** scenario and a **worst case** scenario, based on the minimum requirements. Institutions are required to submit the stress test results to the Central Banks’ Bank Supervision Department by the 10<sup>th</sup> day after end of each quarter. The submission should cover the following:

### 5.5.1 Coverage

- A description of the risk areas being subjected to stress tests.
- Conditions prevailing and assumptions used for the stress test. Institutions are required to describe the event as well as give details of the conditions prevailing in each scenario such as the level of GDP, interest rates, unemployment, concentration in properties. Institutions should also include any other significant assumptions used in the stress tests.

### 5.5.2 Results of Latest Stress Test

The results of the stress test to be reported as indicated in Table 1 below and should include, at a minimum, the impact on the profitability, capital and asset quality at end of each reporting quarter. Both absolute amounts and key financial ratios should be reported. Other indicators and ratios may be included by the institution if deemed useful.

**TABLE 1: STRESS TESTING RESULTS REPORT**

	Baseline				Exceptional but Plausible event scenario				Worst Case Scenario			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1) Impact of Shock on:												
Profit												
Capital												
Asset Quality, etc												
2)Description of Condition, assumptions												
Interest Rate												
Inflation, etc												

**NOTE:** For all the stress tests carried out present the results in this format as shown in the table above.

## **PART VI Remedial Measures**

Where any provision of this Guideline is breached or not observed, the Central Bank may pursue any or all of the remedial actions and administrative sanctions provided for under the Banking Act.

**PART VII: Effective Date:** The effective date of this Guideline shall be 1<sup>st</sup> January 2013.

### **ENQUIRIES**

Enquiries on any aspect of this guideline should be referred to:

The Director,

Bank Supervision Department

Central Bank of Kenya

P. O. Box 60000 - 00200

**NAIROBI**

TEL.2860000 e-mail: [fin@centralbank.go.ke](mailto:fin@centralbank.go.ke)

# **GUIDELINE ON PROMPT CORRECTIVE ACTION CBK/PG 21**

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### **PART VI Effective Date**

- 6.1 Effective Date
- 6.2 Supersedence

## **PART I      PRELIMINARY**

- 1.1    **Title** - Guideline on Prompt Corrective Action.
- 1.2    **Application** - All institutions licensed under the Banking Act (Cap.488).
- 1.3    **Authorization** - This Guideline is issued under Sections 33 and 34 of the Banking Act, which empowers the Central Bank of Kenya to issue Guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.
- 1.4    **Definitions** – Terms used in this regulation are as defined in the Banking Act.

**“Banking Act”** means the Banking Act as amended from time to time

**“CAMELS”** refers to an acronym for Capital Adequacy, Asset Quality, Management, Liquidity and Sensitivity to Market Risk”.

**“Capital Restoration Plan”** means a plan to restore the institution to capital adequacy pursuant to Section 18 of the Banking Act, or in the case of issues unrelated to capital such as violations of the law or regulations, a plan to resolve all deficiencies to the satisfaction of the Central Bank. A capital restoration plan can be implemented voluntarily by an institution under the oversight of its board of directors or, its implementation can be mandated by the Central Bank.

**“Capital Compliant”** “An institution will be considered to be capital compliant if it fully meets the capital requirements fully stipulated in Section 18 of the Banking Act.

**“Final Agreement”** means an agreement made between the Central Bank and a significantly undercapitalized institution’s board of directors for the purpose of recapitalizing the institution in a timely manner.

**“PCA Order”** is a written directive by the Central Bank to an institution stipulating the actions and violations from which the institution must cease. The remedial actions that the institution should take, include:

- 1)      Adopt a Capital Restoration Plan; and
- 2)      Strengthen the board of directors and management.

**“Significant Shareholder”** - A person, other than the Government or a public entity, who holds (directly or indirectly) or otherwise has beneficial ownership in more than five percent of an institution or who otherwise has the ability to exert a significant influence on the decision-making process of the institution as determined by the Central Bank.

**“Significantly Undercapitalized”** means an institution which holds less than 50% of the capital requirements prescribed under Section 18 of the Banking Act.

**“Undercapitalized bank”** means an institution that does not fully comply with the capital requirements prescribed in section 18 of the Banking Act.

**“Viable”** - For purposes of implementing this guideline, an institution is considered to be “viable” if, in the opinion of the Central Bank, it meets *all* of the following criteria:

- The institution’s business is being conducted in a lawful manner;
- The institution is not significantly undercapitalized; its solvency is not threatened; if the institution is undercapitalized (but not significantly undercapitalized), then it is projected to meet its minimum capital requirement within a reasonable period of time based upon an approved capital restoration plan;
- The institution is able to meet its financial obligations when they fall due; it has not suspended payment nor is it expected to miss a payment;
- There is no evidence of reckless or fraudulent conduct, other malpractices, or public pronouncements that clearly adversely impact the financial standing of the institution; and
- The business of the institution is being conducted in compliance with the Banking Act and regulations, and in a manner which is in the best interests of its depositors and members of the public.

## **PART II STATEMENT OF POLICY**

2.1 **Purpose** – This Guideline has been prepared pursuant to sections 33, 33A and 34 of the Banking Act to assist institutions that are facing difficulties to take prompt corrective action so as to avoid failure or instability in the banking sector.

2.2 **Scope** - This guideline shall apply to all institutions licensed to transact business under the Banking Act. It highlights the corrective actions that can be taken depending on the extent of the difficulties an institution is experiencing. This is meant to restore the financial condition of the institution and protect the interests of depositors from systemic risks.

2.3 **Responsibility** – It is the responsibility of the Board of Directors and Senior Management to ensure that the provisions of this guideline are adhered to by the institution and to ascertain that the affected institution improves its capital position, management, an /or business methods.

## **PART III BACKGROUND**

### **3.1 Prompt Corrective Action**

Prompt Corrective Action (PCA) is a framework of supervisory actions of increasingly severe enforcement actions that are applied to institutions that regularly violate laws and regulations, fail to meet prudential guidelines or regulations or in some other way operate in an unsafe and unsound manner. These actions become increasingly severe as

an institution falls within lower capital categories. Some supervisory actions associated with prompt corrective action are mandatory; that is, the actions immediately apply to the institution as it is classified in a particular category. Other supervisory actions associated with prompt corrective action are not mandatory as they are imposed by the Central Bank of Kenya through a series of remedial actions to be taken by an institution to address problems while they are still of a magnitude that can be managed.

An institution shall be subject to PCA whenever any or all of the following conditions occur:

- (1) When it fails to meet the capital requirements prescribed under section 18 and / or the second schedule (Section 7) of the Banking Act;
- (2) The CAMELS composite rating is less than “3” and Management component rating of less than “3”;
- (3) A serious supervisory concern has been identified that places the institution at more than normal risk of failure in the opinion of the CBK. Such concerns could include, but are not limited, to any one or a combination of the following:
  - (a) Finding of unsafe and unsound activities that could adversely affect the interest of depositors and/or creditors;
  - (b) A finding of repeat violations of law or the continuing failure to comply with CBK Directives; and
  - (c) Significant reporting errors that materially misrepresent the institution’s financial condition.
- (4) The institution’s overall composite risk rating is high while the quality of risk management is weak.

3.2 The purpose of enforcing PCA is to ensure that institutions under the purview of the Central Bank of Kenya:

- (a) Comply with the Banking Act, regulations and guidelines issued thereunder.
- (b) Conduct business in a safe, sound & authorized manner thus enhancing the efficiency of the financial sector.
- (c) Maintain a sound financial condition.
- (d) Protect reputation, solvency, interests of depositors, banking system, and the Public.
- (e) Reduce dependence on the regulator for bailouts.
- (f) Provides effective supervisory remedies that minimize losses to the Deposit Protection Fund now the Kenya Deposit Insurance Corporation (KDIC).

### 3.3 **Supervision of Institutions**

- 3.3.1 The Central Bank supervises all banks, financial institutions, and mortgage finance institutions (together, “institutions”) in Kenya using both off-site and on-site supervisory methods, meetings with management, and its powers of enforcement.
- 3.3.2 The CBK conducts off-site supervision which entails applying financial monitoring and analysis techniques, including financial soundness indicators which are based on the CAMELS bank rating system.
- 3.3.3 On-site examinations of institutions is conducted in order to appraise the quality and competence of an institution’s management and attain an in-depth understanding of the risk profile and operations of an institution.
- 3.3.4 Meetings may be held with management and/or the board of directors as deemed necessary based on results of off-site financial monitoring or at the conclusion of each on-site examination or for any other supervisory reason.

## **PART IV SPECIFIC REQUIREMENTS**

**Specific Measures:** The Board of Directors of an institution shall ensure that management at all times adheres to the prescribed requirements for capital adequacy as set out Under Section 18 and the second schedule of the Banking Act and the relevant prudential and risk management guidelines issued thereunder.

The prompt corrective actions to be undertaken by institutions will be dependent upon the capital adequacy, CAMELS and risk rating and risk:

### 4.1 **For Institutions rated “Strong” or “Satisfactory”**

For Institutions rated “Strong” or “Satisfactory” with CAMELS Composite Rating of 1, or CAMELS Composite Rating of 2 and are capital compliant, CBK may take the following actions;

- a) Direct that a special meeting of the Board of Directors be held within 30 days or such other time that CBK may approve from the date that the report of on-site examination is released.
- b) Within 15 days from the date of the Board Meeting, the institution shall take the following actions:
  - (i) The institution will respond to the onsite examination report.



- (ii) Furnish CBK with a signed copy of certificate of director's awareness confirming that the board has read and understood the transmittal letter and the onsite examination report.
- (iii) The Board commits to ensuring that all required actions stipulated in the onsite examination report will be taken in a timely manner.

#### 4.1.1 The Commitment Letter

If the Board of Directors of an otherwise strong or satisfactorily rated institution delays in complying with CBK directive for corrective action, the Central Bank in addition to the board resolution may direct the institution to provide a Commitment Letter.

In this case, the response from the institution is to include a certified copy of an official board resolution stating that:

- (1) The Board of Directors has read the report of on-site examination, the transmittal letter from the Central Bank, the Chief Executive Officer's response, and the proposed Commitment Letter;
- (2) The Board approves the Chief Executive Officer's response and the proposed Commitment Letter;
- (3) The Board agrees to and has adopted and signed the Commitment Letter; and
- (4) The Board commits to ensuring that all required action will be taken in a timely manner.

4.1.1.1 The Board Resolution, together with the Certificate of Awareness and Commitment Letter signed by each director and the Chief Executive Officer's response must be sent to the Central Bank within 15 days from the date of the board meeting.

#### 4.2. For Institutions rated "Fair"

CAMELS Composite Rating of 3; *and* Capital Compliant

##### 4.2.1 Memorandum of Understanding

4.2.1.1 The institution's Board of Directors and Senior Management will be required to enter into a Memorandum of Understanding with the Central Bank of Kenya wherein the Board gives a commitment to undertake to developing, adopting and implementing prompt corrective measures to improve the management, business methods, compliance and condition of the institution.

4.2.1.2 The Memorandum of Understanding shall be presented to the Board of Directors within 30 days of the inspection report being released; a special Board meeting should be called if necessary for the Board to respond to the Central Bank in a timely manner.

4.2.1.3 The Board Resolution:

After the Board Meeting the Board of Directors is to issue to the Central Bank of Kenya a certified copy of an official board resolution stating that:

- a) The Board of Directors has read the report of on-site examination, the transmittal letter from the Central Bank, the Chief Executive Officer's response, and the Memorandum of Understanding;
- b) The Board approves the Chief Executive Officer's response;
- c) The Board agrees to, and has adopted and signed, the Memorandum of Understanding and;
- d) The Board has directed the institution's officers to implement the provisions of the Memorandum of Understanding and commits to ensuring that the institution will comply with all provisions in the established prompt timeframes.

4.2.1.4 The Board Resolution and a Certificate of Awareness and the Memorandum of Understanding should be signed by each director and the Chief Executive Officer's response must be submitted to the Central Bank within 15 days from the date of the Board Meeting.

#### 4.2.2 **Supervisory Actions**

4.2.2.1 Once the Memorandum of Understanding has been signed, throughout the period that it is in effect, the Central Bank will continue to monitor the institution, using specialized reporting and off-site surveillance. The regular annual on-site examination shall be supplemented with periodic interim examinations that target the institution's specific problem areas and verify the institution's adherence to the provisions of the Memorandum of Understanding.

4.2.2.2 If the institution's financial condition continues to deteriorate in spite of the increased supervisory attention, then additional action may be taken as the Central Bank may deem fit. Either the Memorandum of Understanding could be amended to strengthen its provisions, or a PCA Order be issued to the institution.

4.2.2.3 On a consecutive on-site examination, an institution should be assigned a composite rating of "4," instead of a "3," when:

- a) A Memorandum of Understanding has not been adopted as requested by the Central Bank;
- b) A Memorandum of Understanding has been adopted but not complied with, including the failure of the institution to meet any target, adopt any measure, or report any result in the time frame required; and/or
- c) The institution's capital or other measure of its financial condition has significantly deteriorated since the previous examination.

#### 4.3. **For Institutions rated "Marginal"**

CAMELS Composite Rating = 4; *and/or* Undercapitalized

##### 4.3.1. **Assign a Resolution Specialist**

The Central Bank will assign a Resolution Specialist to the institution. A Resolution Specialist is an official of CBK who is designated to supervise marginal and unsatisfactory institutions.

##### 4.3.2 **Determine whether the institution is Viable**

The Resolution Specialist will make an initial determination as to whether the institution is "viable." An institution shall be deemed to be "viable" if it meets *all* of the prescribed criteria outlined in Section 1.4. An institution that does not meet the prescribed criteria shall be found to be non-viable shall be rated "unsatisfactory" or "5" for the purposes of using the Central Bank's powers of enforcement as outlined in Section 4.5.

##### 4.3.3 **Develop a Supervisory Strategy**

As soon as the institution receives a rating of "4" (or "5") and is deemed to be "viable, CBK will develop a supervisory strategy. The supervisory strategy will require the institution to:

- resolve its problems,
- restores the institution through prompt corrective action to financial and managerial health, and
- enforces compliance with the Banking Act, regulations, and directives of the Central Bank.

##### 4.3.4 **Issue a PCA Order**

In accordance with the provisions stipulated in Sections 33 and 34 of the Banking Act, the Central Bank of Kenya, will issue a PCA Order to the institution and/or one or

more individual persons, including a director, officer, employee, significant shareholder, associate, or other person. The order will specify:

4.3.4.1 The target(s) of the Order, either:

- The institution; and/or
- One or more individual persons, including a director, officer, employee, significant shareholder, associate, or other person.

4.3.4.2 The legal ground(s) on which the Central Bank is enforcing compliance:

- The institution or person conducts its business in a manner contrary to the provisions of the Banking Act or of any regulations made there under or any other Act.
- The institution or person conducts its business in a manner detrimental to, or not in the best interests of, its depositors or members of the public.
- The institution is undercapitalized or significantly undercapitalized

4.3.4.3 The actions and violations from which the institution or person should cease.

4.3.4.4 State the affirmative actions which the institution or person should take to correct the conditions at the institution.

4.3.4.5 If deemed appropriate and necessary as part of the supervisory strategy developed for the institution, order the suspension or removal from office in the institution any person who has engaged in, or is about to engage in, or is otherwise responsible for, the actions or violations that are the basis of the order or for violations of or non-compliance with a Memorandum of Understanding or order from the Central Bank.

4.3.4.6 **Additional Measures**

The Central Bank may in addition impose the following additional provisions which the Banking Act requires the Central Bank to impose on undercapitalized institutions:

- a) Restrict, suspend or prohibit the payment of dividends by the institution.
- b) Prohibit the conversion of any profits of the institution into capital.
- c) Direct the suspension or removal of any officer involved in such conduct from the service of the institution.

- d) Require the institution to reconstitute its board of directors in accordance with the criteria set out in the First Schedule of the Banking Act.
- e) Withhold branch or other corporate approval with respect to such institution.
- f) Undertake more frequent inspections of that institution.
- g) Order the institution to submit to the Central Bank, within forty-five days, a capital restoration plan to the capital adequacy prescribed in section 18 of the Banking Act or, in the case of issues unrelated to capital, a plan to resolve all deficiencies to the satisfaction of the Central Bank.
- h) Prohibit the institution from awarding any bonuses, or increments in salary, emoluments, and other benefits to directors and officers of the institution.
- i) At the expense of the institution, appoint a person suitably qualified and competent, in the opinion of the Central Bank, to advise and assist the institution in designing and implementing a capital restoration plan or other corrective action plan under paragraph (g). The person appointed shall regularly report to the Central Bank on the progress of the plan.
- j) Impose restrictions on growth of assets or liabilities of the institution as it deems fit.
- k) Restrict the rate of interest on savings and time deposits payable by the institution to such rates as the Central Bank shall determine; or
- l) Order the institution to take such other actions that may be deemed necessary to rectify a capital deficiency or other weakness.

4.3.4.7 If the institution is a member of a group, and if another member of that group (other than the institution) is a cause (in whole or in part) of the actions or violations that are the basis of the order or for violations of or non-compliance with a Memorandum of Understanding or order from the Central Bank, the Central Bank may impose the following measures:

- Suspend any further investment by the institution in the affected company or entity;
- Suspend the exercise of a non-operating holding company's control of the institution; and/or
- Suspend transactions between any associated entity and the institution.

- 4.3.4.8 The Central Bank may also set forth the institution's reporting obligations to the Central Bank regarding compliance with the Order and the Capital Restoration Plan. A program of meetings may be planned with the board of directors, the senior and/or other officers, and the institution's independent auditors (as deemed necessary through the supervisory strategy process).
- 4.3.4.9 In addition to the above corrective measures, the Central Bank may in addition assess monetary penalties consistent with the requirements of *The Banking (Penalties) Regulations, 1999*, Legal Notice No. 77/99.

#### **4.4. Require a Capital Restoration Plan**

The Central Bank may require an undercapitalized institution to present it with a Capital Restoration Plan. The Capital Restoration Plan is a written document which will outline the steps that the institution will take to become adequately capitalized.

##### **4.4.1 Appoint a Management Advisor**

For undercapitalized institutions, and for institutions with a composite CAMELS rating of "4" (or "5") for reasons other than undercapitalization, the Central Bank of Kenya will appoint a Management Advisor to advise and assist the institution in designing and implementing the Capital Restoration Plan and other plans for corrective action.

Institutions should note that the actual role of a Management Advisor will vary between institutions depending upon the particular needs and problems of those institutions. The terms-of-reference for the position would be customized on a case-by-case basis. In a situation where an institution's problems are isolated and its underlying financial soundness is not threatened, then the terms-of-reference for the Management Advisor appointed to it may be quite short and include only a few responsibilities.

##### **4.4.2 Require the Board of Directors and Senior Management to be strengthened**

- 4.4.2.1 The Central Bank may direct that the board of directors and management of an institution should be strengthened by adding new persons who are experienced with the particular problems confronted by the institution, with other business work-outs, or with other experience deemed relevant. All persons so appointed should be deemed professionally and morally suitable to hold such positions and their appointment should be subject to the approval of the Central Bank.
- 4.4.2.2 In very urgent and serious cases and when the Board of Directors is unwilling, unable, or slow to act, the Central Bank may suspend or remove and replace the following persons. A person who:

- Caused, contributed to, participated in, assented to, did not correct, or caused to worsen the institution's undercapitalization (or significant undercapitalization), violations of law, or other problems for which the institution was assigned the rating of "4" (or "5");
- Is not considered competent to implement the Capital Restoration Plan;
- Obstructed an auditor in the proper performance of his/her duties;
- Obstructed a duly-authorized examiner of the Central Bank in a lawful examination of the institution;
- With intent to deceive, made a false or misleading statement or entry, or omitted a statement or entry that should have been made, in a book, account, report or statement of the institution;
- Committed gross negligence or intentional wrong in the course of his/her duties;
- Failed to take all reasonable steps to secure compliance by the institution with any requirement of the Banking Act, regulations, order, or Capital Restoration Plan;
- Engaged in an act of, or convicted of an offense involving, dishonesty, fraud, or money-laundering.

#### 4.4.2.4 **Supervisory Follow-up**

4.4.2.5 The Resolution Specialist will regularly monitor the institution's:

- (1) capital and financial condition;
- (2) compliance with the PCA Order; and
- (3) implementation of, and adherence to, the Capital Restoration Plan.
- (4) The institution's adherence to required time-frames and reporting requirements shall be carefully monitored and enforced through follow-up action if necessary.

4.4.2.6 More frequent on-site examinations shall be undertaken, either comprehensive or targeted in scope, in order to:

- (1) assess compliance with the PCA order and Capital Restoration Plan;
- (2) ensure that the Central Bank can rely upon the institution's special compliance reports; and
- (3) assess the current condition of the institution.

4.4.2.7 During the period of time that an institution is operating under an order, the Central Bank shall not accept from the institution:

- applications to open a new branch,
- engage in new activities,
- assume new risks, or
- make capital distributions (including the payment of dividends).

- 4.4.2.8 In certain instances, an order will require an institution to receive Central Bank approval prior to making certain investments, including those above a certain amount, or enter into some other transaction.
- 4.4.2.9 When the results obtained from the Resolution Specialist’s off-site monitoring and from subsequent on-site examinations of the institution warrant, the Central Bank shall recommend updates, revisions, and more stringent enforcement measures to the supervisory strategy and order.
- 4.4.2.10 When there is reasonable cause to believe that: (1) the Board of Directors and/or officers of an institution are unwilling or unable to effect compliance with, or to continue to operate pursuant to, the provisions of the order and/or Capital Restoration Plan; or (2) the institution has become, or is expected to become within six months, significantly undercapitalized, then the institution shall be rated “5” (unsatisfactory) and be made subject to the provisions of Section 34 of the Banking Act, “Powers of the Central Bank to Intervene in Management.”

#### **4.5. For Institutions Rated “Unsatisfactory”**

- CAMELS Composite Rating = 5 and Undercapitalized or Significantly Undercapitalized
- CAMELS Composite Rating = 4 and Deemed “Not Viable”;

#### **4.5.1 Assign the Institution to a Resolution Specialist –**

- 4.5.1.1** An institution which receives a rating of “5” without having previously exhibited warning signs of serious problems (for example, when criminal or fraudulent acts are first exposed) which has not yet been assigned to a Resolution Specialist shall be assigned one at this time.
- 4.5.1.2** For an institution that was previously rated “3” and is rated “5” subject to a Memorandum of Understanding shall be assigned to a Resolution Specialist. The Resolution Specialist will revise the supervisory strategy for the institution which will now include much more stringent features due to the institution’s significant drop in rating (from “3” to “5”). The institution shall now be subject to an order by the Central Bank.
- 4.5.1.3** Issue, or Strengthen, PCA Order to the Institution
- 4.5.1.4** In the case of an undercapitalized institution that has remained stable with a “5” rating while registering no significant improvement in its capital position, or in the case of a 5-rated institution which has been downgraded from a previous “4” rating., the Central Bank shall re-assess both the supervisory strategy (including the order) and the



abilities and attitude of the institution's Board of Directors and officers. Some of the factors to be considered in carrying out this assessment include the following;

- Whether the provisions of the Order should be strengthened or new provisions be added.
- Whether the provisions of the Capital Restoration Plan should be amended.
- Whether any officer should be removed or suspended from office.
- Whether any other employee should be terminated.
- Whether any new competent person(s), familiar with the business of institutions, should be appointed to its board of directors.
- Whether the responsibilities of the Management Advisor should be revised or expanded.

#### 4.5.2 **Supervisory Follow-up**

4.5.2.1 When a 5-rated institution that is “undercapitalized” shows progress in implementing its Capital Restoration Plan, specifically showing improvement in its capital position; and compliance with the order of the Central Bank, then the Central Bank shall continue to closely monitor the institution through off-site and on-site supervision in accordance with established procedures for marginal and unsatisfactory institutions.

4.5.2.2 A 5 rated institution shall be presented with a Final Agreement by the Central Bank of Kenya if it fails to comply for whatever reason with either a Capital Restoration Plan or an Order of the Central Bank and/or its capital declines to a level where it becomes “significantly undercapitalized.”

4.5.2.3 Other circumstances that may lead to a Final Agreement between the Central Bank and an institution being drawn up is when one or more of the following additional criteria contained in the Banking Act have been met:

- a) The institution failed to meet a financial obligation, when it fell due including an obligation to pay any depositor;
- b) A petition has been filed, or a resolution proposed, for the winding-up of the institution;
- c) If the auditor of an institution makes a report to the Central Bank under the provisions of Subsection 4 of Section 24 of the Banking Act, which is required when:
  - 1) There has been a serious breach of or non-compliance with the Banking Act, the Central Bank of Kenya Act or the regulations, guidelines or other matters prescribed by the Central Bank;

- 2) A criminal offence involving fraud or other dishonesty has been committed by the institution or any of its officers or employees;
  - 3) Losses have been incurred which reduce the core capital of the institution by fifty percent (50%) or more;
  - 4) Serious irregularities have occurred which may jeopardize the security of depositors or creditors of the institution; or
  - 5) The auditor is unable to confirm that the claims of depositors and creditors of the institution are capable of being met out of the assets of the institution.
- d) There is evidence of reckless or fraudulent conduct or other malpractices or public pronouncements that clearly adversely impact the financial standing of the institution or the Central Bank has become aware of another fact or circumstance which warrants making the institution subject to the provision of Section 34 of the Banking Act.
  - e) There is evidence that the institution knowingly engaged in serious criminal or fraudulent acts that are likely to cause insolvency, substantial dissipation of assets or earnings or may otherwise weaken the institution's condition or seriously prejudice the interests of depositors.
  - f) The institution is part of a group, the complex structure of which prevents the receipt of information necessary for supervision on a consolidated basis.
  - g) The institution ceases to do business in Kenya.
  - h) If the institution is significantly undercapitalized; or
  - i) If the institution fails –
    - i. To submit a capital restoration plan or a plan to resolve all deficiencies as directed under section 33A of the Banking Act; or
    - ii. To add more capital, and it fails, neglects or refuses to comply with an order or to implement a plan of correction

#### **4.6.1. The Final Agreement**

- 4.6.1.1 Entering into a final agreement represents the institution's last chance to voluntarily recapitalize and to rectify its other deficiencies.

4.6.1.2 The Final Agreement gives the institution three months in which to finalize the plans to consummate its recapitalization and to rectify its other deficiencies.

4.6.1.3 Entering into the Final Agreement represents the institution's last chance to voluntarily:

- (1) Raise new capital;
- (2) Merge with another institution;
- (3) Agree to be acquired by another institution or investor;
- (4) Conclude another tangible, reasonable, and timely solution to its problems;  
or;
- (5) Demonstrate good faith effort to do so.

#### 4.6.2 **Appoint a Manager to Assume Control of an Institution**

In the event that an institution's Board of Directors refuses to sign the Final Agreement, delays signing it, or makes changes to it that are unacceptable to the Central Bank, then the Central Bank shall, without delay, start the process of revoking the institution's license and either appoint a Manager pursuant to Section 34 of the Banking Act or appoint the Kenya Deposit Insurance Corporation as liquidator pursuant to Section 35 of the Banking Act.

4.6.2.1 At the expiration of the three-month period covered by the Final Agreement (or sooner if there is an emergency per Section 34(2) of the Banking Act) if the capital of the institution has not been restored to the legally-compliant level, then the Central Bank shall appoint a Manager to assume the management, control, and conduct of the affairs and business of the institution. The term of a Manager shall last for three months unless the appointment is extended by the High Court for good cause shown by the Central Bank.

4.6.2.2 A person appointed as Manager of an institution on behalf of the Central Bank must be highly competent, experienced, and reputable and must be deemed to meet the Central Bank's "fit and proper" standards of the First Schedule to the Banking Act

#### 4.6.3. **Plan for the Take-over of the Institution**

The Central Bank of Kenya shall issue an order that states

- (1) The effective date and time of the order;
- (2) The appointment of a Manager; the term of such appointment, the powers and responsibilities of the Manager;

- (3) The removal and suspension of identified officers, employees, and/or other persons;
- (4) The appointment of any persons to the board of directors;
- (5) A restriction on engaging in new foreign exchange business;
- (6) A prohibition on the institution engaging in new off-balance sheet transactions; and
- (7) The unfulfilled requirements of the Central Bank's existing order to the institution and of the Capital Restoration Plan.

#### **4.6.4. Terminate the Appointment of a Manager**

4.6.4.1 By the end of the 90-day period after assuming control of an institution, the Manager shall be in a position to make a report to the Central Bank regarding the prospects for recapitalizing or restructuring the institution.

4.6.4.2 If a recapitalization plan is recommended, and if the Central Bank concurs, then an application should be prepared and presented to the High Court showing good cause as to why the period of appointment of the manager should be extended beyond the original 90-day period. A reasonable estimate of time should be provided for the extension.

4.6.4.3 If, instead, the Manager recommends that the institution be liquidated, then the Central Bank should appoint the Kenya Deposit Insurance Cooperation as liquidator of the institution.

### **PART V: REMEDIAL MEASURES**

Central Bank may pursue any or all remedial actions provided under sections 33, 34 of the Banking Act

### **PART VI: EFFECTIVE DATE**

**6.1 Effective Date** - The effective date of this guideline shall be 1<sup>st</sup> January 2013.

### **ENQUIRIES**

Enquiries on any aspect of this guideline should be referred to:

Director,

Bank Supervision Department  
Central Bank of Kenya  
P.O. Box 60000 00200  
**NAIROBI**  
TEL. 2860000 e-mail: [fin@centralbank.go.ke](mailto:fin@centralbank.go.ke)

# **GUIDELINE ON CONSUMER PROTECTION-CBK/PG/22**

## **PART I Preliminary**

- 1.1 Title
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## **PART VI Remedial Measures**

## **PART VII Effective Date**

- 7.1 Effective Date

## **PART I: PRELIMINARY**

- 1.1. **Title** - Guideline on Consumer Protection.
- 1.2. **Authorisation** – This Guideline is issued under Section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.
- 1.3. **Application** – This Guideline applies to all institutions licensed under the Banking Act (Cap.488).
- 1.4. **Definitions**
  - 1.4.1. **“advertisement”** means any form of public notice which invites or induces or attempts to invite or induce, directly or indirectly, any person to purchase or acquire an interest in a product or service;
  - 1.4.2. **“complaint”** means any oral or written expression of dissatisfaction about the provision of, or failure to provide, a financial product or service:
    - (a) which is made to an institution by, or on behalf of, a consumer; and
    - (b) which alleges that, as a result of an act or omission by or on behalf of the institution, the consumer has suffered or may suffer:
      - (i) financial loss;
      - (ii) material damage to his reputation or
      - (iii) material distress.
  - 1.4.3. **“Conflict of interest”** refers to a situation in which a person has direct or indirect private or personal interest in a matter which is sufficient to directly or indirectly influence or has the potential to directly or indirectly influence the objective exercise of his or her official or professional duties or the making of impartial judgment over the same or related matter.
  - 1.4.4. **“consumer”** means any entity or person who uses, has used, or is or may be contemplating using directly or indirectly any of the products or services provided by an institution; The term “consumer” may be used interchangeably with the term “customer”;
  - 1.4.5. **“Institution”** has the meaning respectively assigned to it under the Banking Act.

Other terms used in this Guideline are as defined in the Banking Act

## **PART II: STATEMENT OF POLICY**

### **2.1 Purpose**

The purpose of this Guideline is to;

- (a) promote fair and equitable financial services practices by setting minimum standards for institutions in dealing with consumers;
- (b) increase transparency in order to inform and empower consumers of financial products and services;
- (c) foster confidence in the banking sector; and
- (d) provide efficient and effective mechanisms for handling consumer complaints relating to the provision of financial products and services.

### **2.2 Scope**

This Guideline provides a clear framework for protecting customers against risks of fraud, loss of privacy, unfair practices and lack of full disclosure.

### **2.3 Responsibility**

The Board of Directors of each institution shall be responsible for:

- (i) formulating policies, procedures and guidelines which ensure that consumers' interests are safeguarded through adherence to the established laws, regulations and this Guideline.
- (ii) ensuring that the institutions desist from unethical, inequitable and unfair business practices that negatively affect consumers.
- (iii) overseeing the consumer protection framework and ensuring that consumer complaints are attended to and addressed expeditiously.
- (iv) ensuring that institutions comply with this Guideline.
- (v) developing appropriate policies and procedures for the agents of the institution to comply with this Guideline where appropriate.



## **PART III: CONSUMER PROTECTION: OBLIGATIONS OF INSTITUTIONS**

### **3.1 KEY PRINCIPLES**

- (i) All consumers should be treated equitably, honestly and fairly at all stages of their relationship with institutions. Treating consumers fairly should be an integral part of the good governance and corporate culture of all institutions.
- (ii) The relationship between an institution and a consumer shall be guided by five key principles:
  - (a) Fairness;
  - (b) Reliability;
  - (c) Transparency;
  - (d) Equity;
  - (e) Responsiveness.
- (iii) Institutions are expected to formulate and implement policies and procedures that ensure that these principles are complied with at all times:

### **3.2 FAIRNESS**

#### **3.2.1 General Requirements**

- (a) An institution shall act fairly and reasonably in all its dealings with a consumer.
- (b) A consumer shall be treated in a humane manner whenever an institution, its officers or employees are dealing with the consumer whether through face to face or non-face to face contact.
- (c) An institution shall not:
  - (i) engage in unfair, deceptive, oppressive or aggressive practices such as threatening, intimidating, being violent towards, abusing, being non-responsive or humiliating a consumer;
  - (ii) offer, accept or ask for bribes or other “gifts” as an inducement to serve a consumer;
  - (iii) discriminate against any consumer on the grounds of sex, race, colour, ethnic or social origin, tribe, birth, creed or religion, political opinion, disability, pregnancy, marital status, health status, conscience, belief, culture, dress or language.

- (iv) take advantage of a consumer who is not able to understand the character or nature of a proposed transaction. An institution shall therefore inquire of the consumer's specific needs and shall provide suitable products or services relevant to those needs. An institution shall also inquire from the consumer whether he understands the nature of the product or service and the institution shall provide sufficient information to enable the consumer make an informed decision.
  - (v) include an unconscionable or unreasonable term in an agreement;
  - (vi) exert undue influence or duress on a consumer to enter into a transaction;
  - (vii) disguise, diminish, obscure or conceal a material fact or warning through, among others, use of small prints which cannot be read easily, describing the material fact or warning in complex language, use of voluminous documents or omitting a material fact or warning;
  - (viii) mislead or misadvise the consumer; or
  - (ix) lend recklessly or negligently.
- (d) To ensure prudent lending, an institution shall;
- (i) take steps to assess the proposed consumer's general understanding and appreciation of the risks and total cost of the proposed credit agreement and his rights and obligations under the agreement; his debt repayment history for credit; his existing financial means, prospects and obligations; and whether there is a reasonable basis to conclude that any commercial purpose may prove to be successful, if the consumer has such a purpose in applying for the credit; or
  - (ii) after conducting an assessment, consider the merits or demerits of entering into the credit agreement with the consumer if the information available to the institution indicates that the consumer does not generally understand or appreciate his risks, costs or obligations under the proposed credit agreement;
  - (iii) consider whether entering into the credit agreement would make the consumer over-indebted;
  - (iv) ensure that a decision to deny or limit the amount of credit on account of any of the factors mentioned in Clause 3.2.1 (d) shall be reasonable, justifiable and clearly explained to the consumer and the institution may propose the modalities of addressing the deficiencies or obstacles identified to enable the consumer access the credit.
- (e) A consumer is over-indebted if the prevalence of available information at the time a determination is made indicates that the consumer is or will be unable to satisfy in a timely

manner all the obligations under all the credit agreements to which the consumer is a party, having regard to that consumer's:

- (i) financial means, prospects and obligations; and
  - (ii) probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment and other relevant factors prevailing at the time of credit assessment.
- (f) To ensure prudent use of borrowed funds, an institution advancing credit to a consumer may consider giving free financial advisory services to the consumer on prudent management of the funds, risks to be avoided or mitigated and the steps to take in case of unexpected eventuality. The institution may keep in constant touch with the consumer to keep updated on how the borrowed funds are being used and any intervening development which might affect the repayment obligations of the consumer.

### **3.2.2 Responsible Business Conduct**

- (i) Depending on the nature of the transaction and based on information provided by a customer, an institution should assess and understand the needs of the customer before rendering a service.
- (ii) Staff (especially those who interact directly with customers) should be properly trained and qualified.
- (iii) Where the potential for conflict of interest arises, institutions should endeavor to avoid such conflicts. When such conflicts cannot be avoided institutions should ensure proper disclosure, have in place internal mechanisms to manage such conflicts, or decline to provide the product, advice or service.
- (iv) The remuneration structure for staff of institutions should be designed to encourage responsible business conduct, fair treatment of consumers and to avoid conflicts of interest. The remuneration structure should be disclosed to customers where appropriate, such as when potential conflicts of interest cannot be managed or avoided.

### **3.2.3 Provision of Information and Advice to a Consumer**

- (a) Prior to a consumer choosing a product or service, an institution shall:
  - (i) explain clearly in simple and ordinary language which the consumer understands, the key features of the range of products and services that the consumer is interested in so as to enable the consumer to arrive at an informed decision about these products and services

- (ii) inform the customer of all charges, fees penalties and any other financial liability or obligation which would be incurred arising from the use of the product or the rendering of the service sought; and
  - (iii) request the consumer to provide, where applicable, all the information needed to verify whether or not the consumer is eligible for a product or service in which the consumer is interested.
- (b) Where a consumer has chosen a product or service, an institution shall before the consumer buys the product or service:
- (i) provide the consumer with general information or a summary of the main features of the product or service including the interest rate, charges, fees or other financial obligation relating to the product or service;
  - (ii) give the consumer a copy of any signed agreement which contains the terms and conditions of the agreement and
  - (iii) inform the consumer of the applicable charges, fees or additional interest the consumer will bear should the consumer decide on an early termination of any contract.

#### **3.2.4 Suitability of Advice**

- (a) Where an institution gives advice to a consumer, the institution shall ensure that:
- (i) the advice is suitable, taking into account the circumstances and needs of the consumer;
  - (ii) any product or service which the institution recommends to a consumer to buy is suitable for the consumer. The consumer should be allowed to exercise his free will on whether or not to consume a product or service.
  - (iii) there is no other product or service available to the institution that would be more suitable for the consumer. The institution shall bring to the attention of the consumer all available products or services which may be suitable to the needs of the consumer to enable him choose a product or service which best suits his needs.
- (b) Where an officer or employee of an institution is promoting a product or service of an institution at a fee or commission payable by the institution, the officer, or employee shall inform the consumer of this fact without stating the figures to enable the consumer to consider the impartiality or otherwise with which the product or service is promoted.

- (c) An institution shall obtain from the consumer such information as is necessary for the institution to comply with clause 3.2.3(a) (i), (ii) and (iii).
- (d) Institutions should educate their consumers on their products and services through mechanisms such as:
  - (i) posting frequently asked questions in their websites or disseminating appropriate brochures within its business premises;
  - (ii) operating an effective call centre with competent staff to attend to customers queries and complaints; and
  - (iii) public awareness campaigns.

### **3.2.5 Conditional Sales**

- (a) An institution shall not require a consumer who buys one product or service to buy another product or service from a specified provider.
- (b) Where the provision of a product or service by an institution to a consumer requires additional but ancillary (auxillary) products or services from other providers, the institution shall make available to the consumer, where it is necessary to do so, a list of ancillary products or service providers to choose from and the consumer shall be allowed to exercise his free will. This is applicable where auxiliary financial services are necessary for the consumer to fully enjoy the benefits of a financial service or product.
- (c) However, clause 3.2.5(a) does not preclude an institution from offering linked products (e.g. making it a condition of a salary loan that the consumer has a current account with that same provider) where the provider is itself providing each of these linked products.

### **3.2.6 Cooling Off Period**

- (a) An institution shall prior to entering into a contract with a consumer:
  - (i) explain to the consumer that he has the freedom not to enter into the contract if he is not sure of the suitability of the product or service or if the terms and conditions of the contract appear onerous or if the execution of the contract by the consumer shall be secured with difficulty arising from the financial position or other condition of the consumer.
  - (ii) inform the consumer of his right to take some time to think over the proposed transaction before signing the contract or committing himself to take the product or use the service.

- (iii) request the consumer to confirm whether he needs some time to reconsider the proposed transaction. The institution shall act in accordance with the wishes of the consumer.

### **3.2.7 Protection of consumer assets against fraud and misuse**

Relevant information, control and protection mechanisms should appropriately and with a high degree of certainty protect consumers' deposits, savings, and other similar financial assets, including against fraud, misappropriation or other misuses.

### **3.2.8 Information on Deposit and Loan Accounts**

- (a) Where a consumer has a deposit or loan account with an institution, the institution shall provide the consumer with periodic statements of his deposit or loan account showing what transpired since the last statement that affected the account of the consumer, including balance changes, payments, withdrawals, disbursements and costs.
- (b) The institution shall at such interval as the institution may deem reasonable deliver to the consumer free of charge a statement of his account in a documentary form. This clause does not however preclude an institution from issuing or availing statements to consumers at such frequency and in such form including electronic form for free or at such nominal fees as the institution may charge; or as may be requested by a consumer from time to time; or as may be agreed upon between an institution and a consumer.
- (c) Given the obligations attaching to a loan account, it is advisable that borrowers and their guarantors are frequently notified by means that are convenient and cost effective of the loan statement showing all balance changes, payments, withdrawals, disbursements, costs and any other financial liability that has accrued to that account.
- (d) An institution shall either independently or in agreement with a consumer device means of communicating loan statements to borrowers and their guarantors to ensure that borrowers and their guarantors are constantly informed of the loan repayment status. An institution may establish a mechanism by which a customer may be confidentially notified of his loan statement status through phone, sms, e-mail, internet or other convenient means,
- (e) Consumers have a duty to ensure that they frequently establish from the institutions their loan repayment status and promptly notify the institutions in case of any discrepancy on the repayment records kept by themselves and those kept by the institutions.
- (f) Institutions shall develop procedures for notifying their consumers generally of the need to check their loan repayment status to avoid disputes on the amount owing from them and further to avoid their credit information on non-performing loans being submitted to the credit reference bureaus when the consumer would be in a position to remedy the situation before the information is submitted to the credit reference bureaus.

- (g) The institution shall keep records of all notices issued to a consumer in respect of a loan.
- (h) An institution shall endeavour to notify a consumer of loan performance status by as many means as possible which are likely to reach the consumer instantly or without unnecessary delay. An institution may consider registered mail, e-mail, sms, phone, internet; physical delivery of the notice and such other means as would enable the consumer to receive notices sent by the institution.

### **3.2.9 Notice of Changes to Terms and Conditions and other dealings**

- (a) An institution shall ensure that a consumer is notified within a reasonable time as the circumstances of the case may require and before implementing any changes to the terms and conditions of a contract, fees or charges, discontinuation of services or relocation of premises of the institution.
- (b) For purposes of paragraph 3.2.9 (a) above, the consumer and the institution shall agree at the time of opening the account or signing the loan contract or at such other time as may be convenient, on the mode of notification. The institution may also device suitable methods for reaching or notifying the consumers either individually or generally where it is not possible or convenient to enter into agreements with consumers on the mode of notification.

### **3.2.10 Debt Recovery Expenses**

- (a) Where a consumer is unable to repay a loan as per agreed terms in the loan contract and the institution has to incur expenses to recover the outstanding amount, the institution shall;
  - (i) only incur expenses that are absolutely necessary for the recovery of the amount.
  - (ii) provide the consumer with a detailed breakdown of the costs and expenses incurred and the justification for such costs or expenses;
  - (iii) in the case of the sale of the property of a consumer or his guarantor, ensure that the sale is transparent.
- (b) Where an institution plans to outsource collection of a debt, the person who can collect the debt and the manner in which that debt can be collected should be brought to the customer's attention within a reasonable time before commencement of the debt collection by the outsourced third party.

### **3.2.11 Protection of consumer data and privacy**

- (i) Consumers' financial and personal information should be protected through appropriate control and protection mechanisms.

- (ii) The protection mechanisms should define the purposes for which the data may be collected, processed, held, used or disclosed (especially to third parties).
- (iii) The mechanisms should also acknowledge the rights of consumers to be informed about data-sharing, to access data and to obtain the prompt correction and/or deletion of inaccurate, or unlawfully collected or processed data.

### **3.2.12 Closing of Accounts**

- (a) An institution shall not close an account of a consumer without giving the consumer a reasonable notice of not less than fourteen days except:
  - (i) where the account is being used for illegal activity; or
  - (ii) pursuant to a court order.
- (b) Where an institution seeks to close a consumer's account for reasons other than those stated in Clause 3.2.12 (a), the institution shall inform the consumer of the reasons why the account should be closed.
- (c) Where a consumer can take steps to prevent his account from being closed, he shall be given sufficient time to take such steps as may be necessary to keep the account running.
- (d) Where an institution closes an account of a consumer, the funds in that account shall be paid to the customer or his legal representative in such manner as the institution may deem fit unless there exists grounds or reasons for not paying the funds to the customer or when it is impossible to trace the customer despite several attempts having been made to trace the customer in which case the funds shall be dealt with as may be prescribed by any other written law.
- (e) The funds in an account closed pursuant to a court order may only be dealt with as the court may direct.

## **3.3 RELIABILITY**

### **3.3.1 Updating the Address and other particulars of a Consumer**

- (a) To enable an institution to serve a consumer better and keep a consumer informed, an institution shall request a consumer to keep the institution informed of any change in his or her postal address, physical address, e-mail address, telephone number, or any other particular the record of which is in possession by the institution.
- (b) An institution may, in the course of dealing with a consumer or at such time as the institution may decide, request a consumer to confirm his latest and most reliable address or means of



communication and his preferences for communication purposes between him and the institutions. Preferences are not limited to one means of communication. It is preferable that consumers provide alternative means of communications to enable institutions reach their customers through many means.

### **3.3.2 Reliability of banking channels**

- (a) Institutions should ensure that banking channels used by them to provide services are available most of the time.
- (b) The banking channels should be closely monitored to ensure that they are functioning and are not used for illegal activities.

### **3.3.3 Safeguarding Consumer Information**

- (a) Institutions shall not disclose any information about a consumer to a third party except
  - (i) where the law so requires or permits;
  - (ii) where it is in the interest of the institution to disclose the information;
  - (iii) as may be authorised by the consumer.
- (b) The duty not to disclose any information about the consumer includes information relating to the consumer's accounts and any information about the relationship between the institution and the consumer.

### **3.3.4 Protecting an Account of a Consumer**

- (a) An institution should advise a consumer on the measures to take to protect or safeguard his account, cheque book, bank card, PIN or other document or information pertaining to his account.
- (b) An institution shall provide consumers with a dedicated telephone line(s) to enable consumers to report a lost or stolen card, cheque book or passbook or a suspect transaction.

### **3.3.5 Training, Competence and Supervision**

- (a) An institution shall:
  - (i) assess the training needs of its staff when they take up a new role and at appropriate intervals after that (including if their role changes);
  - (ii) ensure that its staff receive sufficient training;
  - (iii) satisfy itself, on reasonable grounds, that its staff are competent to carry out their roles;
  - (iv) review at appropriate intervals the competence of its staff and take steps to ensure that they remain competent for their role;

- (v) ensure that there is adequate segregation of roles;
  - (vi) arrange for its staff to be appropriately supervised.
- (b) Clause 3.3.5 (a) above applies to the extent necessary to ensure that the institution complies with all other provisions in this Guideline.
- (c) An institution, in determining how to ensure that it complies with clause 3.3.5(a) above, shall take into account such matters as:
- (i) technical knowledge and its application;
  - (ii) skills and expertise; and
  - (iii) changes in the market and to products, legislation and regulation.
- (d) An institution shall consider the level of relevant experience and integrity of a member of staff and the nature of the assignment when determining the level of supervision required.
- (e) The remuneration structure of staff of institutions should be designed to encourage responsible business conduct.

## **3.4 TRANSPARENCY**

### **3.4.1 General Principles**

- (i) Information should be provided on material aspects of the financial product or service. Appropriate information should be provided at all stages of the relationship with the customer.
- (ii) All financial promotional material should be accurate, honest, understandable and not misleading.
- (iii) Standardised pre-contractual disclosure practices (e.g. forms) should be adopted where applicable and possible to allow comparisons between products and services of the same nature.
- (iv) Specific disclosure mechanisms, including possible warnings, should be developed to provide information commensurate with complex and risky products and services.
- (v) Consumer research should be conducted to help determine and improve the effectiveness of disclosure requirements.
- (vi) The provision of advice should be as objective as possible and should in general be based on the consumer's profile considering the complexity of the product or service, the risks associated with it as well as the customer's financial objectives, knowledge, capabilities and experience.

- (vii) Consumers should be made aware of the importance of providing institutions with relevant, accurate and available information.

### **3.4.2 General Requirements**

- (i) An institution shall:
  - (a) ensure that any information given to a consumer on among other things benefits, prices, risks and the terms and conditions; whether in writing, electronically or orally is fair, clear and transparent;
  - (b) ensure that the information in clause 3.4.2(a) above is easily comprehensible so that a consumer can make an informed choice about a product or service;
  - (c) ensure that consumers are informed, at the time of opening an account and at intervals thereafter as necessary, of the implications of inactivity or dormancy of the account.
  - (d) ensure that the information is written in simple language and in a legible font size so that it is clear and readable;
  - (e) where a consumer is unable to understand English and Swahili, provide an oral explanation in a language the consumer understands. The institution may also arrange for a written translation of the information into the language the consumer understands should the nature of the transaction require such a translation and as may be mutually agreed upon by the institution and the consumer;
  - (f) where a consumer is unable to understand written information, explain orally to the consumer the written information;
  - (g) ensure that where an oral explanation in clause 3.4.2(e) and (f) has been provided to the consumer, the consumer shall sign as evidence that an oral explanation has been given where the nature of the transaction would necessitate such a confirmation by the consumer;
  - (h) ensure that information on its products and services is updated and current and easily available at its branches, websites and any other communication channels which it uses;
  - (i) ensure that it discloses at its branches, websites, advertisements, promotional materials and any other communication channels which it uses that it is regulated by the Central Bank of Kenya.
  - (j) Disclose its identity in the correspondence, documents and other written instruments that the institution issues in the course of its business generally or while dealing or contracting with a consumer.
- (ii) Disclosure of the name of the regulator will make a consumer aware that the institution is regulated; and will assist the consumer contact the regulator if the consumer considers that the institution has failed to comply with its regulatory requirements.

### **3.4.3 Key Facts Document**

- (i) An institution shall;
  - (a) prepare and maintain key information in a summarised form that informs the consumer of the fundamental benefits, risks and terms of the product or service.
  - (b) ensure that contracts and other documentation relating to the financial products or services they provide are summarized in a key facts document written in simple language, setting out clearly and briefly all the key information relating to the product or service. The information may relate to the description of the product or service, key features, benefits, requirements to be met to consume the product or service, charges and fees; potential risks, documentation required, transaction process and complaint procedure.
  - (c) on request or as the nature of the transaction may necessitate or with a view to enlightening the consumer better, provide the consumer with a copy of the Key Facts Documents in respect of the product or service the consumer is interested in or related product or service which may be of interest to the consumer. The key facts document may also be made available on the website of the institution to which a consumer may be referred if the consumer has access to the internet.

### **3.4.4 Terms and Conditions**

- (i) The terms and conditions provided by an institution shall highlight to a consumer the fees, charges, penalties, relevant interest rates and any other consumer liabilities or obligations in the use of the financial product or service.
- (ii) An institution shall inform a consumer of all fees, charges, penalties, relevant interest rates and any other consumer liabilities or obligations relating to a product or service a consumer is interested in and shall explain to the consumer how these pecuniary liabilities may be calculated and when they will accrue.

### **3.4.5 Disclosure of Interest Rates**

- (i) For both interest-bearing deposits and loans, institutions shall prior to the consumer signing the contract:
  - (a) inform the consumer of the term of the fixed deposit or loan;
  - (b) inform the consumer of the charges, if any, for, and consequences of, prematurely terminating a fixed deposit or loan;
  - (c) inform the consumer of whether the interest is fixed or variable;
  - (d) give a consumer information on the applicable interest rates for the contracted period and the basis and frequency on which interest payments or deductions are to be made;
  - (e) explain the method used to calculate interest rates;
  - (f) disclose prominently the total amount of income the consumer shall receive on the fixed rate deposits of the consumer;

- (g) provide a repayment schedule over the term of the loan indicating periodic principal repayments and interest charged; and
  - (h) disclose the total cost of credit.
- (ii) Total cost of credit refers to the total amount payable for credit, including all fees and other charges from the lender, after deducting the original loan amount.
- (iii) The total cost of credit is calculated by adding together all costs which the borrower would need to pay over the period of a loan. That is, it is the total sum which the borrower would need to repay, less the capital sum which is to be borrowed. The costs which the borrower would need to pay include interest payments, together with any fees, charges and commissions. These costs will also include other charges paid to third party providers for purposes of the loan such as legal fees, brokerage, insurance, valuation and government levies among others.

### **3.4.6 Fees and Charges**

- (a) Institutions shall, for all charges and fees to be levied:
- (i) provide a consumer with a schedule of ALL fees and charges (including commissions payable) for the product or service that a consumer has chosen;
  - (ii) display prominently its standard fees and charges at all its branches, promotional materials and through any other communication channels which it uses;
  - (iii) inform a consumer, at the time the services or products are offered and on request, of the basis of charges for services rendered which are not subject to standard fees and charges; and
  - (iv) inform a consumer of any additional charges or expenses that a consumer has to pay in respect of a particular transaction.
- (b) Where third party fees and charges are involved, an institution shall inform a consumer in advance of the relevant service or product and applicable fees and charges.
- (c) For the purposes of clause 3.4.6(b) above, third party fees and charges are fees and charges which are not levied directly by an institution but arise when another institution, agent or party is used.
- (d) The third party or agent referred to under clauses 3.4.6(b) and (c) must be approved by the Central Bank of Kenya as stipulated under the relevant legislations such as Outsourcing and Agent Banking Guidelines.

### **3.4.7 Display of Fees and Charges**

- (a) Institutions shall display, in a prominent place, in their places of business and website, information relating to fees and charges relating to their products which would enable the customer to obtain the desired information at a quick glance.

- (b) The display of fees and charges should be in a conspicuous place and should be legible.
- (c) Institutions should also indicate that a customer has the right to obtain a copy of a Key Facts Document.

### **3.4.8 Marketing and Promotions**

- (a) Institutions shall ensure that all advertising and promotional materials are fair, clear and not misleading.
- (b) Institutions shall ensure that the information is written in simple language and in a legible font which is easily readable.
- (c) All printed advertising and promotional materials for financial products or services which make a reference to an interest rate, shall include the total cost of credit and whether the interest rate is per annum or per month and whether the interest rate is fixed or variable.
- (d) For the purposes of clause 3.4.8(c) above, the total cost of credit shall be prominently displayed.

## **PART IV - COMPLAINTS HANDLING AND CONSUMER RECOURSE**

### **4.1 Complaints Procedures**

Institutions shall have in place and operate appropriate and effective procedures, which are documented, for receiving, considering and responding to consumer complaints.

### **4.2 Informing Consumers About Complaints-Handling Procedures**

Institutions shall ensure that information about procedures for handling consumer complaints are easily available at its branches, websites, brochures and any other communication channels which it uses.

### **4.3 Investigating and Determining Complaints**

- (i) Once a complaint has been received by an institution, the institution shall:
  - (a) investigate the complaint competently, promptly and impartially;
  - (b) assess fairly and promptly the subject matter of the complaint, whether the complaint should be upheld and what remedial action or redress (or both) may be appropriate;
  - (c) offer any redress or remedial action which is appropriate;

- (d) explain to the complainant, in a way that is fair, clear and not misleading and in a language the consumer understands its assessment of the complaint, its decision on it, and any offer of remedial action or redress; and
  - (e) comply promptly with any offer of remedial action or redress which the complainant accepts.
- (ii) When assessing the track record of an institution in investigating and determining complaints, the Central Bank of Kenya will have regard to the quality and fairness of the institution's investigations and determinations and to the clarity of its written communications to complainants.

#### **4.4 Keeping the Complainant Informed**

- (a) An institution, on receiving a complaint, shall provide the complainant with a prompt written acknowledgement (at least within 7 days of receipt) that it has received the complaint and is dealing with it.
- (b) Where a complaint which was submitted orally is not resolved within forty eight hours, the institution shall confirm to the consumer in writing, through electronic means or through other means agreeable to the consumer of the existence of the complaint and that it is still pending resolution by the institution

#### **4.5 Time Limit for Resolving Complaints**

- (i) Institutions shall establish timeframes within which various types of complaints will be resolved and notified to the complainant.
- (ii) The Central Bank of Kenya will have regard, when assessing an institution's track record in investigating and determining complaints, to the clarity and reasonableness of requests which the institution has made to complainants for further information, the speed with which the complaint was resolved, whether the institution has taken steps to address generally the factors that led to the complaint to avoid future complaints of a similar nature, the nature of compensation and the responsiveness of the institutions in limiting the number of complaints from its customers.

#### **4.6 Identifying and Remediating Recurring Systemic Problems**

Institutions shall put in place arrangements to ensure that, in handling complaints, it identifies and remedies any recurring or systemic problems by:

- (a) Analyzing the causes of individual complaints in order to identify any failings in processes, products or services and staff; and

(b) Correcting any such failings.

#### **4.7 Quarterly Complaints Reports to Central Bank of Kenya**

- (a) Institutions shall provide Central Bank of Kenya with a report, in the format set out at Appendix A to these Guidelines, concerning its receipt and handling of consumer complaints.
- (b) Reports shall cover the calendar quarters of the year and shall be sent to reach the Central Bank of Kenya within 10 days after the end of every calendar quarter.

### **PART V – CONSUMER PROTECTION PROVISIONS EMBEDDED IN OTHER LEGISLATIONS**

- (a) The consumer protection provisions in this Guideline are applicable concurrently with those stipulated in other legislations such as the Banking Act, Cap 488; and Agent Banking Guidelines.
- (b) The Central Bank of Kenya will consider the provisions in this Guideline together with those in the other legislations, guidelines and regulations in determining whether an institution has adequately safeguarded the interests of consumers as they provide their products and services.

### **PART VI: REMEDIAL MEASURES**

Central Bank may pursue any or all remedial actions provided for under sections 33, 33A, 34 and 55 of the Banking Act and may take such other administrative action as it may deem appropriate.

### **PART VII: EFFECTIVE DATE**

**7.1 Effective Date** - The effective date of this guideline shall be 1<sup>st</sup> January 2013

#### **ENQUIRIES**

Enquiries on any aspect of this guideline should be referred to:

Director,

Bank Supervision Department

Central Bank of Kenya

P.O. Box 60000 00200

**NAIROBI**

TEL. 2860000 e-mail: [fin@centralbank.go.ke](mailto:fin@centralbank.go.ke)



**APPENDIX I**

**CBK/IF 20-1**

**QUARTERLY COMPLAINTS REPORT TO THE CENTRAL BANK OF KENYA**

**Name of Institution -----**

**Quarter Ended-----**

<b>Date of Complaint</b>	<b>Complainant</b>	<b>Nature of Complaint</b>	<b>Status</b>	<b>Resolution</b>