ANALYSIS OF MONEY LAUNDERING CONTROL PRACTICES ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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Abstract- Money laundering is a widespread problem in commercial banks, causing substantial financial losses and eroding customer confidence. This criminal activity encompasses a wide range of activities including misappropriation, embezzlement, fraud, theft, and irregularities. To combat money laundering, Kenya introduced prudent guidelines under the Banking Act of 2006. Despite these efforts, the problem persists, making it hard to find the offenders, stop them, and bring them to justice. The aim of this study was to examine the factors that impact the effectiveness of money laundering control practices and their effect on the financial performance of commercial banks in Kenya. The study explored the relationship between money laundry control practices focusing on bank reports, operation costs, and cost of monitoring with financial performance.

A survey design was used targeting 38 licensed commercial banks. The study used census technique with a total of 104 respondents comprising of account opening manager, risk manager and anti-money laundry manager from each commercial bank. Primary data was collected through structured questionnaires and secondary data obtained from the central bank fraud prevention unit. Both quantitative and qualitative research methods were employed. The research finding quantitative was analyzed using SPSS for both descriptive and inferential statistics. Data was presented in form of tables, bar graphs, tables, figures and pie charts. Descriptive statistics involved mean and standard deviation computations for all the variables. Inferential statistics data was analyzed using multiple regression models to measure the correlation between the money laundry control practices and financial performance. The study findings will provide insight into the money laundry control practices and financial performance. The study findings will provide insight into the money laundry control practices and financial performance. The results showed a show a positive and critical connection between bank reports money laundry control practice and financial performance as upheld by a beta coefficient of 0.589 and p estimation of 0.003. The results also showed a positive relationship between operational cost money laundry control practice on financial performance as shown by a beta coefficient of 0.427 and p estimation of 0.035. Further, results showed a positive connection between cost of monitoring transactions money control practice and financial performance of 0.792 and p estimation of 0.000. Further, the four independent variables were significant predictors of combating money laundering in Kenya. Therefore the findings conclude that money laundry control practices have a positive effect on financial performance of commercial banks. Recommendations were that commercial Banks should ensure bank reports are updated frequently to influence the level money laundry control practice compliance thus affecting the financial performance of commercial banks. On cost of operational, banks should be able to source for highly competent experts to be in charge of the systems. Commercial banks should also put into consideration reducing the number of staff by automating most of the bank operations. Monitoring of transaction was also found to have a significant influence on money laundry control practice. Commercial Banks should find ways of reducing the number of monitoring staff as a way of cutting money laundry control monitoring cost thus improving the financial performance. The central bank of Kenya as the commercial banks regulator needs to enhance its supervisory role to ensure anti money laundry compliance, and therefore impose heavy punitive penalties to non-compliant commercial banks in Kenya.

Key words: Money Laundry, control practices, financial performance.

INTRODUCTION
1.1 Background of the Study

Money laundering can be defined as an economic crime that as greatly impacted Africa’s development in economy. It involves disguising the illicit origin of criminal funds and introducing it into the financial system as legitimate proceeds. Different descriptions are provided by different scholars which includes Douglas (2015) who explained that money laundering is a process involving concealing proceeds of crime by moving it around in order to disguise their location ‘nature, ownership, source, ownership or control. In addition to the dent it has caused in the economic development, it has painted a negative visualization of African countries in the international money arena. The process often involves using the world’s financial system, consisting of interconnected financial institutions, achieved by SWIFT, to move the proceeds of crime. Also, the United Nations Convention against Transnational Organized Crime (2012) defined money laundering as the conversion that involves transfer of property acquired from criminal activities with the aim of concealing or disguising its illicit origin to avoid and evade the legal consequences of these actions.

Anti-money laundering may be defined as a procedure or a group of actions taken in an effort to stop money laundering. Money laundering has a negative effect on the smooth operation of the financial system, according to the US Certified Anti-Money Laundering Specialist Association, so it is crucial that governments consider the opinions of all pertinent parties when creating a national and international anti-money laundering program (Ahmad, 2013). In 1989, G7 summit was first convened and the Financial Action Task Force consisting of all G-7 member states, the European Commission, and eight other supporting states were established and their key responsibilities being to alleviate measures against money launderers and their effects on banking system and financial institutions. FATF first proposed forty guidelines for fighting money laundering, but then added nine additional that were targeted at preventing the financing of terrorism. Since money laundering is a worldwide issue that has a varied impact on all nations, later FATF members included more members from several continents.

Commercial banks must adhere to anti-money laundering laws and train their staff to spot and report questionable transactions. To manage the danger of money laundering, banks may also establish specific risk management divisions. Money laundering is the process of turning illicit funds into "clean" funds that may be utilized in lawful commercial ventures without being noticed by law enforcement. With trillions of dollars involved each year, this illicit activity has a tremendous influence on the world economy. The employment of more sophisticated techniques by money launderers to legalize their illicit riches persists in spite of efforts to identify and stop it. Some commercial banks have been accused of supporting schemes to launder money (Viritha, Mariappan & Venkatachalapathy, 2015). Kenya's Central Bank has prioritized the requirement to build an effective, secure, and dependable payment infrastructure when developing the country's national payment system (Mugarura, 2017). Despite the fact that bank money laundering procedures were developed by rogue bankers and professional criminals, AML procedures' flaws have been largely blamed for the rise in criminality. In addition to losing the trust of its impacted consumers, commercial banks are suffering significant losses because of money laundering operations.

1.2 Statement of the Problem

Money laundering incidents in commercial banks are on the rise despite the implementation of anti-money laundering procedures. Money laundering is estimated to cost anywhere from $725 billion to $1.8 trillion globally, according to the International Monetary Fund. According to Basel Committee on Banking Supervision, anti-money laundering systems are essential, which also sees the financial services sector as a significant actor in the fight against money laundering. Kenyan Anti-Money Laundering framework is ineffective, according to a US Department of State assessment from 2014, which mentioned a significant money laundering case involving Charterhouse Bank Management that occurred in Kenya between 2017 and 2019. Between 2019 and 2021, the bank mishandled accounts, avoided paying taxes, import fees, and audits, and laundered $500 million (Ksh 40 billion).

The bank management was accused of breaking the prudential and Know Your Customer rules of the Central Bank of Kenya (CBK). According to the U.S. Department of State (DoS) report from 2014, Kenya is facing a significant money laundering problem with approximately $101 million (Ksh 8.1 billion) being money laundered annually. This report also highlighted the lack of an effective Anti-Money Laundering (AML) regime in Kenya. The same report referred to a major money laundering case in Kenya between 2018 and 2020 involving Charterhouse Commercial Bank Management, which committed account irregularities and evaded taxes, import duties, and audits to money laundry approximately $510 million (Ksh 40.1 billion) from 2010 to 2017. This report stated that the managers of Charterhouse Bank also violated the Central Bank of Kenya’s (CBK) basic "Know Your Customer” guidelines and CBK Prudential Guidelines.
1.3 Objective of the Study
To assess whether banking reports money laundry control practice has an effect on the financial performance of commercial Banks in Kenya.

1.4 Research Hypothesis
H₀: There is no significant relationship between banking reports on money laundering control practices on the financial performance of commercial banks in Kenya.

LITERATURE REVIEW
2.1 Theoretical review
2.2.1 “Crying Wolf”
Takats (2017) claimed that "crying wolf" behavior, or excessive reporting, might reduce the informational value of bank reports. By conducting the first systematic examination of money laundering enforcement, over reporting was looked into. It was noted that if banks did not disclose money laundering, they risk fines. However, hefty fines compel commercial banks to record less questionable transactions, muddying the data. Using the model, feasible remedial policy recommendations are made, such as lowering fines and instituting reporting costs.

2.2.3 Economic Theory
According to this theory, increased disclosure may point to systemic issues within the banking industry. This results to circumstances that could lead to unfavorable externalities like money runs and worries about the fragility of the financial system. This is mentioned by Smellie (2014), that it is widely agreed that without some type of enforcement put in place. The contribution by broad disclosure policies by central banks should include the enforcement (Murithi, 2013). This hypothesis refers to how much it costs commercial banks to operate especially on money laundry controls thus affecting commercial banks financial performance.

2.3 Empirical Review
Wang (2015) carried out a study and found that Zambia commercial banks had complied with the AML directives from Bank of Zambia since 2004. However, in order to create an effective system to combat AML, it’s important for commercial banks to take stringent measures and policies represented in order to control AML. AML standards like KYC rules were created to respond to calls in order to increase the ability to stop financial sectors from being used as ML conduits. Policy change on the subject of such essential AML instruments has never halted since the inception of AML research (Ai, 2015). The major aim commercial institutions are to make a balance between income and expenses to determine how AML legislation influences commercial banks and other financial institutions (Filoto, 2017).

2.4 Cost Involved in money laundry control practices
2.4.1 Bank Record Keeping Costs.
Kenyan commercial banks must obtain and maintain a record of personal information from customers, including their name, residential address, and source of income, in order to monitor transactions. Know Your Customer (KYC), an AMLR technique, prevents banks from being used by criminal elements for money laundering or other shady operations, whether on purpose or accidently. According to KYC guidelines, financial institutions must also carry out "ongoing due diligence on their business dealings" and "scrutinize transactions undertaken throughout the transactions" to make sure that their financial operations are consistent with what they already know about their customers. KYC is essential for preventing money laundering in financial institutions.
It is crucial to remember that retaining documents for the required amount of time is a statutory requirement, and doing otherwise might result in fines. To preserve sensitive information and guarantee compliance with privacy rules, records destruction should also be done in a secure and private way. The organization's important stakeholders should be informed of the record retention policy, which should be thoroughly documented.

2.5 Conceptual Framework
The conceptual framework is the depiction of the relationship between variables for study. These are: bank reporting, operational costs, cost of monitoring transactions represent the independent variables, while financial performance of commercial banks represents the dependent variable.

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Dependent Variable</th>
</tr>
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<tbody>
<tr>
<td>Bank Reporting</td>
<td>Financial Performance of commercial banks in Kenya</td>
</tr>
<tr>
<td></td>
<td>• Increased number of</td>
</tr>
</tbody>
</table>
RESEARCH METHODOLOGY

3.1 Research Design
This study was conducted using a descriptive survey research design. Wallen (2021) argued that a descriptive survey helps in gathering information from respondents picked from a population in order to ascertain the population's current state with regard to one or more variables. The design examines the degree, difficulties, and impact of money laundry control practices and financial performance of commercial banks. As it aims to describe and understand a condition, this study is a descriptive survey.

3.2 Target Population
The study’s population will be the 38 commercial banks based in Kenya as by June 2021 as provided in Appendix IV. The study population comprised of 104 commercial banks staff members who were serving as managers in departments dealing to money laundry control departments that is accounting opening, risk management and anti money laundry prevention department.

3.3 Sampling Technique and procedure
The study targeted all the 38 risk managers, 38 anti-money laundry managers and 38 account opening managers at commercial banks headquarters located in Nairobi city, Kenya, thus census techniques will be applied. This used a purposeful sampling approach that took into account only those departments dealing with money laundry.

3.4 Pilot test
This was done to evaluate the validity and reliability of the research tool. This was conducted at Nairobi city branch of Equity Bank on Kenyatta Avenue, Equity Bank was selected since it has the most branches in Kenya.

3.5 Validity test of Instruments
The tested questionnaires were to be evaluated for clarity and any questions that were judged to be insufficient or ambiguous was changed in order to improve the research instrument's quality and increased its validity.

3.6 Reliability test of Instruments
The evaluation of the surveys was based on the responses provided. The identical instrument was administered to the same respondents again after a week. To be considered credible, the Pearson Product Moment Correlation for the two sets of data was needed to have a coefficient of over 0.7 (Kumar, 2016).

3.7 Data Collection and Procedure
Both primary and secondary sources of data were be used in the investigation. Using a semi-structured self-administered questionnaire, primary data was gathered. The target respondent’s managers were given the questionnaire after prior arrangement and also on when to pick the filled questionnaires within a period of two weeks to ensure the study was carried out within the planned period. The respondent was briefed on the purpose of the study to ensure respondents confident and confidentiality when filling the questionnaires.

3.8 Data Analysis
Both descriptive and inferential statistics were used to decode the data and evaluate it. Figures, bar charts, pie chart and tables were used for results data presentation. The mean and standard deviation were computed for the study variables. Additionally, multiple regressions model was employed to determine the variables’ relationship with each another. Correlation was also computed to show the relationship between variables. Regression coefficients were computed to show the strength of relationship. ANOVA test was carried out to test the hypothesis.

3.8.1 Regression model
The association between money laundering control practises and the financial performance of the 38 commercial banks will be estimated using a multiple regression model. The regression model was presented as demonstrated below:

\[ \text{Financial performance} = \beta_0 + \beta_1 \text{BR} + \epsilon \]
Financial performance (FP) will be represented by increased bank reports and increased operational and monitoring costs.

\[ FP = f (MLCP), \beta_0 = \text{Constant} = \text{error term}. \]

Where: \( \beta_1 \) is the intercept coefficient.

**RESEARCH FINDINGS**

4.1 Response rate

A total of 104 questionnaires were circulated to the respondents and a total 97 of the questionnaires were received back for data analysis. This was a response rate of 93% which is accepted as appropriate for the study since according to Mugenda (2018) a response rate of more than 60% is considered appropriate for analysis. Similarly, Babie (2018) noted that a response rate of 93% of the sample was appropriate for use in a descriptive study.

4.2 Bank Reporting

The results in table 2 showed an increased transactional Screening scored a mean of 4.62 with a standard deviation of 0.76. Increased the reporting frequency scored a mean of 4.38 with a standard deviation of 0.78. Broadened on the types of bank reports prepared scored a mean of 3.99 with a standard deviation of 1.32. Broadened bank regulatory framework scored a mean of 3.99 with a standard deviation of 0.87. Extent the bank reporting affects ML control practices in Kenya showed a mean of 4.195 with a standard deviation of 0.85. Broadened types of bank reports prepared showed a high variation on bank reporting while increased transactional Screening showed the lowest variation on bank reporting. In order to use factor analysis for bank reporting, it was crucial to evaluate the technique's (the factor analysis technique's) importance. According to the P value of 0.000, the approach is significant at 5%.

4.3 Inferential statistics Results

4.3.1 Correlation Analysis

Table 18 provides the Pearson’s correlation matrix and associated significance level for the main variables bank reporting, operational cost, cost of monitoring transactions and ML control practices.

<table>
<thead>
<tr>
<th></th>
<th>Bank reporting cost</th>
<th>Operational cost monitoring transactions</th>
<th>Cost of ML control practices</th>
<th>Financial performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank reporting</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Correlation</td>
<td>1</td>
<td>.712**</td>
<td>.817**</td>
<td>.727**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
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<tr>
<td>N</td>
<td>97</td>
<td>97</td>
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**SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

5.1 Introduction

The summary of the findings, the conclusion, and the suggestions are covered in this chapter. This was carried out in accordance with the study's goals. Further study directions were also recommended.

5.2 Summary of Major Findings on Bank reports money laundering control practice on financial performance of commercial banks.

The initial goal was to determine how money laundering control practices in bank reports affected the financial performance of commercial banks. Results showed a substantial and favorable association between commercial banks' financial performance and their control of money laundering in their bank reports. The results suggest that increased bank reports through enhanced transactional screening, more frequent reporting. The overall financial performance of commercial banks in Kenya is improved by the preparation of more diverse forms of transactional reports and by the expansion of the regulatory framework on money laundering. The findings agree with Kisoso (2019) conclusion that bank reporting on money laundry is a requirement that plays a critical role in influencing firms’ performance. However, the firms have to broaden the different aspects on bank reporting.

5.2.5 Conclusion

The implication of the results is that effort by the banks to control money laundering is likely to be accompanied with improved bank reports which depends enhance the reporting frequency in response to increasing transactional screening. Expanded regulatory framework and expanded forms of generated transactional reports.
5.3 Recommendations

Commercial Banks should ensure bank reports are updated frequently to enhance the level money laundry control practice compliance thus improving the financial performance of commercial banks. As such, commercial banks should train their staff which should get people with the right skills to implement these money laundry control mechanisms. This will aid in lowering instances of fraud and money laundering. Prior to creating an account, original papers should always be verified and seen.

REFERENCES: