

# Smouldering Evidence

## The Charterhouse Bank Scandal



AFRICA CENTRE FOR OPEN GOVERNANCE  
(AfricOG)



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# List of Acronyms / Abbreviations

CBK	Central Bank of Kenya
CID	Criminal Investigations Department
KACC	Kenya Anti-Corruption Commission
DDT	Due Diligence Team
KRA	Kenya Revenue Authority
NSIS	National Security Intelligence Service
PwC	PricewaterhouseCoopers

# Foreword

***Smouldering Evidence***, AfriCOG's latest report, examines the Charterhouse Bank Scandal which has received much attention in the media recently and dates back several years. The report documents the scandal and analyses violations of law and criminal acts including money laundering and the curious flip-flopping of public officials, including the Kenya Anti-Corruption Commission, on the issue of whether the Bank should remain closed.

Money laundering, or the practice of concealing the origins of illegal funds, is a serious crime that aids and abets the commission of other crimes such as corruption, drug trafficking, terrorism, human trafficking and weapons smuggling. Although Kenya finally passed the Anti-Money Laundering Act in 2009 after years of lobbying by civil society and international partners, the government has yet to demonstrate seriousness and commitment in prosecuting this crime. Indeed the government risks falling afoul of the international Financial Action Task Force through its failure to implement recommendations to strengthen its anti money laundering regime. This inaction opens the door to Kenya being a haven and transit point for various international crimes.

This report is part of a series of studies explaining major corruption cases in order to raise public awareness and knowledge of corruption cases and the measures that can be taken to avoid them and seek accountability for their perpetration. Previously, AfriCOG has published reports on the Maize Scandal and the Triton Oil Scandal. This is in addition to our work documenting the status of implementation of recommendations on major corruption scandals such as the Goldenberg and the Ndung'u Commissions of Inquiry. In collaboration with our partners at Kenyans for Peace with Truth and Justice, AfriCOG has also documented and monitored the recommendations of the Waki and Kriegler Commissions.

We do this to contribute to the fight against graft and impunity in order to secure a better future for Kenya.

AfriCOG thanks its Board of Directors and its dedicated team. We are grateful to the UNDP Amkeni Wakenya programme for its support which made the production of this report possible.

**Gladwell Otieno**  
Executive Director



# 1. Background

The controversy surrounding Charterhouse Bank goes back to 2004 when some former employees of the bank blew the whistle on a raft of irregularities involving the bank and a number of its clients. A series of events culminated in its closure in 2006 after the then shadow Finance Minister Billow Kerrow, the former Mandera Central MP, told Parliament that Dr Andrew Mullei, the immediate former Central Bank Governor, was pushed out of office after he recommended that Charterhouse be shut down for allegedly helping some companies to evade taxes amounting to KES 18 billion (approx 254 Million USD).<sup>1</sup>

At stake are customers' deposits in excess of KES 3 billion (approx 42,432,000 USD) as well as securities and title deeds frozen because the bank cannot operate<sup>2</sup>. This however pales in comparison to the amounts involved in the tax evasion and money laundering that the bank is alleged to have abetted: The BBC, for example, claims that tax evasion and money laundering worth 10% of Kenya's national income are involved<sup>3</sup>.

The lives of a number of people may also be at risk. In October 2006, the Daily Nation, a Kenyan newspaper, reported that three former employees of

Charterhouse Bank who had provided information on the bank's operations that had subsequently led to the investigation, had fled the country fearing for their lives. The newspaper reported that the employees had gone into hiding once the information on the bank became public and that the United States embassy in Nairobi had arranged for their escape from the country. One of the whistle blowers later questioned the government's commitment to the investigation and alleged that nearly all officials hired to probe the Charterhouse case had either been taken off the case or had to flee the country<sup>4</sup>.

Since its closure, various efforts have been made to re-open the bank, the most recent being in July 2010 when a Member of Parliament, Charles Kilonzo, on behalf of 35 depositors, petitioned parliament to re-open the bank.

The controversy is not the first in the banks history. In 2001, the bank was embroiled in a dispute with the Central Bank of Kenya (CBK) over a deposit of KES 2 billion (approx USD 25 Million) which had been paid into the account of a customer of the bank, Crucial Properties Limited. The customer claimed to have received the money as a loan to invest in the property

1 2006 Exchange rate average 70.7 shs= 1 US Dollar

2 Hansard 9-12-2010

3 BBC NEWS: <http://news.bbc.co.uk/go/pr/fr/-/2/hi/africa/6123832.stm> Published: 2006/11/07

4 <http://news.bbc.co.uk/2/hi/africa/6123832.stm>

market. The Central Bank, however, thought it to be proceeds of crime. CBK sought and obtained a court order to freeze the account to enable investigation into the source of the money. The order was however

later lifted following the Court's impatience with the progress made in the investigations and the money was swiftly moved out of the bank.

## Timeline of events

Date	Event
<b>2004</b>	Inter - agency task force consisting of CBK, KACC and KRA formed to investigate Charterhouse Bank's activities. <sup>5</sup>
<b>Jan 2005</b>	Charterhouse Bank fined by Central Bank of Kenya (CBK) for lending to Nakumatt Holdings in excess of the allowed statutory limits and failure to maintain proper account opening documentation.
<b>Feb 2005</b>	A follow up inspection by CBK establishes that the bank had not corrected the identified anomalies
<b>Oct 2005</b>	Further follow up reveals that the bank had still not corrected the aforesaid anomalies as required by CBK.
<b>March 21st 2006</b>	Then CBK Governor Andrew Mullei recommends withdrawal of Charterhouse Bank licence, citing massive financial malpractice at the bank.
<b>2006</b>	CBK Governor Andrew Mullei is charged with abuse of office and suspended from office after investigation into composition of due diligence team <sup>6</sup> .
<b>April 2006</b>	Inspection conducted by CBK reveals the unavailability of customer records for 45 accounts opened; the engagement in offshore money transfers involving splitting of transactions; that cheques drawn on a customer's account were cleared through a lawyer's client account and that the same lawyer's account was being used as a trading account for some customers.

5 <http://www.businessdailyafrica.com/Corporate%20News/Treasury%20puts%20Charterhouse%20decision%20in%20CBKs%20hands/-/539550/1020096/-/view/printVersion/-/p5mi0qz/-/index.html>

6 The due diligence team comprised of Mr. Melville Smith, an auditor who had previously assisted in unravelling the complicated transactions in an inquiry into the Goldenberg Scandal, Mr. Terry Ryan, a respected economist member of the monetary policy committee, Mr. Sila Mullei, the governor's son and a computer expert who previously worked for a Wall Street investment bank.

Date	Event
<b>June 6th 2006</b>	Former Shadow Finance Minister Billow Kerrow, tables before Parliament a leaked government report implicating Charterhouse Bank and Nakumatt Holdings in tax evasion and money laundering. <sup>7</sup>
<b>June 23rd 2006</b>	CBK places Charterhouse Bank under statutory management.
<b>June 2006</b>	The statutory manager commissions an investigation by PriceWaterhouseCoopers (PwC) into the affairs of Charterhouse Bank.
<b>Oct 2006</b>	A Kenyan newspaper reports that three former employees of Charterhouse Bank, who had blown the whistle on its questionable dealings, had sought asylum in USA fearing for their lives. <sup>8</sup>
<b>2009</b>	Central Bank Governor Jacinta Mwatela issues notice indicating that all the bank's branches "will remain closed to the depositors and the public effective June 23 until further announcement from the statutory manager." <sup>9</sup>
<b>Jan 25th 2010</b>	American Ambassador Michael Rannenberger writes to President Kibaki and Prime Minister Raila Odinga raising concerns that the reopening of the Charterhouse Bank: " <i>will be a significant setback to the government's stated commitment to reform</i> ".
<b>July 7, 2010</b>	Yatta MP Charles Kilonzo presents a petition to parliament on behalf of 35 depositors seeking to re-open the bank.
<b>Sept 2010</b>	Parliamentary Committee on Finance undertakes new probe and summons Finance Minister Uhuru Kenyatta, former Finance Minister Amos Kimunya, Kenya Revenue Authority officials, State Law office, Attorney General's office, CBK officials as well as the Kenya Anti-Corruption Commission. <sup>10</sup>
<b>Oct 2010</b>	CBK, (presently under the governorship of Njuguna Ndungu) which ordered the closure of the bank, now backtracks and says it sees no reason for its closure.
<b>Oct 2010</b>	Government officials appearing before the parliamentary committee backtrack and recommend the re-opening of Charterhouse Bank.

7 <http://www.kenyalaw.org/Hansard/download.php?file=/Downloads/Hansard/2006/07/Thursday,%206th%20July,%202006%20-%20Afternoon.pdf>

8 <http://allafrica.com/stories/201010010131.html>

9 <http://www.propertykenya.com/news/007631-charterhouse-closed>

10 <http://allafrica.com/stories/201010010131.html>

## 2. The Allegations against Charterhouse Bank

Three different audits undertaken between 2004 and 2006 by the Central Bank of Kenya's due diligence team, investigations by PricewaterhouseCoopers, and the government's Joint Investigation Task Force all raised serious questions about the operations of Charterhouse Bank. They all found strong indications that the bank's clients were involved in both tax evasion and money laundering. The bank was also found to be violating the Banking Act and the prudential regulations issued by the CBK.

### 2.1 Money Laundering

The PwC audit and the government's Joint Investigation Taskforce uncovered considerable evidence of activities suggesting that there was gross money-laundering at Charterhouse Bank.

According to the CBK prudential guidelines of 2000, the following activities constitute suspicious transactions and may indicate possible money laundering:

- 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;

- Use of multiple or nominee accounts, or similar or related transactions which is not consistent with the customer's normal business activities, financial standing, or indicated reasons thereof;
- Consolidation of multiple smaller accounts at several institutions within same locality prior to request for onward transmission of funds elsewhere;
- 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;
- Company accounts whose transactions, both deposits and withdrawals, are dominated by cash rather than the forms of transactions normally associated with commercial operations.

The guidelines stipulate that an institution, on becoming aware of suspicious activities which would indicate money laundering, has to report them to CBK immediately.

### 2.1.1. Unusual Large Cash Transactions

Money laundering involves making money that comes from illegal or criminal activity appear as if it came from legitimate sources – it involves engaging in financial transactions to conceal the source of proceeds of crime and convert them into assets that appear legitimate. Because criminals, such as drug traffickers, receive their proceeds almost exclusively in cash, which they then try to place into the financial system, large cash transactions in an account are a strong indicator of money laundering activity.

The PwC audit reported numerous cases of unusually large cash transactions involving certain customers. The customers would make unusually large cash deposits and withdrawals which, in the auditor's opinion, indicated an intention to conceal the true source or beneficiary of the payments made. The information furnished to the team was not sufficient to identify the depositors or the beneficiaries of the payments.

In addition, the transactions appeared to have no commercial substance as these customers would deposit material sums which would be followed by full withdrawals on the same day. The team considered the transactions unusual because the amounts of cash withdrawals were high, averaging KES 1 million.

Additionally, some of the accounts operated almost entirely on a cash basis for both deposits and withdrawals and the accounts had very high activity on some particular days during which large sums of money would be deposited and withdrawn.

The following are two examples:

#### **Sailesh Prajapati – Account CA 01 -000148**

Between the time the account was opened in January 1999 and when it was closed in August 2004, it had a debit turnover of KES 2.2 billion. There were numerous transactions of exactly the same amounts. There were over 1,300 cash deposits of KES 1 million each out of 1,570 total credits during the period. Of the remaining credits, KES 105 million was received from Nakumatt in 28 equal transactions of KES 3.76 million each. The auditors observed that transacting business in cash throughout the history of the account was very unusual. Neither the account opening forms nor details of the mandates to operate it were found within the banking system.

#### **Odesys Enterprises account CA 01-000740**

This account was operated by a sole proprietor in Butere, Western Kenya. It had a turnover of KES 554,842,767 (approx USD 7 Million) debits and KES 566,256,592 (approx USD 8 Million) credits respectively over a 10 month period to 23 June 2006. The majority of the transactions were in cash, which the auditors considered unusual for a business in a town where the bank had no branch operations. It had significant cash deposits accompanied by withdrawals of similar amounts on the same day. The auditors found the transactions to have no commercial rationale and to be inconsistent with a business operating from Butere. The account opening forms contained no details regarding the business.

## 2.1.2. Structuring or Splitting Deposits and Payments

CBK guidelines governing transactions in foreign exchange require banks to maintain supporting documents for all foreign exchange transactions equivalent to or above USD 10,000, and to report any transaction above USD 50,000. A common practice among money launderers to avoid such reporting is to split large deposits or withdrawals into smaller, less suspicious amounts. The money is then deposited

into or paid out from one or more bank accounts over an extended period of time.

Investigations found incidents where single payments were split into several telegraphic transfers. In a letter dated 10 January 2005, for example, Creative Innovations Limited requested the bank to make transfers to one Paolo Sattanino totalling USD 90,000 and Euros 19,000 in amounts of less than USD 10,000 each over consecutive dates as illustrated in the table below

Date	Beneficiary	USD	Account credited
17-Jan-2005	Paolo Sattanino	10,000	CA 01-600006
18-Jan-2005	Paolo Sattanino	10,000	CA 01-600006
19-Jan-2005	Paolo Sattanino	10,000	CA 01-600006
20-Jan-2005	Paolo Sattanino	10,000	CA 01-600006
21-Jan-2005	Paolo Sattanino	10,000	CA 01-600006
24-Jan-2005	Paolo Sattanino	10,000	CA 01-600006
25-Jan-2005	Paolo Sattanino	10,000	CA 01-600006
26-Jan-2005	Paolo Sattanino	10,000	CA 01-600006
27-Jan-2005	Paolo Sattanino	10,000	CA 01-600006
	<b>Total</b>	<b>90,000</b>	
		Euro	
28-Jan-2005	Paolo Sattanino	6,325	CA 01-800145
31-Jan-2005	Paolo Sattanino	6,250	CA 01-800145
01-Feb-2005	Paolo Sattanino	6,425	CA 01-800145
	<b>Total</b>	<b>19,000</b>	

Source: Report to the Statutory Manager, Charterhouse Bank

The customers' instructions appeared to be aimed at ensuring that reporting to CBK did not become necessary. Other payments indicating possible splitting were also found in several remittances involving Creative Innovations Limited, Kingsway Mart Limited and Paolo Sattanino.

### 2.1.3. Know your Customer Regulations

Money launderers naturally go to great lengths to conceal their own identity and the sources and beneficiaries of their transactions. *Know Your Customer* (KYC) regulations require banks to identify and do background checks on depositors to counter this. Banks are further required to maintain a record of the true identity of their customers, as this will promote accountability. These regulations aim to identify and prevent fraud, money laundering and terrorist financing, among other things, by instituting policies that verify customers' identities. The main objective of the CBK KYC guidelines is to ensure that the banking system is shielded from money laundering.<sup>11</sup>

The audits and investigations covering the period 1999 - 2006 found that Charterhouse Bank had violated the CBK's KYC procedures in over 80 percent of its accounts, and were missing basic details such as the customer's name, addresses, ID photo, or signature cards. The violations of KYC rules was the norm rather than the exception- of 1,004 accounts

sampled by PwC, for example, 839 accounts, some involving billions of shillings, lacked opening forms or customer instructions. The PwC report for example states:

*"There is no documented evidence of the bank attempting to obtain an understanding of the identity of some of the bank's active customers or their businesses. There are strong indications of irregular activity. Some of the transactions observed are suspicious and one would expect a bank to report such transactions to the Central Bank. There are indications that bank officials may be involved in abetting these suspicious transactions."*

The report lists the following specific incidents where the bank was not following accepted KYC procedures.

- i) Numerous account opening forms were missing or incomplete;
- ii) A number of accounts did not have customer's contact details/addresses;
- iii) Some personal and corporate accounts did not have the customer's photo image either on the system or on the physical account opening forms as required by the bank's KYC procedures;
- iv) Some accounts did not have proper account names. For example, numerous accounts were only described using initials such as CIL, PIVB, S Shah and D Shah;
- v) The credit histories for most of the advance files were not up to date.

<sup>11</sup> CBK Governor Speech available at [www.centralbank.go.ke](http://www.centralbank.go.ke)

#### 2.1.4. Webs of Related Companies and Accounts

Another common practice in money laundering involves sending the money through a complex web of financial transactions to change its form and make it difficult to follow. Referred to as layering, it may involve myriad bank-to-bank transfers, transfers between different accounts in different names and countries to related companies, changing the money's currency and form and so on. This is aimed at ensuring that the original illegal proceeds become difficult to trace.

The PwC audit found a number of accounts that had similar patterns of transactions. These accounts were operated by the following companies and persons: Fones Direct, Phones Direct, Intra Market Trading, Panorama Imports, Brand Imports, Triton Petroleum, Cashline Forex Bureau, Capricorn SRL, Creative Innovations, Kingsway Mart limited, Paolo Sattanino, Paul Mburu and Cargo Distributors.

According to the report, transactions in these accounts pointed to payments of cash that ended up in either Paolo Sattanino's account or at Paramount Bank Limited before being transferred out of the

country. The trail of payments was outlined as follows:

- Cash was paid from the Fones Direct & Phones Direct accounts into Intra Market Trading. From this account, the cash was then transferred to Cashline Forex Bureau. The bureau then made a transfer to Paramount Bank Limited.
- Brand Imports, Triton Petroleum, and Panorama Imports made transfers to Cashline Forex Bureau account which were then transferred to Paramount Bank Limited.
- Kingsway made payments to Paul Mburu who then made transfers to Cargo Distributors who in turn made a transfer to Paolo Sattanino. Kingsway also made direct transfers into the Paolo Sattanino account.
- Creative Innovations made payments to both the Paolo Sattanino and the Capricorn accounts.
- The credit balances in the Paolo Sattanino and Capricorn accounts were then transferred out of the country through telegraphic transfers without supporting documents other than e-mail correspondence from Paolo Sattanino.

These transactions suggested an intention to conceal the true source or beneficiary of the payment made. Allegations that Charterhouse Bank was operating as a money laundering conduit appear credible in light of the PwC report's findings.

### 3. Tax Evasion

Allegations of tax evasion by Charterhouse Bank were first raised by former employees. In a letter addressed to the Minister for Justice and Constitutional Affairs. One former employee states:

*"My experience at Charterhouse Bank and as their internal auditor convinced me that the Bank was not established to carry out legitimate banking business. In view of this, I became suspicious of over 70% of the total number of accounts maintained by this Bank. In this regard, I provided KRA the whole database of Charterhouse Bank's accounts totalling over 200. Within this list, I highlighted 85 accounts, which from my analysis had either not paid tax at all or had deliberately declared wrong business turnovers in order to pay less tax."*<sup>12</sup>

On 21st June 2006, the then shadow Finance Minister in the official opposition to the Kenya government, Billow Kerrow, tabled before Parliament a leaked report from a government taskforce investigation that implicated Charterhouse Bank and Nakumatt Holdings in serious financial malpractice, including tax evasion and money laundering.

The report claimed that Charterhouse Bank had assisted Nakumatt Holdings to evade tax estimated at KES 18 billion (about USD 250 million) over a six year period. According to the report, Nakumatt Holdings had never declared a profit over this period. The report alleged that this was deliberately done to avoid paying corporate tax. The supermarket chain had also remitted only a small fraction of the value added tax it collected from its customers. The report

further observed that a rival chain of supermarkets, Uchumi Supermarkets, with a much smaller turnover, had remitted more than 10 times more value added tax collections than Nakumatt had. As Value Added Tax (VAT) is paid at the point of sale or transaction there appeared to exist no justification for the shortfall.

A due diligence team set up in 2003 by the Central Bank had found that a number of account holders had multiple bank accounts which in the teams view, is a standard way of detecting potential tax evasion. Almost all of the accounts were linked to Nakumatt Holdings. A subsequent investigation by a Joint Action Team set up under the leadership of the Kenya Anti-Corruption Commission (KACC) fully endorsed the suspicion that there was significant tax evasion and concluded that several organizations (including Nakumatt) appeared to have evaded tax with the collusion of Charterhouse Bank to the tune of between KES 2 and 3 billion in any one year over a period of 5 to 6 years<sup>13</sup>. Given that non-payment of taxes should attract penalties, the amounts that could be demanded from the organizations could very well have been double the amounts evaded.

The accounts included: Creative Innovations Ltd, Sailesh Prajapati, D Shah, Kariuki Muigua & Company, Tuskers Mattresses, Paolo Sattanino and WE Tilley Muthaiga) Ltd. The table below summarizes the findings of the inter-agency task force with regard to these companies.

<sup>12</sup> Wikileaks Charterhouse documents available at [http://www.wikileaks.ch/wiki/A\\_US\\$1.5\\_billion\\_Charter\\_House\\_of\\_horrors](http://www.wikileaks.ch/wiki/A_US$1.5_billion_Charter_House_of_horrors)

<sup>13</sup> Letter from Governor of Central Bank to Minister for Finance dated March 20, 2006

Company	Relationships	Operations	Key Findings
Creative Innovations	Common shareholding with Charterhouse	Major supplier of Nakumatt, KPA, KAA & KPLC	Operated 4 accounts but only disclosed 2. Undisclosed accounts held KES 262m in deposits, thought to be diverted sales not assessed for VAT and Income tax
WE Tilley (Muthaiga ) Ltd	Fishing Companies in Uganda and Tanzania	Fish processing and exports	Credits for Jan to Sept 2004 totalled KES 5.9 Billion, Declared only Kenya sales, none on Tanzanian operations. Unexplained large transfers to persons who had no relationship with fish trade.
Tusker Mattresses		Second largest supermarket chain in Kenya	Operated an account with a balance of KES 4.3Billion opened in 2001 but not disclosed until 2003. Directors operated 75 other personal accounts with huge balances. Estimated undeclared sales- sh911 million
D Shah Account		No documents to reveal real owner	Account received KES 601m between May and November 2004 mainly in huge cash deposits. Account also had huge cash withdrawals. Suspected to be a parallel account to hide undeclared sales
Sailesh Prajapati Account	Account opening documents allegedly destroyed in a fire	Account opening documents allegedly destroyed in a fire	Account received KES 551million between May and August 2004 in huge cash deposits and cheques from Nakumatt. Also had huge cash withdrawals. Suspected to be used for tax evasion
Paolo Sattanino Accounts		Three accounts opened by self and one as Managing Director, Capricorn SRL. Authorized bank to act on emails	Received KES 52 m between April and November 2004 from Creative Innovations and Kingsway.

Source: Adapted from *The Nairobi Law Monthly* 2010. Vol 1. Issue No.2. November 2010.

The Central Bank Governor had also recommended more detailed analysis of the Kingsway Tyres, its associate companies as well as the John Harun Group. These companies also had multiple accounts and were linked to the Nakumatt network but had not been fully examined. The PwC audit later examined some of these and highlighted instances that required further investigations. For example two Kingsway accounts in Charterhouse had a turnover of KES 4.57 billion in less than two years

after being opened in 2004. Another account had a turnover of KES 3.9 billion after opening in 1998. PwC recommended that the turnover in these accounts needed to be compared with the declared statutory returns to ascertain whether there were instances of tax avoidance or money laundering<sup>14</sup>. PwC also queried the massive transfers by Nakumatt from its collection accounts in Barclays into Charterhouse Bank.

## 4. Violations of the Banking Act and Prudential Guidelines

The investigations found the bank to be in breach of the Banking Act and Prudential Guidelines with respect to single borrower limits, insider lending and reporting and the maintenance of documents for foreign currency transactions.

An affidavit filed by the Central Bank of Kenya opposing a suit by Charterhouse Bank contained claims of repeated malpractices by the bank and its customers. According to the Central Bank:

- In January 2005 Charterhouse Bank was fined by the Central Bank of Kenya (CBK) for lending

to Nakumatt Holdings in excess of the allowed statutory limits and for failure to maintain account opening documentation for its customers.

- A follow up inspection by the CBK in February 2005 established that the bank had not corrected the identified anomalies.
- A further follow-up in October 2005 revealed that the bank had still not corrected the anomalies and had not instituted “*Know Your Customer*” procedures as required by the CBK.

<sup>14</sup> <http://allafrica.com/stories/201010020143.html>

- In April 2006, another inspection was conducted by the CBK which revealed that the bank was still engaging in malpractice. Some of the activities included:
  - a) The unavailability of customer records for 45 accounts opened;
  - b) The engagement in offshore money transfers involving splitting of transactions;
  - c) Cheques drawn on a customer's account were cleared through a lawyer's client account and the same lawyer's account was being used as a trading account for some customers.

Charterhouse Bank further violated the Banking Act and the CBK's Prudential Guidelines by not properly maintaining records for foreign currency transactions. Available evidence makes clear that the bank's management had, on a large scale, consistently evaded and ignored normal internal controls by allowing many irregular activities to occur.

### **Loans to Directors**

Charterhouse Bank was also found to have breached the Banking Act by exceeding prudential guidelines for single borrower limits and insider lending. While prudential guidelines prohibit lending amounts above 20% of core capital to an insider or associate, investigators found that loans to companies associated with the Managing Director, Sanjay Shah, were in excess of 40% of the bank's core capital. The associated companies were Creative Innovations, Hameco, Cottex; Nu Metro, MR and SR Shah, Jamachar, Kings Investments and Kingsway Tyres.

Prudential Guidelines and the Banking Act also prohibit the granting of unsecured advances, loans or credit facilities to chief executive officers and management and other officers. There were, however, instances where loans to officers and their associates were unsecured.

The specific violations of provisions of the Banking Act and Prudential regulations are listed in the annexed table<sup>15</sup>.

## **5. Unusual Activities in Some Accounts**

The investigators found further unusual activities in some accounts. Unusual activities can themselves be evidence of money laundering. The Proceeds of Crime and Anti-Money Laundering Act, for example, obliges banks and other reporting institutions to "monitor on an ongoing basis all complex, unusual,

suspicious, large or other transaction as may be specified in the regulations, whether completed or not, and (shall) pay attention to all unusual patterns of transactions, to insignificant but periodic patterns of transactions that have no apparent economic or lawful purpose as stipulated in the regulations." (Section 46 (1))

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<sup>15</sup> See annex 1. Table on violations.

Unusual transactions, therefore, may constitute *prima facie* evidence of money laundering. The following are some examples of such activities uncovered at Charterhouse Bank.

### **Sundry Creditors Account**

Sundry creditors' accounts are used for miscellaneous small or infrequent suppliers who are lumped together as a group. There was evidence that a sundry creditors account was being used to conceal transactions between certain customer accounts. Some of the payments debited to customer accounts such as the Prajapati account as 'cash withdrawals' were traced to the sundry creditors account. Loan repayments for a Parmex account were also made from the sundry creditors account. The amounts involved were quite substantial- KES 5 billion passed through the sundry creditors account between 1998 and 2004.

### **Nakumatt Holdings Limited**

Between May and October 2003, an amount of KES 3.6 million was transferred from a Nakumatt account to a Prajapati account on a weekly basis. There were 22 such transfers totalling KES 79.2 million (approx USD 1.1 Million) for which no supporting documentation was available as these were said to have been destroyed in a fire in September 2004. In December 2003, two large transfers totalling KES 50 million (approx USD 707,000) were also made

to the Prajapati account from the same Nakumatt account for which no supporting documentation was provided.

A debit transfer of KES 120 (approx USD 1.6 million) was made from the sundry creditors account to the Nakumatt account on 20 December 2005. On the same day, another debit transfer of KES 12 million was made.

Regular payments of KES 6.5 million and amounting to KES 286 million (approx USD 4 million) were made from this account to a "Fresh an Juici" account between April 2005 and April 2006. An account maintained by Creative Innovations received most of its credits from Nakumatt Holdings. In 2003, over KES 136 million (approx USD 1.9 Million) was received while KES 212 million (approx 2.9 Million) was received in 2004. Between 1 January 2005 and 23 June 2006, KES 641 million (approx USD 9 Million) was received. In all these transactions, no supporting documentation was made available to the investigators.

### **Paolo Sattanino Accounts**

Several accounts operated by one Paolo Sattanino, based in Italy, had the following unusual activities and features:

- Account opening forms were not made available to investigators.
- A number of companies and individuals such as Creative Innovations Limited, Brand Imports

Limited, Aua Industria Limited and Suresh Shah regularly transferred funds to Paolo Sattanino and Capricorn SRL accounts in lots of USD 10,000 or the Euro equivalent.

- Paolo Sattanino directed the bank to transfer money through telegraphic transfers outside the country using e-mail correspondence. The transfers were not supported by relevant documentation as required for transfers whose value is above USD 10,000.
- Instances were observed which amounted to falsification of documents - Sattanino gave instructions to the bank to transfer funds but to indicate the remitter as a different entity or individual.
- Evidence of account splitting to avoid providing documentation in support of the transactions by ensuring that the values were USD 10,000 or less was found.

### **Crucial Properties Limited**

Crucial Properties Limited operated several accounts at Charterhouse Bank with one Humphrey Kariuki

as the sole signatory. One account was opened in 2001 and a large deposit of KES 1.9 billion (approx USD 25 Million<sup>16</sup>) made. Between January and May 2001, all funds were paid out with KES 1.4 billion of the payments being simply described as “demand drafts”. No supporting documents were availed to investigators to explain the transfers.

Another account was opened in February 2001 and operated for 3 weeks after which it became dormant until its closure in April 2004. The account received a single credit of KES 390 million from the one described in the preceding section. Within three days, KES 312 million of the credited amount was transferred to Kariuki Muigua & Co Advocates Client Account 2. Again no documentation was availed for these transactions.

### **Kariuki Muigua & Co Advocates (Clients a/c)**

During the months of October and November 2005, the account was described as unusually active and received huge credits described as cash as illustrated in the following table.

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<sup>16</sup> At the exchange rate then shs 77= 1 US Dollar

<b>'Cash' received into the account</b>				
	<b>26-Sep-05</b>	<b>28-Sep-05</b>	<b>29-Sep-05</b>	<b>26-Oct-05</b>
Receipts in KES	127,000,000	70,000,000	226,000,000	87,000,000
<b>Payments in KES out of the account</b>				
Kwikfit Tyres Ltd	40,486,555	21,751,200	79,891,600	28,450,400
Kirkby Tyres Ltd	40,854,700	19,921,100	78,912,400	31,400,000
Yellowstone Ltd	14,465,850	22,720,700	61,306,000	18,175,500
Yellowstone Enterprises	18,745,300	-	-	8,974,600
K/way	-	-	7,800,000	-
Port Florence Forwarders	4,482,080	-	-	-
Jubilee Tyres Ltd	7,128,305	-	-	-
<b>Subtotals</b>	<b>126,162,790</b>	<b>64,393,000</b>	<b>227,910,000</b>	<b>87,000,500</b>

Source: Report to the Statutory Manager, Charterhouse Bank "Under Statutory Management". PricewaterhouseCoopers, 2006.

Another account was opened, operated and closed within one week in February 2001. The account received KES 312 million from another Crucial Properties Limited account within the bank which was then paid out within two days. No documentation was provided in support of these transactions.

### **Kingsway Motors Group**

The Managing Director of Kingsway Motors Limited is a brother to the Charterhouse Bank's Managing Director and is also a Director at the Bank. One of

the company's accounts had a credit turnover of KES1.8 billion since it was opened on 2 April 2004 until the time the bank was placed under statutory management on 23 June 2006. Another account had a credit turnover of KES 2.9 billion since its opening on 6 May 2003 until the time the bank was placed under statutory management. Yet another had a debit turnover of KES 3.9 billion for the period 1 January 1999 to 23 June 2006. These accounts had some unusual transactions including:

- Large cash payments and deposits- as high as KES. 65 million.

- Some transactions of almost similar amounts in an account belonging to Kariuki Muigua & Co. Advocates.
- Some transactions of very high value in nature around the same period (September and October 2005).

### **Triton Petroleum Company Limited<sup>17</sup>**

Various large transfers were found to have been made from Triton Petroleum Company to accounts of one Sonal Devani. On 27th December 2005, a total of KES 50 million was transferred in five equal amounts of KES 10 million. Investigators were not provided with the account opening forms for the Sonal Devani accounts.

### **Irregular Banking Operation**

Investigators also found numerous fixed deposit accounts with large debit balances which is unusual.

Normally a fixed deposit account should have credit balances. As at January 1st 2003, the investigators found 34 such accounts with debit balances totalling over KES 515 million. Evidence was also found of irregular operations including:

- Ignoring or over-stepping customer mandates e.g. instructions to transfer funds from individuals who did not have appropriate authority were effected;
- Alteration of cheque details;
- Opening and closing accounts for purposes of passing certain specific transactions;
- Unsigned cheques being honoured for payment;
- Some accounts were opened, operated and closed within an unusually short period of time indicating that they were opened to facilitate specific transactions only;
- Cases of cheques encashed where the account name and details were manually altered.

## **6. The Position of Charterhouse Bank Management**

Throughout the various investigations, the management of Charterhouse Bank made it difficult for investigators to obtain information. The PwC for example complained that they received only minimal cooperation from the bank officials. Upon the auditors' arrival, the bank's general manager went on leave without notice and the acting

manager refused to provide information for the period preceding his arrival. The bank's computer system was not functioning for most of the time of their investigation and the officials also frustrated the team's use of computer-assisted tools to analyse the data.

<sup>17</sup> See also "Analysis of the Triton Oil Scandal", Africa Centre for Open Governance, July 2009, at <http://www.africog.org/reports/Analysis%20of%20the%20Triton%20Oil%20Scandal.pdf>

The CBK inspection team carrying out a due diligence investigation in 2004 faced similar hurdles. The managing director reportedly instructed the operations manager not to provide any information in his absence. The management obstructed the team's efforts to obtain information and even undertook surveillance of the team's work by mounting a CCTV camera and miniature microphone in the team's working room. When, out of frustration, the Fraud Investigation Division obtained court orders obliging Charterhouse Bank to provide all information the CBK needed it was assured that Charterhouse would provide the information the next day. However, the next day, the team was led to a smouldering fire which had allegedly destroyed the entire banks archive<sup>18</sup>.

The directors of Charterhouse Bank argued that the bank had no liquidity problem, was in compliance with the Banking Act, the Central Bank of Kenya Act and the Prudential Guidelines and that placing the bank under statutory management would, therefore, be contrary to the law. However they were clearly in breach of prudential guidelines among them: Banking Act Section 13 (1) and (3) on beneficial ownership exceeding the prescribed amounts and concealment of the same, Know your Customer (KYC) rules, with the existence of several accounts with minimal or no opening details. Section 13 (4) also states that "No institution shall transfer more than five percent of its share capital to an individual

or an entity except with the prior written approval of the Central Bank". The latter are only a selection of the violations by Charterhouse Bank.<sup>19</sup>

In the Charterhouse director's view, it was not the duty of the bank to compel its customers to pay taxes. If an account holder had violated any law, he or she should face the full force of the law but such violation should not interfere with other account holders' deposits and rights. This assertion is weakened by Charterhouse's reluctance to release details of the account holders in addition to aiding in transfers of clients monies to jurisdictions abroad, which could be construed as abetting the tax evasion.

### **Blaming the Victim?**

Charterhouse placed the blame for the non-existence of crucial information and supporting documents on the whistleblowers who were former employees of the Bank. They argued that these former employees were in fact the custodians of the bank's documents and that they either caused or deliberately failed to address the alleged violations. They alleged that the former employees stole data and confidential documents from the bank at the instigation of the Central Bank of Kenya and the Kenya Revenue Authority (KRA). They further alleged that CBK was paying these former employees USD 300 a day to steal documents and that they were rewarded with jobs at CBK. They claimed to have been reporting these

<sup>18</sup> *Nairobi Law Monthly* November 2010

<sup>19</sup> See annex 1 Table of Violations

matters to the police since the year 2003<sup>20</sup>. Contrary to the management's assertions, the whistleblowers were crucial in the uncovering of the scam. In addition a 2004 investigation by KACC revealed that the bank did not keep sufficient information including bank account opening information for two accounts with a combined turnover of KES 1.6 billion<sup>21</sup>. The provision of an Informer Reward Scheme by the regulatory agencies greatly assisted in the capturing of tax evaders. In February 2005, the governor of Central Bank Andrew Mullei appointed one of the whistleblowers to a position at CBK advising the

inter agency taskforce that was set up to look into the activities of Charterhouse.<sup>22</sup>

Regarding the fire that destroyed their archives they pointed out that it occurred immediately after one of the whistleblowers was suspended, and that the location of the archives was only known to the whistleblower, another whistleblower, the Managing Director and one other manager. The insinuation was that the whistleblower could have caused the fire. The management stated that the matter was reported to the police and arson was suspected but that there were no arrests.

## 7. Parliamentary Committee's Attempts to Re-open the Bank

In 2010, the Bank was the focus of a new probe by the Parliamentary Committee on Finance, Planning and Trade. The committee, chaired by Nambale MP Chris Okemo summoned a number of senior government officials, including Finance and Deputy Prime Minister, Uhuru Kenyatta, Kenya Revenue Authority Commissioner General Michael Waweru, Central Bank of Kenya (CBK) Governor Prof. Njuguna Ndung'u, and the Director of Public Prosecutions, Keriako Tobiko.

In a strange turn of events, official after official summoned before the committee seemed to give a green light for the re-opening of the bank.

KRA, through its Commissioner, General Michael Waweru, for example, told the Committee that their investigations on tax evasion focused on Charterhouse Bank customers, not the bank itself. Therefore, KRA had no hand in the bank's closure. This position contradicts KRA's previous position in July 2006 that Charterhouse Bank had abetted

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<sup>20</sup> Letter from CB Director to The Chairman Kenya National Commission On Human Rights dated July 19, 2006 and copied to : Commissioner of Police, Minister for Justice & Constitutional Affairs, Minister for Finance, Minister of State in the Office of the President, Attorney General of the Republic of Kenya, Governor of the Central Bank of Kenya, Director, Kenya Anti-Corruption Commission, Director Criminal Investigations Department Director of Public Prosecutions, Statutory Manager, Charterhouse Bank, Commissioner General, Kenya Revenue Authority.

<sup>21</sup> Letter by KACC to the Governor of Central Bank December 2004 highlighting obstacles in gaining information from the bank.

<sup>22</sup> Nairobi Embassy Cable 2006 available at <http://wikileaks.ch/cable/2006/07/06NAIROBI3217.html>

massive tax evasion. KRA did not reveal whether any of the customers (including Nakumatt supermarkets) were investigated or whether the firms settled their taxes after the statutory closure of their accounts in Charterhouse Bank or any action taken to recover taxes owed.

When summoned before the Committee, the Central Bank Governor Njuguna Ndung'u said his institution did not object to the re-opening of the Bank. CBK had earlier, in 2009, started indicating that it believed Charterhouse Bank should be restructured and re-opened, possibly to avoid the risk of losing court battles against the bank for unfounded closure.

### **Contradictory Evidence**

KACC, through its Deputy Director in charge of investigations and asset tracing, John Mutonyi, told the Committee that, although the matter was still open, the agency would have no objection to the bank's re-opening. "The KACC has nothing against Charterhouse Bank," said Mutonyi in response to a query from Gem MP Jakoyo Midiwo. He further informed the Committee that evidence of money laundering uncovered by the task force could not be acted upon as, according to him, money laundering was not an offence in Kenya at that time. He is reported to have said:

*"Money laundering is not a crime in Kenya and cannot be pursued internationally as it is a requirement that the complaining country should have a law in place. The Anti-Corruption and Economic Crimes Act does not*

*provide for money laundering. Therefore, nothing can be done about money laundering allegations."*

The State Law Office also appeared before the Committee. The Deputy Solicitor-General Muthoni Kimani sought to absolve the State Law Office, indicating the Central Bank had been advised to reopen the bank.

In October 2010, Finance Minister, Uhuru Kenyatta told the Committee that the closure of Charterhouse Bank was purely a CBK decision, which flies in the face of the fact that it was the then Finance Minister, Amos Kimunya who had authorized the closure of the bank. The Finance Minister would therefore seem to be contradicting his predecessor.

"It is not prudent for me, either as Deputy Prime Minister or Minister to intervene on the matter," said Kenyatta. He added: "I am very sympathetic as well about those affected (the bank's depositors) but the law is very clear, and that law was enacted by this House." Mr. Kenyatta's view was that the Central Bank of Kenya (CBK) had the responsibility over the Charterhouse Bank issue and that the Treasury had done all it could within its mandate.

Kenyatta said the ministry had no report or evidence from any government agency on the bank's alleged misdeeds and that he had only seen what was published in newspapers. He said the Ministry had written to the CBK the previous year and told the Governor to act on the matter in the context of an audit report by PricewaterHouse Coopers, the Banking Act and with the input of the State Law Office.

The arguments put forth in support of re-opening of Charterhouse Bank by the Departmental Committee on Finance, Planning and Trade were that the allegations made had not been substantiated. On violations of the Banking Act and Prudential Regulations the Committee argued that though regular banking inspections undertaken by the CBK had pointed out that there were some violations, CBK had granted Charterhouse Bank the banking license after each and every inspection. In addition, the same allegations were reported in 38 other banks which continue to operate.

The Committee further argued that liquidation of a bank by the CBK is only available where an institution is insolvent, is unable to pay its debts and a winding up order has been made against it or a resolution of voluntary winding up by creditors is passed. Charterhouse Bank is not insolvent under the Companies Act. On the allegations of tax evasion involving customers of the Bank – the committee said the government should prosecute the offending

clients in courts of law, and that there is no law which says that a bank should be closed if a customer of the bank is involved in a criminal activity.<sup>23</sup>

The attempt to re-open the bank was met with resistance by the then American Ambassador to Kenya Michael Rannenberger and some civil society organizations. The sittings of the Parliamentary Committee on Finance heard that American Ambassador Michael Rannenberger wrote to the two principals warning against re-opening of the institution. He had, in an earlier communication to Attorney-General Amos Wako, alleged that the bank had been used to launder Sh40 billion, proceeds he claimed were from the evasion of taxes and related crimes from 1999 to 2006.

In a recent twist, the Chief Justice of the Island of Jersey, United Kingdom in June 2011 sought the extradition of the Chairman of the Parliamentary committee and Nambale MP Chris Okemo to Jersey to face fraud and money laundering charges.

## 8. The Unanswered Questions

The collective amnesia displayed by the government officials summoned before the Parliamentary Committee with regard to the Charterhouse Bank raises serious probity concerns. The regulators who, just a couple of years previously, had instituted investigations into the Bank suddenly appeared eager to pass the buck and absolve themselves of

any blame in the Charterhouse saga. Any neutral observer would agree with the committee chairman Chris Okemo who remarked:

*“We are puzzled because every government institution that has appeared before us claims to have no issue with the bank per se but with its customers.”*

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<sup>23</sup> NATIONAL ASSEMBLY OFFICIAL REPORT (Hansard) Thursday, 9th December, 2010

### **Kenya is “a major money laundering country”**

The US State Department’s Money Laundering and Financial Crimes Country Database of 2011 indicates that, while Kenya is a “major money laundering country” there have been no prosecutions for money laundering. The Kenyan financial system may be laundering over \$100 million funds related to piracy, corruption, smuggling, casinos and other crimes<sup>24</sup>. In addition Kenya’s use as an international drug trafficking transit point has increased. The US government recently named a Kenyan politician, Harun Mwau, also mentioned in connection with the Charterhouse saga, as a “drug kingpin” who should be subject to sanctions<sup>25</sup>. The politician has denied these charges.

This does not add up. Why would government bodies and officials deny that there was wrongdoing in Charterhouse Bank, yet it was the same institutions that had earlier called for an investigation into the affairs of Charterhouse Bank? The same institutions were members of the initial taskforce which had unearthed malpractices. What has changed since?

### **Disingenuous Arguments**

Some of the arguments made by the officials were rather disingenuous. The statement by the KACC

Deputy Director to the Committee for example was wildly inaccurate. Money laundering was an offence when this conduct took place. Section 49 Narcotic Drugs and Psychotropic Substances Act creates the offences of concealing the proceeds of drug trafficking and presenting these as proceeds of legitimate activity<sup>26</sup>. Nobody knows the source of funds that were the subject of the transactions by Charterhouse Bank. The Bank never bothered to establish the sources of funds it was asked to deal in and therefore cannot rule out these being the proceeds of drug trafficking, in which case the money laundering provisions under section 49 set in. The argument by Mutonyi that reciprocal legislation needs to be in place for Kenya to assist another jurisdiction investigating money laundering is incorrect and unfounded. This argument is probably based on the tendentious decision by Justice Nyamu in the Spacenet case, with which the KACC was aggrieved and appealed. In 2010, the Court of Appeal reversed Justice Nyamu where he had prohibited the KACC from seeking mutual legal assistance from other jurisdictions to prosecute corruption cases. The KACC had sent a request for assistance to Switzerland, where they believed the crimes under investigation had happened. It is surprising for Mutonyi to make this argument, which the KACC had itself opposed in court.

While it is true that the alleged tax evasion and money laundering involved the banks clients and

24 <http://www.state.gov/p/inl/rls/nrcrpt/2011/database/164077.htm#Kenya>

25 <http://www.whitehouse.gov/the-press-office/2011/06/01/letter-president-foreign-narcotics-kingpin-designation-act>

26 <http://www.estandardsforum.org/kenya/standards/anti-money-laundering-combating-terrorist-financing-standard>

not the bank itself, the investigations revealed that many of those major clients are related to the bank in ways such as common shareholding. Evidence given to the Parliamentary Committee indicated that Nakumatt Holdings, a principal customer of Charterhouse Bank, owned 25% of the issued shares in Charterhouse Bank. Eight of ten Charterhouse branches were located in Nakumatt branches. The bank was also closely linked to other clients such as the Kingsway Group. It seems very likely that the same people are behind the web of companies and the alleged tax evasion and money laundering.

It also seemed odd that the Parliamentary Committee seemed to be lobbying for the re-opening of a bank in spite of continuing investigations. Parliament does not regulate banks. Even if the CBK had acted oppressively, it was doing so within its province and the National Assembly simply lacks the tools to entertain a complaint against the CBK unless it can prove that CBK was operating beyond its mandate.

### **Going Through the Motions?**

The Committee hearings held surprisingly little discussion on the weaknesses that dogged Charterhouse even though there existed evidence from a credible audit firm revealing extensive malpractice. If the Committee was minded to act independently on the petition before it, the least it could have done was to institute an inquiry that examined the primary documentation, and interviewed primary informants, with a view to making a determination on the issues. Relying on the

accounts of officials who had manifestly contradicted themselves was unsafe. The conclusion could be made that the committee was not interested in the truth but was merely going through the motions to validate a pre-meditated decision.

That the petition before the Committee was raised by customers is also curious. Ordinarily customers of a bank are disparate and unconnected individuals who do not know one another. Once a bank is closed, as happened here, they are sundered and will not easily meet again. How were the 35 customers able to organize to petition the National Assembly? They would have needed a central organizing force to bring them together. Who did so? Were they assisted by the officials of Charterhouse Bank? If so, this would be further evidence of what is to be inferred by the circumstances of this case; that a grand conspiracy was in place and these customers were mere pawns in the conspiracy. It may also be prudent to assess the list of the customers in the petition vis à vis the list of suspicious and irregular accounts at Charterhouse.

It is quite possible that the re-opening of the bank would lead to cash flight and render any subsequent investigations irrelevant. This happened in the case of Crucial Properties where 25 million USD mysteriously disappeared upon the lifting of a freezing order against the account. Is the same fate destined for the deposits currently held in Charterhouse? What safeguards has the government put in place to ensure that the reopening of the bank would not risk massive capital flight of the high net worth account and that the small depositors would access their funds?

## 9. Conclusions and Recommendations

The PwC report contains strong independent evidence that Charterhouse Bank violated the Banking Act and other legislation and that its clients were involved in highly suspicious activities. That the authorities, namely, CBK, CID, KACC, AG's office, Treasury, KRA could remain powerless in light of such evidence and fail to follow investigations with prosecutions does not augur well for the sectors of the economy that fall under their purview.

It is very odd that government officials would seem to aim to clear such malfeasance by seeking to re-open the bank alleging that no offences occurred. The regulators tasked with investigation should have prosecuted those involved without interference or intimidation. In addition, the Attorney General's inaction following CID recommendations for prosecution needs to be further explored.

Charterhouse Bank repeatedly flouted the Banking Act and prudential guidelines in complete disregard of CBK regulations as well as the law. The Banking Act gives the CBK the power to revoke the license of a bank that fails to comply with the Act. Charter House Bank's licence should have been revoked ages ago.

Given the change of heart on the part of Kenya Revenue Authority regarding Charterhouse Bank's and affiliated companies' culpability on charges of tax evasion, the KRA Commissioner owes the country

an explanation as to the investigations and actions taken against any of the tax evaders.

Charterhouse Bank's attempts to frustrate initial investigations through tampering with evidence should have been punishable by law. Its actions during the investigation, such as clandestinely monitoring the work of investigators and destroying evidence do not paint a picture of a candid player who has been wronged by the regulators.

Kenya signed an MOU in 2008 under The Eastern and Southern Africa Anti-Money Laundering group (ESAAMLG) committing to adopt and implement the 40 recommendations and other special recommendations of the Financial Action Task Force (FATF)<sup>27</sup>. The Forty Recommendations are a comprehensive blueprint for action against money laundering and have come to be recognized as international best practice. They encompass the financial system and regulation, the criminal justice system, law enforcement, and international co-operation. Each FATF member has made a firm political commitment to combat money laundering based on them. A number of non-FATF Member countries have also used them in developing their efforts to address money laundering. The relevant stage agencies need to implement these recommendations.

<sup>27</sup> The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

### **Kenya risks negative international mention**

Kenya has been listed by the FATF as one of eleven jurisdictions internationally that, despite commitments, has not made progress on the following strategic deficiencies in its anti-moneylaundering/financing of terrorism (AML/CFT) regime:

- adequately criminalising terrorist financing
- ensuring a fully operational and effectively functioning Financial Intelligence Unit
- establishing and implementing an adequate legal framework for identifying and freezing terrorist assets
- raising awareness of AML/CFT issues within the law enforcement community and
- implementing effective, proportionate and dissuasive sanctions in order to deal with natural or legal persons that do not comply with the national AML/CFT requirements<sup>28</sup>.

Continuing lack of progress by June 2011 may see the FATF identifying Kenya as out of compliance with agreed plans and calling members to “consider the risks arising from the deficiencies associated with the jurisdiction”.

In view of the history of banks and their role in the Goldenberg and other scandals, a re-opening of this bank will not help promote probity in the financial sector. Before Charterhouse Bank can be re-opened, the concerns raised need to be sufficiently investigated and relevant prosecutions and remedial measures undertaken. All the evidence points to a known cartel behind an intricate web of companies, involved in massive tax evasion and money laundering. They should be brought to book.

28 <http://www.fint.gov.al/doc/FATF%20AMLCFT%20Improving%20Global%20Compliance%20June2010.pdf>

## Annex 1.

### Violations of the Banking Act and Prudential Guidelines by Charterhouse Bank

Violation	Banking Act
1. Lending to Nakumatt Holdings	<p>Section 10 of the Banking Act CBK Prudential Guidelines 07.3.1</p> <p>10. (1) An institution shall not in Kenya grant to any person or permit to be outstanding any advance or 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 exceed twenty-five per cent of its core capital</p>
2. Directors lending with no security	<p>THE BANKING (PENALTIES) REGULATIONS, 1999</p> <p>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:</p> <p>(c) Outstanding advances, loans or credit facilities which are unsecured or not fully secured –</p> <p>(i) to any of its officers or their associates;</p>
3. Account opening information (KYC)	<p>CBK Prudential guidelines 2000</p> <p>PART IV SPECIFIC REQUIREMENTS</p> <p>1. Specific Measures: Board of directors of an institution operating in Kenya is expected to ensure that management:-</p> <p>a) Obtain and maintain proper identification of customers wishing to open accounts or make transactions whether directly or through proxy;</p> <p>b) Obtain and maintain adequate records 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.</p>

<p>4. Beneficial ownership of No. person other than-</p> <p>(a) another institution;</p> <p>(b) the Government of Kenya or the Government of a foreign sovereign state;</p> <p>(c) a state corporation within the meaning of the State Corporations Act; or</p> <p>(d) a foreign company which is licensed to carry on the business of an institution in its country of incorporation, shall hold, directly or indirectly, or otherwise have a beneficial interest in, more than twenty-five per cent of the share capital of any institution. Charterhouse Sanjay Shah owned 25.36% of total capital which was declared as 10.87% to the CBK.</p>	<p>Banking act Section 13 (1) Restrictions on ownership of share capital of an institution</p>
<p>5. Concealing ultimate beneficial owners</p>	<p>Section 13(3)</p> <p>Where any share is held by a company or by a nominee on behalf of another person, the company or the nominee, as the case may be, shall disclose to the institution and to the Central Bank the full particulars of the individual who is the ultimate beneficial owner of the share.</p>
<p>6. Transfer of more than 5% of the banks share capital without prior written approval</p>	<p>Section 13 (4) No institution shall transfer more than five percent of its share capital to an individual or an entity except with the prior written approval of the Central Bank.</p>
<p>7. Granting advances, credit facilities</p>	<p>Banking act Section 11(1)(h)</p> <p>...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 with the provisions of this Act.</p>

8. Failure to disclose to CBK or furnish board approvals for advances	Section 11(1) (e) ...grant or permit to be outstanding any advance, loan 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
9. Failing to supply information	Section 50 (1) Any officer of an institution who - (c) fails to supply any information required under this Act, shall be guilty of an offence and liable to imprisonment for a term not exceeding one year or to a fine not exceeding twenty thousand shillings or to both.
10. Failing to take all reasonable steps to secure the accuracy and correctness of statements submitted under the CBK guidelines on foreign exchange	Section 50 (1) (b) fails to take all reasonable steps to secure the accuracy and correctness of any statement submitted under this Act or any other written law applicable to banks or financial institutions; or
11. Engaging in business activities for personal gain that conflict with the interest of the institution	Prudential guidelines
12. Failure to obtain and retain appropriate documents for all transaction in foreign currency	CBK guidelines 4 and 6 on foreign exchange transactions 4. All foreign exchange dealers are required to obtain and retain appropriate documents for all transactions above the equivalent of USD 10,000. Alternatively, authorized dealers may accept duly executed declaration forms in lieu of documents where e-banking is adopted. The customers would undertake to produce the transaction documents to the bank on demand; and it would be the authorized dealer to avail the documents to the Central Bank of Kenya for examination purposes. 6. All information on receipts including credit of customers. Foreign currency accounts (exports and inward investments, etc) and inflows in favour of authorized dealers must be submitted on the first working day following the date of the transaction to the Financial Markets Department of the Central Bank of Kenya.

<p>13. Making advances to a non-resident without appropriate documentation</p>	<p>Regulation 5.2 Foreign exchange guidelines</p> <p>5.2 Advances to Non-Residents</p> <p>On advances made to non-residents, the lending banks shall maintain appropriate information including, the following:-</p> <ul style="list-style-type: none"><li>(a) Loan agreements duly executed, specifying terms and conditions of the loans and guarantees, if applicable.</li><li>(b) Documents to show that the collaterals pledged are realizable in foreign currency.</li><li>(c) Declaration to the effect that funds for repayment shall be from abroad.</li></ul>
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## Annex 2

### Legal framework

**1966: Central Bank of Kenya Act of 1966 CAP 491** set up the CBK to, among other functions, foster liquidity, solvency and proper functioning of a stable market-based financial system as stipulated under Section 4 (2) of the Central Bank of Kenya Act.

**1995: Banking Act CAP 488** An Act of Parliament to regulate the business of banking and related matters; among other provisions the Act contains guidance on criteria to determine the moral and professional suitability of directors and significant shareholders. In 2009, the government announced its intention to amend the Banking Act to allow scrutiny of bank accounts and allow for identity of customers and beneficial owners of funds deposited into high value accounts to be verified on request within a specified time<sup>29</sup>.

**1994: The Narcotic Drugs and Psychotropic Substances Act** was enacted, which made it an offence to launder the proceeds of drugs. It thus covered only the proceeds of drug trafficking, excluding money earned from other criminal activities. The Anti-Corruption and Economic Crimes Act was only enacted in 2003, extending anti-money laundering legislation to the proceeds of corruption and economic crime.

**2008:** Kenya signed an MOU under **The Eastern and Southern Africa Anti-Money Laundering group (ESAAAMLG)** committing to adopt and

implement the 40 recommendations and other special recommendations of the FATF. The Forty Recommendations are a comprehensive blueprint for action against money laundering. They encompass the financial system and regulation, the criminal justice system, law enforcement, and international co-operation. Each FATF member has made a firm political commitment to combat money laundering based on them. The Forty Recommendations have come to be recognized as the international standard for anti-money laundering programs. A number of non-FATF Member countries have also used them in developing their efforts to address money laundering. By 2004, in the wake of the 9/11 attack, 9 recommendations targeting terrorist financing were added to the FATF Recommendations.

**2000:** CBK/RG/12 CBK Prudential Guidelines Money Laundering Regulation on Money Laundering. The purpose of this regulation is to provide guidance regarding the prevention, detection and control of possible money laundering activities.

**2003:** The Anti-Corruption and Economic Crimes Act 2003 is an Act of Parliament to provide for the prevention, investigation and punishment of corruption, economic crime and related offences. It defines what acts may be considered as corruption and establishes the Kenya Anti-Corruption Commission.

<sup>29</sup> Cf Kenya: UN Convention Against Corruption Gap Analysis Report and Implementation Plan, Nairobi, 2009, p. xv.

**2009:** The Proceeds of Crime and Anti-Money Laundering Act 2009, which came in to force in June 2010, after many years of lobbying, provides for the offence of money laundering and introduces measures for combating the offence, provides for

the identification, tracing, freezing, seizure and confiscation of the proceeds of crime, and for connected purposes. The Act has never been used to prosecute any crimes, nor have any of its sanctions been operationalised with implementing regulations.