REPUBLIC OF KENYA
KENYA NATIONAL ASSEMBLY
NINTH PARLIAMENT – THIRD SESSION

REPORT

OF THE DEPARTMENTAL COMMITTEE ON FINANCE, TRADE, TOURISM & PLANNING

ON

THE CENTRAL BANK OF KENYA (AMENDMENT) BILL, 2004

NOVEMBER, 2004

1.0 INTRODUCTION

Mr. Speaker Sir, on behalf of the Members of the Departmental Committee No. F on Finance, Trade Tourism & Planning and pursuant to the provisions of Standing Order No. 162, I would like to take this opportunity to present to the House, the Report on the Central Bank of Kenya (Amendment) Bill, 2004.

The membership of the Committee comprise of the following:

The Hon. Mutahi Kagwe, MP **(Chairman)**
The Hon. (Dr.) Oburu Oginga, MP **(Vice Chairman)**
The Hon. Chrysanthus Okemo, MP
The Hon. (Dr.) Adhu Awiti, MP
The Hon. John Mutinda Mutiso, MP
The Hon. Abdi Tari Sasura, M.P.
The Hon. Jakoyo W. Midiwo, MP
The Hon. Nyaga Wambora, MP
The Hon. Wycliffe A. Oparanya, MP
The Hon. S. K. Kanyingi, MP
The Hon. Joel Onyancha, MP

The functions of this Departmental Committee as established under Standing Order No. 151 are *inter alia:-*

(i) to study and review all legislation after First Reading subject to the exemptions under Standing Order No. 101 A (4)

(ii) to make reports and recommendations to the House as often as possible including recommendations of proposed legislation.

The Central Bank of Kenya (Amendment) Bill, 2004 was referred to the Departmental Committee on Finance, Planning and Trade upon a motion moved by the Minister for Finance pursuant to the provisions of Standing Order No. 101(1)..

2.0 DELIBERATION ON THE CENTRAL BANK OF KENYA (AMENDMENT) BILL, 2004

The Committee held a consultative workshop in conjunction with the Ministry of Finance and the Central Bank of Kenya. The Central Bank of Kenya (Amendment) Bill, 2004 was among the Bills discussed during the Workshop. In addition, the Committee visited the United Kingdom to study the monetary policy framework with a view to enriching the Bill.

The Committee deliberated on the Bill as follows:-

Clause 1	-	Agreed to
Clause 2	-	Amendment proposed
Clause 3	-	Agreed to
Clause 4	-	Agreed to
Clause 5	-	Agreed to

3.0 COMMENTS BY THE MANAGEMENT OF THE CENTRAL BANK OF KENYA

The management of the Central Bank of Kenya informed the Committee that the proposed amendments to the Act are geared towards restoring the independence of the Central Bank of Kenya on the operational and licensing aspects of banks and establishing the Monetary Policy Advisory Committee.

The rationale for the proposed amendments are:-

(i) The need to improve the financial credibility of Kenya's banking system. The proposed Monetary Policy Advisory Committee is supposed to add value and enhance CBK transparency and accountability.

(ii) The need to have a realistic lending bank rate i.e. Central Bank Rate. The Treasury Bills currently used as a benchmark does not reflect the real market situation but is a reflection or function of the government demand for credit/borrowing hence unrealistic.

(iii) The need to ensure that all banks licensed by CBK are managed by competent professionals with integrity. The criteria for appointments to be clearly defined in the law to avoid abuse.

(iv) The need to take cognizance of the many challenges in the financial sector and concerns of the public occasioned by differing interpretations of the statues. The proposed amendments seeks to accommodate the in ***duplum rule*** which aims at protecting the borrowers by limiting the total interest institutions can impose on non-performing loans. This would minimize exploitation on borrowers and ensure that the banks conduct effective appraisal and follow-ups on non-performing accounts. This is practiced in countries like South Africa, Netherlands and Zimbabwe.

(v) The need to repeal section 44 of the CBK Act (***Donde Act***) on grounds that the Act, if implemented in its current form, will seriously jeorpadize and completely destabilize the entire financial system. Section 44 also poses a great threat to potential investors as follows:-

- ♦ The cap on lending rates will not allow for appropriate pricing of risk differentiation by commercial banks. Banks will be unwilling to lend at uniform interest rates to various types of risks. Therefore, they will concentrate their lending to well established clients and leave out the poor and the struggling small business and persons who create considerable employment in the small and medium enterprises.

- The partial application of the new law to commercial banks and specified financial institutions and leaving out other institutions providing similar services like the building societies may weaken the monetary policy. Affected institutions will circumvent the law by establishing their own building societies or divert funds to protect their financial position. This will undermine the efficiency of the banking system and compromise the effectiveness of monetary policy.

- Discourage small savers by forcefully placing their deposits into current accounts where they earn no interest. Banks may also raise the minimum deposit that qualify to earn interest among term deposits.

- The introduction of the interest controls is inconsistent with global trends where market forces determine the rates applicable. Therefore, the re-instatement of interest rates controls may be viewed as a clampdown on capital mobility thereby destroying investor confidence and promoting capital flight for both local and external investors to other market where real returns are high.

- An informal mechanism will most likely arise to fill in the void by providing for the credit needs of high-risk local enterprise but at high cost than charged by the controlled market segment.

4.0 COMMITTEE'S OBSERVATIONS ON THE BILL

(i) **CLAUSE 2**

The new Section 4D on the Monetary Advisory Committee reduces the Central Bank of Kenya Officials to two and increases expert membership from five to six. However, the modalities for appointment are not specified and it appears that this can be made from the private or public sectors. This is a lacuna that should be addressed lest appointments be made on criteria other than merit.

(ii) Kenya's biggest legal problem is the enforcement of existing legislation. A relevant example is the failure/refusal to enforce section 44 of the Banking

Act on charges. The Central Bank is presently publishing charges which is illegal, null and void.

Another prime example of conflict and failure of the ***ultra vires*** test is the controversy over section 39 of the Central Bank of Kenya Act. An Act of Parliament can only be repealed by another Act of Parliament. Section 39 was purportedly repealed by a Legal notice of 23rd July, 1991 issued by the then Governor of Central Bank. However, parliament itself repealed the statute only through Act NO. 9 of 1996 effective from April 1997. Therefore, this means that between 23/7/91 and 18/4/97, "***liberlisation***" of the banking sector was and still remains *ultra* ***vires,*** illegal, null and void.

(iii) The spirit of ***Donde Act*** (Section 44) should not be ignored on the basis of demand and supply without being experimented. The ***Donde Act*** was propelled by the general concern that nominal interest rates in Kenya were too high and the spread between the lending and deposit interest rate quite wide. Therefore, in the absence of perfect competition, there should be some sort of control and there is need for balance under section 44 between the control and a viable alternative in the absence of the ***Donde Act.***

(iv) The independence of the Central Bank of Kenya is of necessity to ensure the separation of the Monetary and fiscal policies. There is also no sufficient arms length relationship between CBK and the Deposit Protection Fund. This appears uncomfortable and the distancing should be addressed.

(v) There has been no corresponding adjustment in the Banks' lending rates whenever the Treasury Bills rates currently used as a benchmark reflect a downward trend.

(vi) CBK should address the issue of negative bank balances and the unrealistic bank charges being packaged and levied by the banks. Despite these charges, the banks have not taken the advantage of the liberalization to expand their services but have instead closed down most of their branches.

(vii) Under section 39(1) of the CBK Act, the valuation and legal fees charged by the banks are exploitative. Restriction to the use of the banks' appointed lawyers and valuers is non competitive.

(viii) It is in the interest of CBK to disseminate information to the public on its role *vis-avis* the role-played by other financial authorities elsewhere.

5.0 COMMITTEE'S RECOMMENDATIONS ON THE BILL

(i) The current provision in law that allows directors of financial institutions that have been liquidated to have authority to facilitate the transfer of assets should be reviewed.

(ii) The is need to formulate specific Acts distinct from CBK Act which defines the different tariffs that are allowed such as the Consumer Protection Act applicable in the United Kingdom.

(iii) A new market driven system of setting banks lending rate should be devised instead of using Treasury Bills which is reflective of government demand for credit.

(iv) **CLAUSE 2**

The Bill should address the following in the appointment of the Committee members and the vetting process.

- Who or which institutions or persons are to determine the appointments?
- Can officials of the public institutions sit in the committee if they are experts in the field?
- What vetting processes should be used?
- Should the Governor chair the Monetary Policy Committee, would he not be advising himself since the role of the Committee is to advise the Central Bank?
- Shouldn't the Committee members retire on a rotational basis?

(v) **Responsibility and accountability**

- The Central Bank should be granted independence and operational responsibility for setting up the interest rates to deliver price stability as defined by the government economic policy.

- The Central Bank should also support the government's wider economic policies including its objectives for growth and employment. In this regard, the Government should inform the Central Bank of its economic policy objectives.

- The Central Bank Board of Directors should keep under constant review, the performance and procedures followed by the Monetary Policy Advisory Committee on an on-going basis. This includes ensuring that the Monetary Policy Advisory Committee properly collects sectoral and other information for purposes of formulating monetary policy.

- The Monetary policy Advisory Committee should be accountable to Parliament through quarterly reports and meetings with the relevant Committee of Parliament.

- There should be a Memorandum of Understanding between the Treasury and the Central Bank establishing the cooperation between the two institutions in the field of financial stability. The Treasury should be responsible for defining the monetary policy objectives including the setting of the inflation rate while the Central Bank through the Monetary Policy Advisory Committee should be responsible for maintaining price stability to achieve these objectives.

(vi) **Establishment of the Financial Services Authority**

The government should as a matter of necessity introduce a Bill in Parliament to enable the formation of the Financial Services Authority to enhance the efficiency of the financial management via a single statutory financial authority. The Authority will be responsible for the regulation of deposit taking, insurance and investment business, and the listing Authority for admissions of securities to the official list.

The Authority will take over powers from the following:- Building Societies; Friendly Societies; Investment Management Authorities; Securities & Future Authorities; Supervision & Surveillance Division of the Central Bank.

6.0 PROPOSED AMENDMENTS TO THE BILL

CLAUSE 2

1. **THAT,** Clause **2 4D(1)** be amended by inserting the following **new subsection (b)** immediately after **subsection (a)** and renumbering the subsequent subsections.

(b) Achieve the monetary policy objectives defined by the Government through the Ministry of Finance via the following:-

   (i) Determining the interest rates to deliver price stability.

   (ii) Intervening directly in the financial market to achieve the inflation target set by the government.

<u>Rationale</u>

This is to enable the Central Bank to deal with the day-to-day fluctuations in liquidity and assess the impact of monetary conditions in the financial market in order to limit systematic risk of problems affecting particular institutions spreading to other parts of the financial system

2. **THAT,** Clause **2 4D(2)** be amended as follows:-

   (i) by inserting the following new **sub-section (c)** immediately after **subsection (b)** and renumbering the subsequent subsections.

   2(c) - Two other internal members responsible for monetary policy analysis and operations appointed by the Bank in consultation with the Minister for Finance.

(ii) In **sub-section 2(d)** by inserting the following words after the word "***Minister***"

"with the approval of the relevant Committee of Parliament"

(iii) In **sub-section 3** by inserting a new sub-section **3(i)** - one of the six members appointed under **sub-section (d)** above may be non citizen of Kenya.

<u>Rationale</u>

To take advantage of the existing expertise available globally. Further, as we move to harmonize monetary activities with our regional partners particularly with the East African Countries, it may be necessary to appoint an individual who can revolve into other Central Bank Committees as well.

(iv) In **sub-section (5)** by deleting the words "***two months***" and inserting in place thereof the word ***"one month".***

(v) In **sub-section (6)** by deleting the word "***six***" and inserting in place thereof the word ***"quarterly".***

7.0 CONCLUSION

The Committee recommends that the House adopts its Report on the Central Bank of Kenya (Amendment) Bill, 2004. Mr. Speaker Sir, may I take this opportunity to thank Members of the Committee for their input and valuable contributions during the deliberations on the Bill.

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Hon. Mutahi Kagwe, MP
Chairman
Departmental Committee on
Finance, Trade, Tourism and Planning

Date...................... 30-11-04.