THE IMPACT OF MONEY LAUNDERING AND ILLICIT FINANCIAL FLOWS ON INVESTMENT IN KENYA

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Abstract

Financial crime, in particular money laundering and illicit financial flows are a thriving economy whose value is in the billions of dollars, with robust markets and demand across the world. This paper seeks to identify and assess the impact that money laundering and illicit financial flows have had on Kenya's investment landscape. The paper was premised on findings from desk research of literature written concerning money laundering as an emerging from of transnational and financial crime, as well as from findings of studies conducted by government agencies and other institutions on the risk, prevalence and challenges around anti-money laundering in Kenya. The paper also examines Kenya's legal framework on money laundering and its overall anti-money laundering strategies, and further draws on the researcher's experience as a practitioner in the criminal justice system and expert on transnational organised crime and its occurrence in East Africa.

The research sets out a contextual background which illustrates the measures taken to combat money laundering from the international level, to the national level through the different international instruments ratified and domestic laws enacted by Kenya. The paper additionally discusses at length the country's current standing internationally with regard to efforts made to combat money laundering, the different ways in which money laundering and illicit financial flows manifest in Kenya's economy, and the various factors that have served as enablers for money laundering and illicit financial flows, both within and outside of the legal framework. Key findings in this regard include the presence of a strong cash-based economy, the proliferation of mobile money transactions in Kenya, corruption and low political goodwill, advances in technology which are not matched by tandem advances in the legal framework, overall weaknesses in the investigative and prosecutorial roles that are unable to adequately address the occurrence of money laundering as well as poor coordination of efforts by regulatory agencies to combat money laundering.

The study discusses the implications and impacts of money laundering on Kenya's investment landscape in detail, and proposes various measures which if implemented, would go a long way in reducing the prevalence of money laundering and illicit financial

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flows and by extension, the far reaching impacts on investment, governance and the rule of law.

A. INTRODUCTION

Kenya is a Partner State of the East African Community (EAC), with a population of approximately 54M people. It is the leading economy in the economic bloc that is comprised of Burundi, the Democratic Republic of Congo, Kenya, Rwanda, South Sudan, the United Republic of Tanzania, Uganda and the Republic of Somalia. The nation enjoys a vast array of natural resources, an expansive road and railway network and a strategic geographical positioning along the East African Coast, making it a gateway into other regions of the world including Europe, the Middle East, Asia and other African states.[1] Kenya's present economic ranking is that of lower middle income country.[2] The country's strategic location in addition to being geographically beneficial has also made the country, and more so the capital Nairobi, a regional hub attracting genuine and nefarious investments both internally and from external or foreign investors.

Advances in technology and globalization have not only revolutionized how business is done, but have also had a hand in enabling particular forms of transnational and financial crimes. According to Nasdaq's Global Financial Crime Report of 2024, which examined the state of financial crime and its impact on the integrity of the global financial system, it was reported that the money laundering economy was valued at trillions of dollars. This was fueled by the demand from other forms of organised crime to have their proceeds laundered and infused into the legitimate economies of different regions. In particular, transnational organised crime in form of drug trafficking, fraud and human trafficking were singled out as major criminal markets responsible for powering the proliferation of money laundering.[3]

Money laundering is defined in various ways, but is basically a process by which large amounts of money obtained from the conduct of crime is given the appearance of having originated from a legitimate source, and when done successfully, allows criminal entities to not only retain control over their proceeds of crime, but also provide a legitimate cover for the source of their income.[4] Money laundering is the method of hiding, mixing and

1 Ministry of Foreign Affairs. Government of Kenya. https://mfa.go.ke/country-profile. Accessed on 27th October, 2024.

2 The World Bank Group. *Doing Business 2020.* At p.4.

3 Nasdaq. *Global Financial Crime Report. Insights at the Intersection of Financial Crime Data & Real Survivor Stories.* https://www.nasdaq.com/global-financial-crime-report Accessed on 25th October, 2024.

4 *Vandana Ajay Kumar*. Money Laundering; Concept, Significance and its Impact*,* European Journal of Business and Management. Vol 4, No. 2, 2012, p. 113.

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disguising the proceeds of criminal activities using legitimate institutions and systems in order to obscure the true source of these proceeds.[5]

The United Nations Convention Against Transnational Organised Crime, approved and signed in Palermo in the year 2000, criminalizes the laundering of proceeds of crime vide Article 6 which requires each State Party to adopt, in accordance with fundamental principles of its domestic law,

a. such legislative and other measures as may be necessary to establish as criminal offences, when committed intentionally:
   (i) the conversion or transfer of property, knowing that such property is the proceeds of crime, for the purpose of concealing or disguising the illicit origin of the property or of helping any person who is involved in the commission of the predicate offence to evade the legal consequences of his or her action;
   (ii) The concealment or disguise of the true nature, source, location, disposition, movement or ownership of or rights with respect to property, knowing that such property is the proceeds of crime;
b. Subject to the basic concepts of its legal system:
   (i) The acquisition, possession or use of property, knowing, at the time of receipt, that such property is the proceeds of crime;
   (ii) Participation in, association with or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the offences established in accordance with this article.

Money laundering is by nature process based, seeing that at the heart of it is the integration of proceeds of crime into legitimate economies by creating as much distance as possible between the proceeds and the criminal entities and activities generating these proceeds. As such, there laundering process will embody three main phases namely;

a. Placement – moving funds from direct association with the crime.[6]

This occurs when the illegal money is received introduced into legitimate financial systems (such as banks) in order to give it the appearance of legitimacy.[7] This initial stage has a two-pronged intention namely to dispense with the criminal actor holding the illegally obtained funds, and to introduce the money into legitimate financial systems.[8] It is a sensitive stage because introducing large amounts of illegally obtained finances can easily

5 USAID. *Introduction to Money Laundering.*

6 United Nations Office on Drugs and Crime. *Infiltration of Organised Crime in Business and Government.* Module 4. https://www.unodc.org/e4j/en/organized-crime/module-4/key-issues/money-laundering.html. Accessed on October 25th, 2024.

7 *Peyto Tollasken*. Negative Economic Impacts of Money Laundering in Kenya, Thailand and France. Mathematics and Computer Science Capstones 51, 2023. p.4.

8 UNODC, note 6.

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rouse suspicion and leave the criminal actors vulnerable to detection and subsequent legal action.

b. Layering – moving funds internationally.[9]

This is the most complex part of the money laundering process, and is also known as structuring. This stage is designed to create distance between criminal actors and illegally obtained finances by moving the money around constantly through investments in different kinds of assets.[10] It is also takes place through complex financial transactions crafted to conceal audit and deli-link the money from the criminal activity that generated it in the first place.[11]

c. Integration – availing the proceeds of crime in a legitimate way.

This is the third and final component of the money laundering process and involves returning the proceeds of crime to criminal actors through what appears to be a legitimate source. Having been placed and layered, the money is now fully integrated into a legitimate financial system and can therefore be used in and for other legitimate purposes.[12]

Money laundering tends to be, more often than not, transnational in nature, being used to finance both national and transnational activities that are illicit. Illicit Financial Flows (IFFs) constitute illicit finances that cross borders, and are defined broadly as all cross-border financial transfers which contravene international or domestic laws.[13] The World Bank referred to IFFs as the cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred or used that crosses borders.[14]

In 2016, the United Nations in its world Economic Situation and Prospects report states that;

> *There is no agreed definition of the concept of illicit financial flows, but it is generally used to convey three different sources of Illicit Financial Flows: the proceeds of commercial tax evasion, revenues from criminal activities and public corruption.*[15]

From the foregoing, it is evident that money and capital have an attribute of mobility, and a unilateral approach to money laundering would not be effective without international

9 UNODC, note 6.

10 Tollasken. Note 7, p.4.

11 UNODC, note 6.

12 UNODC., note 6.

13 *Peter Chowla & Tatiana Falcao*. Illicit Financial Flows: Concepts and Scope. Inter-Agency Task Force on Financing for Development. December, 2016., p 5.

14 Chowla & Falcao, note *13,* p. 6.

15 Chowla & Falcao, note *13,* p. 8.

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cooperation, or other form of framework that allows law enforcement agencies to exchange information both at national and international levels to successfully, investigate and prosecute criminal activities that translate into money-laundering. This is the premise upon which the United Nations Convention Against Transnational Organised Crime seeks to establish uniformity in formulation of domestic regulatory and supervisory measures to combat money laundering.[16]

B. BACKGROUND TO THE RESEARCH

Kenya conducted a National Risk Assessment (NRA) exercise in 2019, aimed at detailing the country's specific risk (a combination of threats and vulnerabilities) profile and corresponding strategy and action plan to mitigate against the identified risk areas.[17] In the context of the assessment, threats referred to the scale, volume and characteristics of the proceeds of crime and/or terrorist financing. As such, the assessment addressed internal threats, to mean proceeds of crime generated within the jurisdiction, as well as external threats, to refer to proceeds from other jurisdictions. With regard to vulnerabilities, the assessment focused on weaknesses and gaps in legislation, regulation and overall structures at national and sectoral levels.[18]

Kenya's overall money laundering threat was assessed as medium, with the country's money laundering vulnerability being assessed as medium high. Various industries were assessed on the basis of the nature of contribution they make to the country's economy, and in light of their impact on the country's anti-money laundering regime. In particular, the banking sector was identified as the leading sector in terms of impact on national money laundering vulnerability, due to the key role played by the banking sector in the nation's economy. Other sectors that were assessed include the legal profession, motor vehicle dealers, SACCOs, money remittance providers, money network operators and the real estate sector.[19]

Global initiatives to establish standards and best practices to combat and control money laundering have been developed over the years, with the most prominent international organizations being the Financial Action Task Force (FATF), the Basel Committee on Banking Supervision and the Wolfsberg Principles.[20] The FATF is at the forefront globally in tackling money laundering, terrorist and proliferation financing. The FATF was established in 1989 after the UN Drug Convention of 1988, and has a wide membership drawn from major financial centres in Europe, Asia and North America, with nine regional FATF-style

16 Article7.

17 *Ministry of Planning*. Money Laundering and Terrorism Financing National Risk Assessment Report. October 2021.

18 Ministry of Planning, note 17, executive summary.

19 Ministry of Planning, note 17.

20 USAID, note 5.

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regional bodies across the world. The FATF developed 40 recommendations adopted in February 2012 and regularly updated since, which constitute international standards on combating money laundering and the financing of terrorism and proliferation. The guidelines set standards which countries should implement through their legal and administrative frameworks adapted to their specific context.

One of the strategies used by the FATF to promote compliance with the recommendations is to identify jurisdictions with weak anti-money laundering and terrorist financing frameworks through one of two lists – the black list which details high-risk jurisdictions with serious deficiencies to counter money laundering, terrorist and proliferation financing; and the grey list which details jurisdictions under increased monitoring and that are required to work in close collaboration with the FATF in order to address deficiencies in their respective anti-money laundering regimes within an agreed time frame.[21]

Kenya recently made it back to the grey list in February 2024, having made an unfortunate come-back after a 10-year absence from the list. Kenya's addition to the grey list was attributable to different factors including; the absence of a clear strategy for the prosecution of money laundering offences; inadequate investigation and prosecution for terrorist financing offences; a large, unregulated and unsupervised Non-Profit Organisations landscape; low level of recovery in relation to crimes of fraud, forgery and drug-related offences; poor beneficial ownership disclosure framework; the absence of a regulatory framework or prohibition against virtual assets and virtual asset service providers and poor supervisory frameworks in relation to designated non-financial businesses and professions that play a key role in the economy and that can be conduits for money laundering activities.[22]

The country remains a major corridor for Illicit Financial Flows in different forms including money laundering, a fact attributable in part, to its high score as far as financial secrecy is concerned. A 2018 report by the Tax Justice Network ranked Kenya as the most secretive jurisdiction in Africa, with a secrecy score of 80 %.[23] Opaque banking systems, tax havens (secrecy jurisdictions), hedge funds and private equity funds are some of the major drivers of illicit financial flows, including money laundering, on a global scale.[24] The country's last ranking placed the secrecy score at 67 % as of 2023, which even though is a step in the right direction, still demonstrates a high propensity towards being complicit in helping individuals to hi their finances from the rule of law.[25]

21 USAID, note 5.

22 Tran*sparency International*. Greylisting of Kenya by Financial Action Task Force Calls for Urgent Reforms to Combat Financial Crime. Press Release dated 7th March, 2024.

23 *Tiberius Barasa*. Illicit Financial Flows in Kenya: Mapping the Literature and Synthesis of Evidence. Partnership for African Social and Governance Research (PASGR), 2018, p. 17.

24 Barasa note 23, p. 16.

25 Tax Justice Network. https://fsi.taxjustice.net/country-detail/#country=KE&period=22 Accessed on 24th October, 2024.

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C. MONEY LAUNDERING AND ILLICIT FINANCIAL FLOWS IN KENYA

Illicit financial flows have been described as multidimensional and transnational in their character, and even likened conceptually, to migration, on account of having countries of origin, transit locations and countries of final destination.[26] Money laundering also often entails 'cleaning' the proceeds of organised criminal activity, which is also most times transnational in its very nature. Internationally, legal standards construct money laundering as being;[27]

a. The conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity to evade the legal consequences of his action.
b. The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from criminal activity or from an act of participation in such activity.
c. The acquisition, possession, or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such activity.

In Kenya, the legal framework around anti-money laundering is anchored in two key laws;

a. The Proceeds of Crime and Anti-Money Laundering Act No. 9 of 2009 (POCAMLA)
b. The Anti-Money Laundering and Combating of Terrorism Financing Law (Amendment) Act, 2023.

The Proceeds of Crime and Anti-Money Laundering Act provides for the offence of money laundering and introduces measures for combating the offence, and for identification, tracing, freezing, seizure and confiscation of the proceeds of crime and for connected purposes.[28] The Act defines various terms that are relevant to the anti-money laundering framework including designated non-financial businesses or professions, financial institutions, proceeds of crime, monetary instruments, property and supervisory body.

The Act defines money laundering in the following ways;

A person who knows or who ought reasonably to have known that property is or forms part of the proceeds of crime and[29]—

26 United Nations Conference on Trade and Development. *Tackling Illicit Financial Flows for Sustainable Development in Africa.* Economic Development in Africa Report 2020. United Nations, Geneva, 2020.

27 Mike Levi and Melvin Soudijn. *Understanding the Laundering of Organized Crime Money.* The University of Chicago. March 2020. At p. 7.

28 Proceeds of Crime and Anti-Money Laundering Act – Long Title.

29 Section 3.

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

The Act also criminalizes the acquisition, possession or use of proceeds of crime and provides that;[30] a person who —

a. acquires
b. uses; or
c. has possession of,

property and who, at the time of acquisition, use or possession of such property, knows or ought reasonably to have known that it is or forms part of the proceeds of a crime committed by him or by another person, commits an offence.

The third category of offence defined by the Act as an offence of money laundering is in relation to financial promotion of an offence. More specifically, the act stipulates that a person who, knowingly transports, transmits, transfers or receives or attempts to transport, transmit, transfer or receive a monetary instrument or anything of value to another person, with intent to commit an offence, that person commits an offence.[31] Other offences in the act include failure to report suspicion regarding proceeds of crime;[32] tipping off individuals as to the contents of a report made in compliance with the requirements for reporting institutions to monitor and report all complex, unusual, suspicious, large or similar transactions as the case may be;[33] misrepresentation;[34] malicious reporting;[35] failure to comply with the provisions of the act;[36] and hindering lawful performance of duties by authorized officers under the act,[37] among others.

30 Section 4.
31 Section 7.
32 Section 5.
33 Section 8 as read together with Section 44.
34 Section 9.
35 Section 10.
36 Section 11.
37 Section 15.

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The Anti-Money Laundering and Combating of Terrorism Financing Laws (Amendment) Act as enacted in 2023 amended various laws relating to anti-money laundering and combating of terrorism financing and proliferation financing. The act also introduced measures pertaining to detection and prevention of money laundering and terrorism financing such as enhanced due diligence, reporting obligations by various institutions both within the financial sector and by designated non-financial businesses or professions, a widened scope of activities that constitute money laundering activities as well as increased penalties in respect of non-compliance by relevant institutions and individuals.

Key highlights include the requirement by limited liability companies and limited liability partnerships to disclose beneficial ownership information as well as an enhanced mandate for various regulators including the Central Bank of Kenya, which has been given authority to;[38]

a. vet proposed significant shareholders, beneficial owners, directors and senior officers of reporting institutions;
b. supervise, monitor and ensure compliance with the provisions of the act including having the power to impose monetary, civil or administrative sanctions for non-compliance with the relevant legal requirements;
c. conduct onsite inspections and offline surveillance;
d. compel the production of any relevant documents or information required for the discharge of its supervisory mandate under POCAMLA;
e. issue regulations, guidelines, directions, rules or instructions for anti-money laundering; and
f. undertake consolidated supervision of a reporting institution in its group.

The architecture of this act connotes an awareness of the interconnectivity between money laundering and terrorism financing. beyond terrorism, the centrality of money laundering to the operations and sustenance of organised criminal groups cannot be overlooked. This position is echoed by the UK's National Crime Agency (NCA) which flagged money laundering as being the enabling factor behind most forms of organised crimes, with the end result of this being the furtherance of these groups' criminal activities and successful concealment of their assets,[39] especially because organised crime is highly lucrative and proceeds received would need to be given the appearance of legitimacy. Criminal networks in particular operate by setting up multi-layered, multi-jurisdictional structures to hide the real ownership of funds.[40]

The laundering of proceeds of crimes as described in Section 1 clearly illustrates the involvement of different actors across different sectors including those that are not strictly

38 Central Bank of Kenya Act. Section 51A.

39 Tom Keatinge. *Money Laundering: The Beating Heart of Organised Crime.* Royal United Services Institute. 2020. Available on https://www.rusi.org/explore-our-research/publications/commentary/money-laundering-beating-heart-organised-crime Accessed on 29th October, 2024.

40 *Chowla & Falcao*, note 13, p. 7.

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financial institutions. In Kenya. the Proceeds of Crime and Anti-Money Laundering Act designates them as designated non-financial businesses or professions,[41] and include casinos, real estate agents, accountants, non-governmental organizations, advocates and other independent legal practitioners as well as trust and company service providers.[42] Money laundering will encapsulate the wide array of actors because of the nature of movement of illicit financial flows wherein monies can be moved; to evade anti-money laundering measures; because they have a criminal origin or have a criminal destination (such as corruption, conflict financing or even bribery) or they belong to entities that are subject to international sanctions under various bodies such as the UN security council.[43]

There are various forms of illicit financial flows and manifestations of money laundering in Kenya. Generally, money can be transferred to accounts held in the names of nominees, to shell holding companies or even to offshore banks with strict secrecy laws. A 2017 report on Kenya established that there was a connection between political influence and illicit capital outflows.[44] An interesting finding from the report was the direct correlation between the size of government (measured by the amount of final government consumption of goods and services) and capital flight from the nation,[45]with capital flight being effected through purchase of goods and services by the government.[46]

Money laundering and illicit financial flows from Kenya take place in different ways including through abusive transfer pricing, mis-invoicing of services, using unequal contracts in order to avoid tax, trade mispricing, illegal export of foreign exchange,[47] grand corruption, investments in real estate as well as other businesses that generate income including establishments centered on hospitality (such as hotels), cross-border trade and through transactions in legitimate financial systems. Other proceeds-generating predicate offences that pose a significant money laundering threat in Kenya include fraud and forgery, cybercrime offences, economic crimes (corruption, bribery) as well as environmental and wildlife crimes.[48]

There are various enablers that have created a thriving environment for money laundering to take root in Kenya. From weaknesses in the legal framework to challenges with enforcement by relevant agencies, the enabling factors are diverse and set out in summary as follows;

41 Section 2.

42 Section 2.

43 *Chowla & Falcao*, note 13, p. 5.

44 *Emmanuel Letete and Mare Sarr*. Illicit Financial Flows and Political Institutions in Kenya. African Development Bank Group. Working Paper Series No. 275. July 2017, p. 4.

45 *Letete & Sarr*, note 44*,* at p. 22.

46 *Letete & Sarr*, note 44*,* at p. 22.

47 *Chowla & Falcao*, note 13, p. 9.

48 *Chowla & Falcao,* p. 19.

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a. law enforcement authorities demonstrate an understanding of the key threats around money laundering, but despite that, there is limited understanding of the magnitude of these threats, as well as the various loopholes that criminal entities exploit in order to carry out their money laundering activities. In addition, there is a limited appreciation of the risks posed by proceeds of crime that stem from foreign predicate offences.[49]
b. despite certain sectors being already earmarked as high-risk in respect of money laundering activities, the country had not put in place enhanced measures in order to address the money laundering risks posed by these sectors.[50] Some of these non-financial high-risk sectors include the legal profession, the accountancy profession, motor vehicle dealers, SACCOs, money remittance providers, money network operators, the real estate sector, the gaming industry, dealers in precious stones and metals.[51]
c. There is a focus by prosecuting and investigative agencies on predicate offences (i.e. underlying criminal activities that serve as the foundation for money laundering. In most cases these take the form of other organised crimes such as drug trafficking, human trafficking, fraud, corruption or terrorist financing), as opposed to focusing on investigating and prosecuting money laundering as an offence.[52]
d. Despite the establishment of an independent Financial Reporting Centre under POCAMLA, there is limited use of intelligence from this center by law enforcement agencies that would be helpful in identifying and investigating potential money laundering. In addition, there is an inclination by law enforcement agencies towards using intelligence from the reporting center to pursue predicate offences and proceeds of crime, but not to investigate and prosecute money laundering as an offence.[53] As a result of this imbalance, the capacity of Kenyan courts to adjudicate money laundering has not been adequately put to test.[54]
e. Despite the geographical positioning of Kenya, there has not been adequate focus on detecting and curtailing cross-border movement of money, neither has there been concerted effort to pursue criminal proceeds in foreign countries.[55] Kenya's geographical ownership renders the country's financial sector particularly vulnerable since the country attracts both well-intentioned investors as well as those with criminal intentions.[56]

49 *Eastern and Southern Africa Anti-Money Laundering Group.* Anti-Money Laundering and Counter-Terrorist Financing Measures. Kenya Mutual Evaluation Report. ESAAM. September 2022, p.37.

50 *ESAAM,* note 49, p. 37.

51 *Ministry of Planning*. Money Laundering and Terrorism Financing National Risk Assessment Report. October 2021, p. 82–101.

52 *ESAAM*, note 49, p.37.

53 *ESAAM*, note 49, p.48.

54 *ESAAM,* note 49, p. 49.

55 *ESAAM,* note 49 p. 50.

56 *Barasa*, note 23, p. 144.

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f. Legal persons such as corporations are often abused for money laundering, but law enforcement authorities demonstrate a low understanding of the extent to which these entities are used to carry out money laundering.[57] This is further complicated by the poor reporting framework with regard to requiring disclosure of beneficial ownership information especially from limited liability partnerships and trusts, which are currently not required to file information on beneficial ownership.
g. Weak inter-agency cooperation and collaboration between financial sector regulations, financial institutions and law enforcement agencies in combating money laundering.[58]
h. Challenges in distinguishing between proceeds of legitimate business transactions and illegitimate monetary transactions by various actors, both in the financial and non-financial sectors.[59]
i. Failure to have well established 'know-you-customer' frameworks in the financial sector.[60] The failure to have systems that facilitate the proper and actual identification of customers carrying out financial transactions promotes the kind of secrecy that enables money laundering to thrive.

The above summary is not an exhaustive one, but paints a fairly accurate picture of the enabling factors that have entrenched money laundering in Kenya. The next section looks into the impact of money laundering not only on the economy, but also on other critical areas that are relevant to the Kenya's growth and development as a nation.

D. THE NEXUS BETWEEN MONEY LAUNDERING, ILLICIT FINANCIAL FLOWS & INVESTMENT

Kenya's strategic geographical location, infrastructure network through airports, railways and road connectivity as well as sea ports connecting the country to other regions globally. Based on recent 'ease of doing business' standings, Kenya has been reported to have a favorable legislative and regulatory environment that makes it attractive to investors. Steady economic growth, the presence of a highly skilled work force, high internet penetration and a refined and vibrant financial system, which when taken together, make Kenya the most attractive investment destination in the region.

Money laundering is wrongly perceived to be a victimless crime, yet the truth of the matter is that the ramifications of money laundering are often felt not only in the economy of a nation, but pose a threat to governments and to rule of law generally. According to a 2024 report done on global financial crime, it was established that there is an "inherent connection between the integrity of finance and the stability of the financial system – with

57 *Barasa,* note 23, p. 144.

58 *Barasa,* note 23, p.144.

59 Peyton Tollaksen. *The Negative Economic Impacts of Money Laundering in Kenya, Thailand and France.* Mathematics and Computer Science Capstones. 2023, p 6.

60 *Tollaksen,* note 59, p. 6.

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increasingly complex and international criminal activity being a factor that significantly undermines cross-border financial strength."[61]

There are various effects of money laundering and illicit financial flows that Kenya's economy and investment climate generally are exposed to, and these include:

a. The sustainability and growth of legitimate financial institutions is compromised and at risk. The development of parallel systems and money laundering avenues means that legitimate financial institutions are at risk of losing out, whereas emerging and less equipped financial institutions, find themselves at risk of being completely stifled and displaced by illegal operators engaged in money laundering activities.
b. Kenya's heavily cash-based economy facilitates the circulation of illicit financial flows which also negatively affects trust in legitimate financial institutions, as well as in their ability to detect and report in a timely manner, any activities that are potentially within a money laundering cycle or phase. Illicit financial flows generally, also drain resources from the country, which negatively impacts economic growth.
c. The presence of criminal actors with significant volumes of money generated from criminal activities and which is injected into legitimate businesses and markets can potentially turn the balance of economic power from legitimate entities to criminal actors who are not subject to any kind of social or even political accountability and oversight.
d. Investments set up to clean the proceeds of criminal activities undermine legitimate businesses and can easily force these legitimate businesses out of the market on the basis of unfair competition and business practices attributable to access to large volumes of proceeds of crime which are not subject to legitimate regulatory processes such as taxation. A direct consequence is this, is exposing legitimate businesses to heavier taxation by government due to loss of revenues.
e. Money laundering is often used to fund terrorism and the operations of organised crime. This poses the risk of governments, especially those in developing countries losing control of their economic policies especially where the proceeds of crime exceed government budgets. This can also fuel the emergence and growth of rogue criminal entities that offer services parallel to government (e.g. security) and by so doing, erode rule of law and confidence in government entities to deliver on social contract.
f. Large volumes of illicit financial flows and proceeds of crime circulating in an economy can distort economic growth, as does investment of proceeds of crime into ventures that do not necessarily benefit the growth and development of the nation generally. Proceeds of crime have been known to sustain abnormally lavish lifestyles through seemingly legitimate existing sectors (such as casinos and clubs) that may not necessarily benefit the moral, social and financial well-being of the nation.

61 NASDAQ. *Global Financial Crime Report. Insights at the Intersection of Financial Crime Data and Real Survivor Stories,* 2024, p.3.

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g. Innovative ways of engaging in money laundering are on the increase, including the use of digital currencies and proliferation of mobile money and electronic transactions. The pace of innovation in advancing the conduct of crime, and especially money laundering continues to create an increasingly difficult environment for legitimate financial institutions to operate in, which further exposes vulnerable actors in the financial sector to stringent regulatory requirements that can deter them from fully and actively participating in legitimate business.
h. Kenya's addition to FATF's grey list raises questions on the country's integrity and goodwill to deliberately have in place processes, systems, procedures and controls designed to prevent money laundering in the country. The negative impact on a country's trust also lowers Kenya's credibility as an investment hub.
i. Declines and reduced foreign aid as a result of being on the FATF grey list places Kenya at risk of reduced capital flows into the country. In addition, being in the grey list also places Kenya on the spotlight, with increased scrutiny by international financial institutions occasioning delays in ordinary legitimate business transactions and higher transaction costs.
j. Stringent measures as part of the country's anti-money laundering framework imposes higher costs on financial institutions to ensure that they are compliant with the legal and regulatory requirements imposed by recent amendments to the anti-money laundering regime in the country. These compliance attempts by individuals and institutions, though done in good faith, also increase the cost of doing business in Kenya, which cost is transferred to the consumer, and can serve to deter investment, both from within and outside the country.

From the foregoing, it is possible to derive an impression about the far-reaching impacts of money laundering not only on the financial sector but to the country's overall investment climate and economic standing. There are many lessons that can be derived from the present study. The final section of this paper sets out these lessons and proposes various recommendations that can be deployed to address the money laundering crisis on Kenya and effectively strengthen the responses of various law enforcement agencies, regulators and private institutions towards preventing and/or mitigating the adverse effects of money laundering.

E. KEY LESSONS, CONCLUSIONS & RECOMMENDATIONS

The following are highlights of the key lessons drawn from the research;

a. Kenya has a robust legal framework for anti-money laundering. The Proceeds of Crime and Anti-Money Laundering Act expressly criminalizes money laundering and lays out an elaborate framework not only for the investigation of money laundering offences through the Financial Reporting Centre, but also the raft of orders that can be issued by a court in respect of properties and money that are the proceeds of crime. The Anti-Money Laundering and Combating of Terrorism Financing Law (Amendment)

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Act, 2023 also serves to buttress the regulatory role played by different agencies in the anti-money laundering framework.

b. Technology has contributed to the evolution of criminal activity and how it is carried out, with money laundering not being exempted from this. Unfortunately, the law is still playing catch-up and has not put in place measures to curtail and/or prevent the use of technology to conduct money laundering or facilitate movement of illicit finances across different territories. The use of cryptocurrency in particular, remains an unregulated arena in Kenya.
c. Certain industries, though not traditional financial industries in the strict sense, have a significant bearing on Kenya's overall money laundering risk assessment. These industries are used to channel large amounts of money and as a result, may also knowingly or otherwise be used as money laundering channels.
d. A lot of emphasis is placed on investigating and prosecuting predicate offences without investing the same effort towards following the money and prosecuting money laundering as a stand-alone offence. More often than not, money laundering continues to go undetected and unpunished even when the predicate offences bear an obvious transnational inclination.
e. The impacts of money laundering affect not only the economy of the nation, but also bear significant risk of erosion of the country's governance and rule of law landscape collectively.

From the foregoing, the following recommendations are proposed as part of measures that can be taken at various levels, in order to strengthen state responses to the occurrence of money laundering in the country;

a. Genuine and sustained political goodwill to fight money laundering and illicit financial flows, whose prevalence is enhanced by corrupt and unaccountable leadership regimes. Illicit financial flows and money laundering often take the form of corrupt dealings and bribery, and thrive in environments where accountability for government expenditure is not adhered to.
b. Stricter implementation and enforcement of existing legislation, particularly the Anti-Money Laundering and Combating of Terrorism Financing Law (Amendment) Act, 2023 which introduced more stringent regulatory measures not only for the financial sector and its institutions, but also for the non-financial businesses and professions that contribute significantly to the country's money laundering risk.
c. Structured and deliberate coordination and cooperation between law enforcement agencies involved in investigating, prosecuting and adjudicating money laundering offences should be prioritized. This cooperation and coordination should also be extended to relevant private sector actors in order to avoid disjointed and ineffective responses by the relevant agencies.
d. Strengthening the capacity of institutions and agencies to investigate money laundering and illicit financial flows. This should go hand-in-hand with equipping the same

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agencies to detect and ascertain the volumes and conduits of illicit financial flows in order to form the basis for meaningfully pursuing proceeds of crime, and more so, from predicate offences that fuel money laundering. In addition, financial investigations should run parallel to investigations of crimes that are transnational and/or organised in nature.

e. Strengthening legal and policy frameworks and linking them to both regional and global frameworks centered on anti-money laundering.
f. Leveraging technology to detect and investigate money laundering.

Though not exhaustive, the recommendations also suggest additional areas of research, which, if explored further, present the opportunity for lessons that would go a long way in strengthening state responses towards addressing the money laundering vice in Kenya.

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