

REGULATORY FRAMEWORK OF FINANCIAL INSTITUTIONS AND MARKETS

PURPOSE OF FINANCIAL SECTOR REGULATION

1. Governments primarily regulate industries with a view to protecting consumers. This, for example, is why Governments regulate public utilities which may use monopoly positions to exploit consumers.
2. Related to the above (Protecting consumers), another argument for government regulation is based on the existence of destructive, ruinous, or cutthroat competition. This may drive out firms from the industry leading to monopolies that may exploit consumers.
3. In the financial sector, an additional motivation for regulation is maintaining financial stability, which is a clear public good. Asymmetric information can lead to widespread collapse of financial intermediaries, referred to as a financial panic. Because providers of funds to financial intermediaries may not be able to assess whether the institutions holding their funds are sound, if they have doubts about the overall health of financial intermediaries, they may want to pull their funds out of both sound and unsound institutions. The possible outcome is a financial panic that produces large losses for the public and causes serious damage to the economy.
4. Asymmetric information in financial markets means that investors may be subject to adverse selection and moral hazard problems that may hinder the efficient operation of financial markets. Risky firms or outright crooks/ criminals may be the most eager to sell bad securities to unwary investors, and the resulting adverse selection problem may keep investors out of financial markets. Furthermore, once an investor has bought a security, thereby lending money to a firm, the borrower may have incentives to engage in risky activities or to commit outright fraud. The presence of this moral hazard problem may also keep investors away from financial markets. Government regulation can reduce adverse selection and moral hazard problems in financial markets and increase their efficiency by increasing the amount of information available to investors.

DRAWBACKS OF FINANCIAL SECTOR REGULATION

1. Regulation may depress the returns (Profits) earned by financial institutions by increasing costs needed for compliance with the regulations. An example is the minimum capital requirements of Ksh. 1 billion for commercial banks.
2. Regulation may lead to an increase in prices i.e. the commissions, accounts ledger fees charged to consumers. Alternatively, the financial institutions may resort to cost cutting measures that lower the quality of service. All this will be in a bid to meet the costs of regulation.
3. It has been found that with tighter regulations, financial institutions tend to engage in riskier behavior. For example, they issue riskier loans in order to make an adequate return on capital for the investor.
4. The cost of the regulatory process (to the government) must be emphasized. If regulation is truly to serve the public interest, it must increase the efficiency of the entire social system. That is, its benefits must exceed its costs. Too often the net benefits of regulation are overestimated because of a failure to consider its costs.

5. Regulations may make members of the public (Consumers) develop a false sense of safety. Experience shows that regulations are not an absolute insurance against failure of institutions. The fact is those financial crises occur even when regulations and regulators are present. Regulators often react to crisis by packaging new regulations- which raises the question of whether they have the moral authority to do so.

To protect the public and the economy from financial panics, the governments implements several types of regulations.

- a. Restrictions on Entry. The central bank, the IRA, as well as the other regulatory agencies, have created very tight regulations governing who is allowed to set up a financial intermediary. Individuals or groups that want to establish a financial intermediary, such as a bank, an MFI, SACCO or an insurance company, must obtain a licence from the state. Only if they are upstanding citizens with impeccable credentials and a large amount of initial funds will they be given the licence.
- b. Disclosure. There are stringent reporting requirements for financial intermediaries. Their bookkeeping must follow certain strict principles, their books are subject to periodic inspection, and they must make certain information available to the public.
- c. Deposit Insurance. The government can insure people's deposits so that they do not suffer any financial loss if the financial intermediary that holds these deposits should fail. In Kenya, we have the deposits protection scheme.
- d. Restrictions on Asset Holdings and Bank Capital Requirements. Financial sector regulations that restrict financial institutions from holding risky assets such as common stock are a direct means of making such institutions avoid too much risk. Bank regulations also promote diversification, which reduces risk by limiting the amount of loans in particular categories or to individual borrowers. Requirements that financial institutions have sufficient capital are another way to change the bank's incentives to take on less risk. When a bank is forced to hold a large amount of equity capital, the bank has more to lose if it fails and is thus more likely to pursue less risky activities.
- e. Assessment of Risk Management. Traditionally, on-site bank examinations have focused primarily on assessment of the quality of the bank's balance sheet at a point in time and whether it complies with capital requirements and restrictions on asset holdings. Although the traditional focus is important for reducing excessive risk taking by banks, it is no longer felt to be adequate in today's world, in which financial innovation has produced new markets and instruments that make it easy for banks and their employees to make huge bets easily and quickly. This change in the financial environment for banking institutions has resulted in a major shift in thinking about the bank supervisory process throughout the world. Bank examiners are now placing far greater emphasis on evaluating the soundness of a bank's management processes with regard to controlling risk.

Financial sector supervision thus requires a more elaborate framework and tends to be more rigorous and intensive than is the case in other sectors.

PRINCIPLES OF FINANCIAL SECTOR REGULATION

Clear Objectives – The regulator should have a clear mandate set out in its enabling legislation. Regulation should ideally be only limited to correction of market failures and should not be a burden to the regulated institutions. Any developmental objectives requiring, for example, research and public education, should be clearly provided in the statutes

Pursuant to the Capital Markets Act, the CMA is responsible for the licensing, regulation and supervision of all capital markets participants. The CMA also disseminates rules and regulations within its jurisdiction, and is empowered to carry out enforcement and sanctions.

Independence and Accountability - Decisions by the regulator within its sub-sector should not be subject to undue influence from the Minister or any other parties. The principal officer and top management should have an element of security of tenure or at least clear rules governing their removal. Similarly, their recruitment should be done transparently and competitively and their remuneration should not be significantly discordant with that of senior officials in the regulated entities. Historical evidence shows that lack of independence of financial sector regulators worsens financial crises. For example, the lack of independence of financial supervisors in Japan's Ministry of Finance weakened the financial sector and contributed to prolonged banking sector problems prompting the creation of an independent Financial Services Agency in the late nineties³. At the same time the regulator must be accountable and must report to the legislature through periodic reports including audited financial statements. In addition, there must be a mechanism for the regulator to be held accountable by the regulated industry while avoiding regulatory capture by the industry.

Adequate Resources - The regulator must have adequate funding, preferably through industry levy, so as to enable the industry have a role in checking the regulator's spending. Adequate resources are a prerequisite to enable the regulator recruit, train and retain a cadre of experienced professional staff. In addition, the regulator requires resources for timely and effective data collection and processing.

Effective Enforcement Powers – The regulator must be able to take enforcement measures against all the players that it is required to regulate. These powers should include, inter alia, powers to:

- Require information to be provided;
- Assess probity of owners and managers of regulated entities;
- Inspect the operations of regulated entities;
- Intervene in operations of regulated entities including removal of managers;

- Revoke licenses or registration; and,
- Sanction entities or individuals.

Enforcement powers are best only set out broadly in legislation with regulations having powers to issue guidelines and directives. This allows flexibility and reduces the need for frequent cumbersome and time consuming legislative amendments. Staff of regulators should be protected from legal actions arising from their enforcement actions.

Comprehensiveness of Regulation – Regulation should clearly be comprehensive and not leave any unregulated areas, so called regulatory gaps. Activities should not be left unregulated due to lack of clarity as to which regulator is responsible. Also, this requires regulators to have some flexibility to respond to innovations which may result in new products which were not envisaged at the time of establishment of the regulatory structure.

Cost-Efficient Regulation – The direct cost of regulation in terms of levies and fees should clearly be reasonable and not an undue burden on the regulated institutions. This is clearly more important where, as is usually the case, these costs are ultimately passed on to the consumers. As indicated above, it is important for the amounts raised and how they are utilized to be transparently disclosed and accounted for to the industry and the legislature. In addition, there are indirect costs of compliance which must also be controlled to avoid undue burden on the industry. Indirect costs include costs of appointing service providers and experts, costs of having “compliance officers” within the organizations – including the now popular Head of Regulatory Affairs – as well as costs of installing systems to provide required reports and data to the regulator.

Market Developments and Industry Structure - Regulatory structure should mirror the sectors being regulated. Different countries have different industry structures and each country should seek to have a regulatory structure tailored to this other than attempting a one-size-fits-all structure or borrowing those in other countries. Presence of financial conglomerates, universal banking, bancassurance and other unified products lends the industry to a more unified regulatory framework than in the case of disaggregated sectors. When one financial institution is in several sectors facing different risks, there is a need for some mechanism to assess the overall risk facing the institution.

There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.

In Kenya, there are regulations regarding the minimum capital requirements for financial institutions and insurance firms.

- ✓ General Insurance companies- Ksh. 300,000,000.00 by June 2010.
- ✓ Composite Insurance companies- Ksh. 450,000,000.00 by June 2010.
- ✓ Life insurance companies- Ksh. 150,000,000.00 by June 2010.
- ✓ Commercial banks/ mortgage finance institutions- Ksh. 1,000,000,000.00 by December 2012.

These minimum capital requirements are meant to ensure strong institutions and safeguard the interest of insurance policy holders and depositors.

Accounting and auditing standards should be of a high and internationally acceptable quality.

An assessment of the accounting and auditing environment in Kenya was conducted by the World Bank in 2001. The World Bank noted that Kenya had adopted International Accounting Standards, later renamed International Financial Reporting Standards (IFRSs) in 1998, thereby "closing the gap" between national and international accounting standards. The Institute of Certified Public Accountants of Kenya (ICPAK), in its 2005 self assessment prepared as part of the International Federation of Accountants' member body compliance program, points out that listed entities must prepare interim reports, have an Audit Committee, and comply with corporate governance rules. It is further required that the finance and accounting departments of listed companies be headed by a member of the ICPAK. The self-assessment adds that statutory auditors are appointed by the shareholders. In 2006, the UNCTAD issued a report, which stresses that all listed companies in Kenya prepare accounts in accordance with IFRSs. In practice, however, the level of non-compliance is quite high. The UNCTAD goes on to note that Kenya's adherence to IFRSs has not been achieved.

Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.

There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.

APPROACHES TO REGULATION OF THE FINANCIAL SECTOR

There are two approaches to regulation of the financial sector:

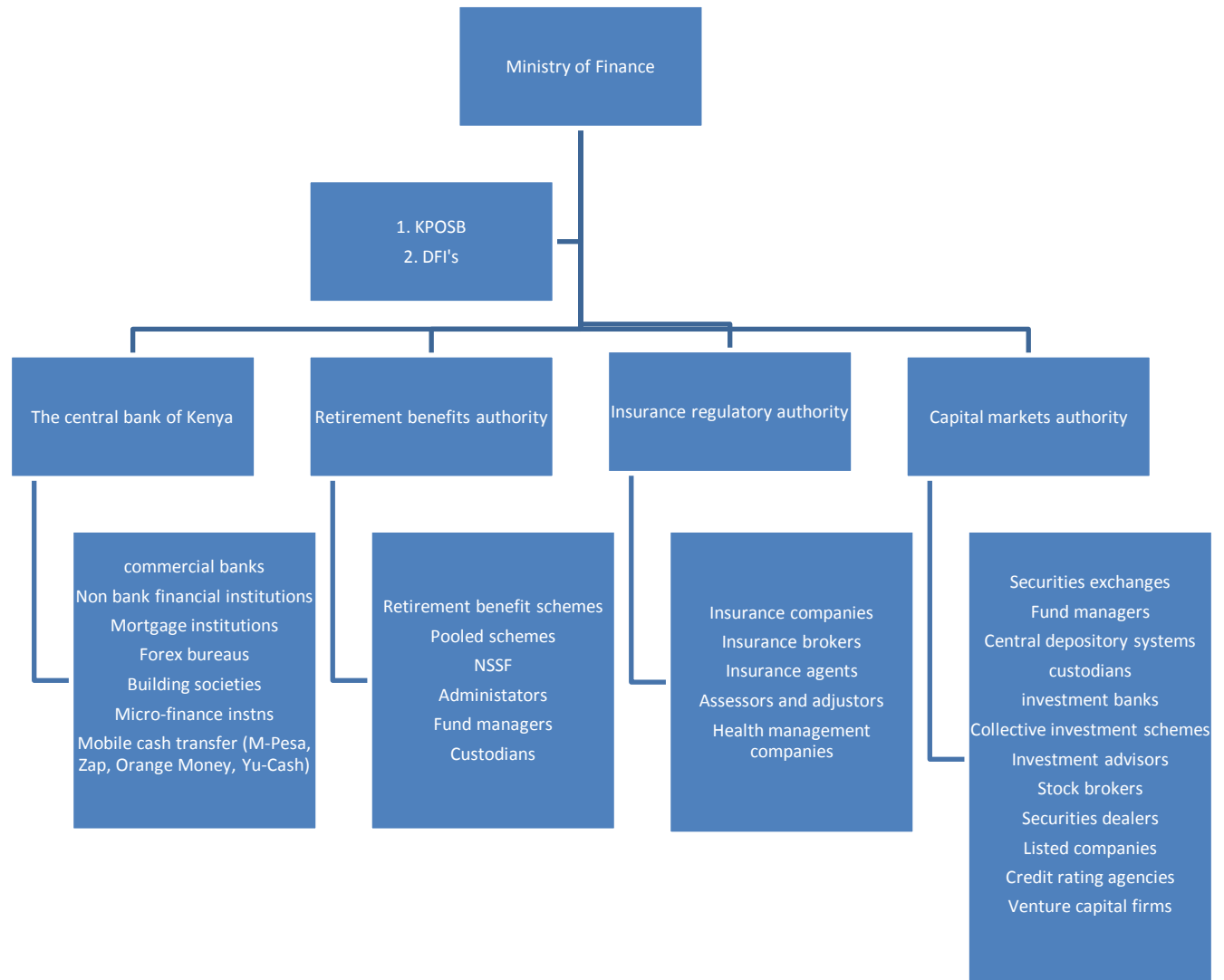
1. Institutional approach
In this approach the view is that firms fall within a particular regulator if they carry a particular label. Here the legal status of an institution determines its regulatory supervision, e.g. an organization registered under the banking act will be regulated by the regulator concerned regardless of the other businesses it may be involved in.
2. Functional approach
Here, financial institutions are regulated depending on the type of business they undertake. Consequently, a firm may fall under different regulators depending on the lines of business it is in.

EXISTING FINANCIAL SECTOR REGULATORY FRAMEWORK IN KENYA

The existing regulatory framework for the financial sector in Kenya consists of a number of independent regulators each charged with the supervision of their particular sub sectors. The recent creation of the Insurance Regulatory Authority has completed the shift from having departments under the Ministry of Finance to having independent regulators for each sub-sector.

The current regulatory structure is characterized by regulatory gaps, regulatory overlaps, multiplicity of regulators, inconsistency of regulations and differences in operational standards. For example, some of the regulators have at least partial exemption from the State Corporations Act while others do not, some have tax exemption, others do not. Some regulators have powers to issue regulations while in other cases the power is retained by the Minister for Finance.

STRUCTURE OF FINANCIAL SECTOR REGULATION IN KENYA



SACCO SOCIETIES REGULATORY AUTHORITY (SASRA)



The Sacco Societies Regulatory Authority (SASRA) is established under the Sacco Societies Act of 2008 with the following mandate:

- License Sacco Societies to carry out deposit taking business;
- Regulate and supervise deposit taking Sacco Societies;
- Manage the Deposit Guarantee Fund under the trustees appointed under the Act;
- Advise the minister on national policy on deposit taking Sacco Societies in Kenya. (Refer www.sasra.go.ke)

THE GAPS IN THE REGULATORY FRAMEWORK

The Kenya Post Office Savings Bank (KPOSB)

The Kenya Post Office Savings Bank (KPOSB) was incorporated in 1978 under the KPOSB Act (Cap 493B). The mission of the bank is “to sustainably provide savings and other financial services to our customers, through a countrywide branch network, by use of modern technology in delivery of efficient and effective customer service, and to the satisfaction of all stakeholders.”

Section 8(1) KPOSB Act that provided for the Government guarantee over the deposits placed with the savings bank was repealed via the Finance Bill 2001. The repeal of the section implies that new avenues should be found for deposit protection. It also implies that the bank should be adequately capitalised as a first step to protect deposits against possible losses.

Companies Act (CAP 486)

The Companies Act, which is a holdover of pre-colonial British Law, is creating problems for private sector activities in Kenya and indeed the financial services sector. Old-fashioned UK companies’ law, currently in use, is complicated, cumbersome, inconsistent and at odds with modern “enabling” regulation of corporations. Another layer of complexity and compliance is added to an already burdensome structure, leading to multiple disclosure

requirements, overlap and expensive duplication. The regulation of companies is currently under the Registrar of Companies in the Office of the Attorney General but could be brought under the financial sector regulatory framework for more responsiveness to market dynamism.

Development Finance Institutions (DFIs)

DFIs have always provided the impetus for economic development be it in the developed or developing countries. In Kenya, DFIs were specifically established to spearhead the development process by:

Availing credit funds to those venturing into commerce, tourism and industry.

- Assisting those wishing to venture into small-scale manufacturing enterprises.
- Assisting in the initiation and expansion of small, medium and large-scale industrial and tourist undertakings.
- Provide long-term lending (Project financing) to sustain economic development
- Provide Technical Assistance/Co-operation extension services
- Provision of special Financing and Support services to stimulate Private Sector to live up to its potential and create jobs and wealth, develop and expand indigenous skills

The existing framework has potential for disharmony as they fall under different regulators. For example ICDC/KIE are under the Ministry of Trade and Industry, IDB is under the Central Bank of Kenya and AFC the Ministry of Agriculture.

Premium and Other Financing

A number of premium finance companies have evolved in the Kenyan market. These companies offer financing to companies and individuals to meet insurance premium payments. This is clearly a financial service but is currently not regulated by any of the existing regulatory institutions. Similarly, there are other money lenders and financiers who are totally unregulated. There is also need for regulation of leasing which is a developing financial service.

E- Banking and Mobile banking

The advent of electronic banking has raised new concerns for banking regulation, specifically about security and privacy

Three Kenyan mobile telephone firms have ventured into m-banking- Yu, Zain and Safaricom. The services provided range from cash transfer to payment of bills to shopping. A number of banks also operate e- banking solutions where a customer may access his/ her account through the internet.

There exists a regulatory gap in mobile banking, especially when such services are being offered by telecommunication firms as opposed to mainstream financial institutions. There is a lack of a precise definition of the supervisory structure for mobile phone banking entities as regards customer protection, distinction between payments and deposits, and provision for cash deposits/withdrawals by agents.

Worries about the security of electronic banking and e-money are an important barrier to their increased use. With electronic banking, you might worry that criminals might access your bank account and steal your money by moving your balances to someone else's account. Indeed, a notorious case of this happened in 1995, when a Russian computer programmer got access to Citibank's (USA) computers and moved funds electronically into his and his conspirators' accounts. Private solutions to deal with this problem have arisen with the development of more secure encryption technologies to prevent this kind of fraud. However, because bank customers are not knowledgeable about computer security issues, there is a role for the government to regulate electronic banking to make sure that encryption procedures are adequate. Similar encryption issues apply to e-money, so requirements that banks make it difficult for criminals to engage in digital counterfeiting make sense.

Electronic banking also raises serious privacy concerns. Because electronic transactions can be stored on databases, banks are able to collect a huge amount of information about their customers—their assets, creditworthiness, what they purchase, and so on—that can be sold to other financial institutions and businesses. This potential invasion of our privacy rightfully raises customer concerns.

Problems in Regulating International Banking

Particular problems in bank regulation occur when banks are engaged in international banking and thus can readily shift their business from one country to another. Bank regulators closely examine the domestic operations of banks in their country, but they often do not have the knowledge or ability to keep a close watch on bank operations in other countries, either by domestic banks' foreign affiliates or by foreign banks with domestic branches. In addition, when a bank operates in many countries, it is not always clear which national regulatory authority should have primary responsibility for keeping the bank from engaging in overly risky activities.

The difficulties inherent in regulating international banking were highlighted by the collapse of the Bank of Credit and Commerce International (BCCI). BCCI, which was operating in more than 70 countries, including the United States and the United Kingdom, was supervised by Luxembourg, a tiny country unlikely to be up to the task. When massive fraud was discovered, the Bank of England closed BCCI down, but not before depositors and stockholders were exposed to huge losses.

Cooperation among regulators in different countries and standardization of regulatory requirements provide potential solutions to the problems of regulating international banking. The world has been moving in this direction through agreements like the Basel Accords and oversight procedures announced by the Basel Committee in July 1992, which require a bank's worldwide

operations to be under the scrutiny of a single home-country regulator with enhanced powers to acquire information on the bank's activities.

INTERNATIONAL EXPERIENCE

COUNTRY SUMMARIES

There is no one single optimal model for the organisational structure of financial regulation. The prevailing circumstances, historical factors and comparative advantages in any given country determine the structure of the integration. It follows therefore, that even if countries have much to learn from each other, different countries adopt different integration approaches.

United Kingdom

Financial Services Authority (FSA) in the UK evolved after an intense debate by the Bank of England and London financial market. The former had a developed supervisory capacity and the latter a well governed market. This led to the creation of the FSA on the basis of conduct of business rather than on prudential aspects. The FSA objectives include reducing financial crime: money laundering; fraud and dishonesty; and criminal market misconduct such as insider dealing, securing the right degree of protection for consumers, and vetting at entry aims to allow only those firms and individuals satisfying the necessary criteria (including honesty, competence and financial soundness) to engage in regulated activity. Once authorized, firms and individuals are expected to maintain particular standards set by FSA and promote public understanding of the financial sector. FSA helps people gain the knowledge, aptitude and skills they need to become informed consumers, so that they can

manage their financial affairs more effectively. Despite the creation of the FSA, pension regulation remained under a separate entity The Occupational Pensions Regulatory Authority, which in 2006 was reformed into The Pensions Regulator. Mortgage advisors and insurance brokers were included in the scope of the FSA at a later stage. Currently, the FSA has been under criticism as being too unwieldy and unresponsive to needs of particular sectors.

Australia

Australia established a prudential regulatory agency – Australian Prudential Regulatory Authority (APRA) and a separate market integrity and consumer protection agency, the Australia Securities and Investment Commission (ASIC). APRA regulates all deposit taking institutions (banks), life and general insurance companies, superannuation funds other than self managed superannuation funds (which are regulated by the Australian Taxation Office) and retirement savings. APRA is accountable to an independent board. APRA operates under a charter that ensures financial safety objectives of prudential regulation are balanced with efficiency, competition and contestability considerations. APRA is enthroned with power to legislate all the above institutions in a manner that will meet the set objectives, to make standards of prudential matters in relation to all the above institutions, initiate wind up or appoint administrators to troubled institutions in order to prevent further losses from accruing. A bulk of the staff of APRA was drawn from the Insurance, superannuation commission and the bank supervision of

the Reserve Bank. APRA is funded by levies paid by the regulated institutions and charges for certain services. The levies are based on a percentage of assets held by the entity, subject to minimum and maximum levy amounts.

Mauritius

The establishment Financial Service Commission – the integrated financial services regulator – was established based on the recommendations of the Committee on Financial Services Regulation in 2001. Integration of the financial services was to be done in two phases. The First phase set up a new Financial Services Commission (FSC) to regulate and supervise the entire financial activities environment save for the banking sector, which was under the supervision of the Bank of Mauritius. The second phase entailed the integration of the FSC and the banking sector to finally achieve a fully integrated supervisory structure. The underlying objective to be achieved through integration in Mauritius was consumer protection. The Financial Services Commission, which was established under the Financial Services Development Act, strongly set out to suppress dishonourable and improper practices, market abuses, set guidelines on conduct of business, promote public understanding of the financial sector and set up of a recourse mechanism for channeling and investigating public complaints.

CASE FOR CONSOLIDATED FINANCIAL SECTOR REGULATION

Market developments

The need for the structure of regulation to mirror the structure of the industry is one of the most compelling arguments for consolidation. If the regulators entities are conglomerates covering banking, insurance, securities and pension then it is difficult for a regulator for a particular sub-sector to draw a view of the overall risks facing the entity. A consolidated regulator on the other hand would be able to understand and monitor risks across the sub sectors and develop policies to address the risks facing the entire financial sector.

Economies of scale and cost reduction

Another popular argument for consolidation arises from the cost efficiency gains that can be obtained by consolidating multiple regulators into a single body. Clearly a consolidated regulator will only have one set of service departments such as administration, finance and human resources hence reducing on staff and other overhead costs. Indeed, even core departments like legal, research, and public awareness can be unified into a single department in the new consolidated regulator leading to significant cost savings. Where there are overlaps in registration and licensing then consolidation will also bring cost reductions and efficiency gains by allowing regulated entities to have a one-stop licensing procedure as opposed to multiple registrations. These gains are maximised where regulation is consolidated by function as in the case of Australia as opposed to consolidation by institutions as in South Africa.

Reduce regulatory arbitrage

Where there are regulatory overlaps, as is the case in Kenya, then having multiple regulators can allow regulated entities to engage in regulatory arbitrage. This is where entities opt to register products in those sub-sectors where regulations are weakest or most cost efficient.

Strengthen accountability

Regulatory gaps often lead to regulators “washing their hands” of certain sub-sectors especially when things go wrong. Blame may be passed from one regulator to another when supervisory failure occurs. In Kenya, we have seen different regulators disavowing blame for an instrument that never came to market with no one ready to accept that they were the ones who had refused to approve the instrument. A consolidated financial regulator would be responsible for supervising all entities and products in the financial sector and would be duly held accountable.

CASE AGAINST CONSOLIDATED FINANCIAL SECTOR REGULATION

Reduced effectiveness

Large consolidated regulators are often criticised for becoming “Bureaucratic Leviathans.” That is, the regulator becomes so big and powerful that it is divorced from the industry it is supposed to be regulating. A consolidated regulator is likely to have a diversity of objectives and striking the appropriate balance between these may be difficult. Indeed, the different objectives may clash forcing the regulator to have to choose between policies many of which may favour one sub-sector over the others.

Loss of focus

Consolidation may undermine overall effectiveness of supervision if the unique characteristics of the sub sectors are not recognized. Operations may become so broad based that they deny managers a chance to understand specific sub-sectors. In developing countries where some sub-sectors are less developed than others then there is a danger of regulation of the dominant sector - usually banking - overriding the others resulting in the smaller sub-sectors, which may require more flexibility, not getting the attention they require to develop. Indeed where multiple regulators are merged but one pre-merger regulator dominates in terms of size and staffing it may subsume the other regulators at the expense of focus paid to those sub-sectors.

Diseconomies of scale

A consolidated regulator is effectively a regulatory monopoly which may give rise to inefficiencies and sub-optimal resource allocation associated with monopolies. There may be merit in having a degree of competition between regulators as this enables learning from each other and striving to out-perform the others.

Moral hazards

There is a compelling argument that a consolidated regulated framework gives consumers a false impression that all financial instruments have similar risks. When banks and securities are regulated by the same regulator consumers may fail to differentiate the very different risks in these two markets. Similarly, all institutions licensed by the regulator may be assumed by the public to be receiving equal protection. Yet, whereas bank depositors may be protected by the Deposit Protection Fund, this is not the case for the other sub-sectors.

CASE: WORLD BANK CALLS FOR TIGHTER MOBILE CASH TRANSFER REGULATIONS

The World Bank has called for Central Bank regulation of telecommunication companies offering money transfer and mobile banking services — a move that could raise customer charges owing to increased compliance costs.

While recognizing that mobile technology offers a chance for an estimated three billion low income earners to get access to financial services, the bank says that the line differentiating financial providers in the banking, telecom, credit card and mobile commerce has become increasingly blurred, yet no robust regulations to guard against money laundering have been passed.

“Distinctive risks concern observers in affected service markets,” said the World Bank. “These perceptions merit urgent attention because mobile financial service providers may fall outside anti-money laundering and combating the financing of terrorism controls generally adhered to by traditional financial institutions,” added the institution in a presentation made at a Citi Bank organized mobile money policy forum in Nairobi last month.

The bank says regulators and players in the industry need to identify perceived risks to avoid formulating laws that will put the sector into the trap of over-regulation.

“Non-bank providers of financial services, such as telcos should be considered as ‘Financial Institutions,’ as defined by the Financial Action Task Force (FATF).”

FATF is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorism financing.

The Central Bank of Kenya (CBK) did not respond to our request for comment.

Speaking on Monday during the launch of a new internet based mobile money transfer system, CBK governor Prof Njuguna Ndung’u said the regulator “will continue to work with the ministry of finance and the financial sector regulators to promote a sound, safe, efficient and inclusive financial system with no room for regulatory arbitrage.”

Kenya is seen as a pioneer in the mobile phone money transfer services since its launch of M-Pesa in 2007. All the four mobile phone service firms currently offer money transfer services, moving an average of Sh76 billion every month, and creating jobs for an estimated 39,449 agents as per CBK's data.

"This reflects the fact that when cost of transactions decline, transactions increase in volume," said Prof Ndung'u.

Under the World Bank proposal, mobile service providers would be put under two regulators, CBK and their present regulator, the Communications Commission of Kenya (CCK).

Although mobile service providers that offer money transfer service are currently subject to some level of regulation by the CBK, giving them financial institution status would increase their reporting compliance requirements.

"It is not necessary (considering mobile phone operators as financial institutions) because it is not our core business. We're not a bank," said Angela Ng'ang'a-Mumo, head of corporate communications at Telkom Kenya.

Ms Mumo said Telkom's Orange money, which is run in partnership with Equity Bank, is already regulated by the CBK since it uses a banking platform.

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