



CENTRAL BANK OF KENYA
‘Governance and Central Bank Independence’

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Good morning!

1. **Let me** begin by acknowledging the presence of Deputy Principal Secretaries from various ministries and Deputy Governors of Central Banks across the MEFMI region. I thank MEFMI for bringing this high level government representation into a single room for what promises to be insightful policy dialogue and information exchange on challenges and opportunities in our respective countries.
2. At the onset, I take this opportunity to congratulate Dr. Atingi-Ego for his appointment as the Executive Director of MEFMI. He comes to steer the boat when knowledge, skills and technology are taking centre-stage in transforming economies. I believe *Datkari’s* vast global experience, while at the IMF, will energize MEFMI to position herself as a premier capacity building institution with significant positive impact to the region.
3. **Ladies and Gentlemen**, we stand in solidarity with our brothers and sisters from Mozambique, Zimbabwe and Malawi, who lost lives and millions of properties destroyed following the ruthless fury of mother nature on March 14-15, 2019 – Cyclone Idai! The aftermath is heartbreaking, highlighting why climate-related disasters are threatening the very human existence.
4. **Shifting focus**, ladies and gentlemen, the choice of the topic **‘Governance and Central Bank Independence’** resonates very well with what is happening globally. Why?
 - a. For economists and regulators in this room, we are alive to the long haul role central banks played in pulling economies out of the 2008 GFC debacle.

- b. We also know that Africa faces huge socio-economic challenges given its high unemployment rate, especially among the youths and informality of their economies.
 - c. We are also hearing murmurs about growing debt burden across the continent with potential implications on monetary policy and financial systems stability.
 - d. Of course the rapid adoption of technology introduces cybersecurity & AML-CFT concerns
 - e. But we cannot also look aside when climate-related disasters are threatening our very existence!
5. **The Forum is therefore timely** for people who deal with these challenges at policy level daily, in order to come up with strategic ways of dealing with all these and emerging challenges with appropriate measures to harness opportunities that come by. As a corporate governance trainer and experienced Chairman of central bank, I can tell you for sure that, **Corporate Governance** and **central bank independence** are pillars of such measures and strategies. Let me expound on these two concepts and then offer my thoughts going forward.
6. **Governance** encompasses processes, structures and information used to direct, to oversight and to control the management of an organization. This include;
- a. Boards of directors that govern and provide direction to their companies.
 - b. Shareholders that appoint the board of directors and the auditors and satisfy themselves that an appropriate governance structure is adopted and implemented.
 - c. Overall goal - to facilitate effective, prudent management and oversight to achieve long-term success of the organization/corporate entity.
7. **Central Bank Independence** on the other hand, refers to the ability of a central bank to achieve its goal or a set of goals as espoused in its legal mandate. The goal would encompass policies, actions or decisions of the central bank. Traditionally, there are three forms of independence – Functional (goal/instrument/operational), institutional (professional/personnel), and financial independence.
- a. In the functional independence embodies, central bank is able to freely set its policy instrument to achieve its objective without influence from outside
 - b. Institutional independence captures hiring and firing of key personnel and directors of the Board of Directors; terms of service; professional qualifications; separation of powers and working relationships.
 - c. Financial independence - With exception of Reserve Bank of South Africa, ownership of the entire paid up capital of most central banks is vested in the National Treasury/Ministry of Finance, making financial independence a challenge.
8. Having **Effective governance structures** and **practices** greatly influences central bank independence, with trickle down effects to the economy and overall society.

These must however be founded on a robust legal framework, strong and dynamic institutional arrangement and adherence to the best practices, reflected in;

- i. A well-constituted oversight board with proper organs to drive central bank mandates.
- ii. Clear roles separation between the Board and those of the executive team to avoid conflicts and enhance coordination in implementing strategic objectives.
- iii. Operating specialized Board Committees for specific issues e.g. Audit Committee working directly with Internal Audit Department.
- iv. Having a synchronized communication strategy of Board's decisions.
- v. Self-assessment guidelines, appraisal guidelines for the performance of the executive, and clear modalities of engaging experts from within and outside central bank on key projects or tasks.
- vi. Ability to shape *policy and strategic direction* of the Bank by working with the Executive on policy and strategy formulation, which in turn helps in conducting performance appraisal of the Governor.
- vii. Transparency in appointment process of the Board Directors and the Executive – well-qualified, be persons of high integrity, competent, reliable, have good judgement, independent of mind, experienced and highly dedicated to work.
- viii. Board members and central bank executive should have a term limit, and appointments should be staggered so that terms of members do not expire on the same date.
- ix. Clear guidelines on self-evaluation, meeting reporting requirements to oversight body or appointing authority as stipulated in the laws.
- x. Capacity building for board members and senior management is a good practice – access to new information, especially given the fast-changing technological world.
- xi. Diversity in governance structure is key to institution dynamics and culture, ensuring cohesiveness and getting things done - professional and academic backgrounds, gender, age, religion, ethnic/minority groups.

9. But what is the practice in Kenya so far? Three key pillars answer this question:

a. Strong Legal frameworks developed overtime –

- i. *Chapter 12 of the Constitution, Article 231* establishes the Central Bank of Kenya (CBK) as an independent institution with specific mandates. It ring-fences CBK from under the direction or control of any person or authority in the exercise of its powers or in the performance of its functions. An Act of Parliament provides institutional arrangement of CBK in terms of the composition, powers, functions and operations, giving Board members strong mandate to effectively play their oversight role.
- ii. *The Central Bank of Kenya Act (Cap. 491)* provides the Board and Governor with the responsibility for determining the policy of the Bank, with later having additional role of monetary policy formulation and implementation. The Act for instance, requires the Board of CBK to -
 - Determine the policy of the Bank, other than monetary policy.
 - Determine strategic objectives of the Bank.
 - Constantly review performance of the Bank in its functions.

- Constantly review performance of the Governor.
 - Keeping under constant review the use of Bank's resources.
- iii. *Chapter 1 of Mwongozo (Leadership in Swahili)* on the Board of Directors of **Government Departments and Agencies** provides that organization should be led by an effective Board with competent, diverse and qualified members capable of exercising objective and independent judgment. The Board should have appropriate autonomy and authority to exercise its functions, and should be accountable to public good and act responsibly towards stakeholders/ public good. In particular;
- Diverse composition and size - gender, competencies and skills sets.
 - Provide strategic direction to the organization, exercise control and remain accountable to shareholders/ public good.
 - Continuous capacity building among Board members.
 - Annual performance appraisal of its committees and individual directors.
- iv. *To mitigate conflict of interest*, the Board members work through Specialized Board Committees and extricate themselves from any matters where they have declared interests. Communication of Board decisions come from one source – the Chairman and decisions are by a majority decisions of Board Members present in the meeting. However, the Chair has a casting vote in case of a stalemate.
- b. ***Strong Institutional Arrangements and Upscaling our capacity*** – between the National Treasury and Central Bank of Kenya; and between the Central Bank of Kenya and other regulators in the financial sector. Collaboration and coordination among all key stakeholders become an engine of economic and financial stability. Constant consultations on policy developments have become a constant. Continuous upgrade of skills and adoption of the best technologies and innovations are becoming part of strengthening governance in Kenya.
- c. ***Benchmarking to international best practices*** – the CBK and other regulators as well the National Treasury continue to align our laws, policies and operations to international standards. This is in recognition of the increasing integration of our financial sector and the economy into the global space and also our intention to exploit opportunities available out there. It is against this goal that Central Bank's vision is to be a 'World Class Modern Central Bank'.
10. **Reforms towards** strengthening governance are crucial for enhancing central bank independence. It is however a gradual process as experienced in Kenya where autonomy of the Central Bank of Kenya from the Ministry of Finance and Planning has evolved overtime. In particular;
- i. *Following developments and reforms highlights improved CBK independence;*
- a. Anchoring the CBK in the constitution in 2010 strengthened her independence
 - b. Limiting of government overdraft utilization at the Central Bank to 5% of the latest government audited revenues contributes to goal independence of CBK
 - c. Establishment of Monetary Policy Committee under an Act of Parliament in 2008 induced autonomy of CBK on price stability

- d. Non- voting rights by the National Treasury in MPC or CBK Board ensures collaboration and independence
 - e. The National Treasury sets inflation targets with growth objective as secondary to CBK, and the latter is held accountable in achieving this target.
 - f. CBK’s reporting to the National Assembly through the Cabinet Secretary to the National Treasury ensures accountability and independence.
 - g. Recruitment and appointment process of the executive team and the Board at CBK has been strengthened, thus contributing to more independence.
- ii. *However, some areas need for continuous review for stronger independence;*
- a. The National Treasury still holds the purse for strengthening capital base of the Central Bank – limiting financial independence
 - b. Episodes of Parliamentary interference have emerged – Amendments to the Banking Act 2016 ushered in the Interest Rates Controls and also curtailed the freedom of CBK to appoint KDIC to control and manage business of a licensed institution facing capital deterioration, unless it consults with the National Treasury.
 - c. There has been also attempts by the National Assembly to water down some provisions in the Banking Law, with significant implications on AML/CFTs law.

The following are some two recent cases of judicial intervention in parliamentary interference with the legal mandate of the Central Bank of Kenya.

- **High Court of Kenya Petition No. 413 of 2016
Boniface Oduor Vs. A.G. and CBK**

Court of Appeal held interest rate capping law to be unconstitutional. National Assembly allowed 12 months to revisit and correct the law. Various aspects of the Judgment not very clear nonetheless and therefore matter now before Supreme Court for clarity.

- **High Court of Kenya Petition No. 426 of 2018
Ajibika Society Vs. A.G. and National Assembly**

High Court suspended the implementation of Section 65 of the Finance Act, 2016. The section had amended Section 33 of the Banking Act to require that Regulations and Guidelines issued by CBK be subjected to Parliamentary approval. Matter coming up for Ruling on 20th June, 2019.

11. Just like Kenya, many countries, including those in this room, have undertaken reforms towards strengthening governance frameworks to ensure independent central banks. There are however a number of challenges that still exist: –

- i. **Occasional policy conflicts and tensions**, limited coordination between CBs and other regulators or government departments/ agencies and political interference on functions of CBs. This is more common where fiscal and monetary policies are not well-coordinated.
- ii. **Expanding scope of central banks mandates**. In some jurisdictions, central banks are expected to actively deliver on growth objectives directly. In post-2008 GFC,

macroprudential policy and financial stability have become key objectives of many central banks globally. These are complex objectives in terms of measurement and implementation, and can compromise central bank independence. They also require more resources in terms of technology and human capital to enhance analytical capability for enhanced decision making and policy. Governance structure and agenda must therefore, reflect this and the dual mandates of central banks and frictions among policies.

- iii. **Rapid technological innovations**, in most cases, beyond the regulatory perimeter wall comes with threats. This is worsened by either legal/regulatory constraints or limited knowledge and skill-sets among the boards' members or even CBs executive committee and staff to deal with them.
 - iv. **Political interference** and **political instability** can hinder development and adoption of strong governance framework and practices to ensure central banks independence. Many central banks have become dysfunctional or even non-existent due to these two issues.
 - v. **Resource constraints** needed to address innovations and technological challenges, enhancing human capital capacity, accessing and analyzing large volume of information in a timely manner to for quick policy decisions, direction and oversight.
 - vi. Increasing regional and global interconnectedness brings with it challenges despite the associated immense opportunities. Geopolitical tensions and unfavorable policy developments quickly spills over to our domestic environment, influencing governance practices and in turn central bank independence.
 - vii. **Anti-Money Laundering (AML)** and **Combating Financing of Terrorism (CFT)** issues, complexities and increasing litigations in the financial sector not only threatens financial system stability but also calls to question integrity of the financial systems. Governance organs must therefore ensure central banks position themselves to address these complexities and rapidly changing environment to ensure integrity and full compliance to AML/CFT standards by the regulated institutions.
 - viii. **Greening' the financial system** for Sustainable Financial Sector, espoused by the United Nations Environment Program in 2014 has added another role to central banks and in turn governance. Climate-related disasters are now a common phenomenon. CBs must now ensure that investment decisions and allocation of credit have significant component of climate-sensitive projects.
12. Despite the challenges ladies and gentlemen, we have a duty to pursue strong governance practices anchored on strong institutional and legal frameworks to ensure independent central banks for macroeconomic stability and realization of growth of objectives.
13. Let me end here distinguished delegates by reiterating my passion for sound corporate governance practices in our region. The benefits to the central banks and overall economy are enormous! Therefore, as we deliberate this topic in the next two days, I trust concrete steps would follow in our respective countries to tighten any loose ends in our governance practices that often compromise central bank independence.

Thank You!