

SECTION 39 OF THE CENTRAL BANK OF KENYA ACT: THE LEGAL DILEMMA IN KENYA'S BANKING LANDSCAPE

There are three issues to be considered;

1. Whether a Gazette Notice by the Governor of The Central Bank of Kenya is sufficient to repeal an Act of Parliament. The clear answer is no.
2. Whether *The Central Bank of Kenya (Amendment) Act 2001* (Donde Act), as read with S. 77 of the *Constitution of Kenya*, was found to be unconstitutional in all its provisions, or not. The clear answer is no; the Donde Act could not have been found to be unconstitutional in all its provisions.
3. What the effective, legal maximum rates of interest chargeable to overdrafts, loans and mortgages were between 23rd June 1991 and 1st August 2005.

1. Gazette Notices vs Acts of Parliament

According to the *Constitution of Kenya*, legislative authority is vested in Parliament. It alone can make law; legislate and repeal (Section 30). Subsidiary legislation made by Ministers, Governors of the Central Bank of Kenya and other functionaries can not usurp the primacy of an Act of Parliament.

For many years up to the late 1980s, The Central Bank of Kenya would publish maximum and minimum interest rates applicable to overdrafts, loans and mortgages. This was done pursuant to S.39(1) of *The Central Bank of Kenya Act*, Cap. 491 of the Laws of Kenya. S. 39(1) provided as follows;

S. 39 (1):

“The bank may from time to time acting in consultation with the Minister, determine and publish the maximum rates of interest which specified banks or specified financial institutions may pay for the deposits and charge for loans or advances ...”

Pursuant to this legislative authority, the Governor of the Central Bank of Kenya published the following Kenya Gazette Notices;

- a) Gazette Notice No. 4939 of 1989, published on 16th October 1989
- b) Gazette Notice No. 1458 of 1990, published on 27th March 1990
- c) Gazette Notice No. 1617 of 1990, published on 2nd April 1990.
- d) Gazette Notice No. 3348 of 1991, published on 23rd July 1991.

Effect of these Gazette Notices

The background to interpretation of these Gazette Notices is that the ‘mother’ legislation, S.39(1) of *The Central Bank of Kenya Act*, Cap. 491, was only repealed on 17th April 1997 by *The Central Bank of Kenya (Amendment) Act 1996*, being Act No. 9 of 1996, through Section 17 thereof which provided as follows;

“The principal Act is amended by repealing Sections 39,40 and 41.”

What this means is simply this; until midnight on 17th April 1997, there existed a mandatory interest rate regime in Kenya. To find and hold otherwise would be to say that a Kenya Gazette Notice (subsidiary legislation) can repeal an Act of Parliament (Section 39 of *The Central Bank of Kenya Act*). This is absurd, and unconstitutional.

What then, was the effect of the Kenya Gazette Notices in (a) through (d) above?

Gazette Notice No. 4939 of 1989, published on 16th October 1989, provided the following maximum interest rates;

- Loans and advances for less than 3 years: 15.5% p.a.
- Loans and advances for more than 3 years: 18 % p.a.

G.N. No. 4939 of 1989 was then repealed by Gazette Notice No. 1458 of 1990, published on 27th March 1990, which provided the following NEW maximum interest rates;

- Loans and advances for less than 3 years: 16.5% p.a.
- Loans and advances for more than 3 years: 19% p.a.

G.N. No. 1458 of 1990 was then ***superseded*** by Gazette Notice No. 1617 of 1990, published on 2nd April 1990, which provided the following NEW maximum interest rates;

- Loans and advances for less than 3 years: 16.5% p.a.
- Loans and advances for more than 3 years: 19% p.a.

It was then decided at bureaucratic level (NOT by Parliament), that interest rates controls should be removed. This is what led to Gazette Notice No. 3348 of 1991, published on 23rd July 1991. This Gazette Notice simply revoked the previously effective Gazette Notice No. 1617 of 1990.

The effect of this is as clear as a clean glass of pure water;

- a) Since Section 39(1) of *The Central Bank of Kenya Act*, Cap. 491, was still in force up to midnight on 17th April 1997, the intention of the Legislature/Parliament, as constitutionally provided for, was that interest rates controls remained. To find otherwise would be to say that bureaucrats of whatever kind, be they Governors of the Central Bank or Ministers of Finance, can usurp the legislative functions of Parliament. This cannot be so.
- b) If (a) above is true, then the effect of G.N. No. 3348 of 1991 in repealing G.N. No. 1617 of 1990 cannot be more than this; that the immediately preceding Gazette Notice No. 1458 of 1990, stands.
- c) To hold and find that (b) above is not true would be to say that it does not matter what Parliament legislates; the Governor of the Central Bank of Kenya can nullify the requirements of an Act of Parliament through a Notice in the Kenya Gazette. This is plainly absurd.
- d) The truth of (a) through (c) above is proved by the passing, by Parliament, of Section 17 of Act No. 9 of 1996, *The Central Bank of Kenya (Amendment) Act 1996*, which repealed Sections 39,40 and 41 of *The Central Bank of Kenya Act*, Cap. 491. If the Governor could remove interest rate controls by himself through a Gazette Notice, there would have been no need to legislate Act No. 9 of 1996.

Consequently, between 23rd July 1991 and midnight on 17th April 1997;

- a) There was an effective, constitutional, maximum interest rate regime in Kenya.
- b) This regime is found in Gazette Notice No. 1458 of 1990.
- c) Gazette Notice No. 1458 of 1990 provided the following;

“ In exercise of the powers conferred by Sections 39 and 41 of the Central Bank of Kenya Act, it is notified that the Central Bank of Kenya has determined the following to be the minimum and maximum rates of interest which specified financial institutions may pay on deposits and charge for loans and advances or instalment facilities;

- a) ...

- b) The maximum rate of interest which specified banks may charge for loans or advances granted for a term not exceeding 3 years shall be 16.5% per annum calculated on a reducing balance method with monthly rests.
- c) The maximum rate of interest which specified banks may charge for loans or advances granted for a term exceeding 3 years shall be 19% per annum calculated on a reducing balance method with monthly rests.
- d) The maximum rate of interest which specified financial institutions may charge for loans, advances or instalment facilities shall be 19% per annum calculated on a reducing balance method with monthly rests.
- e) This notice shall come into effect on 1st April 1990 and shall apply to savings, deposits, loans and advances or instalment facilities outstanding in the books of any specified bank or financial institution and to term deposits placed with any specified bank or financial institution on or after that date.
- f) Interest rates paid on savings, deposits or charged on loans, advances or instalment facilities granted by any specified bank or financial institution on or before 31st March 1990 shall not be affected by this notice.

The simple fact is that a Gazette Notice cannot repeal either a provision of an Act of Parliament, or negate the intention of Parliament as expressed in a legislative provision. Beginning on the 18th April 1997, and not a minute before, Kenyans were finally left on their own to negotiate interest rates with banks.

Those who had borrowing contracts with banks between **23rd July 1991** and **17th April 1997** are protected by Gazette Notice No. 1458 of 1990 and its provisions as to maximum interest rates chargeable on their borrowing. It does not matter if their contracts with the lenders provided for interest at 36% p.a. You see, contracts are made, read and interpreted subject to law – you cannot make a valid contract to perform an illegality.

To find and hold otherwise would be to turn the law onto its head, and make it an ass, which it is in many other respects, except this one.

2. Whether or not the Donde Act was unconstitutional in all its provisions

The “Donde Bill” became the “Donde Act” after its publication in the Kenya Gazette on 7th August 2001 after receiving Presidential assent on 6th August 2001. The Donde Act therefore came into being, or was enacted into law, on 6th August 2001, with a *retrospective commencement date*, of 1st January 2001.

The only way the Donde Act could be stopped from operating to decimate the profits of the banking sector and to liberate the financial burden on Kenya was through litigation.

Section 39(4) of the Donde Act provided the Kenya Bankers Association with a lifeline, providing, as it did, the following;

“A specified bank or specified financial institution which contravenes any of the provisions of this section shall be guilty of an offence under The Banking Act and be liable to such penalty as the Minister may prescribe under section 55 of that Act.”

What **Section 39(4)** meant is that even though the Donde Act was enacted on 7th August 2001, the **retrospective commencement date** of 1st January 2001 meant that the Minister for Finance could levy penalties on banks that contravened any provision of the Donde Act in terms of **Section 55** of *The Central Bank of Kenya Act* beginning from 1st January 2001.

The Kenya Bankers Association had a good case on that narrow point; nobody should be criminalized for engaging in conduct that, when it was done, was not a crime according to any law. Indeed, **Section 77** of the *Constitution of Kenya*, on the right to a fair trial, protects any person retrospective application of criminal sanctions. To put it differently, you cannot make a new law today criminalizing my conduct yesterday, and punish me for my conduct yesterday with this new law made today.

The High Court agreed with the Kenya Bankers Association; retrospective application of criminal charges is unconstitutional, and that the Donde Act was unconstitutional **to the extent** (the limitation placed by Section 3 of the Constitution of Kenya) that it had criminal provisions that could be applied retrospectively.

For purposes of the case brought by the Kenya Bankers Association, there is no doubt, in the Constitution of Kenya at any rate, that Section 77 thereof applies to and can only relate to retrospective application of criminal charges.

In other words

- a) The entirety of the Donde Act was not declared unconstitutional – that would be unconstitutional in itself in terms of Section 3 of the Constitution of Kenya.
- b) It is only that aspect of the Donde Act that provided for retrospective application of criminal charges that was struck down as unconstitutional.
- c) All other aspects of the Donde Act, specifically, non-criminal, civil aspects, were as constitutional as you and I are.

However, and this is where the dishonesty comes in, the Kenya Bankers Association, in cahoots with the World Bank, the IMF ganged up against Kenya's weak, suppliant, unprincipled Ministry of Finance, and led Kenyans to believe, by commission and omission, that the entirety of the Donde Act had been declared unconstitutional by the High Court of Kenya.

Complete, total and utter lies. Only the criminal sanctions that could be retrospectively applied were found to be unconstitutional, and even then, only between 1st January 2001 and 24th January 2002 when the High Court read its judgment. But that is a story for another day.

What, then, are the non-criminal, civil aspects of *The Central Bank of Kenya (Amendment) Act 2000, Act No. 4 of 2001* (Donde Act)?

The Donde Act provided that the maximum interest rate chargeable on all loans and advances from 1st January 2001 is

“the 91-day Treasury-Bill rate published by the Central Bank of Kenya on the last Friday of each month, or the latest published 91-day Treasury Bill rate, plus 4 per centum”.

It went further, by way of proviso, to provide that

“Provided that the maximum interest chargeable shall not exceed the principal sum, and that the section should only apply to loans and advances made or renewed after commencement of the Act”.

These provisions are not criminal in nature. They are also not retrospectively applied. They are good law, and were saved by the wording of **Section 77** of the *Constitution of Kenya* (on the right to a fair trial) as read with **Section 3** thereof (declarations of

unconstitutionality must be only to the extent of the unconstitutionality itself and not more).

The *coup de grace* is that from the date of the judgment of the High Court on 24th January 2002, the entirety of the Donde Act was good law, including **Section 39(4)** allowing the Minister to levy penalties on banks that failed and/or refused to comply with the interest rates prescribed in the law.

This position on the Donde Act has lately been approved by the Highcourt in the recent ruling in *Mohammed Gulambussein Farzal Karmali & Another -vs- C.F.C Bank Limited & Garam Investments HCCC No.3 of 2006*. In his ruling, Judge Fred Ochieng rightly stated that: “There is no doubt that the said Act, which is otherwise known as the Central Bank of Kenya (Amendment) Act, 2000 came into force on 1st January 2001.”

NB: The parties in the above case entered into an out of Court settlement premised on a [review](#) of the said ruling which is posted here for your information.

3. What are the effective, legal interest rates between 23rd January 1991 and 1st August 2005?

What many Kenyans are not aware of is that the Donde Act was quietly repealed through *The Central Bank of Kenya (Amendment) Act 2004*, Act No. 8 of 2004, effective 1st August 2005.

This is what should have been done immediately after enactment of the Donde Act by the then President Moi on 7th August 2001 if the intention was to reverse the attempts by Parliament to level the playing ground between banks and the citizens of Kenya.

Consequently, what exists in Kenya today is the following;

- a) Between 23rd July 1991 and 1st August 2005, there are serious legal problems relating to the question of interest rate controls as between Gazette Notices and Acts of Parliament, and as between Contracts and Acts of Parliament. In both scenarios, Parliament is supreme. Only it can legislate, and un-legislate/repeal. Gazette Notices and Banking Facility Contracts cannot usurp the constitutional role of the Legislature in **Section 30** of the *Constitution of Kenya*.
- b) The approach taken to resolution of these problems is doomed to fail. The Ministry of Finance is unable to stand on principle and explain to the World Bank and the IMF that the problem requires a fair, legal

solution, and not hit-and-run bandit tactics such as tactical litigation through The Kenya Bankers Association.

- c) That this approach is doomed to fail is clear in the separate, but similar matter relating to **Section 44** of *The Banking Act*. Following the abdication of the Ministry of Finance, it has now been left to individual citizens, their lawyers and the courts of Kenya to deal with the issues. This has led to judgments¹ holding clearly that banks have ran foul of Section 44 of *The Banking Act*, and that they should make restitution. This is the future for **Section 39** of *The Central Bank of Kenya Act* if things continue the way they are doing.
- d) There are practical, workable, effective solutions that will resolve these issues once and for all. Someone only needs to put on a thinking hat. Either there are too few thinking hats, or there are too few heads that can think.
- e) The legal interest rate regime in Kenya between 23rd July 1991 and 1st August 2005 is as follows;

	DATE	EFFECTIVE LEGISLATION	INTEREST RATE
1	Between 23/07/1991 & 17 th April 1997	Gazette Notice No. 1458 of 1990	Loans /Advances for less than 3 years-16.5% Loans /Advances for more than 3 years-19%
2	Between 18 th April 1997 & 31 st December 2000	None. Full, complete and legal deregulation of interest rates.	As per contracts between borrowers and lenders
3	Between 1 st January 2001 & 31 st July 2005	Section 39 of The Central Bank of Kenya (Amendment) Act 2000, Cap. 491, Laws of Kenya	The 91-day Treasury-Bill rate published by the Central Bank of Kenya on the last Friday of each month, or the latest

¹Prof David Musyimi Ndeti –vs- Daima Bank Ltd and National Bank of Kenya –vs- Barrack Okul Deya

			published 91-day Treasury Bill rate, plus 4 per centum
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This position will be restated, from time to time, by the High Court. Every time it is restated, one or ten more litigants will take to the courts. In about 5 years, this will be a crisis of monumental proportions, affecting property ownership and transfer, the Kenya Revenue Authority. It will surely be the Goldenberg of the banking sector in Kenya.

Fortunately, following the repeal of the Donde Act, the risks are now contained between 23rd July 1991 and 1st August 2005.

All that is required, and all that is missing, is a thinking Man or Woman in the Right Place. Daudi Mwiraria was such a Man in the Year 2003, before he was overcome by strange, dark forces that made him eat his words clearly spelt out in the Budget Speech.

Will the same strange, dark (white?) forces visit Amos Kimunya in his sleep, and turn him from a thinking action Man to yet another unremarkable Minister for Finance who was unable to resolve this matter? Only time will tell.

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