COLLAPSE OF CHASE BANK KENYA LTD LINKED TO POOR CORPORATE GOVERNANCE

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ABSTRACT

The research paper's objective was to establish the corporate governance issues that caused receivership in Chase Bank (K) Ltd. The key role of corporate governance lies in regulating the board of directors' actions. It is a control and monitoring system in which the board of directors oversees the work of management to maximize shareholder value The reviewed literature revealed that the Chase Bank(k) failure was attributed to the high number of non-performing loans in the sector and could have been a result of weak lending policies laced with management failures and interests. It is evident that the failure of Chase Bank was a direct result of substandard corporate governance. The lack of effective oversight and accountability has led to devastating consequences, impacting not only the bank and its stakeholders but also the wider economy. It is learned that banks must prioritize good governance practices to ensure sustainable growth and mitigate the risks of failure. The collapse of Chase Bank serves as a stark reminder that corporate governance is not an option but a critical aspect of business success. The importance of banks disclosing financial and non-financial information about leadership provides shareholders with tangible evidence to gauge how well their investment is being used and hold management accountable. This should also follow in line with up-to-date filings, compliance with international standards, and web-based disclosures.

Keywords: Corporate governance, Board of Directors, Board expertise Stakeholders.

CHAPTER ONE

1.0 BACKGROUND/ INTRODUCTION

Corporate governance is essential for the proper functioning of the banking sector and the economy. Banks direct funds to promote business growth and economic development. Weak governance in significant financial institutions can spread issues across the sector and the economy. Corporate governance's primary objective is to protect stakeholders' interests sustainably. In retail banking, depositors' interests should take precedence over shareholders' interests. Corporate governance allocates authority and responsibilities to a bank's board and senior management.[1]

Banking is the focal part of the financial zone in every financial system subsequently the power banking gadget becomes critical in making sure increase in addition to favorable financial balance. Banks are the primary component of the financial services region for ensuring favorable financial balance and boom Koch and McDonald (2013).[2] The role of audit committees to ensure corporate financial reporting quality became a crucial issue due to recent high-profile accounting scandals, the existence of an Audit committee is a potentially powerful tool that can improve the financial information's reliability and transparency. In addition to improving the reliability and transparency of financial information, audit committees can also be of substantial help to the board in implementing, monitoring, and lasting good corporate governance practices that benefit the corporation and its stakeholders.

Banks have experienced major challenges caused by both external and internal factors. The Kenyan economy, in the 90s and early 21st century, has been very unstable and there has been growing competition from other banks. Internal factors that have affected banks' performance

Keywords: Corporate governance,

[1] Bank for International Settlements "Corporate governance principles for banks the BIS"(2015) website (www.bis.org). Accessed 2 March 2024
[2] Adelegan, O. J. "*Capital market efficiency and the effects of dividend announcement on share prices in Nigeria.* African Development" Review, 15 (2&3), 218–236. (2013)

were attributed to the fact that many banks were ill-prepared to handle demands such as the provision of a diversified range of financial services, demands on liquidity, foreign exchange, credit products, and capital finance obligations. [3]

Lehman Brothers firm, which traced its roots back to the 1850s filed for bankruptcy on September 15, 2008, as the global financial crisis related to the subprime mortgage era was unfolding. By 2007, Lehman had amassed a portfolio of mortgage-backed securities valued at $85 billion, four times the value of its shareholders' equity. To disguise some of this leverage, Lehman entered into agreements with banks in the Cayman Islands that effectively transferred some of the firm's liabilities, agreeing to repurchase them later. By manipulating accounting standards to record these agreements as sales, the company obtained cash in the short run without recording any liabilities.[4]

Governance, being an exercise of power in managing both economic and social resources for sustainable human development has become a critical area of concern for countries and economies. At the corporate level, it is more about providing certainty in leadership through processes and systems, towards harnessing the relationship between various stakeholders. It is evident in the set of rules and regulations that create such systems and processes. This aims to provide transparency to all stakeholders and accountability for various players, especially management.[5]

In Kenya, the banking sector is regulated and supervised by the financial institution of the Republic of Kenya which ensures that the bank area unit is ruled in line with the Banking Act Chapter 488 of the Republic of Kenya constitution.[6]

Keywords: Manipulating Accounting standards, transparency, Accountability. Stakeholders

[3] Caroline Mwangi 'Strategic Responses by Chase Bank Kenya Limited to Environmental Changes in the Banking sector'UON Digital Repository 2009. http://erepository.uonbi.ac.ke/bitstream/handle/11295/13036/Mwangi_ Strategic%20re sponses Accessed 2 March 2024

[4] Free encyclopedia 'Bankruptcy of Lehman Brothers. ttps://en.wikipedia.org/wiki/Bankruptcy_of_Lehman_Brothers Accessed 2 March 2024

[5] Onyango, J. ' Mega Corruption Scandals in Kenya Which Have Never Been Resolved." Https://www.tuko.co.ke/ 274539-15-mega-corruption-scandals-kenya-resolved.html#274539 Accessed 2 March 2024

[6] The Banking Act CHAPTER 488

Different constitutional acts that give governance rules applicable to banks are the Businesses Act, CMA gazetted the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 which succeeded the 2002 Guidelines. One of the major changes in the 2015 Code is that it moved from the "Comply or Explain" approach to the "Apply or Explain" approach. This new approach requires Boards to fully comply with the 2015 Code failure to which the non-compliant companies must 'disclose to the CMA the reasons for non-application and indicate the time frame required and the strategies to be put in place towards full compliance.[7]

Chase Bank Kenya Limited (CBK) was a commercial bank in Kenya, licensed by the Central Bank of Kenya, and was a large financial services provider in Kenya, with an estimated asset valuation of approximately US$1.428 billion (KES:142 billion), as of December 2015. At that time, shareholders' equity was valued at US$119.7 million (KES:11.9 billion).[8] It served millions of people with a broad range of financial services, including personal banking, credit cards, mortgages, auto financing, investment advice, small business loans, and payment processing.

Chase Bank was placed under receivership by the Central Bank of Kenya this was mainly due to the reporting of insider loans and not meeting the statutory banking ratios.[9] Chase (K) Ltd distinguished itself as a relationship bank seeking to build long-term partnerships with customers that would enable them to achieve what mattered to them most.

Having primarily targeted SMEs, Chase Bank (K) Ltd embarked on a strategy to grow its retail presence, as well as to consolidate its position in the SME segment. Chase Bank (K) Ltd had a total of 62 branches as of June 2016[10]

Keywords: Code of corporate governance

[7] The Code of Corporate Governance Practices for Issuers of Securities to the Public. 2015 https://www.google.com/search?q=Corporate+Governance+Practices+for+Issuers+of+Securities+to+the+Public%2C+2015 Accessed 4 March 2024

[8] CBK . "Directory of Licenced Commercial Banks, Mortgage Finance Institutions And Authorised Non-Operating Bank Holding Companies: Commercial Banks" (PDF). Central Bank of Kenya (CBK). Accessed 2 March 2024.

[9] *Mwaniki, Charles (7 April 2016). "Chase Bank shocks market with Sh8 billion secret insider loans". Business Daily Africa. Nairobi. Accessed 2 March l 2024*

[10] *ZOH (2017) A case study of chase bank (k) ltd https://erepo.usiu.ac.ke › bitstream › handle accessed 3 March 2024*

Section 43(2) of the Kenya Deposit Insurance Act, 2012 requires CBK to appoint the Kenya Deposit Insurance Corporation as a receiver of a bank, if, among others, an unsafe or unsound condition to transact exists; a bank is likely to fail to meet its financial obligations; a bank has substantially insufficient capital or if there is a violation of any law or Corporate governance problems faced by the local banking sector are partly caused by the tendency for bankers to pursue other interests besides their core business. This has created the temptation for insider lending, as these bankers want to promote their interests outside of banking. So, in effect, governance malpractice within banks has become a way of life in some parts of the industry, enriching a few at the expense of many depositors and investors (Wehliye.2016).[11] According to the Central Bank prudential guidelines (2016), the board is responsible for considering the legitimate interests and expectations of the institution's stakeholders in its deliberations, decisions, and actions. Central Bank of Kenya (CBK).[12]

Effective risk management requires robust internal communication within the bank about risk, both across the organization and through reporting to the board and senior management. Information should be communicated to the board and senior management in a timely, complete, understandable, and accurate manner so that they are equipped to make informed decisions. regulation.[13]

Keywords: Corporate governance, Insider trading, Prudential guidelines,

[11] Allan Olingo Dubai Bank Kenya Limited was issued with a banking licence in April 2000. https://www.centralbank.go.ke/images/docs/media/2015/DubaiBankpressrelease.pdf accessed 3 March 2024

[12] Wehliye. M. . *How to restore confidence in the financial sector after banks run into headwinds.* confidence-in-the-financial-sector/-/539548/3156058/ /9wuegiz/ accessed 3 March 2024

[13] Prudential Guidelines 2016.,2013. pdf. accessed 2 March 2024. https://www.google.com/search?q=prudential+guidelines+2016+kenya&rlz=1C1GCEA_enKE1080KE1080&oq=Prudential+Guidelines+2016Prudential Guidelines 2016. accessed 2 March 2024

CHAPTER TWO

2.1 THE CASE STUDY ISSUE(S)

This chapter presents a l reviewed literature on strategic issues causing receivership in commercial banks in Kenya, the case of Chase Bank (K) Ltd. In this chapter, the reader will be provided with a review of literature relevant to the stated research questions, which are: Investigate the influence of corporate governance issues that have led to receivership. Investigate the influence of risk management that has led to receivership. In addition, investigate monitoring and compliance issues that have led to receivership. On 7 April 2016, Chase Bank was placed under receivership by the Central Bank of Kenya making it the third bank to be placed under receivership in twelve months. This was mainly due to the reporting of insider loans and not meeting the statutory banking ratios.[14]

The Central Bank of Kenya in the exercise of its mandate appointed the Kenya Deposit Insurance Fund (as a receiver of the Chase Bank in the interest of its depositors, creditors, and members because it was experiencing liquidity difficulties and was unable to meet its financial obligations. KDIC appointed a consulting firm to investigate its management transactions and annual financial statements as of 31st December 2015 and specifically to investigate (a) The balance sheets; (b) Advances to the former director and significant shareholder; (c) Advances to the third parties owned by the bank's former director; and (d) Withdrawals and payments made on behalf of its former director for the period January 2016 to December 2017. The investigation revealed massive theft, fraud, and misappropriation of the Chase Bank funds by its former Director/Chairman and companies affiliated with him.[15]

Chase Bank (K) Ltd insider loans jumped from 5.72 Billion to 13.63 Billion in their revised financials for December 2015. Chase Bank (K) Ltd insiders effectively borrowed more than the lender’s total shareholder funds (equity), which stands at Sh11.19 billion.

[14] Wikipedia. ‘What led to the collapse of Chase Bank in Kenya?’ https://www.google.com/search?q=KRA+v+Chase+Bank+Kenya+Ltd%2C+October+2021&rlz=1C1GCEA_enKE1080KE1080&oq=KRA+v+Chase+Bank+Kenya+Ltd%2C+October+2021&gs_accessed 2 March 2024

[15] KRA v Chase Bank Kenya Ltd, October 2021. https://www.google.com/search?q=case+law+KRA+v+ Chase+ Bank+Kenya accessed 2 March 2024

Keywords: Frauds, Theft, Misappropriation

The inconsistency in insider loan reporting was on the account of the bank's directors and shareholders that was earlier reported at Sh2.6 billion but rose to Sh10.52 billion.[16]

Chase Bank (K) Ltd's troubles came with speed after depositors got wind of the fact that it had reported billions of shillings in insider loans that had not been previously disclosed in the accounts. The situation was made worse by the fact that the auditors – Deloitte East Africa said they could not certify whether the accounts and financial statements represented the actual situation in the bank. Victor Amadala.[17]

Chase Bank (K) Ltd faced issues due to internal and external factors, such as risk management and regulatory adherence. According to Wafula, (2016), Chase Bank (Kenya) Ltd directors had accused their auditors of professional ignorance that saw the bank pay a heavy price. The bank claimed that its auditors, Deloitte and Touche, who had been with them for 20 years, abandoned them in the hour of need. "All the explanations to the auditors fell on deaf ears, and the Central Bank had no option but to place Chase Bank under receivership," explained the former directors. The question arises that the auditors had the opportunity over the years to question how the bank treated Islamic products however never did so until the 2015 audit.[18]

In the case of Chase Bank (Kenya) Ltd internal audits were not carried out regularly with many of the fraudulent activities falling through the cracks. Processes and procedures were never followed and hence inconsistency in operations across the branches. Former Chase Bank chairman Mohammed Zafrullah Khan was charged with conspiring to defraud the bank of Sh1,683,000,000. He was also charged with several counts of stealing. from Chase

[16] Mwaniki. C.'*Chase Bank (K) Ltd shocks the market with Sh8bn secret insider loans*.. 2016 http://www.businessdailyafrica.com/Corporate- News/Chase-Bankshocks-marketwith-Sh8bn-secret-insider-loans/-/539550/3149358/-/15aosjsz/-/index.html. accessed 2March 2024

[17] Revealed: How insiders' loans fraud sank Chase Bank' https://www.the-star.co.ke/news/2019-02-18-revealed-how-insiders-loans-fraud-sank-chase-bank/ accessed 4 March 2024

[18] Paul Wafula '*Our Auditors of 20 Years Threw Us Under a Bus*' *The Standard June 10 2016* . https://www.standardmedia.co.ke/business/article/2000204669/chase-bank-our-auditors-of-20-years-threw-us-under-the-bus. accessed 3 March 2024

Keywords: Directors, Stakeholders, Receivership,

Bank and one count of failing to comply with provisions of the Proceeds of Crime and Anti-Money Laundering Act.[19]

The auditing profession standards at a major crossroad and needs a radicle reform if bank failures need to be averted. Deloitte had over the years audited the bank but never raised the issue of secret insider loans or uncollateralized credit in their audit reports. The audit firm was fined by the Capital Markets Authority last year, over the failure to detect a non-existent Sh2.1 billion Chase Bank account at the central bank that enticed bond investors to offer the collapsed lender billions.[20] The chair should encourage and promote critical discussion and ensure that dissenting views can be freely expressed and discussed within the decision-making process. The chair should dedicate sufficient time to the exercise of his or her responsibilities.

Keywords: The auding Professional standards,

[19] Business Daily: **Former Chase Bank boss Zafrullah Khan charged with Sh1.7 billion fraud** https://www.theeastafrican.co.ke/tea/business/kenyan-lenders-breached-rules-after-chase-bank-collapse- Kenyan lenders breached rules after Chase Bank collapse accessed 2 March 2024.

[20] Sam Kiplagat "Chase Bank shareholders' Deloitte case thrown out" Business Daily https://www.businessdailyafrica.com accessed 2 March 2024

CHAPTER THREE
RECOMMENDATIONS AND CONCLUSION

3.1 RECOMMENDATIONS

From reviewed literature for the collapse of Chase Bank, it is recommended that the quality of corporate governance needs to be enhanced. The bank should provide access to information to its shareholders providing stakeholder confidence and transparency. The bank needs to enhance policies and procedures of risk management to improve performance. Having skilled and ethical workers is vital, however accountability or responsibility for business processes is necessary. The bank should also adapt to the changing regulatory environment which can be a detriment to performance if not adhered to. It also needs to enhance its procedures of monitoring the position of resultant risk and risk governance in which it can identify, measure, and mitigate operational risk. The bank requires an effective and active monitoring and compliance department. Internal audit creates value for the bank in terms of sound corporate governance, however it needs to be an independent function that carries out audits regularly.

Effective implementation of sound corporate governance requires relevant legal, regulatory, and institutional foundations. A variety of factors, including the system of business laws, stock exchange rules, and accounting standards, can affect market integrity and systemic stability. Such factors, however, are often outside the scope of banking supervision. Supervisors are nevertheless encouraged to be aware of legal and institutional impediments to sound corporate governance and to take steps to foster effective foundations for corporate governance where it is within their legal authority to do so. A bank's governance must be transparent and provide clear information to stakeholders. The board's investment in corporate governance initiatives is crucial for the company's success. They are responsible for the bank's strategy, financial stability, personnel decisions, governance structure, risk management, and compliance. Board members must exercise their "duty of care" and "duty of loyalty" to the bank. Competitive compensation packages are essential to attract and retain talented employees.

The bank should provide access to information to its shareholders providing stakeholder confidence and transparency. Board composition, competency and experience, and remuneration and compensation are vital factors that affect board performance and hence factors that should be considered when appointing board members. Loan reviews and portfolio analysis are crucial in determining credit and investment risks. Credit policies in banks need to be reviewed and stronger control should be put in place to avert losses from non-performing loans. Risk committees should be independent from management and report to the board. Strict penalties should be levied for non-compliant banks.

3.2 CONCLUSION

Inclusion Chase Bank (K) Ltd had a highly experienced board with expertise however lacked professionalism in that they sought their agendas rather than the overall corporate objectives. The chairman had an overbearing influence on the board and even had an office at the bank and was involved in the day-to-day running of the bank. The board failure to oversee policies to identify and manage conflicts of interest.

The board has ultimate responsibility for the bank's business strategy and financial soundness, key personnel decisions, internal organization and governance structure and practices, and risk management and compliance obligations. The board may delegate some of its functions, though not its responsibilities, to board committees where appropriate. The members of the board should exercise their "duty of care" and "duty of loyalty" to the bank under applicable national laws and supervisory standards.

It is noted that corporate governance is vital for banks, allowing supervisors to rely on internal processes. It requires clear authority, responsibility, accountability, and checks and balances, including for the board of directors, senior management, and risk functions. The board should establish and uphold values that promote ethical and legal business conduct, oversee adherence, and promote risk awareness. Communication and enforcement of values, standards, and policies are critical, as is accountability for misconduct.

Corporate governance is vital for banks, requiring clear authority, responsibility, accountability, and checks and balances for the board, management, and risk functions. The board should establish ethical and legal values, oversee adherence, and promote risk awareness. Communication and enforcement of standards and policies are critical, with accountability for misconduct. Banks should monitor economic conditions, manage portfolio risks, and maintain strict credit standards and policies on insider lending,

In discharging these responsibilities, the board should consider the legitimate interests of depositors, shareholders, and other relevant stakeholders. It should also ensure that the bank maintains an effective relationship with its supervisors. A fundamental component of good governance is a corporate culture of reinforcing appropriate norms for responsible and ethical behavior. These norms are especially critical in terms of a bank’s risk awareness, risk-taking behavior, and risk. accountability. Further, it examines how to adopt efficient management as well as secure the institution using mechanisms. The board should oversee conflict-of-interest policies and their implementation. Senior management manages bank activities by approved policies, under board direction and oversight. of care" and "duty of loyalty" to the bank under applicable laws and standards. Kenya has done well in enacting laws, but little has been done in terms of enforcement. Both Imperial and Chase Bank (K) Ltd were cleared by the Capital Markets Authority (CMA) to issue corporate bonds and yet both banks had liquidity and regulatory issues with CBK.

Corporate governance is vital for banks, requiring clear authority, responsibility, accountability, and checks and balances for the board, management, and risk functions. The board should establish ethical and legal values, oversee adherence, and promote risk awareness. Communication and enforcement of standards and policies are critical, with accountability for misconduct. Banks should monitor economic conditions, manage portfolio risks, and maintain strict credit standards and policies on insider lending. Good corporate governance increases stakeholder confidence, which facilitates access to capital and increases market share which in turn improves profitability and liquidity. Robust Independent Risk Management units were lacking in the banking system that could identify, monitor, measure, and manage key risks facing the bank.

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