Association of Global Custodians

Middle East and Africa Focus Committee ("AGC ME&A");

Subject to Supplemental Comments

The Chairman
Parliamentary Committee on Finance, Planning and Trade
Parliament Buildings
Postal Code:00100
Nairobi - Kenya

Dear Sir,

Re: The Kenyan 2018/19 tax budget: transfer tax on banks and financial institutions

The Association of Global Custodians Middle East & Africa ("AGC ME&A") represents the international banking community[1].

Our letter seeks to highlight concerns raised from our members following the recent Kenyan 2018/19 budget ("the budget") in respect of the proposed tax of 0.05% on transfers of KES 500,000 and above that are made through banks and financial institutions ('the Levy').

The budget was only announced on 14 June 2018 and the tax legislation cited became effective 1 July 2018. This came into effect without any consultation from the financial community.

The immediate concern is one of timing and operational challenges given the uncertainty in terms of the practical considerations over its implementation. There are too many unknowns and this creates uncertainty within the international financial community. Such tax policy is likely to make the Kenyan market less attractive to the international financial community which is likely to lower its attractiveness as an investment market. This is likely to have adverse economic impacts for raising capital from the international capital markets as there will be additional costs, charges and red tape to enter the market.

We have elaborated on these concerns below and would welcome the opportunity to discuss further:

1. **Implementation challenges due to lack of clarity**

There is a current lack of clarity concerning the scope, collection of the tax and the operational processing and payments required. This is an important consideration given global custodians and their clients will be required to make changes to operational processes to accommodate local Kenyan requirements which will further increase costs and make the market less attractive to investors. Further definition on the scope would also be welcomed to avoid double levy as well as to ensure the proper controls are in place. The AGC ME&A would request further guidance concerning the collection process and requirements especially if capital markets transactions are included.

2. **Scope of the proposed amendment**

It is not clear to our members and their clients how the tax will be levied and at what point it would be collected especially for capital markets transactions and corresponding foreign transactions. Specifically, the AGC ME&A suggests that there is a need to clarify at what stage of the transaction the levy is to be applied (i.e. when the issuer pays dividends or interest, when the local custodian settles the transaction or when the foreign exchange is undertaken for purposes of repatriation). Without such clarification, market participants will have difficulty in establishing compliance structures and there is even a potential for duplication of application of the Levy which is obviously unsatisfactory and will unnecessarily increase the burden on market participants and the Kenyan tax authorities.

3. **Reconciliation challenges: investment vs repatriation**

There have been concerns raised with respect to provisions of the Levy that govern reporting to the ultimate investors of the amounts to be repatriated. As it reads currently, the practical application of the Levy would result in investors receiving reporting of income/dividends that do not match the final amounts that will be repatriated. This will lead to reconciliation breaks. Without clarity of the process concerning the collection and processing of the Levy, reconciliation breaks and the need to explain these will be difficult to manage and will further reduce confidence levels of investors in the Kenyan market and create possible regulatory and audit issues that will require ongoing management.

4. MSCI Impact

The AGC ME&A notes the importance of clarity when implementing amendments and in particular, with respect to tax developments. As noted by the Kenya Capital Markets Master Plan 'Vision 2030', tax plays an important role in the relative attractiveness of an international financial centre and global financial institutions would be attracted to an international financial centre that offers attractive legal, regulatory and institutional frameworks, world-class infrastructure, and favourable investment and tax incentives. Vision 2030 also noted that the tax arrangements need to be competitive for the users of the markets and it envisaged that by 2023, Nairobi would become a market of choice for domestic, regional and international issuers and investors. In line with the development of the infrastructure under the Master Plan it was also forecast that during the period of implementation the Kenyan capital markets will qualify for rating by the Morgan Stanley Capital International (MSCI) Index as an emerging market. Such inclusion would boost the attractiveness of the Kenyan Financial markets. However, developments that affect clarity and increase complexity may well have impact on the capital markets master plan, the capital inflow and liquidity which may further impact Kenya's inclusion in the index.

5. Timing of implementation and lack of Consultation.

We reiterate the implementation timeframe is very short and there has been no opportunity for industry consultation. These deficiencies did not allow participants, foreign investors and their clients to discuss, consider and understand the impact and prepare and make system changes to manage the requirements. In other markets changes are implemented post consultation and this enables participants to assess and update operational systems to ensure changes can be managed. The short implementation time frame and the absence of consultation in this instance are inconsistent with established international practice. We would like to restate that the AGC ME&A are open to pre-implementation discussions and proposals and believe that such collaboration assists a successful implementation in the market, therein creating investor confidence and alleviating post implementation issues and actions being taken by the market.

Ultimately, and there are examples that we can elaborate upon during our further discussions with you, changes that are implemented in tight timeframes without consultation and clarity of process alienate the market and the short and medium-term impact is that investors exit the market.

Finally, we note the pending legal actions may affect the transfer tax, further adding to the uncertainty surrounding this issue.

As noted above, we would like to discuss this matter with you. The AGC ME&A Committee communication details are as follows:

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Yours sincerely,

Julia McKenny

Prepared by the Middle East and Africa Association of Global Custodian Committee,
11 July 2018

The Association of Global Custodians is an informal group of 12 financial institutions that provide securities safekeeping services and asset-servicing functions to primarily institutional cross-border investors worldwide. As a non-partisan advocacy organization, the Association represents members' common interests on regulatory and market structure matters through comment letters, white papers and interaction with legislative and regulatory *authorities and financial industry organizations around the globe. The members of the Association of Global Custodians are: BNP Paribas; BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; Northern Trust; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company.*

For more information visit www.theagc.com.

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