

Legal History of Banking in Uganda from Pre Independence to Present Day

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Abstract

In Uganda started since Colonial rule with the promulgation of the 1950 Ugandan credit and savings Bank. This however did not correct the inadequacies that have been the bane of banking in Colonial Uganda. Consequently, with the attainment of independence various reforms were made in the Banking sector with the aim of making the banking terrain more impact and relevant to THE ECONOMY OF Uganda. This paper examines the legal and institutional frameworks that has been put in place from pre independence to present day for effective banking sector. the paper finds that such reforms has positive impact on the Ugandan economy...it concludes that despite the slow pace of reforms in the banking sector the sector is gradually playing a significant role in the business and economy of Uganda.

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Historical Background

The pre-independence commercial banking sector was dominated by office foreign owned banks. These banks were very conservative in their lending policies usually giving loans on strict commercial criteria because they were foreign owned they were somehow shielded from political interference in their lending decisions. As a result, others banks tended to lend to larger companies and to finance trade all of which were owned or controlled by foreigners. They discriminated against Africans because the majority could not meet strict commercial criteria as they did not have acceptable securities such as land titles, life insurance policies, bills of exchange and so on and they were largely engaged high risk and relatively non-commercial ventures such as agriculture and animal husbandry.

The colonial government reacted to the perceived inadequacies of foreign owned banks by enacting in early 1950s The Uganda Credit and Savings Bank Act¹ which created the Uganda Credit and Savings Bank. This was the first Public Sector bank in Uganda. The major purpose of the bank was to facilitate loans to Africans in furtherance of agricultural, commercial, building and co-operative society purpose in Uganda. This bank was expected to increase access to credit by African business and farmers.

The Independence Era 1962-1993

Dissatisfaction with foreign controlled banks continued after independence. They were widely criticized because of their discrimination in lending money. The independent government regarded this as irrational and unjust and as a constraint on its development objectives. The primary objective of the reforms of the banking sector in 1960s and 1970s was therefore to fill the financing gaps, and influence allocation of credit directly through administrative controls. In 1965 the Uganda Credit and Savings Bank was transformed into Uganda Commercial Bank (UCB) which is now Stanbic Bank. The Bank of Uganda was set up in 1966, Co-operative Bank was set up in 1972 and it was owned by the Co-operative Societies. These banks were expected to fulfill development objectives based on government development plans. In early 1970s the government acquired 49% of the shares in the foreign owned banks, except Standard Chartered Bank.

The foreign owned banks reacted by closing down most of their branches in the rest of the country except for those in Kampala. The vacuum left was filled by Uganda Commercial Bank and the Co-operatives bank which embarked on expansion programmes. By 1991 the Cooperative bank had 24 branches and Uganda Commercial Bank had 190 branches and the latter held about 50% of all the bank deposits.

This expansion was based on a very inadequate legal framework. **The Banking Act**² which was enacted in 1955 required banks to have a paid up capital of one million shillings and to be licensed by the Registrar of Companies Prudential Regulation and Supervision were neglected. This was in part a legacy of the British colonial rule and the dominance of foreign banks.

¹Cap 90

²Cap 88

Because these banks were subsidiaries of reputable foreign banks which had their own prudential management rules, it appeared unlikely that they would be allowed to fail by their parent banks. Prudential Regulation seemed irrelevant and the banks' regulation system prevailing in Britain at the time was of a highly informal nature which entailed no independent on-site examination of banks by supervisors.

The 1955 Act was repealed and replaced by the Banking Act³ as amended by the Banking (Amendment) Act⁴. This Act was a great improvement on the previous one. Only companies incorporated in Uganda were allowed to do banking business and the minimum paid up capital was raised to twenty million. They were required to make mandatory periodic returns. The Act provided for capital reserves and prohibited unsecured credit facilities and loans. However these measures did not address Prudential Regulation concerns. They did not address the issue of insider lending which has been one of the leading causes of bank distress and collapse. They did not address the quality and experience of directors and managers. The licensing and revocation of licenses was left at the absolute discretion of the Minister without sufficient guidelines on how to exercise the discretion. The inspection of banks therefore was not clearly assigned to any single authority, the law only provided that the Minister or Bank of Uganda could carry out non-mandatory periodic inspections. Yet if a single authority had the mandate to inspect and to force improvement in management and internal working of banks it could, possibly, prevent bank failures.

The Bank of Uganda Act⁵ was equally inadequate. The Minister had powers to give directions to the Central Bank relating to the financial and economic policy of the bank and the bank was bound to comply with any such direction. The law was definitely not intended to give Central Bank prudential regulatory powers.

The law did not set out or impose standard uniform accounting procedures and record keeping standards. The Central Bank was not given powers to vary minimum paid up capital or to adjust it as circumstances arose. An illustration of this was the currency reform of 1987. By removing two zeroes from the currency, the minimum capital requirement of shillings 20,000,000 was reduced to shs. 200,000. The two zeroes were 'brought back' by inflation and exchange rate depreciation. But still a bank could be licensed with a minimum paid up capital of shs. 200,000. The low minimum capital requirement and political licensing of banks largely contributed to attract locally owned undercapitalized¹ banks to enter the market. The banks were largely owned by manufacturing, commercial or trading interest and real property owners.

Commercial Banking Environment

The rapid expansion of Uganda Commercial Bank and the Co-operative bank in the 1970s and 1980s was carried out when there was shortage of professional and skilled personnel. This development coupled with a weak regulatory framework undermined the banks

³No.16 of 1969

⁴Act No.34 of 1966

⁵Act No. 5of 1966

managerial efficiency and internal controls further; both banks were imprudently managed leading the Uganda Commercial Bank to accumulate non-performing loans of around 75% of its total loans portfolio by 1990s.

This situation was brought about by a number of factors; There was automatic liquidity support for Uganda Commercial Bank from the Bank of Uganda. The bank did not have proper accounting procedures. There was political influence on lending policies of the Uganda Commercial Bank and corruption. Because the loans were politically influenced, the borrower's repayment discipline was very low. Political instability, protracted economic crisis, loan disruptions and a weak legal regime made the lending environment very difficult.

All these factors influenced the way new private sector banks such as Greenland Bank, Teffe Bank, International Credit Bank, Centenary Rural Development Bank and others were operated. This situation persisted until 1993 when the Financial Institutions Act⁶ and the new Bank of Uganda Act⁷ were enacted the weak points of the Banking Act 1969 were addressed. Insider lending, large credit exposures, investment in non-bank business and purchase of real estate were all addressed accordingly.

The Central Bank was given wide powers to carry out both on-site and off-site supervision with a range of options to take against violations. It also set up a Deposit Insurance Fund to be funded by the assessments from the banks. The licensing of banks was taken away from the Minister. The Central Bank used its powers under the statute to intervene in Nile Bank and Sembule Bank (now Allied Bank) and to close down Teeffe Bank, International Credit Bank, Co-operative Bank and Greenland Bank all of which were insolvent by intervention time. What is noteworthy, however, is that when these banks were closed, the government directed that all depositors should be paid whether they were protected or not at the expense of the tax payers.

The Institutional Legal Framework

Article 161⁸ establishes the Central Bank as the only authority to issue the currency of Uganda and **Article 162 (1)**⁹ lays down the functions of the Central bank to include among others;

1. To promote and maintain the stability of the value of the currency of Uganda.
2. Regulate the currency system in the interest of economic progress of Uganda
3. Encourage economic development and efficient utilization of resources of Uganda through effective and efficient operation of banking and credit system.

Section 4 (1), (2)¹⁰ enumerates the functions of the bank and it is to the effect that, the functions of the bank shall be to formulate and implement monetary policy directed to economic objectives of achieving and maintaining economic stability.

⁶No. 4 1993 Cap 54.

⁷No.5 of 1993.

⁸Of the 1995 constitution of Uganda

⁹(a) (b) ©, of the 1995 constitution of Uganda

¹⁰of Bank Uganda Act 2000

Section 3¹¹ defines a bank” as any company licensed to carry on financial institution business as its principal business, as specified in the Second Schedule to this Act and includes all branches and offices of that company in Uganda.

The Financial Institutions Act¹²

The enactment of **the Financial Institutions Act 2004** stemmed from the banks failures between 1994-1999 and the need to strengthen the regulation of the banks.

A judicial commission of inquiry into the closure of banks instituted under Legal Notice¹³ and the terms of reference of the commission among others were to:

1. Examine the primary cause of the failure and subsequent closure of international Credit bank (ICB) the Greenland bank ltd (GLB), and the co-operative bank Ltd.
2. To make recommendations to strengthen the prudential regulation and supervision of the banks and strengthen the bank of Uganda's intervention policy towards failed banks in order to protect depositors and the public funds.

The recommendations of the commission were incorporated in the Financial Institutions Act **2004**. With the aim of revising and consolidating the law relating to financial institutions, to provide for the regulation, control and discipline of financial institutions by the Central bank and to provide for other related matters.

In January 2016 parliament passed the Financial Institutions (Amendment) Act, 2016 with the objective of amending the Financial Institutions Act 2004 to provide for Islamic banking, to provide for bank assurance, to provide for agent banking, to provide for special access to the credit reference bureau by other accredited providers and service providers, to form the deposit protection fund and for related purposes.

Licensing

According to **section 4(1), (2)**¹⁴, the Act prohibits any person from transacting any deposit taking Financial Institutions business in Uganda without a license and it is only a company that can apply for a license to transact financial business In Uganda.

The Financial Institutions (Licensing) Regulations¹⁵ is to the effect that an applicant proposing to transact financial institution business as a bank, shall have a minimum paid up capital of not less than four billion.

Section 4 (2a)¹⁶ allows a company licensed to transact financial institutions business to carry out the licensed business through an agent.

¹¹Financial Institutions Act 2004

¹²Act No. 2 of 2004

¹³No.4/1999 of 29th October, and Sworn on 7th Feb 2000.

¹⁴Financial Institutions Act 2004

¹⁵2005

¹⁶The 2016 amendment Act

The Act introduced stringent measures to be considered by the central bank to grant a license for example vetting of directors, substantial shareholders and officers of a financial institution under a proper and fit test. This was illustrated in the case of Kizito v Bank of Uganda.¹⁷

The Act provides for the classes of license and the permitted functional services particulars of which are in the second schedule¹⁸ and these are:

- i. Commercial banks
- ii. Merchant bank
- iii. Post Office Saving bank
- iv. Mortgage bank

The 2016 amendment Act introduced the business of Islamic bank class 9 among others.

Section 17¹⁹, The Central bank is given wide powers to revoke a license at any time. The grounds to revoking the license among others are:

1. When a bank is under-capitalized
2. Conducting business in a manner detrimental to the interests of the depositors.
3. Engaging in deception to the Central bank or the general public of the bank's financial position, ownership, management, operations or other acts material to its business.
4. When the bank has without the consent of the Central bank amalgamated with another financial institution or sold or otherwise transferred its assets and liabilities to another financial institution, the case in point was experienced in 2014 when bank of Uganda revoked the license of Global Trust bank (U) Ltd. In accordance with section 17 ©, 89 (2) (f) and 7© as well as 99(1)²⁰ and the same sold to DFCU bank.

Shareholding

Section 18(1)(a),(b)²¹ and the Financial Institution (ownership and control) Regulations²² prohibits a person or body corporate controlled by one person or group of related persons or body corporate owned or controlled directly or indirectly by a group of related persons from owning or acquiring more than 49% of the shares of a financial institution.

Section 19²³ in consonant with the Financial Institution (ownership and control) Regulations²⁴ prohibits a financial institution from allotting , issuing, or registering the transfer of more than 5% or more of its shares to any person or group of related persons without permission from the Central bank, the central bank will grant such a transfer if;

¹⁷(MCS Cause No. 244 of 2016) (2017) UGHCCD 2913 January,2017).

¹⁸Of the financial institutions Act 2004

¹⁹Financial institutions Act 2004

²⁰Financial institutions Act 2004

²¹Financial institution Act 2004

²²2005 as per regulation no. 6 (b)

²³Financial institutions Act 2004

²⁴2005

- i. It will not be contrary to public interest
- ii. It will not be contrary to the interests of the financial institution concerned or its depositor
- iii. It will not be detrimental to the finance services industry in general.

Capital Requirement

According to the Financial Institutions (Revision of minimum capital requirements) instrument²⁵ the minimum paid up cash capital of not less than one million two hundred and fifty currency points investment was to be built (Uganda shillings 25 billion), this means that for any Bank to operate in Uganda it must have at least capital of Uganda shillings 25 billion.

Prohibitions and Restrictions

In order to further protect depositors, there are prohibitions which are intended to protect the capital of the bank thus banks under section 29 and 30²⁶, are prohibited from granting advance or credit facility or accommodation against any security of its shares or of those of a company affiliated to it or such instrument which may qualify as capital, the Act further emphasizes that. A financial institution is prohibited from granting a loan to any of its affiliates and associates, directors, persons with executive authority, substantial shareholders to any of their related persons or their related interest (insiders) except on terms which are non preferential in all aspects including credit worthiness, term, interest rate and the value of the collateral.

According to Section 37 (a)²⁷, banks are not allowed to engage in trade, commerce, agriculture, invest in real estate or engage in underwriting of shares or securities brokerage, this is intended to protect depositors whose money may be invested in high risk investments; this prohibition does not apply to financial instructions engaging in Islamic financial business.

Accounts and Financial Statements

The Act under **sections 48(8), 50(1), (3)**²⁸ requires the banks to submit audited financial statements to the Central bank and thereafter their publication in the newspaper of a nation-wide circulation and these are to be exhibited in their respective banking halls.

Corporate Governance

Section 52(1), (2)²⁹ is to the effect that a bank must have a Board of Directors of not less than five directors whose chairman must be a non-executive director, the prohibition of an executive director being the chairman is an attempt to secure the board independence by preventing it being manipulated by an executive director. Suffice to mention is section 52 (8)³⁰ Prohibits a member of the Shariah Advisory board in any financial institution to be appointed a director while still he holds that position.

²⁵2010

²⁶The financial institutions Act 2004

²⁷Financial institutions Act 2004

²⁸Financial institutions Act 2004

²⁹Financial institutions Act 2004

³⁰Financial institutions (amendment) Act 2016

Credit Reference Bureau

The Act further under **section 78,78A**³¹ and the financial institutions (Credit Reference Bureau) Regulations 2005 requires the establishment of a credit reference bureau for the purposes of disseminating credit information among financial institutions or their business all financial institutions should report to the bureau the details of non-performing loans and other accredited credit facilities classified as doubtful or loss in their loan portfolio also customers involved in financial malpractices including bouncing of cheques due to lack of funds and fraud, banks are required to perform a credit check on a customer who applies for credit from the financial institution.

Supervision

The Act under **section 79(1)**³², lays great emphasis on the onsite inspection and off site surveillance and prompt provision of accurate information when required in onsite inspection, the Central bank or another person appointed by it can inspect any bank and its financial records and books of accounts on its premises. YOff site inspection requires banks to furnish periodic information to the Central bank, periodic returns and the audited financial balance sheet and profit and loss account including those of subsidiary, affiliate, and associates.

Corrective actions

The Central bank is given wide powers under Part IX³³ to take punitive measures against the bank or individual in the violation of laws, regulations and directive if the violations are not severe, the Central bank may order the bank to take remedial action to comply with the regulation and directives if the violations are severe the central bank can issue formal and legally enforceable actions such as cease and desist orders.

The most far reaching powers of the Central bank is to take over management of the bank if the continuation of its activities is detrimental to the interests of the depositors or example the central bank on 20 October 2016 took over the management of Crane bank ltd under **section 87(3) 88(1) (a) and (b)**³⁴ and appointed a statutory manager of the affairs of Crane bank and suspended the board of Crane bank.

Liquidation

The Act provides that liquidation or winding up of a bank shall only be commenced by the central bank or the institution itself under provisions of voluntary liquidation, reference seen under part X³⁵. On 28th September 2012 the constitutional court issued an interim order³⁶ of Humphrey Nzeyi petitioner/applicant) against bank of Uganda and the Attorney General: against the actions of bank of Uganda to wind up the affairs of National bank of commerce until the hearing of the main application and the entire case.

³¹Of the Act 2004

³²Financial Institutions Act 2004

³³of the financial Institutions Act 2004

³⁴of the financial Institutions Act 2004

³⁵of the financial Institutions Act 2004

³⁶Misc Application No.38/2012

Deposit Protection Fund

Under section 108 (1) (2) (3)³⁷, establishes the deposit protection fund as a body corporate and a separate legal entity from the Central bank. The purpose of the fund is to be a deposit insurance scheme for customers of contributing institutions may act as a receiver or liquidator of a financial institution if appointed by the Central bank. The idea behind the fund is that it reduces bank panic and loss of public confidence in the banking system, with the fund all but the largest depositors are assured that they will not suffer deposit loss even if the bank failed therefore the tax payers money will not be used to pay depositors as was the case when Greenland, Teefe, International Credit Bank and the cooperative banks failed. Every financial institution is required to contribute to the fund and amount specified in the notice even micro finance deposit taking institutions contribute to the fund.

Special Provisions of Islamic Banking

Section 115A (1),(2)³⁸ allows the existing banks to apply to the Central bank to carry on Islamic financial business in addition to the existing licensed business through an Islamic window.

Every financial institution which conducts Islamic financial business is required to appoint and maintain a Sharia Advisory Board; the Central bank is also required to have a Central Shariah Advisory Council. However in order to operationalize the financial institutions (amendment) Act 2016 regarding Islamic banking, bank of Uganda is in advanced stages of instituting regulations and supervisory framework for Islamic banking in Uganda and is yet to take off.

Conduct of Bank Assurance

Bank assurance means using a financial institution and its branches, sale network and customer relationship to sell insurance products a financial institution wishing to engage in the business of bank assurance or Islamic insurance as a principle agent should get prior written authorization of the Central bank and the activities shall comply with the insurance Act as per section 115D (1) (2) (3)³⁹

Amalgamation, arrangements and affected transactions

Recognizing the fact that the safeguards of licensing may be swept away by change in ownership of a financial institution therefore **section 112**⁴⁰ is to the effect that, any form of amalgamation, arrangement between financial institutions can only be done or effected with prior consent of the Central bank, the Central bank may under some circumstances refuse to grant such transactions.

Miscellaneous

The act under section 116 (4)⁴¹ imposes stringent fines and penalties the fines and penalties expressed in monetary terms and recovered by the central bank shall be used to offset the

³⁷The 2016 amendment to the Financial Institutions Act

³⁸The Financial Institutions (Amendment) Act 2016

³⁹The Financial Institutions (Amendment) Act 2016

⁴⁰The Financial Institutions Act 2004

⁴¹The Financial institutions Act 2004

costs of supervising financial institutions the same is pointed out under section 43⁴² and Basing on **section 119 (4),(6)**⁴³ unclaimed balances are transferred to a dormant account of the bank after 2 years and the bank shall cause it advertised in the print media after 3 years, then after 5 years from the date of advertisement the money shall be transferred to the Central bank to off-set the costs of supervising financial institutions.

The Act as per **section 47**⁴⁴ also requires banks to report any suspected money laundering activity to the Financial Intelligence Authority. The Act under section 124⁴⁵ prohibits suits or legal proceedings against the Bank of Uganda or any office for acts done in good faith.

In conclusion therefore, the institutional framework of conducting banking business in Uganda stems back from the colonial era to date and bank of Uganda has been at the forefront in regulating and controlling the banking business with mandate directly derived from Article 161 and Article 162 of the 1995 constitution of Uganda.

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⁴³The Financial Institutions Act 2004

⁴⁴The Financial Institutions (amendment) Act 2016

⁴⁵Financial Institutions Act