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**NOTES ON REGULATORY FRAMEWORK OF BANKING
 BUSINESS IN UGANDA**

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Introduction: The need for regulation

Financial institutions business is very sensitive because it is a kind of business which trades in the life-stream of every economy which is money. This sensitivity calls for a very stringent regulatory regime. Challenges that may stem from weak regulatory framework of banking business are mismanagement of depositors' money, unconventional banking and credit practices, collapse of banks, collapse of depositors' businesses which depend on these banks and finally, loss of confidence in these institutions by the public.

It is against this background that most of the financial institutions have in the recent past been brought under regulation by some statutory regulators which enforce the stringent laws and procedures relating to ownership, licensing and general supervision of these institutions.

REGULATION OF BANKING BUSINESS IN UGANDA

Banks are not specifically regulated under special banking law/s. They are regulated under a general law under which other financial institutions are also regulated which is the **Financial Institutions Act, (FIA), 2004** (herein after referred to as "the FIA"). The regulatory role of banking business in Uganda is performed by the Central Bank. The **Central Bank** is set up under Article 161 of the **Constitution of the Republic Uganda, 1995**. Under Article 162, it is provided that the Central Bank shall have the following duties:

1. To promote and maintain the stability of the value of the currency in Uganda;
2. To regulate the currency system in the interest of the economic progress in Uganda;
3. To encourage and promote economic development and efficient utilisation of Ugandan resources through effective and efficient operation of Banking and credit system; and
4. To do all such other things not inconsistent with this Article as prescribed by law.

The regulation of banking business by the Central Bank falls under 8 (eight) heads namely:

- a) Licensing;
- b) Approval of minimum capital of Banks;
- c) Supervision;
- d) Restriction on the type of trade or investments engaged in by Banks;
- e) Seizure, re-organisation and liquidation of banks in extreme cases;
- f) Control of mergers and transfer of shares;
- g) Corporate Governance;
- h) Approval of alteration of name, memorandum and articles of association.

Let us elaborate these eight ways in which banking business is regulated

Licensing

The Financial Institutions Act, (FIA), 2004 as amended from time to time (the latest amendment is of 2023) makes it an offence for any person to transact any deposit – taking or other financial institution business in Uganda without a valid licence granted for that purpose. A person is eligible to apply for and be granted a financial institution business licence if that person is **a company** within the meaning of the FIA.

A company is defined to mean a company incorporated or registered under the Companies Act and includes the Uganda Development Bank, a building society and any institution classified as a financial institution under the Act. That company must be limited by shares not guarantee or a company with unlimited liability.

How to obtain a financial institution business license

A licence is obtained by applying in writing to the Central Bank. The application must contain the following information, among others:

- The name and address of the proposed financial institution, its directors and shareholders
- The nationality of the directors
- The nationality and shareholding of each shareholder
- The proposed location where the institution is going to operate from
- The estimated number of employees
- The qualifications, experience, nationality and other relevant particulars of the proposed management and staff
- The capital structure and earning prospects of the financial institution
- The applicant's business financial plans and earning forecasts namely, balance sheet, income statement and cash flow, for at least 3 years and sufficient detail to describe the operating plan, demand for financial products and services and existing competition in the proposed market
- A summary of the applicant's board risk management policies and management operating procedures and systems that will ensure the integrity of its financial controls;
- A description of the applicant's proposed organizational and management structure, reporting lines and responsibilities of its board;
- Any other information relating to the viability of the financial institution or other matters as the applicant considers relevant to its application.
- The **class of licence** in which the applicant seeks to be licensed.

Classes of Licenses

S.10 (3) of the FIA provides for the different classes of licenses available under the Act but the particulars of the permitted activities conducted by institutions of these classes are elaborately specified in the **Second Schedule to the Act**. The classes are:

Banking FIs

- Class 1: the business of a commercial bank
- Class 2: the business of a Post Office Savings Bank (now Postbank)
- Class 3: the business of a merchant bank
- Class 4: the business of a mortgage bank
- Class 5: the business of an Islamic Bank

Non-bank FIs

- Class 6: the business of an acceptance house
- Class 7: the business of a discount house
- Class 8: the business of a finance house
- Class 9: the business of a credit institution
- Class 10: the business of a non-bank Islamic Financial Institution

(See (S.4(b) of the Financial Institutions (Amendment) Act, 2016) which created Classes 9 and 10.)

The 2nd schedule to the FIA, 2004 as amended in 2016 provides in detail the functions performed by each of the above institutions. The Central Bank is empowered to expand the number of classes of licences to include provision of services which fall within the scope of the Act. And when it did so in 2016 by creating the license of Islamic Bank and Non-bank Islamic Financial Institutions, the Financial Institutions (Islamic Banking) Regulations, 2018 were passed.

The application for a licence must be accompanied by the following:

- The applicant's memorandum and articles of association and a certificate of incorporation;
- A certified copy of the resolution of the board of the applicant authorizing the preparation and submission of the application;
- A declaration for all individuals proposing to become directors, shareholders, controllers or managers.
- The Applicant's Personal Data Protection Policy and Certificate of registration with the Personal Data Protection Office (PDPO)
- The Anti-Money Laundering & Countering the Financing of Terrorism (AML&CFT) Policy and Certificate of registration with the Financial Intelligence Authority (FIA).
- If the information provided is inadequate, the applicant may be called upon to provide the necessary missing information so as to complete the application.
- Any person who provides false or misleading information in relation to the application automatically ceases to be a fit and proper person to manage and control a financial institution and, in addition, subjects oneself to criminal prosecution
- In considering the application, the Central Bank considers the financial condition and history of the applicant, the nature of the business of the applicant, the competence and integrity of the proposed management, adequacy of the capital structure, the conveniences and needs of the community to be served, geographical locations and branch distribution network, fitness of the management team and the promoters among others.

Processing of the application

- The Central Bank is obliged to investigate and prepare a detailed report in respect of the application within six months after receipt of the same.
- At the expiry of the 6 months, the Central Bank should make the decision whether or not to grant the licence within 14 days.
- The decision should be communicated to the applicant with 7 days of its making and it should be in writing.
- A person who is aggrieved by a decision of the Central Bank may appeal to the High Court within 30 days where the decision may be affirmed or set aside.

After issuing the licence

- A financial institution should not engage in any business other than that specified in its licence.
- Every financial institution which has been granted a licence must pay an annual fee which is prescribed by the Central Bank on or before 31st January of each year. Failure to comply attracts a late payment penalty.
- A licence fee is paid only grant of the licence.
- Financial institutions which were licensed before commencement of the FIA 2004 (26th /03/04) were required to submit their licences to the Central Bank within 3 months for classification.

Revocation of the licence

Once granted, the licence remains in force until revoked. A licence may be revoked for any of the following reasons:

- a) Failure of the institution to commence operations within 2 months of granting the licence;
- b) Where the company has failed or ceased to carry on business;
- c) Where the company is unable to pay its liabilities as they mature;
- d) Where it has gone into liquidation/ wound up/dissolved;
- e) If the company is carrying on business in a manner which is risky or detrimental to the interests of depositors;
- f) Where it contravenes the FIA or any other financial law in a serious or persistent manner;
- g) Where it is engaged in serious deception of the Central Bank or the general public about its financial condition, ownership, management or other material facts;
- h) If the company amalgamates with another financial institution or is sold or transfers its assets and liabilities to another FI without the consent of the Central Bank;
- i) Where it fails to comply with any condition or direction stipulated by the Central Bank; and
- j) Failure to fulfil any of the licensing conditions.

b) Capital Requirements

- According to the Financial Institutions (Revision of Minimum Capital Requirements) Instrument, 2022 (dated 16th November 2022), the minimum capital required for setting up a **Bank** in Uganda was raised from 25 billion which was set in 2010 to **Ushs 120 (One Hundred Twenty) billion** by 31/12/2022 and Ushs 150 (One Hundred Fifty) billion by 30/06/2024.
- For a **non-bank financial institution**, the Minimum Capital was raised by the same Instrument from Ushs 1 (one) billion to **Ushs 20 (Twenty) billion** by 31/12/2022 and Ushs 24 (Twenty Four) billion by 30/06/2024. The Central Bank is empowered to review the minimum capital requirements by statutory instrument, which should be laid before parliament.
- Every FI is required to maintain a core capital of not less than 8% of its total risk adjusted assets plus risk adjusted off balance sheet items as may be determined by the Central Bank by Statutory Instrument, and a total capital of not less than 12% of its total risk adjusted assets plus risk adjusted off balance sheet items.
- In addition, every financial institution is required to maintain minimum holding of liquid assets which is expressed as a proportion of the demand and time liabilities of the institution not exceeding 30% of such demand and time liabilities.
- The Central Bank is empowered to prescribe the minimum amount of liquid assets. Liquid assets include notes and coins which are legal tender in Uganda, balances held at the Central Bank, moneys at call and balances at banks in Uganda other than the Central Bank, Uganda treasury bills maturing within a period not exceeding 91 days, uncommitted balances at banks outside Uganda withdrawable on demand and moneys at call outside Uganda, any other assets that the Central Bank may approve by statutory instrument.

c) Supervision (sections 79 – 81 of the FIA)

The Central Bank supervises financial institutions by regulating, monitoring and disciplining them whenever it is appropriate. Whenever the Central Bank considers it necessary for the performance of its supervisory functions, it may summon any officer, director or shareholder, past or present, of a financial institution and obtain information relating to the same. The BOU also exercises its supervisory role by prescribing the minimum reserves, controlling credit and at times investment rates and inspecting the books of accounts of all FIs in accordance with the FIA.

d) Restriction on Trade and Investment

The FIA requires prior approval of the Central Bank for FIs to make certain credits and guarantees. For example, approval is required when a financial institution fails to maintain the minimum amount of liquid assets. A financial institution is also prohibited from engaging in trade, commerce, industry, insurance or agriculture except in the course of satisfaction of its debts and in which case all such activities should be disposed of as soon as possible.

A FI should not acquire or hold shares in enterprises engaged in trade, commerce, industry or agriculture in excess of 25% of its core capital except in the course of satisfying its debts. The FIA prohibits financial institutions from purchasing or acquiring immovable property except as it may be necessary for conducting its business or housing staff in which case the cost of the property should not exceed 100% of the financial institution's core capital.

But a financial institution may secure a loan with immovable property and sell the same on default of payment. Contravention of the above requirements attracts a civil penalty fine payable to the Central Bank.

See the 2010 Foreign exchange Regulations restricting Foreign exchange business by FIs to B.O.U. approval

e) Corporate Governance (Part VII of the FIA, 2004)

This covers the overall environment in which the financial institution operates, comprising a system of checks and balances which promotes a healthy balancing of risk and return, and for a financial institution which conducts Islamic Financial business, which promotes compliance with the Shari'ah. (See S.55 of the FIA as amended by S.18 of the Financial Institutions (Amendment) Act, 2016. It includes laws, policies and procedures applied by an organisation.

Every financial institution must have a board of directors of not less than five Directors, headed by a Chairperson who shall be a non-executive director. Not more than fifty percent of the directors of the financial institution should be employees of the financial institution or any of its subsidiaries or affiliates except where the Central Bank is satisfied that all those directors who are employees have been deemed fit and proper to be directors of a financial institution by the home country regulator of the financial institution. No person who is not a fit and proper person in accordance with the fit and proper test specified in the Third Schedule shall become or remain a director of a financial institution, unless vetted by the Central Bank. Vetting could be through suspension or removal. Where the Central Bank removes or suspends the whole board of directors; or removes any directors from the board and as a result of the removal the number of board members falls below the minimum prescribed in the FIA, the Central Bank must immediately assume the powers of the board of directors and within 14 days summon a meeting of the shareholders for the purpose of electing a new board of directors, which shall be required to satisfy the provisions of the FIA relating to the appointment of directors.

For a person to be fit to become a director of a FI,

- (a) he or she is above eighteen years of age;
- (b) he or she is of sound mind and has not been declared to be of unsound mind by any court of law in Uganda or elsewhere;
- (c) he or she is not an undischarged bankrupt;
- (d) he or she is a natural person;
- (e) the financial institution has served a written notice on the Central Bank of its nomination of that person to become a director; and
- (f) the Central Bank has given a written approval of his or her compliance with the fit and proper persons test.

- Every financial institution should have internal and external auditors suitably qualified and experienced in banking who shall report to the committee on audit of the board of directors. The external auditor must be approved by the BOU. The duties of the internal auditor are: to evaluate the reliability of the information produced by accounting and computer systems; (b) to provide an independent appraisal function; (c) to evaluate the effectiveness, efficiency and economy of operations; (e) to evaluate compliance with laws, policies and operating instructions; (e) to provide investigative services to line management; and (f) to certify returns submitted to the Central Bank by the financial institution.

- On the other hand, an external auditor must inform the Central Bank if there are reasonable grounds to believe that—(a) the financial institution is insolvent, or there is a significant risk that the financial institution will become insolvent; or (b) the financial institution has contravened a—(i) a prudential standard, (ii) a requirement in FIA, regulation, notice or directive issued under this Act; or (iii) a condition imposed on its license. (2) The external auditor shall verify all quarterly returns and other reports of the financial institution which the Central Bank may from time to time require to be verified. (3) The external auditor shall submit to the Central Bank a management letter in which they shall disclose all shortcomings or any contravention of the law which may not be sufficiently fundamental to lead to qualification of the accounts.

f) Seizure, Reorganization and Liquidation in extreme cases

If the Central Bank warns a financial institution to stop conducting its business in a manner which is risky or detrimental to the interests of the depositors, its own interests or in contravention of the law or which has refused to submit to inspection and the institution fails to comply, the Central Bank may appoint a suitably qualified person to manage the affairs of that institution for purpose of rectifying the problem.

The Central Bank may take over the management and control of a financial institution if;-

- It is conducting business in a manner contrary to the provisions of the FIA or the interests of the depositors;
- It refuses to submit itself to inspection by the Central Bank as required;
- Its licence has been revoked;
- It is engaged in or is knowingly facilitating criminal activities.

On such take over, the public should be informed. The Central Bank on seizure of the institution may close or sell it, re-organise or liquidate it as it may deem necessary. Lastly, no financial institution is allowed to be wound up or be liquidated except by the Central Bank or its authorized agent or with prior approval of the Central Bank under voluntary liquidation.

g) Control of Mergers and Transfer of Shares

The FIA prohibits a financial institution from amalgamating, consolidating or reconstructing with or being taken over by any other company without the prior approval of the Central Bank.

h) Alteration of name, memorandum and articles of association of a financial institution

- A financial institution is not allowed to alter its memorandum or articles of association or change its registered name without prior written approval of the Central Bank. Any alterations or change made or registered in contravention of this requirement shall have no legal force.
- The application for approval should be lodged with the Central Bank before the proposed special resolution is laid before a general meeting of the company and it should be accompanied by the following:
 - 2 copies of the proposed special resolution; and
 - An explanation of the reasons for the resolution.
- The Central Bank has power to reject the application if in its opinion the proposed alteration contradicts the FIA or is undesirable as far as the activities of the applicant are concerned.
- If the application is allowed, the registered resolution should be returned to the Central Bank for registration on payment of the prescribed fees.
- The Central Bank then issues the financial institution in question with a certificate.
- But the Central Bank also has power to direct a financial institution to alter its memorandum or articles in order to remove anomalies or undesirable divergences in the activities of different financial institutions.
- If a financial institution fails to comply with the direction, the Central Bank may submit a copy of that direction to the registrar of companies who then deals with it as if it had been contained in a resolution.

REGULATION OF FOREIGN EXCHANGE BUSINESS IN UGANDA

Law Applicable:

- The Foreign Exchange Act, (FEA) 2004
- The Foreign Exchange (Forex Bureaus and Money Remittance) Regulations, 2006
- The Foreign Exchange (Amendment) Act, 2023

According to the FEA 2004, Forex Exchange Bureau is defined as a person holding a license issued by the Bank of Uganda to engage in the business of foreign exchange. **Foreign Exchange business** is defined by the FEA 2004 as amended in 2023 to mean the business of physical or virtual buying and selling of foreign currency. The FEA makes it an offence to deal in foreign exchange business without a license issued by the Central Bank.

A license is obtained by applying in writing and the applicant must meet the following requirement;

- (a) Must be a Company registered under the Company's Act, 2012 or any other Act of Parliament as a limited liability Company whose main objective is provision of foreign exchange services. Single member companies are not allowed to apply for this license because the Applicant must have a minimum of two (2) shareholders.
- (b) Must have a minimum paid up share capital of ushs. 50,000,000/= (Fifty million) as per the FEA (Amendment) Act, 2023.
- (c) Must have a fixed and identifiable place of business that is accessible to the public and suitable for the business of a forex bureau.
- (d) If owned by a bank, it must be registered as a wholly owned subsidiary of that bank.
- (e) Name and full address of the proposed forex bureau.
- (f) Must provide the names of the shareholders and the proposed management team who must be persons of good repute and integrity with the necessary qualifications and competence.

The application must be accompanied by the following;

- (i) Memorandum and articles of association plus a certificate of incorporation.
- (ii) Individual references respecting as to whether to the fitness and proper status of each of the applicant's shareholders and proposed directors.
- (iii) A certified copy of the resolution of the applicant authorizing the submission of the application.
- (iv) Names and C.Vs of all the applicants proposed shareholders and management team.
- (v) Work permits for non-Ugandan employees of the applicant.
- (vi) Business and financial plans of the applicant.
- (vii) The Applicant's Personal Data Protection Policy and Certificate of registration with the Personal Data Protection Office (PDPO)
- (viii) The Anti-Money Laundering & Countering the Financing of Terrorism (AML&CFT) Policy and Certificate of registration with the Financial Intelligence Authority (FIA)
- (ix) Any other information required by the Central Bank.

The decision to grant or reject the application should be made and communicated to the applicant within a period of 3 months from the date of receipt of the application. If granted, the license remains valid unless suspended or revoked (See the 2023 amendment). This license may be suspended or revoked if the Central bank has reasonable cause to believe that it's holder has infringed the provisions of the Act (FEA) or regulations made there under. A license may be revoked if the holder;

- does not commence business within 3 months;
- has failed to disclose material information of which it was aware or should have been aware with the exercise of reasonable diligence;
- has provided false information which is material to the application;
- has contravened the provisions of the FEA or any regulations made there under, permission, instruction or direction made by the Central Bank;
- has ceased to qualify for the license
- Is guilty of a malpractice or irregularity in the management of it's affairs; or
- Is placed under liquidation or receivership.

NOTE

1. The Regulations exempt banks licensed under the FIA, 2004 from the provisions of the Act and the regulations. The Central Bank also has powers to exempt any person from these provisions. The Government may require a Bank or a forex bureau to obtain prior permission from the Government before executing any foreign exchange deal if it has reason to believe that the law will be contravened by the transaction.
2. However, according to the Financial Institutions (Foreign Exchange Business) Rules, 2010, banks are required to obtain a separate license from the Central Bank in order to conduct foreign exchange business legally.

CUSTOMERS' DUTIES

1. The customer must provide to the forex bureau information on the source or purpose of the foreign exchange transaction;
2. The customer must ensure that the source or purpose of the funds indicated on the official Bank of Uganda receipt is correctly and accurately stated.
3. A customer must always demand for and obtain an official Bank of Uganda receipt or any other receipt approved by the Bank of Uganda for every foreign exchange related transaction.

DUTIES OF THE FOREX BUREAUS

1. To promptly report any suspicious transaction to the Bank of Uganda and to a law enforcement authority.
2. To display prominently, its current buying and selling exchange rates of foreign currency including all commissions and charges associated with each transaction.
3. To prominently display, at all times, in a conspicuous place on its premise, a notice informing its customers that they are entitled to be issued with a receipt for any purchase or sale of foreign currency made by and to them;
4. To display to the public, at its premises, a valid licence issued by the Bank of Uganda.
5. To issue an official receipt for every transaction concluded
6. To ensure that all transactions are done and maintained in the strictest confidence.
7. To cross check and satisfy itself that notes exchanged are legal tender and a transaction is deemed to be concluded at the counter.
8. To seize all counterfeit notes and other instruments presented by a customer and to issue the customer with a receipt indicating the serial number of the counterfeit notes. The counterfeit notes or instruments should be submitted to the Bank of Uganda, and under no circumstances should the forged items be returned to the customer. Where the customer refuses to surrender counterfeit notes, the licensee should notify the police. A person aggrieved by any decision of the forex Bureau may report to the Bank of Uganda.

CREDIT REFERENCE BUREAU

- What it is- Database for credit status information about borrowers from FIs and related service providers eg MDIs, MFIs, credit institutions, money lenders, Insurance companies, etc
- The information is collected by subscribing institutions & submitted to the CRB electronically
- Subscription- how? –What kind of information is captured by CRB?
 - Identity data- Name, Gender, Residence, Age, Occupation, mobile phone, e-mail, P. O. Box no., physical address, NIN, TIN. Marital status, no. of children, dependants, etc
 - Income Data: Employer, location, duration, income band (5-10m)
 - Credit data: present & past Loans, loan status- granted, rejected/deferred, pending Applications plus reasons, loans in arrears, written off, collateral/security for the loans & value, mortgages on the collateral
 - Alive or dead
- A subscribing institution gains access to the customer's data with CRB
- Every subscribing institution must have a CRB officer – why?
- A registered/subscribed customer does not have automatic access except on Application & payment of a minimal fee – gets a print report

DEPOSIT PROTECTION FUND (DPF)

- Provided for and established under Part XII (Sections 108-111) of the FIA, 2004 and Section 80 of the MDI Act. It is now one DPF for FIs and MDIs
- Established to offer a form of insurance to the depositor's money up to a tune that shall be prescribed by the Central Bank from time to time. Currently it is Ugx 10 million
- Contributions to the Fund is made by all licensed institutions annually and the Central Bank may increase the amount of contribution for a particular institution whose operations are pointing towards collapsing in the near future
- Protected deposits are the customer's credit balances at the FI or MDI which is recoverable upon closure of the regulated institution.
- Preconditions for DPF to pay the customer: (1) The customer must have had an account in the collapsed institution (2) Customer must have had a credit balance (3) Identification (4) proof of entitlement (5) proof of legality of the process of accumulating/acquiring the credit balances (6) If the closing institution cannot meet its financial obligations to the customers
- Circumstances under which the customer may be denied payment: participation in the activities or events leading to the institutional collapse

NATIONAL PAYMENT SYSTEMS

- Payment Systems are defined as (check the National Payment Systems Act and Regulations)
- There are different licenses issued under this Act
 1. Payment system
 2. Payment system
 3. Sandbox
 4. Examples include VISA, Inter-switch, Mastercard, mobile money platforms, EFT & RTGS, etc
- They are regulated by the Central Bank under the National Payment Systems Act, 2020 and the 2021 Regulations
- The law was intended to provide for the safety and efficiency of payment systems which is one of the major concerns of banks and their customers in electronic payments and banking.
- The law provides for the functions of the central bank as the regulator of banks, in relation to payment systems.
- The law prescribes the rules governing oversights in payment systems, which is an area that needed to be strictly regulated.
- It provides for protection of payment systems and this covers banks' payment systems;
- It provides for financial collateral arrangements to regulate payment service providers which include banks.
- It also regulates the issuance of electronic money which could now me more than the cash money handled by banks.
- This law also provides for the oversight of payment instruments and for other related matters which concerns banks as issuers of payment instruments such as VISA, Credit, Debit and other Cards.
- Protects the consumer/bank customers by prescribing stringent regulatory procedures and well as some degree of customer controls over initiated electronic payments eg the requirement for the licensees to provide reversal mechanisms in case of an erroneous mobile money payment