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# The Role of the Central Bank in Financial Distress Management and Resolution in Developing Economies

Hamiisi Junior Nsubuga\*

## Abstract

A decade following the 2007 – 2008 financial crisis, jurisdictions have responded through legislative and policy reforms. However, the role and effectiveness of the central bank in financial distress management and resolution in developing economies has faced increased scrutiny. This treatise analyses the need for an accountable, effective and independent central bank to steer the economy through socio-economic and financial policies.

## Introduction

The financial crisis of 2007 / 2008 instigated a paradigmatic shift in the approaches that nations adopt in designing or enacting legislation and corresponding policies and processes that deal with corporate insolvencies.<sup>1</sup> While developed economies such as the United Kingdom (UK) and the United States of America (USA) have implemented reforms to their corporate insolvency laws and processes as a response to this crisis, other developing or emerging economies have also followed suit.<sup>2</sup>

Although this crisis and the sovereign debt that ensued are thought to have been caused by considerable macroeconomic imbalances precipitated by uncontrolled borrowing and unproductive spending, these crises were to a larger extent exacerbated by institutional

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<sup>1</sup> D. Burdette, R. Parry and A. Walters, "The Global Financial Crisis and the Call for Reform of Insolvency Law Systems" (2012) 4(1) *Int. Insol. Rev.* 13; B. Moro, "Lessons from the European Economic and Financial Great Crisis: A Survey" (2014) 34 *Eur. J. Pol. Econ.* 59.

<sup>2</sup> See for example, M. Prochniak and K. Wasiak, "The Impact of the Financial Systems on Economic Growth in the Context of the Global Crisis: Empirical Evidence for the EU and OECD Countries" (2017) 44 *Empirica* 295 - 337.

weaknesses.<sup>3</sup> It is envisaged that the roles independent central banks ought to have played, such as devising and enforcing efficient monetary policies and frameworks to regulate the financial sectors were largely disregarded. These policies and frameworks would have informed stricter financial regulations, economic forecasts and reforms that would have led to financial and economic stability.<sup>4</sup>

Apart from sovereign states, other agencies, such as the United Nations (UN) also responded to this crisis. For example, in September 2015, the 193 Member States of the UN adopted 17 Sustainable Development Goals (SDGs) as a master-plan to foster sustainable development to be achieved by 2030.<sup>5</sup> Among these is SDG 16 – Peace, Justice and Strong Institutions.<sup>6</sup> SDG 16 has twelve targets that it aims to achieve which include target 16.6 – Developing Effective, Accountable and Transparent Institutions at all levels.<sup>7</sup> However, when discourses are invoked on effective, accountable and transparent institutions, much regard is accorded institutions such as the judiciary or the parliament. Less regard is accorded financial institutions such as the central bank and its role in a given jurisdiction yet the central bank is a key institution that facilitates and promotes economic growth and development through economic and monetary policies.

This treatise analyses the need for an accountable, effective and independent central bank in developing economies and its role in streamlining the economy through efficient socio-

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<sup>3</sup> D. Acemoglu et al, "When Does Policy Reform Work? The Case of Central Bank Independence" (2008) *Brookings Papers on Economic Activity*, 351, 417.

<sup>4</sup> D. Bursian and E. Faia, "Trust in the Monetary Authority" (2018) 98 *Journal of Monetary Economics*, 66 – 79.

<sup>5</sup> United Nations, "Sustainable Development Goals 2030", <<https://www.un.org/sustainabledevelopment/sustainable-development-goals/>> ; see also, United Nations, "Transforming Our World" <[Transforming Our World: the 2030 Agenda for Sustainable Development](https://www.un.org/sustainabledevelopment/transforming-our-world/)> (accessed November 2019).

<sup>6</sup> The United Nations, Sustainable Development Goal 16, at <<https://www.un.org/sustainabledevelopment/peace-justice/>> (accessed November 2019).

<sup>7</sup> Ibid, (target 16.6).

economic, monetary and financial policies. These are the policies that guide and regulate the financial system to guard against potential financial and economic crises by providing a framework through which financial risks are sufficiently dealt with to avoid financial crises. A case study of the recent collapse of Crane Bank Ltd in Uganda (as a developing economy) is undertaken to highlight the relevance of an independent central bank in a developing economy and its role in financial distress management and resolution.

### **The Need for an Independent Central Bank**

Proponents of economic theory are of the view that an independent central bank is better placed to deal with monetary and financial policy imperatives such as maintaining inflationary fluctuations than a central bank whose independence is dictated by political influence from national governments or other institutions.<sup>8</sup> In developing economies, there is a need to reconceptualise the idea that a central bank is a " crisis response" institution rather than a regulatory and supervisory institution. Central banks supervise and regulate commercial banks and other financial institutions and their dealings with consumers in these jurisdictions. Therefore, central banks' independence is paramount to a well-functioning financial system.<sup>9</sup>

Where a central bank is independent, principles such as openness and transparency may be attained which are key to enforcing financial and commercial morality, which in turn enhance public trust.<sup>10</sup> It should be noted that one of the consequences of the 2007 / 2008 financial crisis was the public loss of confidence and trust in banks and financial institutions. One way

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<sup>8</sup> I. Iwasaki and A. Uegaki, "Central Bank Independence and Inflation in Transition Economies: A Comparative Meta-Analysis with Developed and Developing Economies" (2015) RRC Working Paper No. 55; A.C. Garriga, "Central Bank Independence in the World – A New Dataset" (2016) 42 *International Interactions*, 849, 868.

<sup>9</sup> U. Malmendier and S. Nagel, "Learning from Inflationary Experiences" (2016) 131 *The Quarterly Journal of Economics* 53, 87.

<sup>10</sup> A. S. Blinder, "Central Banking in a Democracy" (1996) 82 *Federal Reserve Bank of Richmond Quarterly*, 12.

of winning back the trust and confidence lost is through improved accountability and openness.<sup>11</sup>

The central bank should openly disclose and explain its financial and monetary policies to consumers and the public in general, as public accountability is corollary of central bank's independence. Moreover, the dictates of democracy in society imply an obligation onto the central bank to hold itself accountable to the public.<sup>12</sup> This would ensure that the public is well apprised of the key policies of the central bank and a basic knowledge of issues such as inflation or interest rates which may boost trust that forms part of the success and independence of the central bank.<sup>13</sup>

### **Streamlining the Financial System: The Role of the Central Bank**

The availability of a coherent financial system and access to financial services within a given jurisdiction may incentivise individuals and business owners to efficiently plan, manage and balance their income and expenses, manage current and projected financial and business risks to enhance business growth and productivity.<sup>14</sup> This may not only lead to investment in their businesses, but also to the development of human and physical capital.

Financial services availability may also serve as an intermediation that encourages and promotes easy access to financial credit for start-up capital or business improvement.<sup>15</sup> It may also lead to a reduction in the cost of credit, which has the benefit of overall reduced transactions cost of loan capital or credit, which makes the financial economy more

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<sup>11</sup> Ibid.

<sup>12</sup> B. Braun and L. Hoffmann- Axthelm, "Two Sides of the Same Coin? Independence and Accountability of the European Central Bank" (2017) *Transparency International*, 4.

<sup>13</sup> Ibid.

<sup>14</sup> Thorsten Beck, et al, "Finance, Firm Size and Growth" (2008) (40) *Journal of Money, Credit and Banking*, 1380.

<sup>15</sup> M. Prochniak & K. Wasiak, "The Impact of Financial Systems on Economic Growth in the Context of the Global Crisis: Empirical Evidence for the EU and OECD Countries" (2017) (44) *Empirica*, 295 – 337.

competitive.<sup>16</sup> Moreover, encouraging the emergence of new business support for the growth of existing businesses and supporting and encouraging business owners to save and invest to accelerate economic growth are some of the key characteristics of a well-functioning financial system.<sup>17</sup>

However, to achieve these objectives in a financial system, there must be strong coherence to the rule of law, such as the rules that establish, enforce and regulate strategic relationships, such as the financial – consumer relationships in that financial system. Incoherence to these rules by actors in the financial system may lead to unregulated financial practices and arbitrary enforcement of the rules or policies which may impact the functioning of the financial system. Therefore, the main responsibility of streamlining a country's financial system is entrusted with the central bank, by extending its powers and responsibilities established through the rule of law enshrined in legislation that set out first; for its establishment and second; its supervisory and regulatory duties over the financial system.

### **The Central Bank of Uganda – A Case Study**

Uganda is one of the developing economies in Sub-Saharan Africa<sup>18</sup> that responded to the 2007 /2008 financial crisis through changes to its corporate and insolvency laws and processes in a bid to guard against subsequent financial crises.<sup>19</sup> The 2007/ 2008 crisis did not

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<sup>16</sup> L. J. Ezzo, "Re-examining the Finance-Growth Nexus: Structural Break, Threshold Cointegration and Causality Evidence from the ECOWAS" (2010) (35) *J. Econ. Dev.* 57–80.

<sup>17</sup> Ibid.

<sup>18</sup> According to the World Bank, Uganda is one of the fifty-eight countries that make up Sub-Saharan Africa and rated as a developing country. <<https://data.worldbank.org/region/sub-saharan-africa>> (accessed December 2019).

<sup>19</sup> C. Nyombi, A. Kibandama & D. Bakibinga, "The Motivation Behind Uganda's Insolvency Act 2011" (2014) (8) *J. B. L.* 651, 666; C. Nyombi, "The Development of Corporate Rescue Laws in Uganda and UK" (2015) (57) (2) *International Journal of Law and Management* 214.

only affect main-stream private companies but also affected commercial banks and other financial institutions.

The central bank of Uganda has the mandate to supervise and regulate all operations of commercial and financial institutions in the country.<sup>20</sup> This mandate is enshrined in legislation such as the Bank of Uganda Act 1969, the Bank of Uganda Act 2000, the Financial Institutions Act 2004, the Financial Institutions (Amendment) Act 2016, the Micro Deposit Taking Institutions Act 2003 and the Tier 4 Microfinance Institutions Money Lenders Act 2016.<sup>21</sup> However, the central bank has recently been the subject of scrutiny in its intervention with the financial difficulties of Crane Bank (Uganda), especially, the choice of intervention model taken, as discussed below.

### **The Collapse of Crane Bank and its Aftermath**

Crane Bank was a registered commercial bank in Uganda under the supervision of the central bank of Uganda. Prior to its financial demise in 2016, the bank had over 750,000 customers with several branches nationwide and branches in Rwanda, a Member State of the East African Community (EAC). However, towards the end of 2015, reports in the media were circulating regarding the financial difficulties the bank was experiencing.<sup>22</sup> On 20 October 2016, Crane Bank was officially taken over by the central bank via a corrective action courtesy of the Financial Institutions Act 2004 (FIA 2004).<sup>23</sup>

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<sup>20</sup> These institutions include but not limited to commercial banks, credit institutions, micro finance deposit taking institutions (MDIs) and forex bureaus.

<sup>21</sup> These Acts of Parliament and other operational regulations are listed on the Bank of Uganda website, <<https://www.bou.or.ug/bou/bouwebsite/Supervision/>> (accessed December 2019).

<sup>22</sup> B. Busulwa, "How DFCU Beat Others Bidders in the Race to Acquire Uganda's Crane Bank", *The East African*, (Kenya, 6 February 2017). <<https://www.theeastafrican.co.ke/business/How-DFCU-won-bid-acquire-Uganda-Crane-Bank-/2560-3801860-format-xhtml-lisgu8z/index.html>> (accessed December 2019).

<sup>23</sup> B. Busulwa, "Uganda's Central Bank Takes Control over Crane Bank" *The East African*, (Kenya, 20 October 2016), <<https://www.theeastafrican.co.ke/business/Uganda-central-bank-takes-control-of-Crane-Bank/2560-3423876-108c3voz/index.html>> (accessed December 2019).

At the Annual Bankers' Conference held in Kampala, Uganda, on 17 July 2018, organised by the Uganda Bankers' Association,<sup>24</sup> the governor of the central bank in his address to the delegates reiterated why the central bank had to takeover Crane Bank and the rationale for the rapid sale of its assets to another bank – the DFCU Bank.<sup>25</sup>

The governor emphasised that “the transformation of financial services was changing the risks facing financial institutions and financial markets.”<sup>26</sup> The governor admitted that as a regulator, the primary objectives of the central bank are mainly: to protect the interests of depositors and to ensure overall stability of the financial systems through prudential regulations and supervision of deposit-taking institutions.<sup>27</sup> He further reiterated that “the central bank sought to enhance public confidence in the financial system thereby fostering financial intermediation and limiting the harmful effects of systemic crises”.<sup>28</sup>

However, most interestingly, the governor stressed that the central bank “has no obligation to bail out a distressed bank by providing it with liquidity support with the hope that it will somehow be restored to financial health.”<sup>29</sup> The rationale given in support of this statement was that if the central bank was to bail out a distressed bank through liquidity support, it would allow the distressed bank to continue being mismanaged in the same manner that caused it to become distressed.

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<sup>24</sup> Uganda Bankers' Association is an umbrella body established in 1981 comprising of commercial banks, Uganda Development Bank and other non-bank financial institutions licensed and supervised by the central bank of Uganda.<[www.ugandabankers.org](http://www.ugandabankers.org)>.

<sup>25</sup> T. Mutebile, “Why We Had to Take Over Crane Bank” *New Vision*, (Uganda, 17 July 2018) <[https://www.newvision.co.ug/new\\_vision/news/1481579/crane-bank-mutebile](https://www.newvision.co.ug/new_vision/news/1481579/crane-bank-mutebile)> (accessed December 2019); See also, the Governor's Speech at the UBA Conference 17 July 2018, <[http://www.sunrise.ug/wp-content/uploads/2018/07/UBA-Bankers-Conference-2018\\_17.7.2018.pdf](http://www.sunrise.ug/wp-content/uploads/2018/07/UBA-Bankers-Conference-2018_17.7.2018.pdf)> (accessed December 2019).

<sup>26</sup> *Ibid*, 2.

<sup>27</sup> *Ibid*, 3, para. 3.

<sup>28</sup> *Ibid*.

<sup>29</sup> *Ibid*, 6, Para. 2.

However, this statement may be interpreted as a misconception (from a regulator's point of view). It may be argued that this statement was made by the governor with no regard to the principles of insolvency law, whose main policy objective is to support the rescue of financially struggling corporations and financial institutions, rather than outright piecemeal liquidation of these entities. Supporting financially struggling companies or institutions with liquidity or financial support may be one of the options adopted by the legal system (the state) as a rehabilitative response.<sup>30</sup>

### **Choice of Intervention Model: The (FIA 2004) vs Insolvency Act (2011)**

The FIA (2004) provides for several resolutions that may be adopted by the central bank in dealing with financially distressed institutions. For example, FIA 2004 provides for corrective action to be taken by the central bank in relation to distressed financial institutions where it deems it necessary to safeguard extant stakeholder interests and the financial system at large.<sup>31</sup> Under corrective action, the central bank may sell the financially distressed institution as a going concern, merge it with another financial institution, subject it to a 'Purchase of Assets and Assumption of Liability' (P&A) transaction, or liquidate the distressed institution.<sup>32</sup>

FIA 2004 also affords the central bank power to take over the management through the appointment of a special manager to oversee the operational duties of the distressed institution.<sup>33</sup> However, FIA 2004 also has provisions that are somewhat aligned to the

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<sup>30</sup> See for example; Hamiisi J. Nsubuga, "The Interpretative Approach to Bankruptcy Law: Remedying the Theoretical Limitations in the Traditionalist and the Proceduralist Perspectives on Corporate Insolvency" (2018) 60 (3) *International Journal of Law and Management*, 824-841, where I analyze the theoretical arguments between the Traditionalist and Proceduralist perspectives on the role that a State ought to play in rescuing financially struggling companies.

<sup>31</sup> FIA 2004, Part IX, s.82 – s.93.

<sup>32</sup> FIA 2004, s.89(1) + (2).

<sup>33</sup> FIA 2004, s.88.

rehabilitation or rescue of the financially struggling institutions. For example, the Act provides for the central bank, upon taking over the management of the distressed institution to employ necessary staff<sup>34</sup> to reorganize or liquidate the distressed institution<sup>35</sup> or to appoint a person to be known as a 'statutory manager' to manage, control and direct the affairs of the distressed institution.<sup>36</sup>

#### **FIA 2004 Model: Rescue or Liquidation?**

The FIA 2004, under s.89 (2), prescribes a rescue approach to financially struggling institutions whereby if invoked, and adopted by the central bank, the main purpose of the intervention would be the rescue of bank / financial institution, rather than a piecemeal sale of assets followed by liquidation. With this approach, the financially struggling institution could be rehabilitated.<sup>37</sup> This would not only boost confidence in the financial system but improve access to financial credit and financial services to consumers.<sup>38</sup>

However, it may also be argued that the central bank's main policy objectives in invoking corrective actions against distressed banks and financial institutions is mainly to liquidate but not rehabilitate and rescue these failed banks as going concerns. Inadvertently, the central bank opted to utilize a 'purchase of assets and assumption of liability' (P&A) transaction as the most viable option in dealing with Crane Bank's financial difficulties which is not a rehabilitative option but an option geared towards liquidation. Although this option carries the advantage of transferring substantial parts of the failed financial institution including all

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<sup>34</sup> FIA 2004, s.89 (2) (c).

<sup>35</sup> FIA 2004, s.89 (2) (f).

<sup>36</sup> FIA 2004, s.89 (2) (g).

<sup>37</sup> D. Asiimwe, "Report Indicts BOU for Illegal Closure of Banks" *The East African*, (Kenya, 22 September 2018). <<https://www.theeastafrican.co.ke/business/Report-indicts-BoU-for-illegal-closure-of-banks/2560-4772380-c1yot7z/index.html>> (accessed November 2019).

<sup>38</sup> Prochniak and Wasiak (n 15).

or most of its deposits and all or most parts of its book loans, this option is not geared toward rehabilitation of the distressed institution as a going concern but liquidation.

It is the contention that if the central bank opted for the powers afforded to it by the FIA 2004 under s.89 (2)(g) to appoint a statutory manager to manage, control and direct the affairs of distressed bank with the main policy objective of rescuing the bank as a going concern rather than a quick fire sale of the assets and assumption of liabilities, the rescue of the bank would arguably, have been possible. Under s.89 (2) (f) of FIA 2004, the central bank or the appointed statutory manager is afforded two options: either to reorganize or liquidate the financial institution in accordance with the Act.<sup>39</sup> The statutory manager would in this context be analogous to an insolvency practitioner whose main priority would be a first attempt at rescuing the distressed bank as a going concern as set out in the IA 2011.<sup>40</sup>

Very often, attempts to rescue an insolvent but viable company may involve strategies such as closing off underperforming sections or branches of the business or corporate restructuring or rebranding to minimize losses.<sup>41</sup> These rehabilitative options were not utilized by the central bank. It is the contention that if Crane Bank had been placed under administration, strategies such as closing off some underperforming branches nationwide to limit operational losses would have been an option. However, administration proceedings as established in IA 2011 were totally disregarded by the central bank and relied on the FIA 2004.

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<sup>39</sup> FIA 2004, s.89 (2) (f).

<sup>40</sup> IA 2011, s.140 (b) (i).

<sup>41</sup> Hamiisi J. Nsubuga, "Corporate Insolvency and Employment Protection – A Theoretical Perspective" (2016) 4 (1) *NIBLeJ* 221.

There is sense in the argument that financial difficulties of banks and financial institutions should not be approached in the same context as corporations. Therefore, a need for specific legislation such as the FIA. However, there is also sense in the argument that some of the key indicators of the central bank's independence and effectiveness, is the ability to utilize available laws established by the legal system to deal with legal issues and challenges. The central bank would therefore have adopted the IA 2011 were it offered better rescue prospects than the FIA 2004.

### **Intersection between FIA 2004 and IA 2011**

In a bid to reform its laws in the field of banking law, company law and insolvency law, the Ugandan government, in 2009 commissioned the Uganda Law Reform Commission (ULRC) to review these areas of the law and make recommendations on how they may be reformed to match international trends.<sup>42</sup>

Part of the reforms recommended by the ULRC's report was the introduction of a single statute to deal with and regulate the administration of corporate institutions undergoing financial difficulties.<sup>43</sup> This was to ensure that abusive practices during the administration of financially distressed companies would be minimised and overall reduction in the cost of proceedings. The ULRC also recommended that Uganda's corporate rescue processes (such as receivership and Deeds of arrangements) be reformed to boost the survival rates of financially struggling companies as these corporate rescue processes were modelled on the Bankruptcy Act 1931 which was over 80 years old.<sup>44</sup>

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<sup>42</sup> Nyombi et al, (n 19).

<sup>43</sup> Insolvency Bill 2009, Part iv and Sch.4

<sup>44</sup> Nyombi et al, (n 19).

These recommendations were adopted by the Ugandan Parliament and as a result, the IA 2011 was passed. Among the corporate rescue processes that the IA 2011 introduced was the administration procedure. The administration procedure was introduced as a measure to improve insolvency proceedings in financially struggling companies to boost survival rates as there were high liquidation rates of financially struggling companies premised on other rescue processes, such as receivership which were mainly geared towards liquidation rather than rehabilitation.<sup>45</sup>

A key feature of the administration procedure is that once formal insolvency proceedings are initiated, either through the resolution of the company's board of directors, (out of court route)<sup>46</sup> or via court order,<sup>47</sup> a moratorium is triggered. A moratorium is a statutory stay on all creditor enforcement actions or any legal proceedings against the company during the administration process.<sup>48</sup> The moratorium affords the financially struggling company time and protection to pursue its rehabilitation endeavours without interruptions from creditors.

Because the administration procedure was introduced by the IA 2011 to boost corporate rescue, the appointed administrator's main objective is to rescue the company as a going concern.<sup>49</sup> Other objectives include achieving the best outcome for creditors as whole than winding up<sup>50</sup> or realising property to distribute to one or more secured or preferential creditors.<sup>51</sup>

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<sup>45</sup> IA 2011, s.140.

<sup>46</sup> IA 2011, s.139 (i).

<sup>47</sup> IA 2011, s.139 (ii).

<sup>48</sup> IA 2011, s.139 (4); s.164.

<sup>49</sup> IA 2011, s.140 (b) (i).

<sup>50</sup> IA 2011, s. 140 (b) (ii).

<sup>51</sup> IA 2011, s.140 (b) (iii).

Moreover, the IA 2011 requires all insolvency practitioners such as administrators to be licenced practitioners and subject to a regulatory body which may guide and sanction practitioners in cases of professional misconduct.<sup>52</sup> In addition, the class or category of people allowed to register and work as professional insolvency practitioners must be members of professional bodies or organizations such as certified accountants, auditors or advocates.<sup>53</sup> This is to ensure fairness, honesty, transparency and compliance within the insolvency process and the financial system at large.

It was envisaged that having insolvency practitioners professionally regulated and subject to certain codes of practice and conduct would lead to compliance with the rule of law and combat abusive practices and arbitrary use of power in enforcing substantive interests by extant stakeholders on the one hand, and with the coordination of these enforcement processes by the insolvency practitioners on the other hand which was hostile to both private and public business sectors.<sup>54</sup>

From the above discussed objectives of the administration procedure, it may be argued that the main policy objectives of the IA 2011 is corporate rescue, that is; rescuing insolvent but viable companies as going concerns rather than a piecemeal sale of assets through the invocation of corrective action mandated by the FIA 2004. However, it is still a point of contention that in a majority of bank insolvencies administered by the central bank of Uganda, there was a blatant disregard of the IA 2011, which if utilized, might have offered better outcomes than those under the FIA 2004.

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<sup>52</sup> IA 2011, Part VIII.

<sup>53</sup> IA 2011, ss. 198 – 211.

<sup>54</sup> Nyombi et al, (n 19).

If indeed, the financial or insolvency policies of the central bank, and of the government at large were to promote the rescue of financially distressed but viable corporations / institutions as set out in IA 2011 rather than a quick fire sale of the insolvent banks' assets and eventual liquidation as witnessed under FIA 2004, the central bank ought to have taken over control of Crane bank and placed it under administration proceedings such that attempts at rescuing the bank as a going concern would be initiated.<sup>55</sup>

### **The Aftermath: Loss of Public Confidence and Trust and the Financial Sector**

Very often, the rules that coordinate and regulate financial services within a financial system arise out of statutory instruments such as Acts of Parliament passed to respond to certain situations prevalent in a given jurisdiction. However, although legislation may be passed to address certain challenges in a legal system, such legislation requires complimentary policies and procedures to ensure enforceability and compliance with the law to achieve the intended outcomes. Compliance with such legislation requires a two-way strand: that is, compliance from the enforcer of the law (for example the central bank) and compliance from institutions / consumers.

It may be noted that between 2010 - 2017 the central bank had intervened in five bank undergoing financial difficulties. However, out of the five banks, the central bank liquidated /closed off three banks outright and took-over the other two banks in temporary statutory management with the eventual outcome – liquidation.<sup>56</sup> These bank failings affected a majority of consumers, especially, those that had secured loans through collateralisation

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<sup>55</sup> Asiimwe, (n 37).

<sup>56</sup> Ibid.

such as land and business assets. They either lost their collateral or recuperated less due to insolvency law distributive rules.

In January 2017, the World Bank issued the 8<sup>th</sup> edition of Uganda's Economic Update.<sup>57</sup> Part one of this report analysed the recent economic developments and economic outlook with particular emphasis on dampening expectations for accelerated economic growth, risks abound and the key factors that will drive Uganda's growth acceleration.<sup>58</sup> Part two of the Economic Update analysed the deeper financial growth accelerators, the factors that constrain financial credit inclusion and exploratory options for closing the gaps in financial credit inclusion.<sup>59</sup>

This update reported that only 28 percent of Uganda's population held a bank account with a formal bank.<sup>60</sup> Although this was a big improvement from the 21 percent that was reported in 2011, this trend is indicative of the fact that a large population still has limited access to credit, savings and overall financial services from the formal financial sector which is a major concern. The report further indicated that Uganda's economic growth acceleration was lower than expected as the country's long standing deficiencies in physical infrastructure had not catalysed acceleration of private investment.<sup>61</sup>

In Uganda, a majority of businesses are either sole trade or small – medium sized enterprises (SMEs).<sup>62</sup> It is an accepted practice in this jurisdiction that the main source of securing start-

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<sup>57</sup> World Bank, *Uganda's Economic Update: Step by Step – Lets Solve the Finance Puzzle to Accelerate Growth and Shared Prosperity*, (7 February 2017). <<https://openknowledge.worldbank.org/handle/10986/26038?locale-attribute=en>> (accessed November 2019).

<sup>58</sup> Ibid, 15 – 18.

<sup>59</sup> Ibid, 35 – 41.

<sup>60</sup> Ibid, 34.

<sup>61</sup> World Bank (n 56), Foreword, (v).

<sup>62</sup> Joseph S. Lutwama, "Small and Medium Enterprises (smes) Financing in Uganda: Are Capital Markets a Viable Option?" *Capital Markets Authority Research*

up capital or business improvement credit is through collateralised bank loans.<sup>63</sup> However, bank failings have exacerbated the loss of public confidence in the banking and financial sectors. This has had the effect that a majority of business owners or those that seek access to financial services for start-up capital have either reverted to informal saving and investment practices, such as keeping their money (cash) at home or investing in livestock farming at a relatively low scale.<sup>64</sup>

In order to boost both private and public sector investment and financial inclusion, there is a need to strengthen the financial system of the country through the central bank to enhance faster investment, research and innovation. This may be in the form of 'business support through the rule of law.' Adherence to the rule of law to support business growth provides businesses and commercial enterprises with stability, consistency, good governance and accountability.<sup>65</sup> This is not only essential in reducing corporate financial risks but also promotes investment and accelerates economic growth.

## Conclusion

There have been attempts by the Ugandan government to liberalise the financial sector through the introduction of other financial institutions other than commercial banks to provide financial services and access to credit. This is in a bid to boost growth acceleration and economic efficiency. These financial institutions include for example, Microfinance Depository Institutions (MDIs), Savings and Credit Cooperative Organizations (SACCOs),

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[https://www.researchgate.net/publication/256010004\\_Small\\_Medium\\_Enterprises\\_Smes\\_Financing\\_in\\_Uganda\\_Are\\_Capital\\_Markets\\_a\\_Viable\\_Option](https://www.researchgate.net/publication/256010004_Small_Medium_Enterprises_Smes_Financing_in_Uganda_Are_Capital_Markets_a_Viable_Option) (accessed October 2019).

<sup>63</sup> Ibid.

<sup>64</sup> World Bank (n 56) 18.

<sup>65</sup> Michael Trebilcock and Ron Daniels, *The Rule of Law Reform and Economic Development*, (2008 Edward Elgar Publishing).

Pension Schemes, et cetera. However, although these financial institutions especially the SACCOs have a somewhat wider geographical scope, access and inclusion into these schemes is still a major concern.<sup>66</sup>

There is poor, albeit no public confidence in formal financial institutions largely attributed to financial crises and systemic banking failures over the years.<sup>67</sup> There has also been improved investment in Information and Communication Technology (ICT) in the country and across the East African region (EAC) through the introduction of Mobile Money Transfer Service, which has particularly improved commerce and financial transactions across the country and its borders.<sup>68</sup> However, this has also been constricted not only by the government taxes (charges) on all mobile money transactions across the country<sup>69</sup> but also, by a number of banking system setbacks such as the ever fluctuating and uncertain interest rates issued periodically by the central bank.<sup>70</sup>

Moreover, the recent introduction and wider usage of Mobile Money transfer services across the country has had the effect that a majority of the population prefer to keep their money via Mobile Money Service on their mobile accounts, accessed at any time rather than accessing financial services through Microfinance and SACCO institutions. Therefore, although these steps have been taken by the government, the underlying point of concern

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<sup>66</sup> Musa M. Lwanga and A. Adong, "A Pathway to Financial Inclusion – Mobile Money and Individual Savings in Uganda", *Economic Policy Research Series No.127*, (2016)

<<http://ageconsearch.umn.edu/bitstream/234553/2/127%20A%20pathway%20to%20financial%20inclusion%20-%20Mobile%20money%20and%20individual%20savings%20in%20Uganda.pdf>> (accessed November 2019).

<sup>67</sup> Rachel K. Sebudde, "In Uganda, greater financial inclusion is the key to unlocking rapid growth" (*World Bank*, 09 February 2017), <<http://blogs.worldbank.org/africacan/in-uganda-greater-financial-inclusion-is-the-key-to-unlocking-rapid-growth>> (accessed November 2017).

<sup>68</sup> Lwanga and Adong (n 66).

<sup>69</sup> Anna Ferracuti, "Understanding the Consequences of Mobile Money Taxes in Uganda" *United Nations Capital Development Fund* (Uganda, 29 August 2018 <<http://www.uncdf.org/article/3892/understanding-the-consequences-of-mobile-money-taxes-in-uganda>> (accessed November 2019).

<sup>70</sup> Lwanga and Adong (n 71).

still remains unsolved. The main actors in this regard, banks and financial institutions that provide access to credit, finance and financial services to consumers within the financial system are not efficiently regulated and supported by the central bank when they experience financial difficulties leading to accelerated liquidation. When these banks and financial institutions are liquidated not only consumers are affected but also the financial system as a whole which is the main driver of the country's economy.

There is therefore, a need to design an efficient financial and insolvency framework to guide banks and financial institutions within the financial system under the supervision of the central bank. A good financial or insolvency framework is not mainly to address corporate or institutional failure. It is also relevant to companies and financial institutions that are in a good solvent state. Such a framework would benefit banks and financial institutions in solvent states by setting out policies, strategies or guidance through which enhanced financial risk management and compliance with good financial practices may be maintained to inhibit potential or future financial crises.<sup>71</sup>

However, this requires the central bank to be independent and able to adopt relevant legislation to manage financial risks. Where needed, the Central Bank should be able to invoke the provisions in other relevant legislation within the legal system, such as the IA 2011, work with sector professionals, such as financiers and insolvency practitioners with particular financial management skills and expertise rather than being constricted by the dictates of specific legislation such as the FIA 2004 in dealing with banks and financial institution insolvencies.

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<sup>71</sup> L. Qi, "Managerial Model during Corporate Reorganization Period and their Governance Effects: The UK and US Perspective" (2008), *Company Lawyer*, 131.