THE SUPERVISORY MODEL THAT ZAMBIA HAS ADOPTED UNDER BANK OF ZAMBIA TO REGULATE FINANCIAL INSTITUTIONS IN PARTICULAR THE ZAMBIAN BANKS

By

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A dissertation submitted to the University of Zambia in Partial fulfillment of the requirements for the Award of the Bachelor of Laws (LLB) Degree.

UNZA 2011
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21/04/11  .....................................................

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ABSTRACT

There has recently been an enormous interest around the world in the organization of the structure of financial supervision. In the last few years, a number of industrialized countries have moved to integrate their different supervisory agencies of the banking, securities and insurance sectors in a single agency by application of what is known as the integrated model of financial supervision. These integrated agencies are referred to generically as integrated financial sector supervisory agencies (IFSSAs). On the other hand, the supervisory model that Zambia uses to regulate financial institutions is loosely referred to as the fragmented or sector-specific self regulation model. This model is one in which financial institutions are organized around, and supervised by specialist agencies.

Thus, the question that has been addressed is whether this model, adequately and effectively regulates the financial institutions, in particular the banks, in light of the country’s current needs such as the increasing complexity and growth of the financial sector in Zambia, the underlying integration of the financial markets and the emergence of financial conglomerates in Zambia, if any.

The first chapter gives an overview of the Zambian regulatory and supervisory framework since independence to date while highlighting some problems of this framework. The second chapter discusses what bank supervision and regulation entails while pointing out that the objective of supervision is to promote a safe, sound and efficient financial system which is necessary for effective financial intermediation to take place and to promote confidence in the financial sector. Also, the challenges and constraints that the Bank of Zambia faces in its supervisory role such as political pressure and interference, human and monetary capital have been highlighted.

The third chapter basically examines the legal framework for banking supervision and regulation in Zambia. The fourth chapter discusses the fragmented and integrated models of supervision. Further, it has established that Zambia’s supervisory model is well suited to the country’s current needs such as the increasing complexity and the rise of financial business in that the current regulatory framework has performed relatively well since 2000 owing to reforms in banking law and regulations.

The last chapter sums up the findings of the research which are that, the fragmented model of supervision has been adequate and efficient in as far as regulation and supervision of the
financial sector, in particular the banks is concerned. It goes on, however, to recommend several changes to this model so as to strengthen it. These involve institutional changes, particularly to the Bank of Zambia; funding to Bank of Zambia by Parliament under budgetary allocation; law reform by expediting the enactment of the draft Depositors Protection Bill into law, providing a definition for ‘unsafe and unsound’ bank practices and amendment to the BFSA by clearly delineating the extent to which banks can engage in activities on various financial markets; strengthening financial and prudential regulation in compliance with International Standards.
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DEDICATION

To my parents, Mr and Mrs Ernest C. Mwansa, my pillar of strength, my mentors not only with regards to my school, but in life.
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The BFSA (Amendment) Act of 2000 Act No. 18 of 2000
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<td>Financial Services Authority</td>
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CHAPTER ONE

AN OVERVIEW OF THE ZAMBIAN REGULATORY AND SUPERVISORY FRAMEWORK

1.1 INTRODUCTION

The Zambian financial sector has experienced remarkable growth since independence. This growth has attracted financial reforms that have been aimed at strengthening the regulatory and supervisory framework of the banking system and improving efficiency of the financial sector as a whole. However, these reforms have been dictated by the prevailing political and economic environment. Thus, the focus of this chapter is to give a background of the banking sector and to show how the political and economic environment have influenced Bank of Zambia’s regulatory and supervisory practices between 1970 to date. It will also deal with the basic aspects of the research. These include the statement of the problem, significance of the study, its objectives, research hypothesis and methodology.

The Zambian financial system is made up of the central bank, the Bank of Zambia (BOZ) which is the regulatory and supervisory authority, commercial banks and numerous non-bank financial institutions. BOZ was established by BOZ Act No. 43 of 1996.1 In accordance thereof, BOZ is empowered to formulate and implement monetary and supervisory policies.2 The main objective of monetary policy in Zambia is to ensure the maintenance of price stability in order to promote balanced macroeconomic development while the main objective of supervisory policy which is particularly targeted towards the banks and financial institutions entails licensing, supervision and regulation so as to promote price and financial system stability.3

1.2 A BRIEF BACKGROUND OF THE BANKING SECTOR BETWEEN 1970 TO DATE

In the period between 1970 and the early 1990s, the banking sector consisted of four distinct groups - old foreign banks, state banks, new foreign banks and the local banks. Three of the

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1 A successor Act of the 1985 BOZ Act
2 Section 4 of the Bank of Zambia Act, Chapter 360 of the Laws of Zambia
major banks which were foreign, Barclays Bank, Standard Chartered Bank and Grindlays Bank (now Stanbic Bank) were concerned with serving the interests of foreign corporate entities. In order to meet the needs of the local population and redress this imbalance, the government established a number banks such as the National Savings and Credit Bank (Natsave), Zambia National Commercial Bank (now ZANACO), Lima Bank and Cooperative Bank.

Government further intervened in the financial sector by establishing government owned non-bank financial institutions (NBFI), the most notable being the Zambia National Building Society (ZNBS) and the Zambia National Provident Fund (ZNPF) which, until the early 1990’s, provided long term mortgage finance and social security services respectively.

As the Zambian economy was state controlled, the primary role of the central bank particularly during the 1970s and 1980s, was to ensure that banks complied with the policies formulated by the government. Government involvement in the financial sector was manifest through the creation of government owned financial institutions, selective credit allocation directives and price control mechanisms. This interference resulted in the absence of an appropriate regulatory and supervisory framework for the development of the financial sector as banks were either owned by well established foreign banks or the government and thus, it was perceived that they needed minimum prudential supervision. Additionally, the controlled economy provided a relatively safe environment for bank lending but which later proved to the detriment of the newly formed local banks.

Maimbo has advanced that overall, government involvement in the financial sector led to an inefficient and non-competitive market as the Zambian government like other developing countries at the time, placed emphasis on protecting the real sector with the financial sector

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5 C. Chiumya, ‘Banking Sector Reforms and Financial Regulation,’ Page 9
7 S. Maimbo, ‘Design and Development of the Zambia Banking Regulatory and Supervisory Frameworks’ page 15
only playing a subsidiary role. Mehran has noted five negative effects of this trend on the financial systems of developing countries during the 1970’s and 1980’s that are applicable to Zambia. One of those being that “interest rate ceilings and credit allocation directives undermined liquidity management by banks, resulting in disintermediation and the reduction of the banking systems’ client base and overall profitability.”

The financial sector recorded a rise in local banks between 1987 and 1990. These are Finance Bank (1988), African Commercial Bank (1987), New Capital Bank (1989) and Manifold Investment Bank (1987) which were attracted to the financial sector by the high returns on average investment and easy access for the new banks was made possible by the un-regulated nature of the banking entry by the BOZ.

The change in government from a one party state to multi-partism led by the Movement for Multi Party Democracy (MMD) resulted in radical economic reform from a state controlled economy to a free market or liberalised economy. Therefore, financial sector reforms though inevitable, were partly instigated by the World Bank/IMF Structural Adjustment and Financial Stabilisation Programmes. They had two major parts. The first one included the abolishment of interest rates and exchange controls in 1992 and 1993 while the second involved reforms to prudential regulation and supervision of financial institutions through the enactment of new banking laws in 1994.

One of the most significant reforms was that concerned with the restructuring of government owned financial institutions. This was necessary as these financial institutions though initially successful in providing savings facilities were faced with severe financial problems due to

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high transaction costs, mis-management and political interference. Another was that, by January 1994, the government abolished exchange and interest rates controls. This culminated in the merging of the official exchange rate and the market rate and, all foreign exchange regulations were suspended. The abolishment of foreign exchange and interest rates controls had a profound effect on the profitability and competitiveness of the banking sector. Interest rates rose from 40 per cent (1992) to 192 per cent (1993) on loans and government securities attracting not only new banks to the financial sector but also a number of NBFIs, such that by 1996, there were 26 NBFIs registered with BOZ. Thirdly, another significant reform was that made to the prudential system made between 1994 and 1997 which consisted of increasing the BOZ human resource to counter act the increased responsibilities of the central bank and a complete revision of the banking law which led to the enactment of the Banking and Financial Services Act (BFSA) of 1994. The enactment of BFSA was meant to strengthen BOZ’s supervisory capacity.

The aforementioned reforms initially led to the proliferation of financial institutions as by 1994 there were 25 registered banks and by 1996, there were over 26 NBFIs. However, as inflation and the exchange rate began to stabilise between 1993 and 1994, it became difficult to maintain the levels of profitability enjoyed by the banking sector. Instead of banks altering their activities in line with the declining profit margins, they engaged in activities to their own detriment such as “reckless lending left banks with irrecoverable loans and, in the quest to attract and retain customers, banks were disregarding prudent loan procedures and security arrangements.” Consequently, Zambia experienced financial sector distress resulting in the collapse of nine commercial banks between 1995 and 1998, and several government owned

17 S. Maimbo, ‘Design and Development of the Zambian Banking Regulatory and Supervisory Frameworks’ Chapter 387 of the Laws of Zambia
19 S. Maimbo, ‘Design and Development of the Zambian Banking Regulatory and Supervisory Frameworks’
financial institutions. Among these include Lima Bank, the Cooperative Bank of Zambia and Meridien BIAO Bank Zambia (MBBZ).

The bank closures led to a loss of confidence in the financial system and discouraged people from placing their monies in financial institutions for fear of loss in the event of failure. Brownbridge has observed that the financial reforms led to a number of bank closures as "substantial new entry into the banking industry was allowed before adequate prudential legislation and supervisory capacities had been put in place."22

The primary law governing the financial sector is the BFSA of 199423 and subsidiary legislation such as BOZ directives and regulations. The Act was amended in 2000 to cover all institutions that provided financial services as defined in the Act and further to “strengthen the Bank of Zambia’s regulatory and supervisory powers, incorporate best practices and internationally accepted standards for licensing and prudential regulation and supervision...”24 The Act was further amended in 200525 to provide for the regulation and supervision of microfinance institutions and to clearly show the distinction among commercial banks, financial institutions and financial businesses.26

The BFSA defines a bank as a company conducting banking business.27 Banking business means the receiving of deposits from the public including chequing accounts and current accounts deposits as well as the use of such deposits, the providing of financial services and any custom, practice or activity prescribed by the Bank of Zambia as banking business.28 The BFSA (Amendment) Act of 200029 extended the Bank of Zambia’s regulatory and supervisory mandate to non-bank financial institutions (NBFI’s). A financial institution is defined by the Act as a person other than a bank, conducting a financial service business

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23 Chapter 387 of the Laws of Zambia


25 Banking and Financial Services Act as amended by Act No. 25 of 2005

26 Interview with Mr. Richard Chirwa, Inspector – Financial Analysis, Bank of Zambia. 11/01/11

27 Chapter 1 (section 2) of the Act, Cap 387 of the Laws of Zambia

28 Section 2 of the BFSA

29 Act No. 18 of 2000
which includes receiving deposits from the public but does not include chequing.\textsuperscript{30} The term ‘person’ in the definition of a financial institution refers to both natural and legal persons, and this has been qualified by the BFSA by defining a person as “an individual, a company, a partnership, an association and any group of persons acting in concert, whether or not incorporated.”\textsuperscript{31} As a result of the amendment Act No. 18 of 2000 to the BFSA, financial institutions such as the development banks, building societies and savings and credit banks which were established under separate statutes and previously outside the supervisory ambit of the Bank of Zambia are now directly under the supervision of the Bank of Zambia.\textsuperscript{32} Thus, what is important is that an institution is conducting, in whole or in part, banking business or that an institution providing financial services is a financial institution within the definition provided for in the Act, whether or not that institution is incorporated under the Companies Act of 1994\textsuperscript{33} still falls under the supervision of the central bank.\textsuperscript{34}

In addition, micro finance institutions consisting of co-operatives, non-governmental organizations (NGOs) and others are now under the supervision of Bank of Zambia.\textsuperscript{35} BFSA (Microfinance) Regulations of 2006 defines a microfinance institution as a person who as part of their business advances micro credit facilities while microfinance service is defined as the provision of services primarily to small or micro enterprises or low income customers.\textsuperscript{36}

Zambia currently has 19 banks, all are international banks (their existence in Zambia is in the form of a subsidiary bank) except Investrust Bank, Cavmont Capital Bank, Finance Bank, ZANACO and Natsave.\textsuperscript{37} A commercial bank is an “institution which accepts deposits, makes business loans, and offers related services....They are primarily concerned with receiving deposits and lending to businesses.”\textsuperscript{38} These institutions are essentially run to make profit and are owned by a group of persons.

\textsuperscript{30} Chapter I (section 2) of the Act, Cap 387 of the Laws of Zambia
\textsuperscript{31} Section 2 of the BFSA
\textsuperscript{32} Chapter VI (Sections 69-84) of the Banking and Financial Services Act, Cap 387
\textsuperscript{33} Chapter 388 of the Laws of Zambia
\textsuperscript{34} K. Mwenda, Banking and Micro-finance Regulation and Supervision: Lessons from Zambia (Parkland: Brown Walker Press, 2002) page. 165
\textsuperscript{35} Chapter VI (sections 69-84) of the BFSA as amended by Act No. 25 of 2005
\textsuperscript{36} Section 2 of the Regulations.
\textsuperscript{37} Interview with Mr. Richard Chirwa, Inspector – Financial Analysis, Bank of Zambia. 11/01/11
\textsuperscript{38} Available at: http://www.investorwords.com. Accessed on 11/01/11
Other financial sector regulators are the Pensions and Insurance Authority (PIA) and the Securities Exchange Commission (SEC). PIA is an independent regulator established by the Pensions and Insurance Act\textsuperscript{39} to regulate the operation of insurance and pension schemes. On the other hand, SEC was established by the Securities Act\textsuperscript{40} and is responsible for supervising and monitoring the activities of any securities exchange and particularly the Lusaka Stock Exchange’s discharge of its functions as Zambia’s competent authority for official listing of securities.

1.3 STATEMENT OF THE PROBLEM

The Bank of Zambia in its regulatory and supervisory role of the banks and financial institutions has encountered problems in getting information about other financial sector players such as Insurance Companies and the Securities Markets which are not under its supervision, but such information is necessary in its supervision of the Commercial Banks as these players of the financial sector have business dealings with the banks. Thus, the Bank of Zambia has either not received this information or, it has been received very late. Therefore, the Central Bank has resorted to signing memoranda of understanding with other regulators such as the PIA and the SEC. The purpose of these agreements is to facilitate the exchange of information among the financial sector regulators which relates to the persons involved in financial businesses, in some cases the integrity of those persons, key performance indicators of the financial sector, information on money laundering activities, amongst others.

The issue to be addressed is whether the sharing of information among the financial sector regulators points to the problem caused by the current supervisory model, in essence, that it is inefficient and whether this is an indication for the need to revise the supervisory model. This is because there seems to be an underlying integration of the financial markets in Zambia as evidenced by the emergence of financial conglomerates, these being the rise in banks, insurance companies and security markets and if it points to the need for integrated supervision. This research is therefore concerned with the adequacy and effectiveness of the model of supervision of the banking sector and whether it can withstand the increasing complexity and rise of financial business in Zambia. It is also important to address the

\textsuperscript{39} Act No. 27 of 2005
\textsuperscript{40} Chapter 354 of the Laws of Zambia
arguments advanced for integrated supervision, which are that a developing country with a small economy and invariably, a small financial sector should consider moving to an integrated model in order to ensure effective supervision of financial conglomerates and obtain significant economies of scale.

1.4 SIGNIFICANCE OF THE RESEARCH

This research is pertinent and timely in view of the growth of the banking sector as it will not only assess the effectiveness and performance of the banks in light of the supervisory and regulatory model that Zambia has adopted to regulate financial institutions through the enactment of the BFSA of 1994 but will also indirectly assess its effectiveness and resilience to a financial crises. This will ascertain whether it is adequate and sufficient to withstand economic or financial crises. Moreover, at a time when a number of industrialized countries move to integrate the different supervisory functions of their financial sectors in a single agency, it is important to consider whether this is necessary, prudent and expedient for Zambia’s small financial sector.

1.5 OBJECTIVES OF THIS RESEARCH

The broad objectives of this study are as follows:

(a) To determine the purpose of bank supervision, as well as BOZ’s legal mandate for so doing, and the aim of the supervisory role of BOZ in regulation and supervision of the banking sector.

(b) To bring to the fore the legal and practical constraints or difficulties faced by BOZ in supervision of the banking sector especially in light of the increasing complexity and rise of the financial market in Zambia.

(c) To determine whether the supervisory model that BOZ uses in the regulation of financial institutions, particularly the banks, is adequate and effective in light of the growth of the financial market and growth in the banking sector.

(d) To ascertain whether the supervisory model adopted by BOZ is adequate and effective in addressing the emergence of financial conglomerates, if any or whether there is an underlying integration of the financial markets in Zambia which will cause BOZ to change the current supervisory model.
1.6 HYPOTHESIS

The underlying hypothesis of this research is whether the supervisory model that Zambia has adopted to regulate financial institutions, particularly the banks is well suited to the country’s current needs such as the growth and complexity of the banking sector, the emergence of financial conglomerates, if any and other factors that will be shown in this research.

1.7 METHODOLOGY

The method of collection of data in this research has been and will be conducted through desk research and where possible, field investigations. The desk research will be through the collection of secondary data from the Laws of Zambia, primarily the BFSA, books, journals, dissertations and as well as the internet. Field investigations shall be in the form of interviews conducted with the relevant officials from the Bank of Zambia, Commercial banks and where possible, other financial institutions who are vested with the knowledge and experience of regulation and supervision of the financial sector.

1.8 CONCLUSION

In conclusion, this chapter has given an overview and development of the banking sector between 1970 to date. It has further shown how the political and economic environment in Zambian history have influenced BOZ’s regulatory and supervisory framework and in particular, how the financial reforms were dictated by the prevailing political and economic environment.
CHAPTER TWO

BANK SUPERVISION AND REGULATION

2.1 INTRODUCTION

A safe, sound and efficient financial system is the life blood for the economic development of any nation as it promotes confidence among market players and allows financial intermediation between surplus and deficit units in an economy. The banking sector is a unique feature of the financial sector as it is the means through which payment systems of commercial transactions are securely and efficiently done. The privatisation programmes that were undertaken in the Third Republic have not only brought about competition and new business opportunities for banks but have also brought about a number of challenges in the financial sector. This rise in financial business has increased risks in the banking sector. As such, BOZ seeks to provide the highest quality of bank supervision in the regulation of banks in order to maintain a stable and efficient financial system.

There is no single tool kit for banking supervision which provides solutions to banking crises and risks characteristic of the banking sector. However, effective bank supervision can be undertaken through constant reviewing, adoption and implementation of regulations that are responsive to the changes in the banking environment.

The aim of this chapter is to ascertain what bank supervision is. Firstly, It will discuss the role of the central bank in bank supervision and its purpose while bringing to the fore the practical aspects of bank supervision. Secondly, the activities of banks which are subject to banking supervision will be brought to the fore. Thereafter, the challenges and constraints that BOZ faces in its supervisory role will be highlighted and a short analysis of the current regulatory framework will be given. Then, a conclusion will made.

2.2 THE PURPOSE OF BANK SUPERVISION

It is imperative to understand the role of banks in the development of national economies before seeking to determine what bank supervision is. A key function of banks is to provide financing through financial intermediation. This is the accepting of deposits from those with
excess funds and lending to individuals and businesses requiring funds for use or to begin basic development projects such as small businesses. Another important role of banks is that they provide payment systems through which various economic players can transact securely and efficiently, thereby promoting trade, commerce and financial linkages among the various sectors of the economy which are agents for national development.\textsuperscript{41} A sound, effective and stable financial system is therefore necessary for effective financial intermediation to take place, and to promote confidence amongst market players in the financial sector so as to move the economy forward. It is for this reason that national Governments have established supervisory authorities to supervise the banks and the financial institutions. BOZ as the supervisory authority of the banking system in Zambia has recognised that financial stability is essential for strong macroeconomic performance and execution of monetary policy.\textsuperscript{42} The central bank has advanced that financial stability can only exist when all financial system risks are adequately identified, allocated, priced and managed.\textsuperscript{43} Thus, the aim of the supervisory role of BOZ is to maintain a stable and efficient financial system.

It is now cardinal to consider what bank supervision is. Bank supervision is essentially the process of monitoring banking activities and taking various measures to ensure that laws and regulations that deal with the operations of a bank are complied with. It includes overseeing the banking system’s operations through the licensing, formulation, continuous review of banking laws and regulations, continuous off-site surveillance of periodic monthly prudential returns, and on-site inspection of banks.\textsuperscript{44} The purpose of bank supervision is to “determine whether the bank subject of supervision is solvent by verification of assets and liabilities and whether management is complying with laid down rules.” \textsuperscript{45}

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\textsuperscript{44} Interview with Mr. Fidelis Chamunda, Inspector – Bank Inspections, Bank of Zambia. 28/01/11

The legal mandate for the supervision of banking business is the BFSA. This mandate is supplemented by various regulations and circulars promulgated pursuant to the BFSA, whose primary aim is to safeguard the viability of the financial sector.

The main objective of supervisory policy is to promote a safe, sound and efficient financial system. This is achieved by ensuring that the financial system remains stable for effective intermediation to take place in that it leads to economic growth, and to protect depositors from loss of savings, thus leading to public confidence in the financial system.

The bank supervision department (BSD) of BOZ is the department that is responsible for the supervision of banks and it carries out this function through three divisions namely, Bank Inspections, Financial Analysis and Regulatory Policy, Licensing and Liquidation. The Bank Inspection Division is responsible for conducting regular on-site inspections of all banks in order to monitor the overall condition. The Financial Analysis Division is responsible for the continuous off-site monitoring and analysis of all banks. Lastly, the Regulatory Policy, Licensing and Regulatory Policy is responsible for instituting and monitoring preventive, corrective action in response to identified unsafe and unsound banking practices, reviewing licensing applications and managing the orderly exit of banks.

In seeking to achieve its objectives, BOZ employs an approach called risk-based approach to supervision (RBS). This approach combines both on-site inspections and off-site surveillance complimented by regulatory reform and orderly exit of failed banks.

However, the process of supervision starts with the licensing, which is the first stage of supervision. Leo Quebec has observed that “the decision to grant a license to an applicant is among the most important decisions that faces a regulator.” The Registrar of Banks and financial Institutions in consultation with the Minister of Finance decides that a bank should be registered. Licensing requirements include the consideration of the amount of capital that a bank has and determination whether management has proper credentials such as sufficient qualifications, experience in banking, integrity, good character and understanding of bank

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Chapter VI (sections 69 – 84) of the BFSA, Cap 387
Interview with Mr. Fidelis Chamunda, Inspector – Bank Inspections, Bank of Zambia. 28/01/11
L. Quebec. ‘Licensing of financial institutions’ (Toronto: 2003) page 1
operation.\textsuperscript{50} The Licensing of banks is provided for in Chapter 2 of the BFSA\textsuperscript{51} and will be adequately discussed in Chapter 3 of this research which deals with the legal provisions that pertain to supervision.

2.3 PRACTICAL ASPECTS OF BANK SUPERVISION

The practical aspects of supervision make up the monitoring system. These include on-site inspections, off-site inspections and the implementation of regulatory policy.

On-site inspection involves actual visitation to the banks’ premises to verify the accuracy of the published bank statements of affairs; review the policies and procedures in place; assess compliance with prudential requirements; assess the risks inherent in the banks; and assess the adequacy of management practices in place among others.\textsuperscript{52}

Off-site surveillance involves continuous off-site assessment of the individual bank’s financial condition as well as the industry as a whole through periodic prudential returns (most of them monthly) covering the bank’s capital adequacy levels; asset quality; earnings performance and liquidity positions.\textsuperscript{53}

The implementation of regulatory policy involves continuous review, and where appropriate amendment and/or formulation of new regulations, regulatory framework, and the management of orderly exit of failed banks.\textsuperscript{54}

Having established that BOZ supervises the banking system, it is important to understand that supervision may differ depending on the type of banks involved. There are essentially two groups of banks that BOZ supervises. The first group consist of banks which decide on their own volition to concentrate on a comparatively narrow range of activities, while the second includes banks which are established by the Government so as to undertake certain specified activities to assist societies in developing their economic potential. Phiri has noted that in the first category, the supervisors task is to ensure that there is not too much concentration of risk

\textsuperscript{50} K.T Phiri, ‘The role of the Central Bank in the supervision of the Commercial Banks.’ Obligatory Essay. 2004) ,page 22
\textsuperscript{51} Sections 4-22 of the Act, Cap 387
\textsuperscript{52} Interview with Mr. Fidelis Chamunda, Inspector – Bank Inspections, Bank of Zambia. 28/01/11
\textsuperscript{53} Interview with Mr. Fidelis Chamunda
\textsuperscript{54} Interview with Mr. Fidelis Chamunda
that might jeopardise depositor’s interests.\textsuperscript{55}

Citibank Zambia Limited and Banc ABC Zambia Limited are examples of banks which belong to the first category. Citibank Zambia Limited was established in Zambia in 1979, it focuses on innovative cash management, trade finance, treasury, transaction banking and corporate finance solutions for its customers.\textsuperscript{56} Being a corporate and institutional bank, its clientele comprise of multinationals, local top tier Corporations, non-governmental organisations, financial institutions, embassies, governmental institutions and public sector corporations. On the other hand, Banc ABC Zambia Limited is a subsidiary of ABC Holdings Limited, a parent company of a number of sub-Saharan Africa banks operating under the Banc ABC brand that offer a diverse range of financial services. These include personal, business and corporate banking as well as asset management, stock broking and treasury services.\textsuperscript{57} Banc ABC, previously known as African Banking Corporation, rebranded in April 2009, in line with its expansion into retail banking.

NATSAVE and DBZ are examples of banks in the second category, which in the past were not supervised by BOZ but as a result of the amendment Act No. 18 of 2000 to the BFSA, the specialised banks are now directly supervised by BOZ under the department responsible for supervising non-bank financial institutions.\textsuperscript{58} NATSAVE, a savings bank was established essentially to cater for people who deposit household savings so as to provide country wide access to basic banking services for people with low income levels.\textsuperscript{59} DBZ which is a development bank was founded to promote longer term capital formation for development projects.\textsuperscript{60} It has been observed that “participation by the state in the specialised banks is done because market forces and the usual parameters of prudent banking are not capable of providing the required funding.”\textsuperscript{61} The fact that most of the shares in these banks are owned by government, there is a likelihood that poor management will characterize them. Therefore, there is need for proper regulation of these banks especially in the area of corporate

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\textsuperscript{5} K.T Phiri, ‘The role of the Central Bank in the supervision of the Commercial Banks.’ Obligatory Essay. 2004, page 4
\textsuperscript{6} www.citigroup.com accessed on 01/03/11
\textsuperscript{7} www.bancABC.com accessed on 01/03/11
\textsuperscript{8} Chapter VI (sections 69 -84) of the Banking and Financial Services Act, Cap 387
\textsuperscript{10} Interview with Mr. Fidelis Chamunda, Inspector – Bank Inspections, Bank of Zambia. 28/01/11
\textsuperscript{11} www.thisismoney.co.uk accessed on 04/03/11
governance guidelines to counteract potential difficulties that are eminent in such entities such as mismanagement of resources, accounting and auditing scandals so as to protect the interests of the depositors and maintain financial viability of entities.

2.4 INTERNATIONAL DEVELOPMENTS THAT ENHANCE BANKING SUPERVISION

Prudential regulation is a component of the overall supervision of banks. It refers to the framework of regulations which include guidelines and standards developed by the Basel Committee on Banking Supervision (BCBS) for the supervision of the conduct of banks and sets out requirements that limit their risk-taking.\textsuperscript{62} These guidelines and standards will normally cover such areas as risk management, corporate governance, know your customer (KYC), and anti money laundering.\textsuperscript{63} The BCBS provides an international forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches and techniques and the formulation of broad supervisory standards and guidelines. It further recommends the best practice in banking supervision with the expectation that member authorities will take steps to implement them through their own national systems. The Committee is best known for its international standards on capital adequacy; the Core Principles for Effective Banking Supervision; and the Concordat on cross-border banking supervision.

The 1988 Basel Accord, commonly known as Basel I primarily addressed banking in the sense of deposit taking and lending, thus, it did not apply to securities firms.\textsuperscript{64} Its aim was to determine capital adequacy of banks explicitly to credit risk. The International Convergence of Capital Measurement and Capital Standards, commonly known as Basel II was adopted in 2006 to improve on Basel I. Basel II requires financial institutions to maintain enough cash reserves to cover risks incurred by operation. Essentially, it mandates that banks holding riskier assets should be required to have more capital on hand than those maintaining safer

\textsuperscript{62} www.thisismoney.co.uk accessed on 04/03/11
\textsuperscript{63} Interview with Mr. Fidelis Chamunda, Inspector – Bank Inspections, Bank of Zambia. 28/01/11
\textsuperscript{64} www.riskglossary.com accessed on 04/03/11
portfolios. Basel II has a three mutually reinforcing pillar system and BOZ made a decision in 2006 to implement it through a phased approach over time.

The banking sector like any other sector is not immune from changes. Indeed, new situations and challenges such as bank crises often arise that necessitate the formulation of new guidelines in response to those situations. The global financial crisis of the 21\textsuperscript{st} Century which was triggered by the United States mortgage market default has changed the financial sector drastically and has impacted on the financial systems world over, Zambia inclusive. Consequently, credit lines for businesses have been affected, while some banks and financial institutions have been wound up. Thus, the world economy has been negatively impacted. It is for this reason that policy makers around the world have attempted to formulate solutions to problems caused by the global crisis to the financial sector.

In response to the global financial crisis, the BCBS has formulated new rules to prevent a repeat of the crisis. These rules are a broad agreements on the overall design of the capital reform package reached by governors and heads of supervision in 2010. They include the definition of capital and how much capital banks must hold, the treatment of counter party risk, the leverage ratio, and the global liquidity standard. These new rules may form part of Basel III to be adopted on a later date by the G20 summit. It must be noted however, that the rules will only be implemented starting 1\textsuperscript{st} January 2013 to 1\textsuperscript{st} January 2018. This grace period has been given to banks by the Committee to enable them support the economic recovery put in place by policy makers in their jurisdictions outlining a package of regulations for the financial system. The Washington Post reported that Nout Wellink, chairman of the Basle Committee, applauded the agreement, saying it "should reduce market uncertainty and aid the economic recovery." It is hoped that these new rules will strengthen the banking sector resilience in a manner that reflects the key lessons of the crisis.

While it is appreciated that on the International front there is always a continuous formulation of new guidelines, standards and rules to address the ever evolving trends in the banking sector in order to make effective supervision possible, it is not clear as to whether BOZ

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www.Bitpipe.com accessed on 04/03/11
www.baslecommitteee.com visited on 04/03/11
likewise, is constantly formulating new rules to address the changes and needs that arise in the Zambian banking sector. For instance, it is true that the Zambian economy was not directly exposed to the global financial and economic crisis as Zambian banks are not internationally active banks to the extent of being exposed to toxic assets that precipitated the crisis and the wholesale markets that subsequently dried up as confidence eroded. However, the banking sector was exposed through the secondary effects of the crisis which affected the Zambian economy as a whole as commodity prices dropped resulting in the closure of some mines while others were placed on care and maintenance leading to job losses. The Zambian banking sector was exposed to the crisis though indirectly as individual depositors lost their jobs and farmers whose commodities were produced at higher costs than they fetched on the international market could not keep pace with their previous deposits.

The fact that no Zambian bank failed as a result of the crisis does not mean that there are no lessons that can be learnt from the crisis so as to strengthen the banking sector. It is in on record that, there are proposed revisions to Statutory Instrument 142 – The Banking and Financial Services (Classification and Provisioning of Loans) Regulations, 1995 necessitated in part by the adoption of the International Financial Reporting Standards (IFRS); the proposed SI on Bank Charges intended to protect the public from unreasonable bank charges. In light of lessons of the crisis however, BOZ would have embarked on strengthening corporate governance in financial institutions, protection of deposits, continual updating of regulatory frameworks that meet the country’s unique needs to keep pace with innovation and evolving trends in the banking sector while accommodating changes to global best practice.

The BCBS published the Core Principles of Effective Banking Supervision in September 1997. They comprise 25 basic principles that need to be in place for a supervisory system to effective and cover the following areas: preconditions for effective banking supervision; licensing and structure; prudential regulations and requirements; methods of ongoing banking supervision; information requirements; formal powers of supervisors; cross border banking. These principles have become the most important global standards for prudential regulation and supervision, and the vast majority of countries have endorsed these principles by declaring their intention to implement them. However, it is not yet clear whether these

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Interview with Mr. Fidelis Chamunda, Inspector – Bank Inspections, Bank of Zambia. 28/01/11
principles have become customary international law. The Basle Committee is of the view that these principles should serve as a basic reference for supervisory authorities in all countries. Individual jurisdictions (national supervisors) may decide to give some of these guidelines and standards the force of law by domesticating them. For example, in Zambia, the term ‘banking business’ has been defined in the BFSA in line with Core Principle 2 of the Basle Core Principle for Effective Banking Supervision. Core Principle 2 provides that “the permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined.” Consequently, the BFSA defines ‘banking business’ thereby making it clear as to what activities of banks are subject to supervision. It provides that ‘banking business’ means the business of:

(a) receiving deposits from the public including chequing account and current account deposits and the use of such deposits, either in whole or in part, for the account of and at the risk of the person carrying on the business, to make loans, advances or investments

(b) providing financial services; and

(c) any custom, practice or activity prescribed by the Bank of Zambia as banking business.

4.5 ACTIVITIES OF BANK WHICH ARE SUBJECT TO BANK SUPERVISION

It is clear from the definition of ‘banking business’ that only activities of the banks that fall within that definition are subject to supervision by BOZ. The implication therefore is that, not all activities of banks are subject to supervision by BOZ. It is acknowledged that there is a nexus between activities of some banks and those of institutions such as LUSE through arrangements such as collective investment schemes. These are institutions that serve as financial vehicles through which banks often accommodate small and risk investors on the stock market, and one bank that offers such in; Zambia is Banc ABC. Through these schemes, averse investors can invest their capital in units of unit trusts for a better realisation of economic returns. As such, they are a major vehicle through which some banks

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www.baslecommittee.com visited on 04/03/11
Section 2 of the Act, cap 387


www.forexfraud.com visited on 05/03/11
participate on the stock exchange in a bid to enable LUSE as an emerging market to overcome some liquidity problems. The Securities Act of 1993\textsuperscript{75} defines a collective investment scheme as:

- any arrangements with respect to money or other property of any description, under which-

(a) provision is made for persons taking part in the arrangements to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income;

The issue to be dealt with, is whether in the running of collective investment schemes, banks in Zambia fall entirely under the BFSA or under a different regulatory framework altogether.

It is submitted that while the BFSA defines what is meant by banking business and thereby capturing the activities of these banks that are subject to supervision by BOZ, the Act does not state or make mention of how or which body has the authority to regulate activities of banks as they participate on LUSE, for example, in the form of collective investment schemes. Meanwhile, the Securities Act does clear this ambiguity by providing that “The Commission may authorise collective investment schemes for the purposes of this Part.”\textsuperscript{76}

The cited provision clearly shows that the Securities and Exchange Commission (SEC) has power to authorise the establishment of collective investment schemes and to regulate the conduct of business of collective investment schemes in Zambia as provided for in the Act.\textsuperscript{77} Thus, any banking institution intending to set up a collective investment scheme in Zambia must first seek the authorisation of the SEC. Mwenda has pointed out that the implications of this are that, whereas banks remain under the prudential supervision of the BOZ, collective investment schemes set up by banks fall under the supervision of SEC\textsuperscript{78}. However, in Zambia, the law on collective investment schemes does not adequately address the protection of assets of investors and the question worth considering is whether the idea of a single regulator and a single regulatory framework would adequately address this shortcoming as there is a nexus between activities of some banks and those of institutions

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\textsuperscript{75} S. 72 (a), Cap 354
\textsuperscript{76} S. 73 (1), Cap 354
\textsuperscript{77} Ibid, section 73
\end{center}
under the banks which participate on the stock exchange. With regard to the inadequacy of the law on collective investment schemes, Mwenda has observed that:

Under the Zambian Securities Act 1993, apart from provisions on the Compensation Fund which apply generally to securities investment done through intermediaries on securities markets, there are no provisions in the Act on the need for collective investment schemes to protect small (usually risk-averse) investors from market abuses. Market abuses could range from investment companies misappropriating customer funds or not taking proper care in the selection of investment portfolio to matters such as investment companies profiting from use of inside information. Also, apart from the need to have securities legislation in Zambia to redress these shortcomings, it would be prudent to provide for appropriate measures to protect investors who have interests in collective investment schemes (under an investment company) that are undergoing liquidation.

There is a need for BOZ to co-ordinate with the SEC in supervising and regulating banks and the collective investment schemes set up by these banks. It is as a result of “the cognisance of these linkages, and given the segregated supervisory approach of the financial sector in place in Zambia, that BOZ felt it prudent to sign memorandums of understanding with PIA and SEC, primarily to exchange information on the performance of each subsector so as to proactively be aware of potential cross subsector influences.”79 Needless to say, it is important to consider whether the adoption of a fused system of supervision would be a better approach to effective supervision of the financial sector. This will be addressed in Chapter 4 of this paper which deals with the issue of whether factors that necessitate fused integration are present in Zambia and whether it will be prudent to change to this mode of supervision.

4.6 PRACTICAL CONSTRAINTS THAT BOZ FACES IN ITS SUPERVISORY ROLE

It is now important to consider the constraints that BOZ faces in its supervisory role. One of these is political pressure and interference which may be exhibited in the appointment of the Governor of BOZ by the President which is subject to ratification by the National Assembly.80 However, this power of appointment vested in the President may be abused if the President appoints a Governor he can control and direct, thus preventing the

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79 Interview with Mr. Fidelis Chamunda, Inspector – Bank Inspections, Bank of Zambia. 28/01/11
80 Section 10 of the Bank of Zambia Act, Chapter 360 of the Laws of Zambia
Governor from exercising his responsibility of managing the Bank independently and without interference. This may well be the case if National Assembly consists of majority of members of Parliament from the ruling party such that appointments by the President are not scrutinized but are supported and rubberstamped owing to loyalty to the ruling party. Further, the Governor is vested with too much power in that, he is also chairman of the Board of BOZ⁸¹, which is responsible for formulation of policy of the Bank. Thus, if this power is not checked by ensuring that it is exercised in conformity to the law, it can lead to arbitrariness. In addition, a study conducted by Professor Mwenda, has revealed that a major constraint facing the regulatory framework for banking supervision in Zambia includes the inability of BOZ to extricate itself from political pressure and interference. He observes:

...whilst it was the view of Bank of Zambia that under the Banking and Financial Services Act 1994 a person who was director of a bank that has since collapsed cannot be appointed as director of another bank or financial institution – without being cleared by the Bank of Zambia – there have been cases in Zambia where the law has been flagrantly disregarded. Indeed, some ineligible individuals have been granted permission by the Bank of Zambia to act as directors and managers of banks and financial institutions at the request of some senior State Officials. Whether such departure from the law can be treated as ‘regulatory forbearance’ or not, on part of the Zambian government, is an issue that is fraught with political overtones and illogical difficulties.⁸²

It is important for BOZ to extricate itself from political pressure in order to effectively supervise the banking sector. Failure to do so will prevent the central bank from making decisions that would help save the banks and financial institutions from collapse as political pressure necessitates working on directives from those in authority. The officials at BOZ are experts in whom the mandate to supervise and regulate the banking and financial institutions is entrusted, therefore, they are well vested with what is best for the banking environment and should be left to perform their mandate without interference and within the precinct of the law as this is in the best interest of financial stability and the Zambian economy.

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⁸¹ Section 13 (1) (a) of the BOZ Act.
Another constraint that BOZ is facing is human and monetary capital. The rise in financial business in Zambia necessitates the need for BOZ to have sufficient resources to be able to keep up with industry evolution and innovation through continuous training, research and law reviews. Such resources tend to be scarce in most developing countries, Zambia being no exception.

2.7 A SHORT ANALYSIS OF THE CURRENT REGULATORY FRAMEWORK

The current regulatory framework of the banking sector has performed relatively well since 2000 to date. Before then, the banking sector witnessed a number of bank failures. As of 2004, nine banks had closed and this led to a loss of confidence in the financial system because people were discouraged from placing their monies in the banks for fear of loss. This can be attributed to a weak regulatory framework that consequently precluded effective supervision of the sector.

Banking instability can have serious adverse effects on a nation’s economy because it can “impair payment mechanism, reduce the nation’s savings rate, diminish the financial intermediation process, and inflict serious harm on small savers.” To prevent these adverse effects, there are some efforts by Government to introduce legislation on Depositor’s Protection which would enable Government make certain that liabilities of major banks are effectively insured, and one form of this protection is the Deposit Insurance Scheme. This development would be welcome as the primary purpose of such legislation would not only preserve public confidence in the banking system, but would also provide the Government with a formal mechanism for dealing with insolvent banks, and ensure that depositors’ monies are protected in the event of bank failures.

The regulatory framework of the banking sector has since 2000 been strengthened through revision of the banking legislation such as Act No. 18 of 2000 and Act No.25 of 2005 to

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83 Interview with Mr. Fidelis Chamunda, Inspector – Bank Inspections, Bank of Zambia, giving his personal opinion. 28/01/11
86 This Act extended BOZ’s regulatory and supervisory mandate to non-bank financial institutions (NBFI’s).
the BFSA which were primarily intended to strengthen BOZ’s regulatory and supervisory powers in light of the best bank practices and international standards for prudential regulation and supervision. This has been coupled with the formulation of regulations against money laundering, corporate governance guidelines and minimum capital adequacy, among others. Further, BOZ has enhanced capacity within the supervision department of BOZ by increasing BOZ’s human resource over the years, to ensure more effective supervision of the sector, although there is still room to do more. Consequently, the sector has been and continuous to be stable. It has also witnessed steady growth as market confidence has grown. This is evidenced by the fact that there are 19 banks\textsuperscript{88} currently operating in Zambia which are financially viable and the fact that no bank has failed as a result of the global financial and economic crisis may be a pointer to the resilience of current regulatory framework.

It must be noted however that, the greatest problem faced in regulation is not supervision but enforcement. Supervision has to do with complying with the provisions of the enabling legislation, whereas enforcement involves the actual implementation of those provisions. In as much as BOZ tries to keep abreast with effective regulation by formulation of laws and rules, rules are not sufficient in and of themselves on paper if they are not practical and enforceable. Thus, regulation should not just be on paper, but there should be serious enforcement of those laws against perpetrators of financial crimes such as money laundering, insider dealing and breach of the banking law, as an effective supervisory model is one that incorporates a punitive and reward system.

2.8 CONCLUSION

This chapter has not only outlined the practical aspects of supervision and regulation but has defined what supervision is, the role of the central bank in supervision and its objectives in so doing. It has also highlighted some constraints that BOZ faces in its supervisory role. Further, analysis of the current regulatory framework has been given. The next chapter will discuss the legal framework of bank supervision and regulation

\textsuperscript{87} This Act provided for the regulation and supervision of microfinance institutions

\textsuperscript{88} Interview with Mr Richard Chirwe, Inspector – Financial Analysis, BOZ. 11/01/11
CHAPTER 3

THE LEGAL FRAMEWORK FOR BANKING SUPERVISION

3.1 INTRODUCTION

This chapter examines the legal framework for banking supervision and regulation in Zambia. Reference will be made only to the national legal framework because not only are there no international treaties on bank supervision but the guidelines and principles developed by the BCBS for the supervision of the conduct of banks have been comprehensively alluded to in the preceding chapter. These principles have become the most important global standards for prudential regulation and supervision, and the vast majority of countries have endorsed them by declaring their intention to implement them. However, it is not yet clear as to whether these principles have become customary international law.\textsuperscript{89} Therefore, it can be concluded that the Basle Core Principles constitute soft law as of now, in that they are globally the main guidelines for central bank supervision of the commercial banks.

The Banking Act of 1965\textsuperscript{90}, was the first Act that regulated the conduct of banking business in Zambia. This Act was tailored to address the needs of the banking environment of a newly independent state as Zambia had just gained independence in 1964. It was formulated specifically to regulate commercial banks. The Banking Act of 1972\textsuperscript{91} repealed that of 1965. The Banking Act of 1972 was formulated so as to be in line with the Zambian economy, which as of 1972 had become state controlled. It was enacted, among other things, to enable government to compel commercial banks to be locally incorporated in order to bring in large amounts of equity capital, and commercial banks were mandated under this Act, to appoint Zambians as half the number of directors in those banks.\textsuperscript{92} This was intended to help government to place its citizens in leading roles in as far as national development was concerned.

\textsuperscript{90} Repealed by the Banking Act of 1972
\textsuperscript{91} Since repealed by BFSA 1994
\textsuperscript{92} K. T Phiri, ‘The role of the Central Bank in the supervision of the Commercial Banks.’ Obligatory Essay. (2004), page 11
The BFSA of 1994\(^3\) repealed the Banking Act of 1972 owing to the change of economic policy of liberalisation which was adopted by the new government. The change in government from a one party state to a multi party state led by the MMD resulted in radical reform from a state controlled economy to a free market or liberalised economy. Therefore, financial sector reforms were not only inevitable but expected and this was evident in reforms to prudential regulation and supervision of banking and financial institutions through the enactment of a new banking law in 1994.

The objectives of the BFSA 1994 are to provide for the regulation of the conduct of banking and financial services, safeguard the interests of investors and customers of banks and financial institutions and to provide for matters connected with or incidental to the foregoing.\(^4\) In this vein, the Act endeavours not only to create both legal and institutional safeguards for depositors’ monies but also to promote a safe, sound and efficient financial system.

3.2 THE LEGAL ASPECTS OF BANK SUPERVISION AND REGULATION

The legal aspects of bank supervision and regulation are dealt with in Chapter IV of the BFSA. However, this chapter will examine other relevant parts of the Act as well that pertain to supervision and regulation.

It is imperative to note from the onset that, while the Registrar of Banks and Financial Institutions, in consultation with the Minister of Finance has the statutory power to authorize a company to conduct banking business,\(^5\) BOZ as the central bank is empowered by law as the competent authority for supervising banks.\(^6\) It carries out its role under the provisions of the BFSA.

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\(^3\) Chapter 387 of the Laws of Zambia
\(^4\) As stated in the preamble to the Act, Chapter 387 of the Laws of Zambia.
\(^5\) Section 4(1) of the BFSA
\(^6\) Section 4(2)(a) of the Bank of Zambia Act
The licensing procedure is an important aspect of supervision. Banks are only permitted to engage in business covered by a banking license or by the BFSA.\textsuperscript{97} Thus, BOZ, through the registrar of banks and financial services regulates the licensing procedure by determining applications for banking licences.\textsuperscript{98} The application is required to be in such form and accompanied by such fees as may be prescribed by regulation, and accompanied by information on the physical and postal address of its head office and the permanent addresses of its directors, chief executive officer, managers and shareholder. The applicant should also provide information on the particulars of the business it proposes to conduct, the amount of capital, and other relevant information. This statutory requirement is in line with postulates of the Basle Cole Principles for Effective Banking Supervision.\textsuperscript{99}

Further, the Bank has power to investigate applicants in deciding whether or not to grant a banking licence, the Registrar can have regard to the capital adequacy of the applicant; the financial condition, resources and history of the applicant and the applicant’s associates and affiliates; the character and experience of the directors and major shareholders; and the prospects for profitable operation of that business.\textsuperscript{100} The purpose of this information is meant for stringent scrutiny of new entrants in banking business in order to ensure that well capitalized banks with skilled managers are allowed to operate and to protect depositors’ interests against fraudulent people. The Amendment Act of 2000 adds:

(1) The Registrar shall not grant a licence if the applicant does not meet the requirements prescribed by the Bank of Zambia

(2) An applicant for a licence aggrieved by the refusal of the Registrar to grant a licence may appeal against that decision in accordance with Chapter VIII.\textsuperscript{101}

Under the BFSA, a licence granted to an applicant remains in force until it is revoked by the Registrar of Banks and Financial Institutions.\textsuperscript{102} A licence can be revoked if that licence is in breach of any of the requirements of the Act, for example, if there was fraud.\textsuperscript{103} It is interesting to note that while an appeal can lie under Chapter VIII of the Act against the

\textsuperscript{97} Section 17 (3) of BFSA
\textsuperscript{98} Sections 4-22 of BFSA
\textsuperscript{99} Core Principles 23 and 24 of the Basle Core Principles for Effective Banking Supervision
\textsuperscript{100} Section 7 of the BFSA
\textsuperscript{101} BFSA 1994 (as amended by the Amendment Act No. 18 of 2000), sec. 6
\textsuperscript{102} Section 14 of the BFSA.
\textsuperscript{103} Section 16 of BFSA
As a further safeguard of the interests of depositors and investors, banks are required to keep records. Financial service providers, banks inclusive, are required to create and maintain credit documentation and any information concerning business relations with customers or any person that the Bank may prescribe. This ensures transparency and accountability of financial service providers. The information needed here includes: current financial statements of the indebtedness of the borrower, and any guarantor of the borrower to the bank or institution; a description of any collateral over which the financial service provider has any collateral over which the financial service provider has any mortgage or charge as security for the due payment of the indebtedness to; a statement of the terms of credit, including the principal amount, rate of interest, schedule of repayments, and the borrowers objective or purpose for borrowing; and the signature of each person who authorized the credit on behalf the financial service provider. It is these records that bank inspectors review during onsite inspection of the banks to assess compliance with prudential requirements.

Financial accountability is a cardinal requisite of banks provided for under the Act as it promotes transparency, protects depositors' interests and gives bank supervisors knowledge as to adequate capital. Every bank is required to deliver its monthly statements to BOZ after the end of each calendar month. These include statements showing: the banks liabilities to the public; the amount of each liquid assets held by the bank; assets and liabilities; the amount of regulatory capital and reserve funds; loans that are non performing; statements concerning its operation, financial condition and resources. These statements assist bank supervisors in determining whether a particular bank is financially stable and is not engaged in unsafe or unsound banking practices to the detriment of its customers.

The core statutory rules governing banking and financial services supervision and prudential regulation are found in Chapter VI of the BFSA. Under these rules, a bank is required to maintain a reserve account, the minimum amount of which is prescribed by BOZ. This account is important as it ensures that banks do not pay out profits to their shareholders until

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109 Provided under sections 51-55 of BFSA
110 Section 52 of BFSA
111 Chapter IV (sections 56-68) of BFSA
112 Section 60 of BFSA
113 Section 69 of BFSA
sufficient capital remains in the bank to provide protection for depositors, and creditors of banks.

As a safeguard for investor protection, banks are prohibited from pledging their asses for the purposes of borrowing except in the ordinary course of business to BOZ for short term liquidity advances.\textsuperscript{114} A further safeguard is the limitation placed by the Act on the banks on the grant of advances against the security of a bank’s shares.\textsuperscript{115} Also, a bank is not allowed, whether transacting directly or indirectly, except with the approval of BOZ to grant or permit to be outstanding any secured or unsecured advances to its directors, persons having de jure or de facto control of the bank, partners, managers, agents or members.

It is interesting to note that the BFSA has codified and strengthened the common law position which permits the lifting of the corporate veil where bodies corporate are engaged in co-mingled activities that, say, perpetrate fraud. Section 73(9) of the Amendment Act 2000\textsuperscript{116} now provides that BOZ can lift the veil of incorporation of banks by reading as follows:

In the application of the limitations imposed by subsections (1) and (3), if the Bank of Zambia determines that a group of two or more persons to whom any grants, advances or guarantees have been or are to be made are a common enterprise or are so inter-related that they should be considered as a unit, the total indebtedness of that group shall, if the Bank of Zambia by notice served on the bank or financial institution concerned so provides, be combined and shall be deemed to be the indebtedness of a single person:

Provided that a bank or financial institution shall not be taken to have contravened subsection (1) or (3) by virtue of a determination under this subsection, if the bank or financial institution disposes of the indebtedness of the group, to the extent that it exceeds the relevant limitation, within such reasonable time as the Bank of Zambia may determine.

As a general rule, a bank is prohibited from investing in equity interests in any person (such as a company), property or undertaking in an amount exceeding fifteen per centum of the total of all equity interests in the said person, property or undertaking.\textsuperscript{117} However, this

\textsuperscript{114} Section 72 of BFSA
\textsuperscript{115} Section 73 of BFSA
\textsuperscript{116} Amendment Act No.18 of 2000 of the BFSA.
\textsuperscript{117} BFSA (as amended by Amendment Act No. 18 of 2000), sec. 75(1)
limitation does not apply to investment(s) by a bank in the shares of its subsidiary, if the aggregate of all investments by the bank does not exceed twenty five per centum of its regulatory capital.\textsuperscript{118} Equity interests are defined as:

(a) "equity interest in a person" means
   (i) in the case of a company, any share issued by the company, the terms of which entitle the registered holder or bearer to a share in the profits of the company; or
   (ii) in the case of a partnership, association or other body of persons acting in concert, any right to share in the profits of the person;
(b) "equity interest in a property or undertaking" means an ownership interest and includes any right to share in the profits of the operation or proceeds of disposition of the property or undertaking;

It is also imperative to note that where a bank refuses to comply with an order or directive of BOZ under the BFSA, or refuses to permit an inspection to be made, or has otherwise obstructed such an inspection to be made, or breaches any written law, or is likely to become unable to continue operations BOZ can take supervisory action.\textsuperscript{119} Such action would involve any one or more of the following: possession of the bank; suspension of the bank’s licence for a period not exceeding six months; restricting the banks licence; revoking the bank’s licence.

The coming into force of Amendment Act 2000\textsuperscript{120} ushered in some regulatory changes. BOZ now has the power to prescribe the minimum required primary capital for banks, and as such, every bank is required to maintain capital equal to the amount prescribed by the BOZ. This is to ensure that a bank is financially stable in order to safeguard the interests of the depositors and investors. Another safeguard for investors in banks is the requirement for banks to maintain a special reserve account, to an amount which BOZ considers adequate, meant for purposes of making good any loss resulting from the negligence of officers of the bank.\textsuperscript{121}

\textsuperscript{118} Section 75 (5) of BFSA
\textsuperscript{119} Section 81 of BFSA
\textsuperscript{120} Amendment Act No. 18 of 2000 of BFSA, s.83
\textsuperscript{121} Section 82(a) of BFSA
Further, the Act requires that a bank insure itself against such loss, to an amount which BOZ considers adequate.\textsuperscript{122}

3.3 A LACUNA IN THE LAW AS TO WHAT CONSTITUTES ‘UNSAFE AND UNSOUND PRACTICE’

Section 77 prohibits banks from engaging in ‘unsafe and unsound practice’ and empowers BOZ to take up enforcement action to correct such practice. It must be noted that the BFSA simply prohibits any person from carrying out ‘unsafe or unsound practice’ but does not define this term. This creates uncertainty in the law in that what exactly constitutes such practice is not known and this inhibits the promotion of the regulator, that is BOZ’s consistent and well-meaning enforcement of the law.

An opportunity arose in 2003 for the High Court of Zambia to examine critically the concept of unsafe and unsound practice under the BFSA, but the Court missed that opportunity. In Access Finance Services Limited and Access Leasing Limited v Bank of Zambia,\textsuperscript{123} In this case, BOZ took over possession of both Access Finance Services Limited (AFSL) and Access Leasing Limited (ALL) in 2003. The two companies were alleged to have been involved in criminal activities, as according to BOZ they had been using journal vouchers to post receipt of funds to general accounts with confusing or misleading narrations, and this amounted to unsafe and unsound practice. The applicants challenged the decision of BOZ to place them into compulsory winding up contending that the alleged unsafe and unsound practices committed by AFSL and ALL were not defined anywhere in BFSA. Although an order for certiorari was granted, on grounds that BOZ misdirected itself in determining that AFSL and ALL were insolvent and that the two companies should be placed under compulsory liquidation, the court did not address fully the issue whether AFSL and ALL had engaged in unsafe and unsound practice to entitle BOZ to take punitive or corrective measures against the companies.

\textsuperscript{122} Section 82(b) of BFSA
\textsuperscript{123} (2003) HP 359, Unreported
In the United States of America (US), by contrast, the judiciary has often deferred to the expertise of bank regulatory agencies the definition of what constitutes an ‘unsafe and unsound practice, thus, the judiciary limits their view to a determination of whether the regulatory agency’s action was arbitrary, capricious, or unsupported by substantial evidence on record.\textsuperscript{124} On the other hand, in the case Access Finance Services and Another v Bank of Zambia, merely alluded to section 77 of BFSA without explaining, in obiter dictum, what would be regarded, for example, arbitrary or capricious action by a regulatory agency such as BOZ.

Mwenda has pointed out that while it is not the primary responsibility of the courts or the central bank to legislate a definition of ‘unsafe and unsound practice,’ BOZ is not prohibited by law from providing policy guidance on the meaning of the term ‘unsafe and unsound practice.’\textsuperscript{125} He goes on to say that, “while it is parliament that should have provided a definition, in the absence of such a definition, the central bank should give a policy statement interpreting the term ‘unsafe and unsound practice.’” By contrast, in the US, the Federal Deposit Insurance Corporation (FDIC) argues that an unsafe or unsound practice is any action, or lack of action, that is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.\textsuperscript{126}

3.4 CONCLUSION
This chapter has examined some of the most important legal provisions on banking supervision and regulation, citing their relevance and also pointing out some lacunas in the law, that is the BFSA 1994.

\textsuperscript{124} K. Mwenda, ‘Aspects of Banking Regulation: Common law Perspectives from Zambia’(Pretoria: Pretoria University Law Press, 2010), page. 210
\textsuperscript{125} K. Mwenda, ‘Aspects of Banking Regulation,’ page 204
\textsuperscript{126} www.fdic.gov/bank/enforcement: unsafe or unsound banking practices – statutory standards visited on 3\textsuperscript{rd} March 2011
CHAPTER 4

THE FRAGMENTED AND INTEGRATED MODELS OF SUPERVISION

4.1 INTRODUCTION

Around the world, many countries are considering the organization of the structure of financial supervision on the grounds that the existing structures, which were often established in a markedly different market and institutional environment than exists today, may have become inappropriate. This is owing to the quickly evolving financial sector characterized by a fast pace of financial innovation and growth, including the emergence of financial conglomerates offering a wide range of financial services. In responding to the increasing complexity and rise of financial business, governments are examining the options for aligning their supervisory agencies with the evolving financial sector in order to ascertain what kind of supervisory model is best to withstand the changing risk characteristic of the banking environment. Further, whether the changes in financial supervisory structure will lead to improvements in the efficiency and effectiveness of their financial supervisory function.

The aim of this paper is to discuss the fragmented and integrated models of supervision while bringing to the fore, their advantages and disadvantages. The purpose thereof, is to determine whether the supervisory model that Zambia has adopted is adequate in addressing the country’s current needs such as the growth of the financial market, the increasing complexity and growth in the banking sector, in terms of financial innovation, and the emergence of financial conglomerates, if any, and whether it is sufficient to withstand the risks occasioned by changes in the banking environment.

4.2 THE FRAGMENTED MODEL OF SUPERVISION

Historically, supervision of the financial business tended to follow sector lines, that is, each financial sector had its own supervisory authority.¹²⁷ This is what is known as the fragmented or sector-specific regulatory model of supervision. It is one in which financial institutions are organised around, and supervised by specialist agencies. Thus, bank supervision is by a bank regulator, securities markets have their own supervisor, and the insurance sector is overseen

¹²⁷ K. Vagneur, Corporate Governance. (Edinburgh: Heriot-Watt University Press, 2004), page 7/21
by an insurance specialist agency. This trend of having specialist agencies for each sector of the financial market has not changed in most countries, Zambia inclusive. Accordingly, in countries which have adopted this model of supervision, there are substantial body of laws and regulations governing a specific sector of the financial market. The purpose of these laws and regulations is to provide macroeconomic stability and to protect individual depositors and investors of the financial markets.

Indeed, Zambia is one such country that has adopted the fragmented or sector-specific regulatory model of supervision as there are three institutions that regulate the financial sector in Zambia. These are BOZ, SEC and PIA. Under this model, BOZ is responsible for the supervision of banks, non bank financial institutions (NBFIs), and micro finance institutions. Further, BOZ is charged with the responsibility of formulating and executing monetary and supervisory policies, with the ultimate objective of achieving price and financial systems stability. Apart from serving as a banker for all commercial banks, BOZ is an adviser to the Government. The BOZ currently derives its mandate from the BOZ Act of 1996\textsuperscript{128} and the BFSA, 1994\textsuperscript{129} as amended by Act No. 18 of 2000\textsuperscript{130} and Act No. 25 of 2005.\textsuperscript{131}

SEC was established by the Securities Act, 1993\textsuperscript{132}. Its constitutive Act charges it with the responsibility of, among other functions, regulating, supervising and developing the securities industry in Zambia. The regulatory powers of the Commission require that: any person dealing or advising on securities must be licensed by the Commission; that any securities market must be licensed as a securities exchange by SEC; that all securities of a public company which are publicly traded must be registered by SEC and; that collective investment schemes must be authorised by the Commission.\textsuperscript{133} It must be noted that the Zambian securities market has been designed as a “unified market” where trading is conducted through the stock exchange, this entails that securities of public companies that are not listed are, nevertheless, quoted and traded on a second tier market within Lusaka Stock Exchange.

\textsuperscript{128} Chapter 360 of the Laws of Zambia
\textsuperscript{129} Chapter 387 of the Laws of Zambia
\textsuperscript{130} This Act extended BOZ’s regulatory and supervisory mandate to NBFIs.
\textsuperscript{131} This Act gave BOZ, the power to supervise micro finance institutions.
\textsuperscript{132} Chapter 354 of the Laws of Zambia
\textsuperscript{133} Available at \url{www.sec.gov.za} visited on 14/03/11
LUSE is essentially a market place where shares and bonds can be bought and sold. It is made up of stock-broking corporate members, who conduct trade on behalf of their customers. It is incorporated as a non-profit limited liability company, and the main instruments traded on the Zambian securities markets are equities, government bonds, and corporate bonds. Notably, five banks are registered by SEC as dealers on LUSE, and these are Banc ABC Zambia Limited, Stanbic Bank Zambia Limited, Standard Chartered Bank Zambia Plc, Citibank Zambia Limited and ZANACO.

PIA is an independent regulator established by the Pensions and Insurance Act to supervise the operations of insurance and pension schemes. As at 29th March 2010, PIA had licensed 231 insurance entities, and among these, four banks are registered as insurance agencies. These are Barclays Bank Zambia Plc, Standard Chartered Bank Zambia Plc, Stanbic Bank Zambia Limited and Finance Bank Zambia Limited.

It is now important to consider the pros and cons of the fragmented model of supervision. One of the advantages of distinguishing three broad types of financial business namely, banking, insurance and securities trading is to enable the objectives of supervision, that is effectiveness and efficiency of regulation to be fully met by specialist regulators as they are only concerned with individual entities in a group. According to Carmicheal et al, effectiveness relates to whether the objectives are met, while efficiency relates to whether they are met in an efficient way and without imposing unnecessary costs on customers and regulated firms. Thus, it is argued that the most appropriate basis for organizing the financial sector is by supervision through specialist agencies because:

first, regulatory agencies are most effective and efficient when they have clearly defined, and precisely delineated objectives and when their mandate is clear and precise. Second, accountability might be more effective and transparent when particular agencies are responsible for clear objectives.

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134 Available at www.sec.gov.za visited on 14/03/11
135 Available at www.luse.za visited on 14/03/11
136 Available at www.sec.gov.za visited on 14/03/11
137 Act No. 27 of 2005
138 Information available at www.pia.gov.za visited on 14/03/11
It follows from the foregoing that when specialist agencies are concerned only with individual entities in a group, there are more able to obtain a better perspective about the performance of each financial sector so as to adequately address any challenges and concentrate on countering the risks characteristic of the individual sectors which they oversee, and thus, be able to maintain viable financial stability. In essence therefore, specialist regulators have a clear focus on the objectives and rationale of regulation and supervision of their individual entities and are better equipped to make the necessary differentiation between different types of institutions and their businesses. On the other hand, if supervision is vested in a single unified agency, the agency only obtains a group wide perspective of the financial sector as a whole, and thus may ignore certain risks that are peculiar to an individual sector, but which create the problem of systematic risk. That is risk to the whole financial system arising from the failure of one or more of its parts.\textsuperscript{140}

Another advantage of this model, and the reason why several countries have not vested the powers of supervision in a single unified agency is to guard against a unified regulatory and supervisory agency that would become an extremely powerful institution,\textsuperscript{141} and thus begin to have political influence. This is true, most especially is if it is independent of government in the operation of monetary policy. Further, there might be merit in having a fragmented model in that it creates a degree of competition and diversity in regulation so that one supervisory agency can learn from the experience of different approaches to supervision.

Having looked at the advantages, the fragmented model has two main disadvantages. One is that the fragmented structure creates the problems of competitive inequality, inconsistencies, duplication and gaps that arise because similar products offered by, for example banks and insurance companies are regulated differently because they are supplied by different types of financial firms. Another disadvantage is that multiple agencies supervising different financial sectors impair the overall effectiveness of the financial firms as they engage in regulatory

\textsuperscript{140} K. Vagneur, 'Corporate Governance.' (Edinburgh: Heriot-Watt University Press, 2004), page 7/21

\textsuperscript{141} J. Carmicheal et al. ‘Aligning Financial Supervisory Structure with Country Needs’ (Washington D.C: World Bank Institute, 2004), page 27
arbitrage. Abrams and Taylor\textsuperscript{142} describe the problem of regulatory arbitrage in the following terms:

Regulatory arbitrage can involve the placement of a particular financial service or product in a given financial conglomerate where the supervisory costs are lowest or where supervisory oversight is least, thus leading to firms designing new financial institutions to minimize or avoid supervisory oversight.

4.3 THE INTEGRATED OR UNIFIED MODEL OF SUPERVISION

Integrated or unified supervision refers to a model where supervision of more than one sector of the financial system is conducted within the same or one agency. The United Kingdom (UK) abandoned the sector specific regulation model and unified supervision of its financial markets into the Financial Services Authority (FSA), an independent body established by the Financial Services and Markets Act (FSMA) of 2000 which created a single legal framework for financial supervision. Carmicheal et al\textsuperscript{143} has stated that the reason for creating a single regulatory agency in the UK and moving banking supervision from the Bank of England was because of the strong case of a unified regulator and the opinion that such agency should not be the central bank.

It has been reported however that the system of financial regulation in the UK will be abolished, and further that the FSA will cease to exist in its current form, as was confirmed by Chancellor George Osborne who stated that he will give the Bank of England the key role in regulating the UK financial sector.\textsuperscript{144} The reason for so deciding was as a result of the “...lessons of the greatest banking crisis in our time,” in particular, as no one was controlling levels of debt, when the credit crunch began, it was difficult to ascertain who was in charge.\textsuperscript{145} The report further states:

Mr Osborne paid tribute to Alistair Darling, his predecessor as chancellor but went on to criticise the current tripartite system of regulation, which divided responsibility between the Bank of England, the FSA and the Treasury. As expected, he confirmed that the FSA would

\textsuperscript{143} J. Carmicheal et al. ‘Aligning Financial Supervisory Structure with Country Needs’ (Washington D.C: World Bank Institute, 2004), page 28
\textsuperscript{144} www.fsa.com visited on 02/11/11
\textsuperscript{145} www.fsa.com visited on 02/11/11
be broken up and the part that monitors financial institutions would continue as a "new prudential regulator" but would operate as a full subsidiary of the Bank of England.\textsuperscript{146}

The most important advantages of this model of supervision are that integrated supervision allows for more effective supervision of financial conglomerates and permits economies of scale to be obtained in regulation, especially with regards to resources in administration and infrastructure support. These two benefits form the basis upon which most countries decide to integrate their supervisory authorities. A useful definition of a financial conglomerate\textsuperscript{147} is that, it is “any group of companies under common control whose exclusive or predominant activities consist of providing services in at least two different financial sectors, (banking, securities, insurance).”

The growth of financial conglomerate groups such as bancassurance business, that is combining both banking and insurance activities is most effectively supervised under an integrated approach to regulation as supervision of banking and insurance sectors not only share common features but also the legislation governing the two sectors.\textsuperscript{148} Thus, a unified agency is better able to coordinate the aspects of supervision such as licensing and other structural tasks as it is able to assess a group wide picture of the risks of an institution more clearly. This is especially true in instances when financial conglomerates themselves adopt a centralised approach to risk management and risk taking, and a consequence thereof is that a more rapid response to emerging group wide problems are possible.\textsuperscript{149}

It goes without saying therefore that the fragmented model of supervision is best suited to countries where there is an underlying integration of the financial markets, for example, the growth of financial conglomerates in that a single conglomerate regulator might be able to monitor the full range of a firm’s business more effectively be better able to detect potential risks emanating from different parts of a financial institution’s business.

\textsuperscript{146} \url{www.fsa.com} visited on 02/11/11

\textsuperscript{147} Given in the report of the Tripartite Group of Bank, Securities and Insurance Regulators (Tripartite Group, 1995), page 65


\textsuperscript{149} J. Carmicheal et al. Aligning Financial Supervisory Structure with Country Needs (Washington D.C: World Bank Institute, 2004), page 44
The second advantage, that an integrated agency will be able to achieve significant economies of scale holds true in that centralizing regulatory functions and activities can permit significant gains from economies of scale through joint administrative of suitably qualified regulatory personnel, the gathering and using of technology in specialist areas and the development and improvement of supervisory methods.\textsuperscript{150} In short, a single regulator might be more efficient due to shared resources and, in particular, shared information technology systems and staff support services. This economy of scale argument which is termed the ‘small country argument’ is cited by all the Scandinavian countries as a significant factor in their adoption of an integrated approach.\textsuperscript{151} This is because it applies more to countries with limited financial resources.

One important disadvantage of the integrated model of supervision is that there is a danger within a single agency that the necessary distinctions between different products and institutions will not be made as the agency may not have a clear focus on the objectives and rationale of regulation, and as such will not deal with the different problems and risks of the individual sectors. This is because, even though subsectors of the financial system have diversified, their core business invariable remain the same, and thus, the nature of the risks may be sufficiently different to warrant a differentiated approach to regulation and supervision.\textsuperscript{152} It follows therefore that, accountability of the single regulatory agency might be more difficult owing to the problem of not clearly defining objectives for the agency. Thirdly, a fully integrated regulator can become extremely powerful, and this power might become excessive. As Taylor and Fleming argue, a single regulator “with a remit covering both prudential regulation in banking, securities and insurance and with the power to undertake civil proceedings against those suspected of insider dealing or market abuse could

\textsuperscript{151} Taylor, Michael William and Fleming, Alex, Integrated Financial Supervision: Lessons from Northern European Experience: http://ssrn.com/abstract=623981 visited on 03/14/11
\textsuperscript{152} J, Carmicheal et al. ‘Aligning Financial Supervisory Structure with Country Needs’ (Washington D.C: World Bank Institute, 2004), page 48
potentially become a bully, a bureaucratic Leviathan divorced from the industry it regulates."\(^{153}\)

4.4 IS ZAMBIA’S SUPERVISORY MODEL WELL SUITED TO THE COUNTRY’S CURRENT NEEDS?

It is now cardinal to address the fact of whether Zambia’s supervisory model is well suited to the country’s current needs, and thus adequate. Indeed, the Zambian banking sector has grown, not only with regards to the number of banks currently operating in the country, but also as evidenced by the developments and expansion of banking services. Growth in the banking sector is deduced by: growth in the size of the balance sheet as measured by total assets which increased from K3, 459 billion to K23, 038 billion in December 2010; growth in total loans as measured by total loans which in December 2001 were K1, 079 billion but increased to K9, 164, billion in December 2010; and growth in the number of commercial banks which increased from 14 in 2001 to 18 as at 31\(^{st}\) December, 2010.\(^{154}\) There has been also, in the Zambian banking sector an increase in bank physical infrastructure such as new branches and agencies. In terms of complexities in products that are offered by commercial banks, there has been advance in technology, in that there is financial innovation now than before such as electronic banking, phone banking, ATMs, tailor made bank accounts, to mention a few.\(^{155}\)

There are no emergence of financial conglomerates in Zambia as no commercial bank in Zambia would be said to be a conglomerate because not only are most of these banks subsidiaries of foreign banks, but all of them are strictly into banking business. This restriction of banking business is provided for under the BFSA\(^{156}\) which stipulates:

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\(^{154}\) Evidenced by consolidated balance sheets and report for banks for December 2001 and December 2010 by BOZ. Sourced from BOZ offices on 23\(^{rd}\) March 2011.

\(^{155}\) A. Mwenda ‘Bank Performance and Economic Growth in Zambia’ available at [www.africanforumreview.org](http://www.africanforumreview.org) visited on 18/03/11

\(^{156}\) Section 2 of BFSA
banking business" means the business of-

(a) receiving deposits from the public including chequing account and current account deposits and the use of such deposits, either in whole or in part, for the account of and at the risk of the person carrying on the business, to make loans, advances or investments

(b) providing financial services; and

(c) any custom, practice or activity prescribed by the Bank of Zambia as banking business;

It is clear from the foregoing that the definition of banking business does not allow banks to be financial conglomerates by prescribing the combination of insurance, banking and securities activities. Indeed, one might argue that when banks participate on LUSE, for example, in the form of collective investment schemes as discussed in Chapter 2 of this paper or when they act as insurance agents and are thereby registered as such by PIA, can they then, not be said to be financial conglomerates. The answer is in the negative because even though they engage in these activities in the insurance and securities markets, they do not exclusively or predominantly engage in these activities, as would enable them to be called a financial conglomerate owing to the definition given in this paper. For example, for a bank to be called a financial conglomerate, it must be engaged in bancassurance exclusively or predominately as a form of business.

4.5 CONCLUSION

The fragmented model of supervision in Zambia is adequate in light of the increasing complexity and growth in the banking sector in that, although some of the conditions that should allow a country to move to an integrated model of financial supervision such as a small economy with limited resources, and possibly, potential for achievement of economies of scale are present in Zambia, such a move is not necessary at the moment. This is because the current regulatory framework of the banking sector has performed relatively well since 2000 to date as pointed out in Chapter Two. Further, the very fact that no bank has failed as a result of the global financial and economic crisis may be a pointer to the success of this model. With regard to financial conglomerates, these are largely not existence as the Zambian banks are not financial holding companies as most of them exist in Zambia as subsidiaries of foreign owned banks. And while there are obvious linkages among key financial sectors, the
insurance, banking and securities markets, our financial markets are not fully integrated. Due to these linkages among the financial subsectors, activities in one subsector can have a significant impact on the other subsectors. For example, the pensions and insurance subsector provides significant liquidity to the banking subsector. A collapse of say, National Pension Schemes Authority (NAPSA) would have a significant impact on the liquidity position of the banking subsector. It is as a result of these linkages of the financial sectors that caused BOZ to sign MOU with PIA and SEC, primarily in order to be able to exchange information among the key players of the Zambian financial market on the performance of these sectors. Further, the model of supervision to the regulate the financial industry is beyond the bank of Zambia’s authority to determine. That is more of Government policy decision.
CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

Having come to the end of this study, whose overall objective was to determine whether the supervisory model that Zambia, under the Bank of Zambia has adopted to regulate the financial institutions, in particular the Banks is efficient and effective, therefore, successful in as far as regulation and supervision of the financial sector is concerned. And if not, whether there is need for change to an integrated or unified model of supervision, or whether there is need to enhance the model by way of reform. It is now important firstly, to state the findings of this study, and in line with those findings to suggest reforms to imperfections or indeed uncertainties in the law.

5.2 THE FINDINGS

The broad objectives of the study (a) to (d) as set out in Chapter one have revealed the following:

(a) In chapter two, it was ascertained that the purpose of bank supervision by BOZ is to establish whether the banking sector is sound, effective and stable by verification of assets and liabilities of the banks and to ensure that management of banks comply with laid down rules. This is necessary for effective financial intermediation to take place and to promote confidence amongst market players in the financial sector so as to enable the economy to move forward. Thus, the aim of the supervisory role of BOZ is to maintain a stable and efficient financial system. The legal mandate to supervise banking business is derived from the BFSA, which is supplemented by various regulations and circulars promulgated pursuant thereto.

(b) Chapter 2 identified some practical constraints or difficulties that BOZ encounters in its supervisory role, these include political pressure and interference by senior state official. Other constraints are insufficient human and monetary capital which impede BOZ from keeping up with industry evolution and innovation through continuous training, research and law reviews so as to adequately supervise the growth and rise of
banking business. On the other hand, the legal constraints that BOZ faces include lack of legislation on Depositors Protection which would provide Government through BOZ with a formal mechanism for dealing with insolvent banks, thus ensuring that depositors monies are protected in case of bank failures. Another legal constraint is a lack of definition of what constitutes ‘unsafe and unsound practices.’ This uncertainty in the law prevents BOZ as regulator form promoting consistent and well meaning enforcement of the law as it is not clear what those practices constitute. Further, chapter four pointed out that although the definition of banking business does not include banks offering insurance services to the public, some banks do act as agents of insurance companies. This points to the fact that the BFSA has not clearly delineated the extent to which banks can engage in activities on the insurance and securities markets and which supervisory bodies can oversee such activities.

(c) In chapter four, it was established that the current supervisory model has been adequate and effective in light of the growth of the financial market, these being the insurance and securities markets, and the growth in the banking sector in terms of financial innovation. The fragmented model of supervision is adequate in that although some conditions that allow a country to move to an integrated approach of supervision such as a small country with limited resources, and possibly, potential for achievement of economies of scale are present in Zambia, such a move is not necessary at the moment. This is because the current regulatory framework of the banking sector has performed relatively well since 2000 owing to various legal, regulatory and institutional reforms. Also, the fact that no Zambian bank has failed as a result of the global financial and economic crisis may be a pointer to the resilience of this model.

(d) In chapter four, the study determined that financial conglomerates are largely not existent in Zambia as Zambian banks are not financial holding companies, in that most of them exist in Zambia as subsidiaries of foreign owned banks. Further that, while there are obvious linkages among key financial sectors, the insurance, banking and securities markets, our financial markets are not fully integrated to cause BOZ to change the approach of supervision from the fragmented to the integrated model of supervision. Thus, the fragmented model is adequate and effective at present.
5.3 RECOMMENDATIONS

(a) Institutional Reforms

It has been identified in this paper that political pressure and interference is one of the major constraints that BOZ faces in its supervisory role of banks and financial institutions. It is therefore submitted that BOZ should extricate itself from such pressure in order to effectively supervise the banks and financial institutions. In this regard, the following are specifically recommended:

i. The Governor should be appointed by the President on the recommendation of an independent body subject to ratification by Parliament.

ii. The Governor should enjoy tenure of office, removed only by an appropriate independent body.

iii. The tenure of the Governor’s term of office must not run concurrently with the term of office of a particular Government. This will guarantee the Governor’s continuity in office, and enhance professionalism.

iv. The Board of Directors of the Bank of Zambia should comprise members from key financial and economic associations and stakeholders in the economy. The directors should be Zambian nationals with recognised and appropriate qualifications and experience in economic and financial affairs.

v. The Governor should not be chairperson of the board of directors. This will be in conformity with corporate governance best practice which require the chief executive of an institution not to be appointed chairperson of the board of directors.

vi. There is need to amend the BOZ Act and any other relevant law to enhance and protect the independence of BOZ in carrying out its central bank functions as highlighted above.

As BOZ faces human and monetary capital constraints, it is submitted that Parliament should deliberately designate funding to BOZ under the budgetary allocation to enable the institution
keep up with industry evolution and innovation through continuous training and recruitment of necessary officials, research and law reviews.

(b) Law Reform

The law should provide for appropriate measures to protect depositors and investors who have interests in collective investments schemes (under an investment company) that are undergoing liquidation. Firstly, it is acknowledged that there is a draft Depositors Protection bill that is undergoing the process of enactment in Parliament, there is need for expediting of the enactment of the bill into law as it is important that depositor’s funds be protected in case of bank failure. Secondly, BOZ and SEC should co-ordinate in supervising and regulating the banks as they set up and run the collective investment schemes by formulating a law that will protect investors in these schemes, especially in cases of bank failure.

Further, the BFSA should be amended by defining what constitutes ‘unsafe and unsound’ bank practices so as to prevent uncertainty in the law and enable BOZ as regulator promote consistent and well meaning enforcement of the law, or the Central Bank can provide a policy definition as has been done in the US by the Federal Deposit Insurance Corporation.

The BFSA should also be amended by providing how far banks can engage in activities under the insurance and securities markets and which supervisory body will oversee such activities. For instance, although the definition of banking business does not include banks offering insurance services to the public, some banks do act as agents of insurance companies. Thus, the BFSA should clearly delineate the extent to which such services linked to other financial sectors should be provided.

(b) Strengthening Financial and Prudential Regulation and Compliance with International Standards

BOZ should embark on strengthening corporate governance in financial institutions such as corporate governance regulations and continual review and updating of the regulatory frameworks that meet the country’s unique needs to keep pace with innovation and evolving trends in the banking sector while accommodating changes to global best practice.
5.4 CONCLUSION

Having found that the fragmented model of supervision that is used to regulate financial institutions, in particular the banks has been adequate and effective in that the current regulatory framework has performed relatively well since 2000 to date. This model is thus, well suited to the country’s current needs such as the growth of the financial market, the increasing complexity and growth in the banking sector, in terms of financial innovation. Further, there is no emergence of financial conglomerates in Zambia, as all Zambian banks are not financial holding companies and as such our financial markets are not fully integrated to necessitate the change to an integrated or unified model of supervision. Also, the fact that no bank in Zambia has failed as a result of the 21st Century global financial and economic crisis is a pointer to the resilience of the model and that it can withstand the risks occasioned by changes in the banking environment. Indeed, even though the banking sector is financially viable and has witnessed steady growth since 2000, and as a result market confidence has grown, attributing to the success of the fragmented model of supervision, there is still need for reform in certain areas as demonstrated.
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