Legal aspects of banking regulation: Common law perspectives from Zambia

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One of the most important causes of the current global economic crisis was the failure of financial regulation. National regulatory frameworks in many countries failed to adequately control the activities of those financial institutions over which they had jurisdiction. In addition, in some cases they did not have the authority to regulate either certain key financial actors, such as hedge funds, or many important financial instruments, for example many forms of derivatives. The result has been the worst economic crisis since the Great Depression and a number of states being forced to bail out their banking institutions. In addition, the crisis showed that there was insufficient co-ordination between national regulators at the global level.

It is clear that one essential element in our efforts to avoid experiencing such a crisis again is to design and implement more effective regulatory frameworks for banking and financial institutions. Since all financial institutions are created under national law and most financial institutions operate primarily in national markets, an essential step in this process must be revising national regulatory frameworks in each country. These frameworks must take into account that the major financial institutions have significant cross-border activity. For this activity to promote human welfare, there needs to be a minimum level of consistency across national regulatory regimes and some degree of co-ordination between different national banking and financial regulators.

Given the great diversity in levels of economic development across countries and in their banking systems, it is inevitable that efforts to promote regulatory consistency are limited to articulating a set of general principles that can then be adapted to the individual situation of each country. The currently applicable set of principles is the Core Principles of Banking Supervision (Core Principles) which were developed and further refined by the Basel Committee of Banking Supervisors (Basel Committee). Given the severity of the recent regulatory failures, it is to be expected that the Basel Committee will eventually revisit these Core Principles and make adjustments to them.

The Basel Committee will face an important challenge in undertaking this assignment. It will need to demonstrate that it has followed a participatory process in developing the new principles. This is necessary to ensure that the resulting general principles address the regulatory concerns of all the countries of the world and can be adapted to the wide variety of circumstances in which they will be applied.

Unfortunately, the Basel Committee, because of its relatively restricted membership, has a 'participation deficit'. One way to correct this deficit is to generate information on how the regulatory frameworks in different countries are incorporating the Core
Principles and on the challenges they face in doing so. The technical experts on the Committee can then use this information to make adjustments in the Core Principles.

Kenneth Mwenda's book is as an excellent example of the work that is needed if the Basel Committee and other international regulatory co-ordination bodies are to develop effective and universally applicable general principles. In this book, he analyses how the Zambian banking regulatory regime incorporates the Core Principles and other applicable international principles, such as the Principles and Guidelines for Effective Insolvency Systems and principles on money laundering. He points out areas where the Zambian regulatory framework functions well and where it needs further adjustments in order to comply with these principles and function effectively as the regulator of the Zambian banking system. In so doing, he also implicitly raises questions about the applicability of the Core Principles to a small country like Zambia.

Thus, while his book is an important contribution to the development of Zambian law, it is also a template for the kind of work that needs to be done across Africa so that both African countries and the international banking regulatory community have a better understanding of the banking regulatory requirements in Africa. This information should both inform the work of the Basel Committee in developing new universally applicable general principles and help national authorities apply them in their different national contexts.

Professor Daniel Bradlow
SARCHI Professor of International Development Law and African Economic Governance, University of Pretoria, South Africa, and Professor of Law, American University Washington College of Law, Washington DC, USA
Valuable international and comparative legal perspectives on banking regulation and supervision are presented in this book. The book is a sequel to my earlier published scholarship in the fields of financial services regulation and international and comparative corporate law, reaffirming a sustained commitment to legal scholarship in these fields.

Like the eclectic taste of an artist developing a mosaic, a scholar, too, must finesse his or her eclectic taste of erudition. There is a certain quiet and loneliness that comes with indulging clairvoyantly in matters of erudition, especially when it comes to scholarly writing, albeit some warm and cordial intermissions that may come from family, friends and colleagues. However, with some commitment, applied competence and lasting perseverance, there is usually a sense of elated but humane decorum in the actual physical product of the mind.

In the sojourns of international legal practice, such as the road I have traversed in the last ten to eleven years, I have come to understand that nothing is as practical as a good theory. Often a time, a good theory is reflective of, and a culmination of, evidence of best practice. As such, there is no substitute for research when it comes to seeking the truth. And the kernels of intellectual leadership cannot be divorced by any justifiable means from what obtains in practice for there is a strong nexus between sound intellect, on the one hand, and best practice, on the other. For example, for a development practitioner or policy maker to articulate or lead policy dialogue proficiently, it would be too costly to rely solely on some long-held dogmatic practice. Such dogmas or articles of faith do not often benefit from circumspection to determine the validity of the underlying theoretical or ideological premise. Yet, there are some people who claim, and proudly too, to have many years of practical experience in doing the same thing over and over again, forgetting that they may have been doing that same thing wrongly much of their life. Such human failings, predicated on robotic and dogmatic intuitions, are often a result of treating lightly, or paying insufficient attention to, valuable and useful theories or ideas in a relevant discipline. Indeed, practice devoid of enlightenment is a good recipe for failure, as much as the carrying out of unintelligent repetitive tasks does not make one a genius. There can be no substitute for erudition, and, thus, may our cooking places never grow cold.

By parity of reasoning, many theoretical and ideological constructs are developed on the basis of systematically and repeatedly observed facts. Therefore, a theory that subsists in the abstract only, without much relevance to concrete reality, is of less value to socio-economic and political inquiry. In this vein, intellectual leadership should not be understood as confined solely to the congenial habitats of classroom pedagogy. This form of leadership extends also to the practical implementation of policies, projects and programmes, as it often
points to evidence of best practice. It is, therefore, utopian and a fallacy for some apologists who, not having the necessary appetite or intellectual capacity to pursue knowledge fully, argue that legal practice, for example, is entirely different from academia. For those of our friends who hold dear such myths, we say, as they would say in Russia: God save us from our friends; from our enemies we can defend ourselves. To argue that theory and practice are totally de-linked, or that there is no correlation between the two, is a shortsighted sanctuary of laziness or simply the economical treatment of the truth. The two, academia and legal practice, do feed into each other like a hand and a matching glove, or like the blossoming love between a bride and a groom. And that particular cross-breed is a path that some of us have chosen to take. I can only profess best that which I have put to test or practised, as much as I can only practise diligently that which is grounded in sound and scientific theory.

It follows from the foregoing that, in March 2008, after the successful examination of some of my published scholarly work, which included several notable books and peer-reviewed journal articles, by a distinguished panel of eminent senior law professors drawn from the United Kingdom, South Africa and Germany, I was formally admitted to the Higher/Senior Doctorate Degree of Doctor of Laws (LLD) by Rhodes University. This Higher Doctorate, earned almost ten years after the completion of my PhD in Law at the University of Warwick, encouraged me to keep pushing the frontiers of knowledge. It was the first time ever that a Higher Doctorate was being awarded to a national of my home country, Zambia. And Commonwealth Africa, as a whole, has, arguably, not more than seven to eight Higher Doctorate degree holders in Law.

In the formal citation for the award of this Higher Doctorate Degree by Rhodes University, the then Dean of the Faculty of Law, Professor JR Midgley, had the following to say:

Mr Chancellor

This University does not often award a senior doctoral degree based on the examination of a person’s published scholarly works. In fact, this is the first time ever that such a degree is conferred in the Faculty of Law.

The examiners commented that our graduand’s books and articles show a remarkable broad and detailed knowledge of financial and supervisory systems all over the world—not only of legal issues, but also of economic structures and processes, especially in the financial industry.

Although he often concentrates on special structures in Southern Africa, especially his home country, Zambia, the candidate regularly raises issues of global importance. He is said to own a real treasure of experiences regarding developments in post-communist and post-colonial countries and his work evidences a blend of different legal cultures, statutory law and international law, which makes it unique in its field.

All the examiners had high praise for our graduand’s work, which in their view, constitutes a distinguished contribution to the advancement of knowledge in the field of national, regional and international financial institutional and legal framework.

1 See I Shivji ‘The life and time of Babu: The age of revolution and liberation’ (2001)
Mr Chancellor, I have the honour to request you to confer the degree Doctor of Laws on Kenneth Kaoma Mwenda.

The long scholarly journey leading to the aforesaid Higher Doctorate degree from Rhodes University started many years ago. From a period of gaining knowledge to an epoch of adding to the existing body of knowledge and then passing down that knowledge, it has been a journey of courage and determination. It started with an academic career at the University of Zambia, and continued through Oxford (as a Rhodes Scholar), the latter institution where I obtained my graduate BCL degree. After that, I found myself back in academia, but this time as a law lecturer at the University of Warwick. I have always found myself gravitating towards the world of the mind. It is something that seems to be a part of me and that I have warmly and gladly accepted.

In January 2009, I was honoured by an invitation from the Centre for Human Rights at the Faculty of Law, University of Pretoria, to take up the position of Extraordinary Professor of Law. This was a noble and honourable gesture that I could not afford to turn down. Here was a chance to give back to Africa. In a way, like a prodigal son that had fled from home to wander around and seek out what lies beyond home, I have found myself returning to academia time and time again. They say home is where the heart is. I would bet this should be home, especially if you have to return with some nostalgic cravings to add a voice to the world of the mind.

In this book, whose idea came through while I sat on a flight from South Africa, after graduating from Rhodes University, I examine the efficacy of the legal and institutional framework for banking regulation in Zambia and other common law countries. At the time of developing the idea of the book, the global economic crisis was just beginning to unfold in the US. It was, however, evident that sooner or later the roof would come crashing in. It is in the light of the global economic crisis that I began to think around the idea of writing a book on the legal and regulatory aspects of banking supervision in sub-Saharan Africa. Zambia stood out as a natural choice for a case study. I know the country and its legal system very well. But then, I did not want to confine the book to Zambia alone. It is for this reason that the book brings out a number of themes that are of wider application to many other common law jurisdictions.

Bearing in mind that a meta-paradigmatic and holistic approach is useful in understanding the intricate interdisciplinary aspects of banking supervision, a critical exposition of the legal, regulatory and institutional framework for banking supervision is provided. The book draws on various facets of knowledge from both interdisciplinary and multidisciplinary perspectives. Also, that there is a dearth of literature on topics such as banking regulation, as it obtains in sub-Saharan Africa, provides a compelling case for the study. This is a book that stands out from many other books that have been written on banking regulation law and practice in that it is the first authoritative work on banking regulation law in a sub-Saharan African country.
The book begins by setting out the context of the legal meaning of terms such as 'bank' and 'banking business'. And the impact of the legislative efforts to abolish the *ultra vires* doctrine in Zambia is analysed to show how this doctrine impacts on the powers of a bank or financial institution to conduct its business. Closely related to this, the book examines the role of the central bank in Zambia as a banking regulator and supervisor. The book posits that the Bank of Zambia lacks political independence, citing strong evidence to support this view. The legal and regulatory framework for preventing and combating financial crime relating to banking business is also examined. Such crimes include activities of money laundering. Also, the book examines issues pertaining to the statutory prohibition of banks or financial institutions to engage in unsafe and unsound practices. The legal and regulatory framework for corporate governance and risk management in banks and financial institutions is examined, highlighting areas of possible improvement and setting forth policy recommendations for achieving such improvements. The legal aspects of bank insolvency are also explored, showing how these aspects are an intricate part of the legal and regulatory framework for banking supervision.

This book is useful not only to a limited geographical audience, but also to many audiences in other common law jurisdictions, including the United Kingdom, the United States of America, Canada, Australia, New Zealand, South Africa, and many more. The book is informed by critically insightful perspectives that draw from both primary and secondary sources of data. It is an informative tool to those in academia and industry concerned with the practice of central banking and banking supervision, as well as to those preoccupied with the supervision of banks and financial institutions, including relevant policy makers and legislators.

The law and information presented in this book are stated on the basis of materials available to me as at 20 May 2010. However, the interpretations and conclusions expressed in the book are entirely mine. They do not represent the views of the World Bank, its executive directors or the countries they represent.

Professor Kenneth K Mwenda, PhD LLD
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ACKNOWLEDGMENTS

Now that the writing of the book is complete, I am faced with a task which is by no means easy to fulfil. I would like to thank my dear wife, Dr Judith M Mvula-Mwenda, MD, MBA, MPH, and my admirable son, Joseph T Mwenda II, for their unfailing love and support.

I would also like to acknowledge the inspiration that I continue to draw from my dear parents, the late Mr Joseph T Mwenda and Mrs Esther M Mwenda. My father, in particular, remains an unsung hero who taught me the virtues of truth, honesty, integrity, fairness and love. He may not have been as famous as many hopelessly corrupt politicians of our time, or as ubiquitously conspicuous as many celebrities or those supposedly influential business personalities that we so often crave to associate with, but he was, as far as I am concerned, among ‘the hidden righteous men who, according to Jewish mythology, are the only reason why the Almighty has refrained from destroying our sinful world’.\(^2\) My father was a man of exceptionally well-cultivated values. That is where his wealth lay. A man of great character, he was a true gentleman. Although he has now crossed over, he remains my greatest role model. A humanely decent and God-fearing man, whose life was guided by great moral and ethical values, my father gave his best and his all to the love of God and to the pursuit of knowledge. I have no doubt that he is in the goodness and presence of the Lord.

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I cannot stop here without thanking my many other good friends, family members and professional colleagues whose names, if I were to list them all, would occupy a whole chapter in this book. I thank them all for their support and friendship over the years. I am also grateful to Pretoria University Law Press (PULP) and to the peer reviewers for the excellent work leading to the publication of this book.
DEDICATION

For my admirable son, Joseph T Mwenda II. I love you, son, more than you can ever know ... May God watch over, and guide and guard jealously, every single one of your precious footsteps.
The Zambian legal system is founded on the English common law and principles of equity applied by the English courts. Whereas a number of legislative changes have taken place under the English Acts, the Zambian laws have tended to lag behind and therefore not responsive to the changes in the socio-economic environment, largely, due to the predominance of state controls in the economic management of the country until the emergence of political pluralism and economic liberalisation in 1991 ... In order to have a stable, sound and competitive financial system that facilitates efficient intermediation, it is imperative that the statutes that are applicable to the financial system are constantly reviewed to assess their relevancy and adequacy ... Key recommendations to develop the legal infrastructure include: (i) harmonising and strengthening all pieces of legislation relating to the financial sector, including strengthening corporate governance provisions in the Companies Act, Banking and Financial Services Act, Insurance Act, National Pensions Scheme Act, Securities Act, Building Societies Act, Societies Act and the Co-operative Societies Act; (ii) enacting specific legislation on insolvency, liquidations and winding up of companies, corporate bodies registered under the Societies and Co-operative Societies Act, that are engaged in the financial sector or, in the alternative, strengthening provisions of existing laws; (iii) developing foreign currency regulations or enacting a law that would regulate how financial institutions, tourist enterprises, and others may account for foreign exchange transactions for statistical purposes; and (iv) developing the necessary regulations to give effect to the Prohibition and Prevention of Money Laundering Act number 14 of 2001.


1 Context of the study

In contrast to much of the literature that deals with banking law per se, regarding matters such as a banker-customer relationship, or the legal aspects of deposit taking, the issuing of letters of credit and other arrangements pertaining to export credit, this book examines the efficacy of the legal and institutional framework for regulating banks and financial institutions in Zambia. No attempt is made in the book to look at issues such as the legal aspects of bill of exchange
payments since that is covered mainly under banking and international trade law as well as under commercial law. Also, no attempt is made to delve into historical perspectives of how, for example, banking regulation and supervision has evolved in Zambia since such views fall outside the scope of the study and are, in any event, less helpful to our discourse on contemporary and current issues in banking regulation and supervision in Zambia.

Similarly, this book does not concern itself with micro-finance regulation and supervision in Zambia. Elsewhere, Zambia’s institutional and regulatory framework for micro-finance supervision, as well as the various purposes and objectives of financial services regulation generally, are spelt out in greater detail. Likewise, I have explored elsewhere intricate aspects of the Basel Core Principles for Effective Banking Supervision. That discussion will not be regurgitated here, although the Basel Core Principles serve as useful benchmarks in the development of sound national systems of banking supervision. Instead, we will only flesh out those few elements of the Basel Core Principles that directly impact on the legal, regulatory and institutional framework for banking supervision in Zambia. In outline, however, the Basel Core Principles are broadly categorised into seven groups, namely: (a) objectives, independence, powers, transparency and co-operation (Principle 1); (b) licensing and structure (Principles 2 to 5); (c) prudential regulation and requirements (Principles 6 to 18); (d) methods of ongoing banking supervision (Principles 19 to 21); (e) accounting and disclosure (Principle 22); (f) corrective and remedial powers of supervisors (Principle 23); and, (g) consolidated and cross-border banking supervision (Principles 24 and 25).

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The concept of a bank and banking business

Although the terms 'banking regulation' and 'banking supervision' are sometimes used interchangeably in much of the literature on banking, they actually mean two different things. Regulation refers to a set of binding rules issued by a private or public body. These can be defined as those rules that are applied by all regulators in the fulfillment of their functions; in the financial services area, they include such prudential rules as those influencing the conditions of access to the market (intended to prevent the emergence of entities with doubtful reputation or without financial capacity necessary for the operations they intend to implement) and those aimed at controlling the risks associated with financial activities, corporate governance and internal control systems, conduct-of-business rules, and methods of supervision. Additionally, the body issuing these regulations must have the necessary authority to do so. All in all, the regulatory framework for, say, financial services comprises a combination of two or more of the following: (a) primary enabling legislation; (b) secondary legislation issued pursuant to the enabling statute; (c) principles, rules, and codes issued by regulators; and (d) guidance or policy directives issued by the regulatory authority.

By contrast, the term supervision, in ordinary day parlance, entails carrying out functions of managerial oversight regarding the performance or operation of an entity or person. And this can include market surveillance. According to Singh, the concept of prudence is integral to bank regulation and supervision: it connotes the idea that regulation requires bank activities to be undertaken with reasonable care. To that end, the act of carrying out supervision, whether such supervision is done on-site or off-site, is expected to be done in compliance with the regulations issued by the regulator. It is these regulations that will guide the supervisor in the conduct of his or her functions. And a supervisor can carry out his supervisory roles both on-site and off-site, meaning that some supervisory tasks can be accomplished through desk analysis mainly, while other tasks will also require the supervisor to go on-site physically to inspect the performance of a bank or financial institution. Put simply, one school of thought argues somewhat narrowly that markets are the ones that are regulated and that, by contrast, market players are supervised. This view postulates that, while regulation aims at bolstering market

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7 See International Compliance Association (n 8 above) 46-48.
8 See Mwenda (n 5 above) 5.
9 See International Compliance Association (n 8 above) 22.
11 Under Core Principle 20 of the Basel Core Principles for Effective Banking Supervision (see Basel Committee on Banking Supervision (n 7 above), an effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.
discipline as well as investor protection and confidence, supervision focuses mainly on ensuring that market players are in compliance with the regulations. Through such compliance, market players also find themselves being regulated. Singh, however, observes:

The general debate about the distinction between regulation and supervision has also focused on whether a regulator has adopted a rules- or discretion-based approach to fulfil its statutory responsibilities. While regulation is suggested to prescribe how management should reach decisions, supervision allows a significant degree of judgment to be exercised in decision making. In this respect, the regulation-based approach has tended to place limits on the autonomy of management with prescriptive and restrictive rules, whereas supervision is suggested to respect the autonomy of management to comply with a broad range of standards. In terms of both regulation and supervision regulators have nevertheless the authority to intervene and deal with issues of non-compliance. Indeed, regulation- and supervision-based approaches both house elements of each other, failing which a regulation-based approach could be considered over-inclusive and a supervision-based approach under-inclusive.12

In some countries, such as many African common law countries, including Zambia,13 the central bank is entrusted with both the legal authority to carry out banking supervision as well as the power to issue regulations for the banking industry. In other countries, the power to issue these regulations is reposed in a different body from that carrying out the supervisory functions.14 Further still, the power to mete out sanctions against parties acting in breach of the regulations could be vested in another body altogether.15 In essence, regulatory and supervisory systems differ from one country to another. It all depends on how the industry is structured and governed.

In this book, we will use the terms 'regulation' and 'supervision', or 'regulator' and 'supervisor', interchangeably since Zambia's central bank, the Bank of Zambia, is both a regulator and supervisor.16 Against this background, and mindful that there is a plethora of international standards, principles and codes of best practice in the area of banking regulation and supervision,17 the book

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12 Singh (n 12 above) 47.
13 See ch 3.
14 See Mwenda (n 5 above) 5-18.
15 As above.
16 See ch 3.
17 See generally various standards and principles promulgated by the Basel Committee on Banking Supervision, such as the Basel Core Principles for Banking Supervision and the Basel I and Basel II Capital Framework. The Basel II Capital Framework, eg, has standards pertaining to risk management practices, strengthening banks' management of liquidity and better disclosure and valuation practices. See also generally Mwenda (n 6 above); JR Barth et al Rethinking banking regulation: Till angels govern (2006); Singh (n 12 above).
stands back from the international scene to examine instead the municipal law of Zambia. That said, various aspects of the common law pertaining to the legal regulation of banks are also examined. And international best practices are referred to only where such references do not distract from the main argument pertaining to the examination of the efficacy of the Zambian legal, regulatory and institutional framework.

In this chapter, we begin by setting the context of the study through an examination of the concept of a bank and banking business in Zambia. What does the term 'bank' mean? Can any company or institution call itself a bank? And what constitutes banking business? It would be futile to indulge in a discussion on banking regulation without gaining a deeper understanding of the nature of banking business. By parity of reasoning, we would not be standing on firm ground without a fuller appreciation of the legal characteristics of the institutional vehicle through which banking business is conducted. Such an appreciation will equip us with a better understanding of what constitutes banking business and how the banking sector operates. Acknowledging the changing nature of banking business, Cranston observes:

> With multifunctional ('universal') banking prudential regulation of a bank is needed in respect not only of core banking, but other activities as well — securities, insurance and so on — where they threaten contagion of the financial system.18

Elsewhere, I have examined the concepts of universal banking, unified financial services supervision, principles-based regulation and rules-based regulation.19 For lack of space here, that discussion will not be repeated. We now turn to examine the concept of a bank and banking business.

2 Defining the terms ‘bank’ and ‘banking business’

Core Principle 2 of the Basel Core Principles for Effective Banking Supervision provides that:

> The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word 'bank' in names should be controlled as far as possible.

19 See generally Mwenda (n 5 above).
Similarly, the Banking and Financial Services Act 1994 of Zambia provides that:

(1) A person other than a bank shall not, without the consent of the Bank of Zambia (the central Bank), use the word 'bank' or any of its derivatives in any language, or any other word or symbol indicating the transaction of banking business, in its name or in any prospectus, advertisement or statement of any kind published or made to describe its business in Zambia.

(2) A person shall not falsely represent to the public or any member of the public:

(a) that the person holds a licence to conduct any financial service business; or

(b) that the person is licensed to conduct any financial service business of a particular kind.

(3) Any person acting in contravention of this section shall be guilty of an offence and shall be liable on conviction to a fine not exceeding one hundred thousand penalty units or to imprisonment for a term not exceeding five years, or to both.20

Closely related to the above statutory provision is section 119 of the same statute, providing the following exceptions to the rule limiting or restricting the use of the name 'bank':

(1) Subject to subsection (2), a person carrying on a business shall not use any name which indicates or may reasonably be understood to indicate (whether in English or in any other language) that the business is a bank or a financial institution or is carrying on banking business or financial service business unless the business is licensed under this Act.

(2) Subsection (1):

(a) does not prohibit the use of the kind of name referred to in that subsection by a company or other entity incorporated or otherwise established outside Zambia and which has no permanent place of business in Zambia for the purposes of soliciting business or advertising its business in Zambia;

(b) does not apply to:

(i) a bank or financial institution established by or under a written law of Zambia;

(ii) a regional or international bank or financial institution whose membership consists partly or wholly of member states; or

(iii) such other person as the Minister may, by statutory instrument, exempt.

(3) An authority which, under any written law, is responsible for the registration of businesses or business names shall not register a business

or the name of a business that would be in contravention of subsection (1).

(4) Where on the coming into force of this Act a business or the name of a business is already registered in a style that is otherwise prohibited by subsection (1), the authority responsible for the registration shall, within three months after the coming into force of this Act, notify the Bank of Zambia of the registration and order the owner of the business or the business name to alter or modify the name so as to comply with subsection (1).

The two statutory provisions highlighted above help to explain that not every company or institution in Zambia can call itself a bank or financial institution. Also, at common law, there have been several attempts to define the terms ‘bank’ and ‘banking business’. The courts have been pre-occupied with treating, as a bank, institutions that undertake the business of banking. But, then, how do we define ‘banking business’? The courts have not given a satisfactory definition of the term ‘bank’, although they have succeeded in spelling out some of the characteristics which must be fulfilled if an institution is to be treated as carrying on the business of banking. In United Dominions Trust Ltd v Kirkwood, Lord Denning MR, drawing on the usual characteristics of banking, as spelt out in Paget’s law of banking, ruled:

There are, therefore, two characteristics usually found in bankers today: (i) They accept money from and collect cheques for, their customers and place them to their credit; (ii) They honour cheques or orders drawn on them by their customers when presented for payment and debit their customers accordingly. These two characteristics carry with them also a third, namely (iii) They keep current accounts, or something of that nature, in their books in which the credits and debits are entered.

In the Kirkwood case, the Court of Appeal observed that an institution could qualify as a bank even if it did not carry on the exclusive business of banking. Here, what really mattered was that the institution was carrying on, among other activities, the business of banking and that that business constituted a substantial whole of

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21 See also Mwenda (n 6 above) 2-7; and KK Mwenda ‘Legal construction of the term ‘bank’: A comparative study’ (2000) 8 Tilburg Foreign Law Review 113-120.
22 See eg A Arora Practical banking and building society law (1997) 15.
23 As above.
24 [1966] 2 QB 431 (CA).
26 [1966] 2 QB 431 447; see also 45 per Diplock LJ.
27 See generally [1966] 2 QB 431; see also Re Shields’ Estate [1901] 1 IR 172.
the activities of the institution. Arora observes, however, that in *Re Roe's Legal Charge* the court emphasised that it was not concerned with the size of clearing activities of an alleged bank in comparison to the number of clearings of other recognised banks. Thus:

Where the usual characteristics associated with the banking business were not satisfied the court could take into account the commercial reputation enjoyed by the institution; if the institution was treated as a bank within the commercial community then the courts would recognise it as such. On that approach the evidence produced by UDT in *United Dominions Trusts Ltd v Kirkwood* was sufficient to establish its status as a bank ... The words 'bona fide' carrying on the business of banking were held in *United Dominions Trust Ltd v Kirkwood* to involve two requirements: (a) the banking transaction must not be negligible in size when compared to the rest of the business; (b) the transactions relied on must genuinely be banking transactions and not merely a disguise for other transactions of a different legal nature.

However, to qualify the argument advanced by Arora — that where the usual characteristics associated with the banking business were not satisfied the court could take into account the commercial reputation of the institution — it is now argued that an institution's reputation alone, as Harman LJ rightly noted in the *Kirkwood* case, is not sufficient. To confirm the status of an institution as a bank, other factors must be considered too. These factors include the core business undertaken by the institution. In the next chapter, that is, chapter 2, we shall examine the aspect of what constitutes the core or principal business of a company. Here, suffice it to say, some scholars have argued that the shortcoming of the analysis in *Kirkwood*, on the meaning of banking business, is that that analysis cannot now be regarded as sufficient.

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28 See *Re Shields' Estate* (n 29 above). In *Bank of Chettinad Ltd of Colombo v IT Comrs, Colombo* [1948] AC 378 383, the Privy Council noted that a 'banking company' was 'a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order'. See *Davies v Kennedy* (1868) 17 WR 305, where it was held that a banker is one who is considered in commercial circles to be one. But, then, do each of the cases here provide a satisfactory solution? See also *Re District Savings Bank Ltd ex Coe* (1861) 3 De GF & J 335; *Joachimson v Swiss Bank Corporation* [1921] 3 KB 110.

29 [1982] 2 Lloyd's Rep 370 381.

30 Arora (n 24 above) 17.

31 As above.

32 As above.

33 [1966] 2 QB 431 (CA).

34 See eg Cranston (n 20 above) 4. Also, Prof Ellinger, commenting on the *UDT v Kirkwood* case, as quoted in LS Sealy & RJA Hooley *Text and materials in commercial law* (1994) 553, observes: 'It is clear that the three judgments in the *Kirkwood* case take divergent views regarding the importance of reputation for determining whether or not a given institution is a bank. As a rigorous analysis of
First, it ties itself to payment through the cheque system, thus excluding traditional savings and co-operative banks, quite apart from merchant (investment) banking. More importantly, cheques are only one way in which payments are effected: indeed, before too long, cheques will have had their day. Moreover, to universalise the Kirkwood, or any, definition ignores the point that definitions are developed in a particular context. The notions of a ‘bank’ and ‘banking’ will bear different shades of meaning turning on the issue. Broadly speaking the jurisprudence about the meaning of banking has arisen in three contexts. The first revolves around regulation: For example, is a particular body in breach of the law since it is carrying on banking business in the jurisdiction without a banking licence? Secondly, some legislation confers a privilege or protection on ‘banks’ without defining them, and the issue becomes whether a particular body can take advantage of it. For example under section 4(1) of the Cheques Act 1957 [UK statute], bankers (undefined) who convert cheques by collecting them for customers have a defence if they can establish that they acted in good faith and without negligence. Thirdly, those seeking to avoid a payment obligation have occasionally argued that it arose on an illegal contract, which is void or unenforceable because it is owed by or to an unlicensed bank.

In Zambia, like in many other jurisdictions, there has been legislative intervention in the definition of terms such as ‘bank’ and ‘banking business’. Prior to the enactment of the Banking and Financial Services (Amendment) Act 2000, section 2 of Zambia’s Banking and Financial Services Act 1994 provided as follows:

In this Act, unless the context otherwise requires:
‘bank’ means a company that holds a banking licence;
‘banking licence’ means a licence granted under section four; ...
‘banking business’ means the business of receiving deposits from the public 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, and includes any custom, practice or activity prescribed by regulation as banking business; ...
‘company’ means a body corporate incorporated under the Companies Act or the Co-operative Societies Act ...

Stating clearly in its definition of ‘bank’ and ‘banking business’, that ‘unless the context otherwise requires’, the Banking and Financial Services Act 1994 of Zambia provided definitions which were somewhat in line with the contextual approach advocated by

law, Harman LJ’s view is to be preferred. According to the common law definition, a bank is an institution that actually carries on banking business; not an institution which has the reputation of doing so or of being a bank. This definition postulates an objective test. Lord Denning, and to a lesser extent Diplock LJ, propounded a test based on subjective criteria.’

Cranston (n 20 above) 4-5.
However, defining a bank as simply a company that held a banking licence, as the Zambian Banking and Financial Services Act 1994 did, raised a number of illogical difficulties. That statutory approach entailed that the objects of a bank, as a company holding a banking licence, could be anything far removed from banking business. What mattered most was that the company had a banking licence. And even if we were to assume that before a banking licence is issued to a company, the issuing authority will have vetted the documents furnished by the applicant for a banking licence, including the memorandum of association of the company which contains the company's objects clause, what would happen in the event that the said company, upon being issued with a banking licence, subsequently amends its objects clause so as to enable itself to carry on business unrelated to banking? Will the banking licence cease to have effect just because the objects clause has been so amended?

In determining what constitutes 'banking business' in Zambia, a possible way forward would have been for the Zambian parliament to legislate or codify the broader definition provided by Isaac J in the Australian High Court case of *Commissioners of the State Savings Bank of Victoria v Permewan, Wright & Co Ltd.* In that case, Isaac J's analysis, which was later rejected by Lord Denning MR in the *Kirkwood* case, postulated as follows:

The essential characteristics of the business of banking are ... the collection of money by receiving deposits upon loan, repayable when and as expressly or impliedly agreed upon, and the utilisation of the money so collected by lending it again in such sums as are required. These are the essential functions of a bank as an instrument of society. It is, in effect, a financial reservoir receiving streams of currency in every direction, and from which there issue outflowing streams where and as required to sustain and fructify or assist commercial, industrial or other enterprises or adventures ... The methods by which the functions of a bank are effected — as by current account, deposit account at call, fixed deposit account, orders, cheques, secured loans, discounting bills, note issue, letters of credit, telegraphic transfers, and any other methods that may be developed by the necessities of business — are merely accidental and auxiliary circumstances, any of which may or may not exist in any particular case.

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36 On Cranston's analysis, see above. Art 1 of the EU First Banking Directive defines a bank as 'an undertaking' whose business is to receive deposits or other repayable funds from the public and to grant credit for its own account. By contrast, the interpretation and application section of the Canadian Bank Act 1992 defines a bank as follows: "Bank" means a bank to which this Act applies." 19 CLR 457. See also *Re Bottomgate Industrial Co-operative Society* (1891) 65LT 712.

37 *Commissioners of the State Savings Bank of Victoria v Permewan, Wright & Co Ltd* (1915) 19 CLR 457 470-471.
With the coming into force of the Banking and Financial Services (Amendment) Act 2000, section 3 of the Banking and Financial Services Act 1994 was amended to provide that the Banking and Financial Services Act 1994 applies to all banks and financial institutions, whether or not constituted by any Act: provided that the requirements of this Act are not binding on the Bank of Zambia, except in so far as this Act expressly imposes a duty on that Bank.

And it should be noted that the statutory terms 'bank' and 'financial institution' in the Banking and Financial Services Act 1994 refer, respectively, to a legal person and not an unincorporated association. Examples of unincorporated associations in Zambia include partnerships. Additionally, section 5 of the Zambian Companies Act 1994 provides that:

5(1) Subject to this section, an association or partnership that:
(a) consists of more than twenty persons; and
(b) is not a body corporate;
shall not carry on any business for gain by the association or partnership or individual members of the association or partnership.

(2) Subsection (1) shall not apply to a partnership:
(a) formed for the purpose of carrying on a prescribed profession or calling; and
(b) having not more than the number of partners prescribed for the purposes of that profession.

(3) If an association or partnership contravenes this section, each member of the association or partnership shall be guilty of an offence, and shall be liable on conviction to a fine not exceeding five hundred monetary units.

39 See Banking and Financial Services Act 1994, sec. 2 (as amended through to 2000). Examples of unincorporated associations in Zambia include partnerships. Under the English Partnership Act 1890, the statute that governs partnership law in Zambia, sec 1 of that statute defines a partnership as '(1) the relation which subsists between persons carrying on a business in common with a view of profit. (2) But the relation between members of any company or association which is (a) registered as a company under the Companies Act 1862, or any other Act of Parliament for the time being in force and relating to the registration of joint stock companies, or (b) formed or incorporated by or in pursuance of any other Act of Parliament or letters patent, or Royal Charter, or (c) a company engaged in working mines within and subject to the jurisdiction of the Stannaries: is not a partnership within the meaning of this Act.' By parity of reasoning, the relation between members of a company incorporated under Zambia's Companies Act 1994, or its predecessor, the Zambian Companies Act 1921, does not constitute a partnership. However, a group of companies can, as separate legal persons, acting jointly, or with individuals, form a partnership.

40 As above.
Whereas, originally, section 2(1) of Zambia’s Banking and Financial Services Act 1994 provided that the term ‘bank’ meant ‘a company that held a banking licence’, section 2(c) of Zambia’s Banking and Financial Services (Amendment) Act 2000 now provides that a ‘bank’ means ‘a company conducting banking business’. The definition of a ‘bank’ has been broadened. What this means is that the possession of a banking licence per se by any institution does not on its own form the criterion of determining whether or not an institution is a bank. It is important to look at the business of an institution in order to determine if it is a bank. We may need to ask ourselves: Is a particular institution carrying out ‘banking business’ and, if so, what constitutes ‘banking business’? As noted above, we will examine the concept of the core or principal business of a company in chapter 2. Here, suffice it to say, the definition of banking business must be compatible with the practice pertaining to banking in a particular country. To that end, the statutory definition of banking business in section 2(1) of Zambia’s Banking and Financial Services Act 1994 has now been amended to broaden its scope. Originally, this statutory provision provided as follows:

‘Banking business’ means the business of receiving deposits from the public 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, and includes any custom, practice or activity prescribed by regulation as banking business.

The statutory provision referenced above did not provide an exhaustive list of activities to be considered as ‘banking business’. The provision left room for constructive ambiguity, permitting, in addition to the aforesaid activities, ‘any custom, practice or activity prescribed by regulation as banking business’ to be taken as banking business. However, it was not clear which body or office had the statutory authority to prescribe by regulation that a particular practice or activity constituted banking business. Could the Minister of Finance use any one or more of those statutory powers scattered in the Banking and Financial Services Act 1994 allowing him to pass subsidiary legislation, or was it the central bank that was vested with the statutory power to prescribe by regulation what constituted banking business?

Further, under the Banking and Financial Services Act 1994, the term banking business did not only involve the business of receiving deposits from the public. The term included 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. Thus, for an activity to be regarded as banking business

41 As above.
under the Banking and Financial Services Act 1994, such activity had to involve both the receiving of deposits and the use of such deposits, as explained above. It was not good enough that the activity related only to the receiving of deposits or solely to the use of the deposits. There had to be both the 'receiving' and the 'use' of the deposits.

When the Banking and Financial Services (Amendment) Act 2000 was passed to amend the Banking and Financial Services Act 1994, section 2(1)(c) of the Banking and Financial Services (Amendment) Act 2000 introduced the following changes:

'banking business' means any of the following:

(a) the business of receiving deposits from the public including chequeing 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) financial services; and

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

Although many aspects of the statutory definition of 'banking business' in the Banking and Financial Services Act 1994 were retained in section 2(1)(c) of the Banking and Financial Services (Amendment) Act 2000, the inclusion of the words 'chequeing account', 'current account' and 'financial services' in the amendment statute goes beyond the scope of the original statutory definition. Section 2(1)(c) of the Banking and Financial Services (Amendment) Act 2000 now introduces 'financial services' as part of 'banking business', although, as we shall see later, the respective statutory definitions of 'financial services' and 'financial services business' do not include 'banking business'. Prior to the enactment of the Banking and Financial Services (Amendment) Act 2000, the Banking and Financial Services Act 1994 did not include 'financial services' in its statutory provision for 'banking business'. And after the enactment of the Banking and Financial Services (Amendment) Act 2000,
Act 2000, the determination of what constitutes a 'custom' or 'practice' of banking business shifted to become a responsibility of the Bank of Zambia. The Minister of Finance no longer has statutory powers to pass subsidiary legislation over such matters.

Then, on the one hand, the term 'financial institution' is described in section 2 of the Banking and Financial Services Act 1994 as 'a person other than a bank, conducting financial services business'. A 'financial institution's licence', on the other hand, is described in the same statutory provision as 'a licence under section 10 of the statute', and the said section 10 reads: '... a licence authorising the applicant to conduct any financial services business.'

But, what is 'financial services business'? The term 'financial services business' is described in section 2 of the Banking and Financial Services Act 1994 as 'the business of performing or offering to perform any financial services to the public, but does not include banking business'. Then, the term 'financial services' is defined in section 2 of the Banking and Financial Services (Amendment) Act 2000 as:

any one or more of the following services: (a) commercial or consumer financing services; (b) credit reference services; (c) deposit brokering; (d) factoring, with or without recourse; (e) financial leasing or finance leasing; (f) financing of commercial transactions, including forfeiting; (g) the issue and administration of credit cards, debit cards, travellers' cheques or bankers' drafts; (h) the issue of guarantees, performance bonds or letters of credit; (i) lending on the security of, or dealing in, mortgage or any interest in real property; (k) money transfer or transmission services or the payment of cheques or other demand payment orders drawn or issued by customers and payable from deposits held by the payer; (l) purchase and sale of foreign exchange; (m) issuance of debentures and money market instruments and the acceptance of six months (or such other period as prescribed by the Bank of Zambia) term deposits, other than current accounts and chequeing deposits; (n) issuance of building society and mutual society shares, having characteristics similar or identical to those of deposits; (o) venture capital funding; (p) secured or unsecured credit services; (q) any other services as the Bank of Zambia may designate, but does not include: (i) the underwriting, marketing or administration of contracts of insurance; or (ii) any service excluded from the scope of this definition by a provision of this Act or by the Bank of Zambia under this Act.

All in all, four major categories of companies can apply to the Bank of Zambia for a licence to operate as a bank or a financial institution.

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48 As amended through to 2000.
49 As above.
50 See also generally KK Mwenda 'Legal aspects of banking and financial services supervision in Zambia' (2001) 2 ALSB International Business Law Journal 35.
The concept of a bank and banking business

The first category relates to those companies that were incorporated under the now repealed Zambian Companies Act 1921. The second category relates to companies incorporated under the Zambian Companies Act 1994. The third category relates to companies that, although incorporated under the said 1921 Companies, have adapted to the framework under the Companies Act 1994. The fourth category relates to a statutory body corporate, such as the Development Bank of Zambia, set up under a separate piece of legislation from the Companies Act 1994. Then, we have already established that unincorporated entities, such as partnerships, have no separate legal personality to meet the statutory requirement of separate legal personality in order to get licensed under section 4(1) of the Banking and Financial Services Act 1994 or section 10(1) of that same Act.

In essence, banks and financial institutions in Zambia are subject to two main layers of regulation. The first layer relates to meeting the statutory requirements for a company to be incorporated under the Companies Act 1994. The second layer of regulation can be seen under the regulatory framework established pursuant to the Banking and Financial Services Act 1994, including the terms and conditions of licences issued to banks and financial institutions. Linking the two layers is section 399 of the Companies Act 1994 which provides that nothing in that statute will abrogate or affect any special legislation, such as the Banking and Financial Services Act 1994, pertaining to companies carrying on the business of banking, insurance or any other business.

In Zambia, for an entity to be licensed as a bank, it must first be incorporated as a company under the Zambian Companies Act 1994. The legislative framework that guides the incorporation of companies is the Zambian Companies Act 1994, or in the case of companies incorporated prior to 1994, its predecessor, the repealed Zambian Companies Act 1921. Where a foreign company intends to conduct any type of business in Zambia, it has to meet the requirements of Part XII of the Zambian Companies Act 1994. And only then can a foreign company be eligible, as a company, to be considered for a

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51 See below.
52 See below.
53 See Banking and Financial Services Act 1994, sec 4(1) (as amended through to 2000). See also the statutory definition of ‘bank’ in sec 2 of the Banking and Financial Services Act 1994, sec 4(1) (as amended in 2000), stipulating that ‘bank means a company conducting banking business. We have already examined the term ‘banking business’ above.
54 See generally the Companies Act 1994.
55 See generally the Companies Act 1921.
By contrast, for an entity to be licensed as a financial institution under Zambia’s Banking and Financial Services Act 1994, it need not necessarily be a company incorporated under the Zambian Companies Act 1994 or its predecessor, the repealed Zambian Companies Act 1921. The entity can be a body corporate created under a separate piece of legislation, but recognised by the Bank of Zambia as an acceptable form for a financial institution. This additional limb here, allowing for a body corporate created under a separate piece of legislation but recognised by the Bank of Zambia, came about when, prior to the passing of the Banking and Financial Services (Amendment) Act 2000, the central bank (that is, the Bank of Zambia) faced insurmountable challenges in its attempt to subject the Development Bank of Zambia to its supervisory role. The Development Bank of Zambia objected to such jurisdictional claims, arguing that the Development Bank of Zambia was a separate legal entity created separately by a separate piece of legislation, the Development Bank of Zambia Act 1972, and that it was therefore not subject to the licensing, regulatory or supervisory jurisdiction of the central bank. In this chapter, however, the focus is not on statutory bodies such as the Development Bank of Zambia, but on those financial institutions that are incorporated as companies under the Zambian Companies Act 1994, including those foreign companies that are recognised as companies under Part XII of the Zambian Companies Act 1994. And, here, cognisance should be made of the fact that the Zambian Companies Act 1994, like its predecessor, the repealed Zambian Companies Act 1921, is an independent piece of legislation from Zambia’s Banking and Financial Services Act 1994.

In Zambia, banks and financial institutions, as incorporated companies, are subject to the legal framework under the Companies Act 1994. In addition, banks and financial institutions are also subject to the legal framework under the Banking and Financial Services Act 1994 since these entities are licensed by the central bank, pursuant

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56 It is unlikely that the Registrar of Banks would register a foreign company that is not lawfully constituted or recognised as a company under the Zambian Companies Act 1994. Sec 3 of the Banking and Financial Services Act 1994 (as amended through to 2000) clearly stipulates that the word 'company' under the Banking and Financial Services Act 1994 has the same meaning as that in the Companies Act 1994.

57 See Banking and Financial Services Act 1994, sec 10(1) (as amended through to 2000).

58 n 59 above, sec 10(1).

59 See Mwenda (n 6 above) 35.

60 As amended through to 2005.

61 n 61 above.

62 As above.
to provisions of the Banking and Financial Services Act 1994, to conduct business in the financial sector. While the Registrar of Banks and Financial Institutions, in consultation with the Minister of Finance, has the statutory power to issue a licence or authorise a company to conduct banking or financial services business, it is the central bank — that is, the Bank of Zambia — which is empowered by law to act as the competent authority for supervising banks. However, the distinction here is an artificial one, since the Registrar of Banks and Financial Institutions is actually an officer of the Bank of Zambia.

As the Bank of Zambia points out:

To operate a bank in Zambia, it is a requirement that the bank be licensed by the Registrar of Banks and Financial Institutions (the Registrar) whose office is based at the Bank of Zambia. The decision to licence the bank lies with the Registrar. The applicant must first submit its proposed name to the Registrar for clearance prior to making its application for a licence.

The Bank of Zambia goes on to add:

Upon receipt of a complete application, the Bank of Zambia shall, within 180 days, review the application and determine whether a license should be granted to the applicant or not.

As a general rule, a person is not allowed to conduct or offer to conduct banking business unless that person holds a licence for that...
purpose. A person other than a licensed bank or a licensed financial institution is prohibited from conducting or offering to conduct financial services business. Similarly, a person other than a licensed bank or a licensed financial institution is prohibited from conducting or offering to conduct financial services business. And banks and financial institutions are only permitted to engage in business covered by a banking license or a financial services license as well as the statutory provisions of the Banking and Financial Services Act 1994. So, what does this entail? Under the Banking and Financial Services Act 1994, can the ultra vires act or conduct of a bank or financial institution be construed as unsafe and unsound practice of the bank or financial institution? Given the broad definition of 'financial services' and 'banking business' in the Banking and Financial Services Act 1994, can it not be argued that the Banking and Financial Services Act 1994 has, in principle, introduced the concept of 'universal banking' in Zambia? Indeed, where should we draw the line on what falls within or outside the statutory definition of 'financial services'? The same argument applies here when determining what constitutes banking business, or, rather, where we ought to draw the line between what is or is not banking business.

70 Banking and Financial Services Act 1994, sec 17(1).
71 n 72 above, sec 17(2).
72 n 72 above, sec 17(3). Under sec 8 of the Banking and Financial Services Act 1994, authorised activities of a bank, in addition to the taking of deposits, include the following (see the definition of 'financial services' in sec 2 of the same Act, which replicates most of the provisions here): 'Except where the conditions attached to a particular licence otherwise provide, a banking licence shall be taken to authorise its holder to engage in any of the following activities in addition to banking business: (a) making loans and extending credit to any person on the security of property of any kind or unsecured; (b) dealing as a principal or as an agent in: (i) bills of exchange, promissory notes, cheques, travellers' cheques and like instruments; (ii) the currency of Zambia and, subject to the regulations made under this Act, in the currency of any other country and foreign exchange transactions; and (iii) gold, silver or platinum bullion or coins; (c) providing money transfer services and facilities; (d) the issue and administration of payment, credit or debit cards and, in co-operation with others, the operation of payment, credit card and debit card systems; (e) providing guarantees, letters of credit and other assurances of payment; (f) finance leasing; (g) factoring, with or without recourse; (h) acting as a trustee of any trust, executor or administrator of any estate or in any fiduciary capacity for any person; (i) acting as a financial agent for any person; (j) providing safekeeping and custodial services for financial assets and securities; (k) providing merchant banking services including the arrangement and underwriting of shares, trade financing, corporate financing and the provision of financial advice; and (l) dealing as a principal or as an agent for its customers in financial futures and options and in exchange, currency and interest rate swap agreements. (2) The Minister, on the recommendation of the Bank of Zambia, may by regulation prescribe the meaning to be given to any expression used in this section and not otherwise defined for the purposes of this Act.'
73 On the concept of 'unsafe and unsound practice' of a bank or financial institution in Zambia, see Banking and Financial Services Act 1994, sec 77(1).
74 See above.
3 The element of deposit taking

It has already been established above that section 2(1)(c) of the Banking and Financial Services Act 1994 of Zambia provides that 'banking business' includes the receipt of deposits from the public and use of such deposits to make loans and investments. What, then, is 'receiving deposits'? Or what, in other words, would constitute 'deposit taking' by banks? The term 'deposit' is defined in the Zambian Banking and Financial Services Act 1994 as follows:

(a) an amount of money paid to a bank or financial institution in respect of which:

(i) an equal amount or any part thereof is conditionally or unconditionally repayable with or without a premium, on demand or at specified or unspecified dates or in terms agreed to, by, or on behalf of, the person making the payment and the bank or financial institution receiving it; and

(ii) no interest is payable on the amount so paid or interest is payable thereon at specified or unspecified intervals, notwithstanding that the payment is limited to a fixed amount or that a transferable or nontransferable certificate or other instrument providing for the repayment of the amount referred to in subparagraph (i) or the interest referred to in this subparagraph is issued in respect of that amount or interest;

(b) trust funds received from or held by a bank or financial institution;

(c) money received or held by a bank or financial institution or the credit given for money or its equivalent received or held in the usual course of business for a special or specific purpose regardless of the legal relationship thereby established, including:

(i) escrow funds and funds held as security for an obligation due to the bank or financial institution;

(ii) funds deposited by a debtor to meet maturing obligations; and

(iii) funds held to meet its acceptances or letter of credit;

but does not include funds which are received by the bank or financial institution for immediate application to the reduction of an indebtedness to the receiving bank or financial institution;

(d) outstanding draft, cashier's cheque, money order, or other officer's cheque issued by the bank or financial institution and drawn on customer funds for any purpose in the ordinary course of business; or

(e) such other obligations of a bank or financial institution as the Bank of Zambia may prescribe from time to time ...75

Then, section 2 of the Banking and Financial Services Act 1994 goes on to say a 'deposit-taking financial institution' is a financial institution that, in addition to carrying on financial service business, accepts

75 Banking and Financial Services Act 1994, sec 2.
deposits. Let us, however, take a more reasoned look at the conceptualisation of the term ‘bank’. First, it must be emphasised that statutory definitions of ‘banking’ differ from one country to another.76 Whereas, on the one hand, some jurisdictions have legislation which defines as a bank any body recognised as such by a governmental authority,77 on the other hand, other jurisdictions adopt a formulary approach which defines banks in terms of a few, generalised characteristics.78 A third approach simply lists activities that are treated as banking by legislation.79 As Cranston observes:

Whether the list or formulary approach is adopted, it is clear that bodies may act like banks yet not be categorised in law as banks. If taking deposits from the public is defined as the essential ingredient of banking then the finance house able to fund itself from the wholesale markets, or the co-operative taking deposits from within its membership, would probably not be caught. If banking means deposit taking coupled with making loans, an investment fund will be able to avoid classification as a bank by using its moneys to purchase short term government paper or other money market instruments. Economists sometimes refer to such bodies as ‘non-bank banks’ or ‘non-bank financial intermediaries’. That they may escape the banking net is not necessarily a bad thing — it depends on whether this thwarts the legislative aims.80

4 Conclusion

This chapter has examined the legal meaning of the terms ‘bank’ and ‘banking business’. It was argued that the definitions of ‘bank’ and ‘banking business’ must be compatible with the practice of banking in a particular country. However, a question could be raised: how can we tell, for example, if a corporate entity that has gone bust is a bank for purposes of insolvency distributions? Is it not the position in many countries that in order to protect investors and ensure investor confidence in the market, the regulatory authority in charge of banking supervision can either close down an insolvent bank or supervise its reorganisation? It is such issues that underpin the importance of defining what constitutes a ‘bank’ and ‘banking business.’ Thus, this chapter has shown the relevance of defining the terms ‘bank’ and ‘banking business’, and has further endeavoured to provide meaningful definitions of the terms.

76 Eg, R Bradgate Commercial law (1995) 545-546 notes: ‘Although many statutes refer to “banks”, “banking” and “bankers”, there is no comprehensive legal definition of “bank” or “banking”. The Bills of Exchange Act 1883 defines a bank as “any body of persons, whether incorporated or not, who carry on the business of banking”, leaving open the question of what is “the business of banking”.’
77 See Cranston (n 20 above) 6.
78 As above.
79 As above.
80 Cranston (n 20 above) 7.
CHAPTER 2

APPLICABILITY OF THE ULTRA VIRES DOCTRINE OF COMPANY LAW TO BANKS AND FINANCIAL INSTITUTIONS

1 Introduction

As a corollary to the examination of the efficacy of the legal and institutional framework for regulating banks and financial institutions, this chapter examines the legal and policy bases for doing away with the statutory requirement for companies, such as banks and financial institutions, incorporated under the Zambian Companies Act 1994, to have a memorandum of association. The chapter seeks to find out if this development entails that banks and financial institutions in Zambia are no longer required to have an objects clause, especially that prior to the repeal of the Zambian Companies Act 1921 a company incorporated under that 1921 statute was required to have an objects clause at incorporation and at all times thereafter as part of its memorandum of association.

The introductory part of this chapter sets out the context of the study. The second part delves into the jurisprudential aspects of the ultra vires doctrine in company law, highlighting the development of this doctrine at common law. The third part examines whether the ultra vires doctrine has been abolished in Zambia’s company law, or if it has simply been watered down. Preceding the conclusion, the fourth part of the chapter, focusing primarily on banks and financial institutions as examples of some companies incorporated under Zambia’s Companies Act 1994, explores the question whether the ultra vires doctrine applies to banks and financial institutions in Zambia. Although the chapter draws on some analogous legislative and common law developments in the United Kingdom, no attempt is made to examine whether banks in the United Kingdom are also affected by the ultra vires doctrine. The focus of the chapter, it must

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81 See below for a statutory distinction between the terms ‘bank’ and ‘financial institution’ under Zambia’s Banking and Financial Services Act 1994 (as amended through to 2000).

82 See generally the Companies Act 1921 of Zambia that was repealed and replaced by the Zambian Companies Act 1994. See also Guinness v Land Corporation of Ireland (1882) 22 Ch D 349.
be stressed, is on whether banks and financial institutions in Zambia, and not elsewhere, should have an objects clause given that the Zambian Companies Act 1994 does not require companies incorporated under that piece of legislation to have a memorandum of association.

As evidenced from some of the data provided by sources in Zambia, the dropping of the statutory requirement for a company incorporated under Zambia’s Companies Act 1994 to have a memorandum of association was designed primarily to meet two objectives. On the one hand, there was a policy shift to simplify the process and procedures for incorporating a company. On the other hand, there was a botched intent on the part of the legislative draftsman to do away with the *ultra vires* doctrine in Zambia’s company law. According to explanatory notes of the foreign consultant recruited by the Zambian Government to provide leadership in drafting the Zambian Companies Act 1994,

**Removal of the 'ultra vires' principle**

However, even if there are any such restrictions, the old doctrine of *ultra vires* will not apply. This is set out in section 23:

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83 See below.

84 Telephone interview on 9 December 2008 between Lusaka, Zambia and Washington DC, USA, in which this author, calling from Washington DC, held an interview discussion with Mr Michael Musonda, former Chairperson of the Law Association of Zambia, and currently lecturer in Company Law and Procedure at the Zambia Institute for Advanced Legal Education as well as a senior practising lawyer in Zambia. See also e-mail response from Mr Tony Bwembya, Assistant Registrar at the Zambia Patents and Companies Registration Office (PACRO), to Mr Noyoo Noyoo, a senior corporate lawyer in the banking sector in Zambia, dated 11 December 2008, responding to queries raised by this author through Mr Noyoo Noyoo: ‘My view is that the removal of the memo was merely intended to reduce the requirements for incorporating a company. The requirements for the objects clause has actually been retained in that Companies Form 2 still requires that the applicants specify the principal business and any other business. Furthermore, section 7(2) provides that ‘the articles may contain restrictions on the business that a company may carry on’, thus departing from the traditional role of covering mainly issues to do with the internal management of the company for which articles of association are often known for. Additionally, section 22(3) prohibits the company from carrying on any business that it is restricted by the articles. To this extent, I opine that the *ultra vires* doctrine is pretty much alive.’

Applicability of the ultra vires doctrine of company law

No act of a company, including a transfer of property by or to a company, shall be invalid by reason only that the act or transfer is contrary to its articles or to the Act.86

As we shall see later on,87 the legislative draftsman's view here is somewhat misplaced. Although he has succeeded in dropping from the Zambian Companies Act 1994 the requirement for incorporator(s) of companies to furnish a memorandum of association at incorporation, the draftsman misdirects himself when he makes the assumption that a company's principal business as well as its other business will be spelt out in the company's articles, say, through some 'restrictions'.88 Here, it must be observed that the Zambian Companies Act 1994 refers to what is generally known as 'articles of association' as simply 'articles of the company'.89 The change in nomenclature does not, however, point to any meaningful or substantive departures. In this chapter, we, thus, continue to use the term 'articles of association'.

Overall, a notable shortcoming of the view espoused above by the legislative draftsman is that, under the Zambian Companies Act 1994, there is no mandatory requirement for a company to have articles of association. Strictly speaking, the Companies Act 1994 allows also for a company without any articles of association to be incorporated. Section 7 of the Companies Act 1994 makes it optional for companies to have articles of association by using the term may instead of shall. Indeed, section 7 provides that 'a company may have articles' regulating its conduct, and that such 'articles may contain restrictions on the business that the company may carry on'.

Further, where a company with articles of association is incorporated, the Companies Act 1994 does not place any statutory obligation on the company to have in its articles of association restrictions on the company's business. The issue of such restrictions, we contend, is more of a company's right than a statutory duty on the company. However, where a company decides to place some business restrictions in its articles of association, the company is prohibited by the Zambian Companies Act 1994 from carrying on any business or exercising any power that it is restricted by its articles from carrying on or exercising, nor exercising any of its powers in a manner contrary to the articles.90 Be that as it may, there is very little incentive for a

86 See Graham (n 87 above) 3.
87 That is, when we examine in this chapter the statutory requirement for a summary statement, regarding the principal and other business of a company, to be included in the completed Forms I, II, III or IV of the Companies (Prescribed Forms) Regulations (ie Statutory Instrument No 17 of 1995, issued pursuant to section 400 of the Companies Act 1994).
88 As above.
90 n 91 above, sec 22(3).
Chapter 2

company to spell out its principal and other businesses in the articles of association since such information will already have been provided in the completed Forms I, II, III or IV, whose respective models are captured in the Companies (Prescribed Forms) Regulations.\(^91\) We will examine later the type of information that should be filled in Forms I, II, III and IV.\(^92\) Here, suffice it to say, the legislative draftsman continues through his explanatory notes:

So, a third party who deals with a company is entitled to assume that it has the power to do anything it wishes. If the officers of the company cause it to act in contravention of its articles, the members can take action against those officers, but the interests of the third party are not affected — unless, of course, the third party actually knew of the restrictions.\(^93\)

First, it is not clear that the legislative draftsman has a full appreciation of the rule in *Foss v Harbottle*\(^94\) and the various exceptions to that rule. It is the company, as a legal person, and not the members, that is entitled to take action against the directors, unless the directors have engaged in an *ultra vires* or illegal act, or the matter is one which could validly be done or sanctioned only by some special majority of members, or where the personal and individual rights of the plaintiff as a member have been invaded as well as where what has been done amounts to a 'fraud on the minority' and the wrongdoers are themselves in control of the company.\(^95\)

Secondly, although the draftsman in his explanatory notes refers only to 'knowledge', when he says, 'unless, of course, the third party actually knew of the restrictions', the concept of 'knowledge' in law is different from that of 'notice'.\(^96\) Besides, the relevant statutory provision in the Zambian Companies Act 1994, as we shall see below, in contrast to the draftsman's notes, refers to both 'knowledge' and 'notice'. Elsewhere, I have examined the concept of 'knowledge' in greater detail,\(^97\) while the concept of 'notice' is discussed in the


\(^92\) See below.

\(^93\) Graham (n 87 above) 3.

\(^94\) (1843) 2 Hare 461 (Court of Chancery (Vice-Chancellor)).

\(^95\) See below.

\(^96\) See below.

latter sections of this chapter.\footnote{98}{See below.} In Zambia, section 24 of Zambia’s Companies Act 1994 abolishes the common law doctrine of ‘constructive notice’ as follows:

No person dealing with a company shall be affected by, or presumed to have notice or knowledge of, the contents of a document concerning the company by reason only that the document has been lodged with the Registrar or is held by the company available for inspection.

Here, it would appear that the abolition of the doctrine of constructive notice by section 24 of the Companies Act 1994 was meant to complement and augment the botched efforts of the draftsman to abolish the \textit{ultra vires} doctrine in Zambia. An underlying premise might have been that, by abolishing the constructive notice doctrine, it would no longer be possible to impute any notice to a third party dealing with the company regarding the company’s objects. That way, one might have thought, the \textit{ultra vires} doctrine would have minimal or no effect whatsoever since the third party could not be presumed to have had notice of the objects of the company.

Thirdly, the mere dropping from the Zambian Companies Act 1994 of the requirement for incorporator(s) of a company to furnish the Companies Registrar with the company’s memorandum of association is not in and of itself an abolition of the common law doctrine of \textit{ultra vires}. Nothing in the Zambian Companies Act 1994 bars a company from having a memorandum of association, although there is a view that the Registrar of Companies can, relying on section 370 of the Companies Act 1994, refuse to admit a memorandum of association as part of the documents being lodged to register the company.\footnote{99}{E-mail to this author from Mr Michael Musonda, former Chairperson of the Law Association of Zambia, and currently lecturer in Company Law and Procedure at the Zambia Institute for Advanced Legal Education as well as a senior practising lawyer in Zambia, dated 23 January 2009.}

Section 370 provides as follows:

(1) Where this Act requires any document or particulars to be lodged with the Registrar, the Registrar shall register them in the manner prescribed or, if no manner is prescribed for the document or particulars, as determined by the Registrar.

(2) For the purposes of this Act, a document or particulars shall be deemed not to have been lodged with the Registrar until any fee prescribed under section three hundred and seventy-seven has been paid to the Registrar.

(3) Subject to this Act, where this Act requires a document or particulars to be lodged under this Act, each company concerned shall lodge a separate document or set of particulars.
(4) All documents and particulars which are lodged with the Registrar shall be printed or typewritten on good quality paper to the satisfaction of the Registrar.

(5) If the Registrar is of opinion that any document or particulars lodged with him:

(a) contain matter or matters contrary to law;
(b) by reason of any error, omission or misdescription have not been duly completed;
(c) are insufficiently legible;
(d) are written on paper insufficiently durable; or
(e) otherwise do not comply with the requirements of this Act;

he may refuse to register the document or particulars in that state and direct that they be amended or completed in a specified manner and re-submitted.

(6) If the Registrar gives a direction under subsection (5), the document or particulars shall be deemed not to have been lodged.

(7) The Registrar may require that a document or a fact stated in a document lodged with him shall be verified by statutory declaration.

(8) Where the Registrar is required or permitted under this Act to cause a copy or particulars of a document lodged with him to be published in the Gazette, he may require the lodgment with him of any such document in duplicate, or the provision of any such particulars, and may withhold registration of the document until the requirement has been complied with.

(9) The Registrar may alter a document if so authorised by the person who lodged the document or his representative.

This statutory provision does not, however, place a mandatory obligation on the Registrar of Companies to decline the admission of such important corporate documents as a company's memorandum of association simply because the Companies Act 1994 is silent on the issue of a memorandum of association. Neither does the Companies Act 1994 say that the furnishing of a memorandum of association to the Registrar at incorporation is 'contrary to the law' or that it 'does not comply with the requirements of the Companies Act 1994'. The statute is simply quiet on the matter. Besides, the use of the words 'may refuse' in subsection 5 of section 370 of the Companies Act 1994 indicates that the Registrar of Companies is not under a statutory obligation but has, instead, the option to either accept or turn down the documents. So, in theory, a company can, if it chooses, have a memorandum of association.

Admittedly, the legislative draftsman should have considered more thoughtfully parallel legislative developments in jurisdictions such as the United Kingdom where prospects for abolishing the ultra
Applicability of the ultra vires doctrine of company law

The applicability of the ultra vires doctrine of company law has been debated extensively.\textsuperscript{100} The mere dropping from the Companies Act 1994 of the requirement for a memorandum of association is not good enough, although disappointingly, ten years after the enactment of Zambia's Companies Act 1994, Jamaica did the same thing when it enacted the long-awaited Jamaican Companies Act 2004.\textsuperscript{101} In Zambia and Jamaica, there should have been more deliberate and conscious efforts to spell out more clearly in the respective Companies Acts the extent to which the ultra vires doctrine applies to company law in those countries. To illustrate, as a way of protecting an innocent third-party dealing with a company in good faith, section 28 of the Mauritius Companies Act 2001 provides as follows:\textsuperscript{102}

\textsuperscript{100} See below for a further discussion on this issue. In Canada, the Canadian Supreme Court in the case of Communities Economic Development Fund v Canadian Pickles Corp [1991] 3 SCR 388, available at http://scc.lexum.umontreal.ca/en/1991/1991rcs3-388/1991rcs3-388.html (accessed 11 January 2009), observed that 'the doctrine of ultra vires has been abolished by statute for corporations incorporated under the business corporations legislation in most Canadian jurisdictions. The following jurisdictions have statutory provisions reversing the presumption that corporations have limited capacity: Canada (Canada Business Corporations Act, RSC 1985, c C-44, s 15(1)), Alberta (Business Corporations Act, SA 1981, c B-15, s 15(1)), British Columbia (Company Act, RSBC 1979, c 59, s 21(1)), Manitoba (The Corporations Act, RSM 1978, c C-225, s 15(1)), New Brunswick (Business Corporations Act, SNB 1981, c B-9.1, s 13(1)), New Brunswick (The Corporations Act, SN 1981, c B-9.1, s 13(1)). The doctrine of ultra vires may still apply in the Northwest territories, and in Nova Scotia. Prince Edward Island is a letters patent jurisdiction.' The Canadian Supreme Court continued: '[T]he general abolition of the doctrine of ultra vires is in accordance with sound policy and common sense.' The original purposes of the doctrine, which were, in the words of the 1967 Interim Report of the Select Committee on Company Law (tabled before the Ontario Legislative Assembly 25) 'to protect creditors by ensuring that the company's funds to which creditors must look for payment were not dissipated in unauthorised activities and to protect investors by allowing them to know the objects for which their money was to be used', have been largely frustrated. Subsequent statutory and case law developments have made the doctrine a protection to no one and a trap for the unwary. No less an authority than LCB Gower has recommended, in Gower's principles of modern company law (1979) 179 'total abolition of the ultra vires rule in so far as it affects the capacity of companies and indeed referred favourably to the approach taken by the Canada Business Corporations Act in this respect ...However, in spite of the general trend towards abolition of the doctrine of ultra vires, the limited aspects of the doctrine ...may be present with respect to corporations created by special act for public purposes. Not only is there a long line of cases supporting the principle, but one may argue that this protects the public interest because a company created for a specific purpose by an act of a legislature ought not to have the power to do things not in furtherance of that purpose. Of course, it is open to the legislature to rebut this presumption because, for example, the legislature may provide for other remedies short of invalidity for acts contrary to the statute.'


(1) Where the constitution of a company sets out the objects of the company, there is deemed to be a restriction in the constitution on carrying on any business or activity that is not within those objects, unless the constitution expressly provides otherwise.

(2) Where the constitution of a company provides for any restrictions on the business or activities in which the company may engage:

(a) the capacity and powers of the company shall not be affected by that restriction; and

(b) no act of the company and no contract or other obligation entered into by the company and no transfer of property to or by the company is invalid by reason only that it was done in contravention of that restriction.

(3) Subsection (2) shall be without prejudice to sections 169, 170, 174 and 176.

(4) The capacity of the company to do an act shall not be affected by the fact that the act is not, or would not be, in the best interests of the company.

Similarly, section 39 of the UK Companies Act 2006 provides as follows:

(1) The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution.

(2) This section has effect subject to section 42 (companies that are charities).

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103 Then, sec 169 of the Mauritius Companies Act 2001 deals with applications to a court of law by a company, or any of its directors or shareholders, for an injunction to restrain the company or any of its directors from engaging in conduct that would contravene the constitution of the company. Further, sec 170 of the Mauritius Companies Act 2001 codifies the common law position for a derivative action by a shareholder or director of a company on behalf of the company, and sec 174 of that statute empowers a shareholder or a former shareholder to bring a personal action against a culpable director for breach of duty owed to that shareholder in the latter's capacity as a shareholder.

104 Sec 42 of the UK Companies Act 2006 provides as follows: ' (1) Sections 39 and 40 (company's capacity and power of directors to bind company) do not apply to the acts of a company that is a charity except in favour of a person who: (a) does not know at the time the act is done that the company is a charity, or (b) gives full consideration in money or money's worth in relation to the act in question and does not know (as the case may be): (i) that the act is not permitted by the company's constitution, or (ii) that the act is beyond the powers of the directors. (2) Where a company that is a charity purports to transfer or grant an interest in property, the fact that (as the case may be): (a) the act was not permitted by the company's constitution, or (b) the directors in connection with the act exceeded any limitation on their powers under the company's constitution, does not affect the title of a person who subsequently acquires the property or any interest in it for full consideration without actual notice of any such circumstances affecting the validity of the company's act. (3) In any proceedings arising out of subsection (1) or (2) the burden of proving: (a) that a person knew that the company was a charity, or (b) that a person knew that an act was not permitted by the company's
And section 40 of the said 2006 English statute goes on to add:

(1) In favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorise others to do so, is deemed to be free of any limitation under the company’s constitution.

(2) For this purpose:
   (a) a person ‘deals with’ a company if he is a party to any transaction or other act to which the company is a party,
   (b) a person dealing with a company:
      (i) is not bound to enquire as to any limitation on the powers of the directors to bind the company or authorise others to do so,
      (ii) is presumed to have acted in good faith unless the contrary is proved, and
      (iii) is not to be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company’s constitution.

(3) The references above to limitations on the directors’ powers under the company’s constitution include limitations deriving:
   (a) from a resolution of the company or of any class of shareholders, or
   (b) from any agreement between the members of the company or of any class of shareholders.

(4) This section does not affect any right of a member of the company to bring proceedings to restrain the doing of an action that is beyond the powers of the directors.

But no such proceedings lie in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the company.

(5) This section does not affect any liability incurred by the directors, or any other person, by reason of the directors’ exceeding their powers.

(6) This section has effect subject to:

section 41 (transactions with directors or their associates), and
section 42 (companies that are charities).
Against this background, we submit that not much thoughtful consideration was accorded by the legislative draftsman to the implications of dropping from the Zambian Companies Act 1994 the requirement for incorporator(s) of a company to furnish the Registrar of Companies with the company’s memorandum of association at incorporation. As argued by one source: ‘Generally, the drafting of legislation in Zambia is rushed and without adequate consultations of relevant stakeholders.’\textsuperscript{106}

Many sources contacted in Zambia on the policy bases for doing away with the requirement for incorporator(s) of a company to furnish the Registrar of Companies with the company’s memorandum of association had no clue that the legislative draftsman had actually intended, among other things, to abolish the \textit{ultra vires} doctrine in Zambia’s company law.\textsuperscript{107} A number believed that the legislative changes were only being introduced to simplify the process and procedures for incorporating companies.\textsuperscript{108} Thus, to resolve the conundrum associated with such legislative changes, we examine more critically in this chapter the issue whether the \textit{ultra vires} doctrine has been abolished in Zambia’s company law, or if it has arise. (2) Where: (a) a company enters into such a transaction, and (b) the parties to the transaction include: (i) a director of the company or of its holding company, or (ii) a person connected with any such director, the transaction is voidable at the instance of the company. (3) Whether or not it is avoided, any such party to the transaction as is mentioned in subsection (2)(b)(i) or (ii), and any director of the company who authorised the transaction, is liable: (a) to account to the company for any gain he has made directly or indirectly by the transaction, and (b) to indemnify the company for any loss or damage resulting from the transaction. (4) The transaction ceases to be voidable if: (a) restitution of any money or other asset which was the subject matter of the transaction is no longer possible, or (b) the company is indemnified for any loss or damage resulting from the transaction, or (c) rights acquired bona fide for value and without actual notice of the directors’ exceeding their powers by a person who is not party to the transaction would be affected by the avoidance, or (d) the transaction is affirmed by the company. (5) A person other than a director of the company is not liable under subsection (3) if he shows that at the time the transaction was entered into he did not know that the directors were exceeding their powers. (6) Nothing in the preceding provisions of this section affects the rights of any party to the transaction not within subsection (2)(b)(i) or (ii). But the court may, on the application of the company or any such party, make an order affirming, severing or setting aside the transaction on such terms as appear to the court to be just. (7) In this section: (a) ‘transaction’ includes any act; and (b) the reference to a person connected with a director has the same meaning as in Part 10 (company directors).’\textsuperscript{106}

\textsuperscript{106} E-mail from Ms Annie Senkwe Nsenduluka, Senior State Advocate in the Attorney-General’s Chambers of the Republic of Zambia, to this author, dated 2 January 2009.

\textsuperscript{107} This author held several discussions with many prominent legal scholars and legal practitioners in Lusaka, Zambia, between 15 November 2008 and 15 December 2008. The views expressed on this particular issue were relatively consistent.

\textsuperscript{108} As above.
simply been watered down.\textsuperscript{109} Analogies are drawn from the English common law since Zambia's jurisprudence, largely speaking, is based on the English common law and the latter continues to be a major source of law in Zambia.\textsuperscript{110}

An argument is made that a notable consequence of permitting the incorporation of a company that does not have a memorandum of association is that an investor could be misled to think that the Zambian Companies Act 1994 has done away with the requirement for companies to have an objects clause or at least some form of objects. However, one commentator observes that 'the Companies Act 1994 has not done away with the statutory requirement for companies incorporated thereunder to have an objects clause or some form of objects'.\textsuperscript{111} According to that source:

Section 6(2)(i) of the Act makes it obligatory for the application for incorporation or 'the Incorporation Form' to specify 'the nature of [the company]'s proposed business as the prescribed form may require' (incorporators are required to indicate, on completing the incorporation form, both the 'principal' as well as any 'other business' that the proposed company is to engage in). The view which I hold myself (which may not necessarily be consistent with whatever view (if at all) that the draftsman of the Act held) is that the substance of the Memorandum of Association under the repealed Act has been reduced to the various prescribed Companies Forms (Companies Forms 1 to 4) each one of which has all the features or elements which characterised the old Memorandum of Association, namely:

(a) the Name Clause;

(b) the Objects Clause;

\textsuperscript{109} P Davies Gower's principles of modern company law (1997) 204, examining the position in the United Kingdom, observes that, at some point: 'The courts sought to narrow the scope of the resulting vires by distinguishing between "objects" (in the sense of types of business) and "powers" and, applying the ejusdem generis rule of construction, ruling that the powers could be used only in relation to the objects. But that too was circumvented by the device of ending the "objects" clause by stating that each of the specified objects or powers should be treated as independent and in no way ancillary or subordinate one to another, and, at a later date, by also inserting a power "to carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses or the general business of the company." See Cotman v Brougham [1918] AC 514. See also Introductions Ltd v National Provincial Bank [1970] Ch 199, CA; Bell Houses Ltd v City Wall Properties Ltd [1966] 2 QB 656, CA; Newstead v Frost [1980] 1 WLR 135, HL; Charterbridge Corporation Ltd v Lloyds Bank [1970] Ch 62; Re Halt Garage Ltd [1982] 3 All ER 1016; Rolled Steel Ltd v British Steel Corp [1986] Ch 246; Brady v Brady [1988] BCLC 20, CA, revd [1989] AC 755, HL.

\textsuperscript{110} Sec 2 of the English Law (Extent of Application) Act 1963 of Zambia — the Zambian statute which provides for the applicability of certain aspects of English law to Zambia — provides that, subject to the provisions of the Zambia Independence Order 1964, and to any other written law, the common law and doctrines of equity apply to Zambia.

\textsuperscript{111} E-mail to this author from Mr Michael Musonda (n 101 above).
(c) the Capital Clause;
(d) the 'Association Clause' (This is contained on the page of the Incorporation Form where it is stated 'We, the several persons whose names and addresses are subscribed wish to be formed into (type of company) and we respectively agree to take the number of shares in the capital of the company set opposite our respective names';
(e) The company's registered office.\(^{112}\)

More likely than not, we contend, the draftsman of the Zambian Companies Act 1994 did not give thoughtful consideration to such issues.\(^{113}\) We, thus, argue that while the \textit{ultra vires} doctrine continues to apply in Zambia, its significance has been watered down by the introduction of Forms I, II, III and IV, respectively, as seen in the Companies (Prescribed Forms) Regulations,\(^{114}\) to replace the statutory requirement in the principal statute, the Companies Act 1994, for an objects clause in the memorandum of association. Form I requires incorporators of a public company to spell out the nature of business of the company in the said Form. Form II covers the nature of business of a private company.\(^ {115}\) Form III covers the nature of business of a private company limited by guarantee, and Form IV deals with the nature of business of an unlimited company.\(^ {116}\)

But before delving into the intricacies of company law in Zambia, let us first examine the \textit{ultra vires} doctrine in the United Kingdom since, as established above, the English common law is a major source

\(^{112}\) As above. Mr Musonda continues: '[I]f you examine any typical memorandum of association, you will confirm that it essentially embodies what I have summarised above. The key difference between the different variants of the Incorporation Form and the Memorandum of Association is that the bulk of the latter was devoted to describing the "objects" for which the company had been incorporated ... "objects clauses" were being drafted in such a manner as to entitle a company to virtually engage in any type of business. What the Incorporation Form does is to move away from that needless piling of words upon other words in order to have the company undertake any business by simply making a requirement to have prospective incorporators indicate the "principal business" for which their company had been formed and any other business which may be incidental to the carrying on of the principal business or which, in the opinion of the company's directors, may be beneficial or advantageous to the carrying on of the company's principal business. Having regard to the foregoing, my humble view would be that the document which was known as a memorandum of association under the repealed Act has assumed a different form (as opposed to changing its \textit{substance}) under the new statute. In short, although the Incorporation Form (via its different variants) is distinguishable in form from the memorandum of association, the \textit{substance} of the two documents is substantially the same. Needless to say, the Incorporation Form under the current Act serves the same constitutive function which the memorandum of association served under the repealed Act. (I must confess that the drafter of the Act may not have pondered over the issues I have canvassed above).'

\(^{113}\) As above.


\(^{115}\) See the schedule to the Companies (Prescribed Forms) Regulations for templates of Forms I, II, III and IV, respectively.

\(^{116}\) As above.
of law in Zambia. The focus here is on the *ultra vires* doctrine as it applies to company law and not administrative law. And the discussion below is intended to provide a helpful background against which the efficacy of certain aspects of Zambian company law is analysed.

2 The *ultra vires* doctrine under the English common law

Views have been expressed that, in company law, the *ultra vires* doctrine refers to those acts attempted by a company that are beyond the scope of powers granted by the company's charter or in a clause in its memorandum of association. Other documents clothing the company with the capacity to pursue business objects can be found in the laws authorising the company's formation. Commenting on the *ultra vires* doctrine, Davies observes:

*Ultra vires* is a Latin expression which lawyers and civil servants use to describe acts undertaken beyond (*ultra*) the legal powers (*vires*) of those who have purported to undertake them. In this sense its application extends over a far wider area than company law. For example, those advising a Minister on proposed subordinate legislation will have to ask themselves whether the enabling primary legislation confers vires to make the desired regulations. In its application to bodies of persons, *ultra vires* is habitually used in three different senses which ought to be kept distinct. When used in the strict sense, essentially what is in question is whether the body as such has capacity to act. Unless the body is incorporated, and thus has a personality distinct from its members, this question will normally not arise; the body is simply an association of human beings all or most of whom will have full capacity. Hence *ultra vires* in this sense does not arise in relation to partnerships. And the early case of *Sutton's Hospital* is generally taken to have

117 As above.
119 (1612) 10 Co Rep 1a 23a.
established that it also has no application to chartered corporations despite the fact that they do have a legal personality distinct from that of their members.\textsuperscript{120}

Addressing the case of chartered corporations, Davies goes on to say:

In these cases the only question is whether those have acted are deemed to be authorised to do so in accordance with the normal agency principles ... Nevertheless, it is customary to say that when those so acting (for example, the governing body) have exceeded their authority, they have acted \textit{ultra vires}. Thirdly, the courts have an unfortunate habit of describing as \textit{ultra vires} any activity which a company cannot lawfully undertake (for example one which infringes the capital maintenance provisions).\textsuperscript{121}

From a policy point of view, the \textit{ultra vires} doctrine arose historically due to two main reasons.\textsuperscript{122} First, shareholders who invested money in a company were entitled to see that the money was applied 'for the purposes for which they were presumably induced to invest and not to see it dissipated in unanticipated ventures.'\textsuperscript{123} Secondly, those who advanced credit to a company were entitled to rely on its creditworthiness so far as that could be ascertained from, \textit{inter alia}, its statement of objects and powers.\textsuperscript{124}

The \textit{ultra vires} doctrine, it must be stressed, is a rule concerned with the capacity of the company.\textsuperscript{125} This rule imposes artificial limitations on the acts and things which a company is regarded in law as capable of doing.\textsuperscript{126} To illustrate, in the English case of \textit{Ashbury Ry

\textsuperscript{120}Davies (n 111 above) 202. See \textit{Ashbury Carriage Company v Riche} (1875) LR 7 HL 653. Also, Davies (n 111 above) 203 observes that '[i]t was not until the latter part of the nineteenth century that it was clearly established that the strict type of \textit{ultra vires} applied to companies. Until 1844 the most common type of company—the deed of settlement company—had no corporate personality; that was enjoyed only by chartered companies (to which the strict doctrine did not apply) and by companies directly incorporated by statute (a rare breed until the railway boom). After the Joint Stock Companies Act 1856, deed of settlement companies became superseded by registered incorporated companies with limited liability and memorandum of association which had to specify their objects. Only then were the courts forced to decide whether or not the \textit{ultra vires} doctrine applied. In the landmark decision in \textit{Ashbury Carriage Company v Riche}, the House of Lords finally decided that it did. And if a company, incorporated by or under a statute, acted beyond the scope of the objects stated in the statute or in its memorandum of association, such acts were void as beyond the company's capacity even if ratified by all the members.'


\textsuperscript{122}F Rose \textit{Nutshells: Company law} (1998) 45.

\textsuperscript{123}As above.

\textsuperscript{124}As above.

\textsuperscript{125}LS Sealy \textit{Cases and materials in company law} (1996). 147.

\textsuperscript{126}As above.
Carriage & Iron Co Ltd v Riche,\textsuperscript{127} a company was incorporated under the Act of 1862. Clause 3 of the memorandum provided as follows:

The objects for which the company is established are to make and sell, or lend on hire, railway carriages and wagons, and all kinds of railway plant, fittings, machinery, and rolling-stock; to carry on the business of mechanical engineers and general contractors; to purchase and sell, as merchants, timber, coal, metals, or other materials; and to buy and sell any such materials on commission, or as agents.

Then, clause 4 of the articles provided as follows: 'An extension of the company's business beyond or for other than the objects or purposes expressed or implied in the memorandum of association shall take place only in pursuance of a special resolution.' The company agreed to provide Richie and his brother with finance for the construction of a railway in Belgium. Later, the company decided to repudiate the agreement. And when sued for damages, the company pleaded that it was \textit{ultra vires} for it to enter into such a contract. In the lower courts, the argument centred mainly on whether the contract, though unauthorised, had been approved by the shareholders under clause 4. However, in the House of Lords, it was ruled that the contract was void and that ratification, even if it had taken place, would have been wholly ineffective.

But, in this House of Lords ruling, one of the reasons why the court showed little sympathy to Richie and his brother, although not articulated in the speeches of their Lordships, could be that it had by then been established that persons dealing with a company should discover for themselves the contents of the memorandum and articles of association.\textsuperscript{128} A leading authority on this point is the case of Re Jon Beauforte.\textsuperscript{129} In that English case, a company had been incorporated with an objects clause that authorised the company to carry on business as makers of ladies' clothes, hats and shoes. The company later decided to manufacture veneered panels. In furtherance of this latter business, the company contracted with a builder to construct a factory, entered into a contract with a supplier of veneer and ordered coke from a coke supplier to heat the factory. All three remained unpaid when the company went into liquidation and the liquidator rejected their proofs in the winding-up on the ground the contracts were to further an \textit{ultra vires} activity and therefore void. In his ruling, Roxburgh J upheld the liquidator's contentions. The rejection of the coke supplier's proof was 'particularly harsh, since whereas the builder conceded that the contract was \textit{ultra vires}, the coke supplier was unaware of the

\textsuperscript{127} (1875) LR 7 HL 653 (House of Lords). See also Sealy (n 127 above) 151, for a summary of the facts and the holding.

\textsuperscript{128} See Ennerst v Nicholls (1875) 6 HL Cas 401.

\textsuperscript{129} [1953] Ch 131.
purpose for which the coke would be used and it could easily have been used to further legitimate objects'. But as Roxburgh J pointed out:

They had received orders for the coke on letterhead notepaper which made it clear that the company was now a veneer panel manufacturer and the objects clause, of which the coke supplier would have constructive notice, did not authorise the company to carry on this business.\(^{130}\)

Commenting on the *Re Jon Beauforte* case,\(^{131}\) Goulding argues that, although the 'justification' put forward by Roxburgh J that the letterhead notepaper made it clear that the company was now a veneer panel manufacturer and that there was also constructive notice that the objects clause did not authorise the company to carry on business of dealing in coke, strictly speaking, if a contract was void for being *ultra vires*, then notice on the part of the third party, whether actual or constructive, was irrelevant to the result.\(^{132}\)

Goulding observes further that the problem of the *ultra vires* doctrine was exacerbated by the fact that the objects clause could be altered only within certain specified limits and in any event not so as to affect retrospectively any transaction which was in question.\(^{133}\)

It could prove to have disastrous consequences for a person dealing with a company who was in good faith and was totally innocent apart from failing to obtain and interpret the company's objects clause.\(^{134}\)

Thus:

Companies responded to the *ultra vires* doctrine by drafting very wide and lengthy objects clauses which attempted to include every conceivable form of commercial activity.\(^{135}\) Eventually the Court of Appeal was even prepared to give effect to a clause which provided that the company could 'carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses or the general business of the company'\(^{136}\) and held that a particular transaction was *intra vires* even though it had no objective connection with a relationship to the company's main business.\(^{137}\)

\(^{130}\) See Goulding (n 123 above) 123.
\(^{131}\) [1953] Ch 131.
\(^{132}\) n 123 above. See *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246 per Browne-Wilkinson LJ.
\(^{133}\) Goulding (n 123 above) 123.
\(^{134}\) As above.
\(^{135}\) *Cottman v Brougham* [1918] AC 514.
\(^{136}\) *Bell Houses Ltd v City Wall Properties Ltd* [1966] 1 WLR 1323.
\(^{137}\) Goulding (n 123 above) 123.
There are some acts, as Sealy observes, which in the nature of things a company, or any other kind of corporation, simply cannot perform (eg marry or commit the crime of rape). In addition to these natural limitations on a company’s capacity, the company is also to be regarded as incapable of doing anything which is not within the scope of its objects clause, or reasonably incidental thereto. The doctrine, in other words, as Sealy observes:

restricted the powers of the company to matters covered by its stated objects, and any act which was outside those objects was not simply beyond the authority of the directors as a corporate organ, but beyond the capacity of the company itself — in the eyes of the law a nullity, having no effect whatever. It followed that not even the unanimous decision of the shareholders could authorise or ratify such an act, as the House of Lords established in the leading case of Ashbury Rly Carriage & Iron Co Ltd v Riche in 1875.

Although, in general, the ultra vires doctrine is concerned to confine the activities of a company within its stated objects, it necessarily has had the effect also of restricting the company’s powers. But, in reality, the distinction between objects and powers of a company is not an easy one to make. In A-G v Great Eastern Ry Co, the House of Lords made the concession that a company should be deemed to have implied powers to do anything reasonably incidental to its declared objects. That said, it has long been recognised that not all the contents of the objects clause provided for separate, free-standing objects which constituted the purposes for which the company was formed. In Cotman v Brougham, there were powers which were ancillary in the sense that they were present to support the substantive objects of the company. It could be argued that other examples of ancillary powers include the power for a company to borrow money or give guarantees. In the past, the English courts have implied such ancillary powers if the powers are not express as long as these powers are fairly incidental to achieving the company’s objects. Indeed,
It was at first held that even if express powers were used to further an *ultra vires* purpose, the exercise of the power itself was *ultra vires*. For example, borrowing money to fund an activity not stated in the objects clause.\(^{147}\) But the most recent cases, most notably *Rolled Steel Products (Holdings) Ltd v British Steel Corp*,\(^{148}\) narrowed the scope of *ultra vires* and held that the use of an express power could not be beyond the capacity of the company but rather it was an act done in excess or abuse of the powers of the company.\(^{149}\) The practical difference of this finding was that an act which was *ultra vires* the company was void and a nullity irrespective of the notice of the third party, whereas an act done in excess or abuse of the company's powers was unenforceable only if the third party had notice of this fact. Further, an *ultra vires* act could not be ratified by the shareholders whereas an act done in excess or abuse of powers could be.\(^{150}\)

As far back as 1945, recommendations for the reform of the law applicable to the *ultra vires* doctrine in the United Kingdom had started gaining ground.\(^{151}\) Views had been expressed through the Cohen Committee that the *ultra vires* doctrine served 'no positive purpose' and was 'a cause of unnecessary prolixity and vexation'.\(^{152}\) According to Goulding:

> The Jenkins Committee also recommended reform, but only to provide protection for third parties contracting with companies in good faith.\(^{153}\) No action was taken on these recommendations until the UK became a member state of the EEC and was required to implement the First Directive of Company Law. This reform of the law was originally contained in s 9(2) of the European Communities Act 1972 and subsequently became s 35 of the 1985 Act. But a number of difficulties came to light, and after a report was produced by Dr Prentice for the DTI,\(^{154}\) a much more thorough reform was implemented. This is now contained in ss 35, 35A, 35B 322A and 711A of the 1985 Act as substituted and provided by the 1989 Act.\(^{155}\)

Article 9(1) of the first EEC Directive on Company Law 1972 stipulated that

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\(^{147}\) *Re Introductions Ltd [1970] Ch* 199.

\(^{148}\) *Rolled Steel Products (Holdings) Ltd v British Steel Corp [1986] Ch* 246. The Court of Appeal stated that the ratification should be by all shareholders but then the basis for such a stringent requirement is not clear.

\(^{149}\) See also *Charterbridge Corp Ltd v Lloyds Bank plc [1970] Ch* 62.

\(^{150}\) Goulding (n 123 above) 124.

\(^{151}\) See the Cohen Committee 1945, Cmdn 6659. In the United Kingdom, there have been a number of law reform commissions that have been set up to examine, *inter alia*, the prospects for abolishing, retaining or refining the *ultra vires* doctrine. See eg the Cohen Committee 1945, Cmdn 6659, para 12; the Jenkins Committee 1962, Cmdn 1749, paras 35-42; and DD Prentice *Reform of the ultra vires rules: A consultative document* (1986).

\(^{152}\) 1945 Cmdn 6659, para 12.

\(^{153}\) 1962 Cmdn 1749, para 42.

\(^{154}\) Prentice (n 153 above).

\(^{155}\) Goulding (n 123 above) 124-125.
[a]ct[s] done by the organs of the company shall be binding upon it, even if those acts are not within the objects of the company, unless such acts exceed the powers that the law confers or allows to be conferred on those organs.

The UK’s domestication of article 9(1) of the first EEC Directive on Company Law came through the enactment of sections 35 and 35B of the English Companies Act 1985.\(^\text{156}\) According to Rose:

The *ultra vires* doctrine became less of a protection for members and creditors and more of an obstacle that might have arisen unexpectedly to invalidate an apparently *intra vires* transaction. Following Prentice’s DTI Consultative Document Reform of the *Ultra Vires* Rule (1986), it was, therefore, effectively abolished by the CA 1989 (substituting CA 1985, ss 35-35B). The stated objects in the memorandum may, therefore, be specific and detailed (statement of a wide range of objects was formerly a useful way of avoiding the limitations of the *ultra vires* doctrine). However, the memorandum may state that the object of the company is to carry on business as a general commercial company, in which case the object of the company is to carry on any trade or business whatsoever and the company has power to do all such things as are incidental or conducive to the carrying on of any trade or business by it (CA 1985, s 3A).\(^\text{157}\)

With the enactment and coming into force of the relevant provisions of the English Companies (Amendment) Act 1989, the *ultra vires* doctrine was effectively preserved only for internal purposes of the company.\(^\text{158}\) The doctrine was used as a means of enabling the shareholders to control the activities of company directors.\(^\text{159}\) In line with section 35 of the English Companies Act 1985, the directors had to observe any limitations on the powers of the company as stipulated.

\(^{156}\) Sec 35(1) of the English Companies Act 1985, as amended by the 1989 Companies Act — the latter statute introduced and imported sec 35A and sec 35B into the Companies Act 1985 — provided as follows: ‘'(1) The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company’s memorandum. ’ Davies (n 111 above) 215 observes that subsec (1) of sec 35A of the English Companies Act 1985 retains the expression (‘dealing with the company’ and ‘in good faith’) which caused some difficulty in the earlier version of sec 35. He argues thus: ‘But happily subsection (2) gives help in their interpretation. It provides: “(2) For this purpose — a person ‘deals with’ a company if he is a party to any transaction or other act to which the company is a party; a person shall not be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company’s constitution; and a person shall be deemed to have acted in good faith unless the contrary is proved.” Subsec (2)(a) provides a straightforward test of whether a person is “dealing with the company”. He will be, so long as he is a party to a transaction (eg a contract) or an act (eg a payment of money) to which the company is also a party. It no longer matters whether the person is an insider or an outsider, as it did under the *Turquand* rule.’ On the rule in the *Turquand* case, see Royal British Bank v Turquand (1856) 6 E & B 927, Exch Ch.

\(^{157}\) Rose (n 124 above) 45.

\(^{158}\) As above. See the Zambian case of Bank of Zambia v Chibote Meat Corporation Limited SCZ Judgment 14 of 1999.

\(^{159}\) Rose (n 124 above) 45.
in the company's constitution. Section 35A stated that if the directors acted in excess of the said powers and in excess of their authority, a third party could only enforce the resulting transaction if it were in good faith.

On 8 November 2006, a new legislative framework for company law was introduced in the United Kingdom. The UK Companies Act 2006 received royal assent on the said date, introducing some major changes to English company law. As noted in the earlier parts of this chapter, sections 31 and 39 of the UK Companies Act 2006 greatly reduce the applicability of the ultra vires doctrine to company law in the United Kingdom, although the doctrine continues to apply in relation to charities and a shareholder can also apply for an injunction, in advance only, to prevent an act which is claimed to be ultra vires. Sulkowski and Greenfield observe that the ultra vires doctrine has historically allowed 'a shareholder to sue to prevent a company from engaging in an activity outside of the specific parameters of its corporate charter'. This view is echoed in an exception to the general rule in *Foss v Harbottle*, allowing for an

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160 That is, the Companies Act 2006.
162 See the UK Companies Act 2006 (Commencement No 5, Transitional Provisions and Savings) Order 2007 (Statutory Instrument No 3495 (C 150) of 2007). Significant portions of the UK Companies Act 2006 were implemented on 1 October 2007 and 6 April 2008, respectively, with the remainder expected to come into force on 1 October 2008 and 1 October 2009. It was, indeed, intended that the UK Companies Act 2006 should be implemented in stages, and fully implemented by October 2008, but an announcement from the Department for Business, Enterprise and Regulatory Reform (BERR) delayed this process by a year. The commencement date for most of the provisions that were due to be in force on 1 October 2008 has therefore been postponed until 1 October 2009.
163 See above.
164 See UK Companies Act 2006, sec 42. See also UK Charities Act 1993, sec 65.
165 See below.
167 (1843) 2 Hare 461 (Court of Chancery (Vice-Chancellor)). This case was brought by two shareholders in the Victoria Park Co (incorporated by statute) against the company's five directors and others, alleging that the property of the company had been misapplied and wasted and certain mortgages improperly given over the company's property. It asked that the defendants should be held accountable to the company, and also sought the appointment of a receiver. The Vice-Chancellor ruled, however, that it was incompetent for the plaintiffs to bring such proceedings, the sole right to do so being that of the company in its corporate character. Against this background, the exceptions to the rule in *Foss v Harbottle* are usually grouped under four heads, and these heads are as follows: (a) where
individual shareholder to bring a derivative action on behalf of the company to prevent the company directors from committing the company to an *ultra vires* action.\(^{168}\)

Section 31 of the UK Companies Act 2006, dealing with the statement of a company's objects, provides for a novel approach to the question of a company's objects. Under the Companies Act 1985, all companies were required to have objects and these objects were to be specified in the memorandum of association.\(^{169}\) The Companies Act 1985 also made provision for a company to be specific about its objects where the company was going to be carrying on business as a general commercial company (see section 3A of the 1985 Act).\(^{170}\) However, based on a recommendation of the CLR\(^{171}\) (Final Report, paragraph 9.10), under the newly introduced piece of legislation in the UK, the Companies Act 2006, a different approach is now provided.\(^{172}\) Instead of companies being required to specify their objects,

companies will have unrestricted objects unless the objects are specifically restricted by the articles (see subsection (1)). This will mean that unless a company makes a deliberate choice to restrict its objects, the objects will have no bearing on what it can do. Some companies will continue to restrict their objects. Companies that are charities will need to restrict their objects (under charities legislation) and some community interest companies may also choose to do so.\(^{173}\)

Section 39 of the UK Companies Act 2006 provides that the validity of a company's acts is not to be questioned on the ground of lack of capacity because of anything in a company's constitution.\(^{174}\) This statutory provision replaces subsections 35(1) and (4) of the English Companies Act 1985, which made similar provision for

the act complained of is *ultra vires* or illegal; (b) where the matter is one which could validly be done or sanctioned only by some special majority of members; (c) where the personal and individual rights of the plaintiff as a member have been invaded; and (d) where what has been done amounts to a 'fraud on the minority' and the wrongdoers are themselves in control of the company. For further details on the four exceptions to the rule in *Foss v Harbottle*, see K Wedderburn 'Shareholders' rights and the rule in *Foss v Harbottle* (1957) *Cambridge Law Journal* 194 203.

\(^{168}\) As above.


\(^{170}\) As above.

\(^{171}\) In March 1998, the UK Department of Trade and Industry commissioned a fundamental review of company law in the United Kingdom. An independent steering group led the Company Law Review (CLR) whose terms of reference required them to consider how a core company could be modernised in order to provide a simple, efficient and cost-effective framework for British business in the twenty-first century.

\(^{172}\) n 171 above, 15.

\(^{173}\) As above.

\(^{174}\) n 171 above, 18.
restrictions of capacity contained in the memorandum of association. However, section 39 of the UK Companies Act 2006 does not contain provisions corresponding to subsections 35(2) and (3) of the English Companies Act 1985. It is considered that the combination of the fact that, under the UK Companies Act 2006, a company may have unrestricted objects (and where it has restricted objects the directors' powers are correspondingly restricted), and the fact that a specific duty on directors to abide by the company's constitution is provided for in section 171 of the said 2006 Companies Act, makes these provisions unnecessary. Subsection (2) of section 39 of the Companies Act 2006 indicates that that section, like section 35 of the English Companies Act 1985, is modified in its application to charities.

Finally, section 40 of the UK Companies Act 2006 provides safeguards for a person dealing with a company in good faith and restates section 35A and 35B of the English Companies Act 1985. The power of the directors to bind the company, or authorise others to do so, is deemed not to be constrained by the company's constitution. This means that a third party dealing with a company in good faith need not concern itself about whether a company is acting within its constitution. Under the UK's Companies Act 2006, subsection (2)(b)(i) of section 40 replaces part of section 35B of the English Companies Act 1985:

An external party is not bound to enquire whether there are any limitations on the power of the directors. The first limb of section 35B (which refers to the memorandum) has not been carried forward. This is concerned with restrictions in a company's constitution that limit a company's ability to act and consequently the powers of the directors to bind the company (the so-called ultra vires rule). Under the UK's Companies Act 2006, the objects no longer affect the company's capacity to act and so this limb is not necessary.

A moot question remains, however: What does the statutory phrase 'dealing with a company in good faith' mean? The concept of good faith may have different meanings to different people. However, in day to day ordinary parlance, the term good faith may be understood as simply complying with some standards of decency and honesty.

175 As above.
176 As above.
177 As above.
178 As above.
179 As above.
180 As above.
181 As above.
182 See Vallejo v Wheeler 98 Eng Rep 1012; Banque Financiere de la Cité SA v Westgate Insurance Co Ltd (unreported, Court of Appeal of England, 28 July 1988); Allen v Flood 1898 App Cas 1 46 (PC 1897); The ICC Arbitration Case No 8611 of 1997.
Keily argues that good faith is not a principle which can be adequately defined and that it has been described vaguely as a rechristening of fundamental principles of contract law and a phrase with no general meaning but which operates to exclude various forms of bad faith.\(^{183}\) Good faith is also seen as a discretionary standard preventing parties from recapturing opportunities that were foregone when contracting.\(^{184}\) In addition, good faith has been compared with unconscionability, ‘fairness, fair conduct, reasonable standards of fair dealing, decency, reasonableness, decent behaviour, a common ethical sense, a spirit of solidarity, community standards of fairness’,\(^{185}\) as well as ‘honesty in fact’, indicating that good faith is an extremely versatile concept.\(^{186}\) Commenting on good faith, Keily observes:

Its versatility is an essential characteristic because, as stated by Aristotle, ‘there are some cases for which it is impossible to lay down a law, so that a special ordinance becomes necessary. For what is itself indefinite can only be measured by an indefinite standard.’ However, good faith is not an obligation to act altruistically. Regretfully, Lücke writes, ‘One must leave the universal adoption of such a noble motive to some far-distant and much more enlightened age.’ Good faith does not require the abandoning of self-interest as the governing motive in contractual relations. However, it may prevent a party from abusing a legal right.\(^{187}\)

Having examined the ultra vires doctrine in the United Kingdom, we now turn to examine the ultra vires doctrine in Zambia.

### 3 The ultra vires doctrine in Zambia’s company law

We have already established that, in the United Kingdom, the coming into force of the relevant provisions of the English Companies (Amendment) Act 1989 on the ultra vires doctrine meant that that doctrine was effectively preserved only for internal purposes of companies.\(^{188}\) Further, it was established that the enactment of the

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\(^{186}\) See generally Keily (n 185 above).

\(^{187}\) As above.

\(^{188}\) As above.
UK Companies Act 2006 saw the retention of a number of statutory provisions of the English Companies Act 1985 regarding the *ultra vires* doctrine. And it was pointed out that sections 31 and 39 of the UK Companies Act 2006 greatly reduce the applicability of the *ultra vires* doctrine to company law in the United Kingdom, although the said doctrine continues to apply in relation to charities and that a shareholder, as already established above, can apply for an injunction, in advance only, to prevent an act which is claimed to be *ultra vires*.

In contrast to the position in the United Kingdom, the Zambian Companies Act 1994 presents some interesting challenges. With regard to the *ultra vires* doctrine, the relevant provisions of the Zambian Companies Act 1994 are not drafted in an intelligible manner. By reading the statute alone, it is not immediately clear whether the *ultra vires* doctrine has been abolished through the enactment of the Zambian Companies Act 1994. Indeed, the legal and policy bases of doing away with the statutory requirement for companies, such as banks and financial institutions, incorporated under Zambia’s Companies Act 1994, to have a memorandum of association are not clear. Section 7 of the Companies Act 1994 merely states:

(1) A company may have articles regulating the conduct of the company.

(2) The articles may contain restrictions on the business that the company may carry on.

(3) Where a provision in the articles is inconsistent with this Act or any other written law, the provision is invalid to the extent of the inconsistency.

(4) The articles of a company may adopt the regulations of the Standard Articles, or any specified regulations thereof.

(5) The articles of a public company or a private company limited by shares shall be deemed to have adopted the regulations of the Standard Articles except insofar as the articles exclude or modify those regulations.

(6) The articles of a company shall be divided into paragraphs numbered consecutively.

There is nothing in the statute to indicate why the statutory provision for a memorandum of association was dropped. Then, section 8 of the Companies Act 1994 goes on to say:

(1) Subject to this Act, and to its articles, a company may amend its articles if it passes a special resolution approving the amendment.

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189 As above.
190 As above.
(2) If a company passes a special resolution approving the amendment of its articles, it shall within twenty-one days after the date of the resolution lodge a copy of the resolution with the Registrar together with a copy of each paragraph of the articles affected by the amendment, in its amended form.

(3) The articles have effect in their amended form on and from the day of their lodgment with the Registrar or such later date as may be specified in the resolution.

(4) If a company fails to comply with subsection (2), the company, and each officer in default, shall be guilty of an offence, and shall be liable on conviction to a fine not exceeding three monetary units for each day that the failure continues.

As recently as 2008, the Supreme Court of Zambia passed a ruling confirming, in part, that the ultra vires doctrine still applies to company law in Zambia. In the Zambian case of *Freshint Ltd and Others v Kawambwa Tea Company*, (PW2) Hemant Kumar Jalan, the second plaintiff, a director of both Freshint Limited, the first plaintiff, and Kawambwa Tea Company Limited, the defendant company, negotiated for a loan of US$100,000 from Thompson Lloyd and Ewart Limited, the third plaintiff on behalf of the defendant company. The loan was dully advanced to the defendant company. The condition under which the loan was granted was that the defendant company was to export its tea through the third plaintiff. The loan was to be recovered from the proceeds of the exported tea. The guarantor of this loan was the second plaintiff. The defendant company was, however, put under receivership. Messrs G Sokota and NHC Chiromo were appointed joint receivers/managers by HSBC which was owed some money by the defendant company. The receivership was as a result of the floating charge dated 26 June 2000, created between the defendant company and HSBC. The loan of US$100,000 was not repaid by the defendant company. The receiver/managers acknowledged the said loan but refused to repay it to Thompson Lloyd and Ewart (TLE). The loan was, however, paid off by Freshint Limited (FIL) as per memorandum of understanding between the second plaintiff and the third plaintiff. The documents relating to this loan were signed by the second plaintiff on behalf of the defendant. The plaintiff’s first witness, one Edward Kenneth Clive Foster, confirmed the payment of this loan by TLE to the third plaintiff. The second plaintiff made a personal guarantee for the full payment of the loan on 22 November 2000.

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192 *As above.*
The defendant company (DW1) called one witness, Nallan Chakravarty Narasimhan, its Financial Director. DW1 stated that the defendant was a stranger to the documents purporting to be a memorandum of understanding between the second plaintiff and the third plaintiff. At the time the said document was executed by the parties, the defendant company was already under receivership of George Sokota and Nobert Chiromo. On examining the documents held by the defendant company, DW1 observed that the US$100 000 loan, obtained through the loan agreement dated 28 November 2000, was not in fact applied to purchase machinery or as working capital for the defendant company. The defendant company was forced to carry out some investigations against the second plaintiff and other co-directors for breach of their fiduciary duties to maintain its assets' value or to advance its commercial interests. The records further revealed that the defendant company had paid a total sum of US $265 558 from its tea export sales to third parties from which the defendant company derived no benefits.

Making reference in passing to the common law rule in the *Turquand* case, as well as to the Zambian case of *Zambia Bata Shoe Company v Vin-Mas Limited*, the Supreme Court of Zambia ruled:

In this instant case now before us we are not satisfied that the second plaintiff acted with the authority given to him by the defendant company. He acted without authority hence his failure to produce evidence to that effect. It was not for the defendant company to prove that it had, in fact, not given him such power. Since this was a pleaded issue in its defence it was for the plaintiffs to have been on guard to prove that the second plaintiff had in fact acted within the authority given to him. The defendant company adduced sufficient evidence through its witness who said the loan was not used for the purpose it was obtained. As he acted without authority from the company the loan agreement he entered into, purportedly on behalf of the defendant, was therefore ultra vires and so it was not binding on the defendant. The trial judge was therefore on firm ground when he so found. The plea of subrogation did not apply here and so it fails.

Although one might think that the Supreme Court of Zambia should have explored also the possibility of a *Quistclose* trust in this case of

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193 As above.
Applicability of the ultra vires doctrine of company law

The applicability of the ultra vires doctrine of company law

Freshint Ltd and Others v Kawambwa Tea Company, there was hardly any reference, obiter dictum or otherwise, to the concept of a Quistclose trust.

Some views have been expressed, however, that the drafting of the Zambian Companies Act 1994 has benefited from some models of parallel legislation in different jurisdictions such as New Zealand. Also, as observed earlier, it has been asserted that a primary goal of enacting the Zambian Companies Act 1994 was to simplify the process and procedures for incorporating a company in Zambia. To that end, and in the light of the ruling in Freshint, although the original intent of the legislative draftsman in dropping from the Zambian Companies Act 1994 the requirement for incorporators to furnish a company's memorandum of association at incorporation was to abolish the ultra vires doctrine, the said doctrine has not been abolished and continues to apply to company law in Zambia. Following below are a number of theses premised on the view that this doctrine still applies to company law in Zambia.

196 As above.
197 See Barclays Bank Ltd v Quistclose Investments Ltd [1970] AC 567. In this English case, Rolls Razor Ltd was deeply indebted to Barclays Bank Ltd. It needed further additional sums to be able to pay a dividend which it had declared. Rolls Razor Ltd borrowed funds from Quistclose Investments Ltd in order to satisfy the dividend declared. The terms of the loan were such that the funds would only be used for the sole purpose of paying the dividend. The loan was paid into an account with Barclays Bank Ltd, and Barclays Bank Ltd was given notice of the arrangement. However, between the time that the loan was advanced and the dividend being paid, Rolls Razor Ltd went into liquidation. Barclays Bank Ltd claimed that they were entitled to exercise a set-off of the money in the account against the debts that Rolls Razor Ltd owed with respect of Barclays Bank Ltd. Quistclose Investments Ltd claimed that the monies had to be returned to them, as the purpose for which they had been lent had now failed and were incapable of being fulfilled (as Rolls Razor Ltd was now in liquidation). The House of Lords (with the leading judgment being given by Lord Wilberforce) unanimously held that the money was held by Rolls Razor Ltd on trust for the payment of the dividend; that purpose having failed, the money was held on trust for Quistclose Investments Ltd. The fact that the transaction was a loan did not exclude the implication of a trust. Barclays Bank Ltd, having notice of the trust, could not retain the money as against Quistclose Investments Ltd. Similarly, the liquidator of Rolls Razor Ltd could not claim title to the money, as the assets did not form part the beneficial estate of Rolls Razor Ltd. See also Carreras Rothmans v Freeman Mathews Treasure [1985] Ch 207; Twinsectra v Yardley [2002] UKHL 12; Re Kayford (in liquidation) [1975] 1 WLR 279; and Re EVTRLtd [1987] BCLC 647. Telephone interview with Mr Michael Musonda, former Chairperson of the Law Association of Zambia (n 101 above).
198 See also e-mail response from Mr Tony Bwembya, the Assistant Registrar at Zambia's Patents and Companies Registration Office (PACRO) to Mr Noyoo Noyoo, a senior corporate lawyer in the banking sector of Zambia.
199 As above. See also e-mail response from Mr Tony Bwembya, the Assistant Registrar at Zambia's Patents and Companies Registration Office (PACRO) to Mr Noyoo Noyoo, a senior corporate lawyer in the banking sector of Zambia. Available at: http://www.saflii.org/zm/cases/ZMSC/2008/26.html (accessed 2 January 2009).
200 See Graham (n 87 above) 3.
201 n 201 above.
3.1 Thesis 1

The *ultra vires* doctrine continues to apply to Zambia since the requirements pertaining to Form II in the Companies (Prescribed Forms) Regulations\(^{203}\) require incorporators of a private company to submit to the Registrar of Companies a completed Form II bearing, *inter alia*, a summary statement regarding the 'principal business' of the company. An underpinning, but misleading, assumption inherent in this statutory provision is that every individual incorporating a company has the competence and skill to spell out accurately and sufficiently a summary statement regarding the principal and other businesses of the company\(^{204}\) and/or that, as we shall see below, some restrictions or limitations on the objects and powers will obviously be imbedded in the articles of association. But does the Zambian Companies Registry (PACRO) have the capacity to scrutinise all this information to ensure that incorporators of private companies provide sufficient and accurate information in Form II as well as in the articles of association? A view has been expressed that, given the laxity in some quarters of the Companies Registry, it is quite likely that some incorporators of companies do not always document sufficiently and accurately this type of information and that this weakness presents a challenge.\(^{205}\)

Mindful that section 9(1)(a) of the Zambian Companies Act 1994 provides that

> [a]n application for incorporation shall be accompanied by a statutory declaration that the requirements of this Act in respect of registration and of matters precedent and incidental thereto have been complied with, made by (a) a *legal practitioner* having a practising certificate who was engaged in the formation of the company ...

It is not immediately clear that the legal practitioner here personally has to draft the summary statement in Form II of the Companies

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\(^{203}\) These regulations are contained in Statutory Instrument 17 of 1995, issued pursuant to sec 400 of the Zambian Companies Act 1994.

\(^{204}\) Although in his e-mail to the author (n 101 above), Mr Musonda argues: 'The Companies Act 1994 has somewhat demystified company formations. While it is an obvious advantage for one to possess some "competence" and "skill" when filling out an Incorporation Form, not much "skill" or "competence" may be required for one to indicate the "General business" of the company as "trading", or "farming", or "transportation" or "manufacturing" or "banking" and other business as "any other business incidental to the foregoing or which may be advantageous or beneficial to the carrying on of the principal business". But even this seemingly easy task of entering information in Forms I, II, III or IV may not be that easy to someone who is not literate or who is semi-literate.

\(^{205}\) E-mail from Ms Annie Senkwe Nsenduluka, Senior State Advocate in the Attorney-General's Chambers of the Republic of Zambia, to this author.
(Prescribed Forms) Regulations\textsuperscript{206} regarding the business of the company. It appears that all that is required is for the legal practitioner to make a statutory declaration that there has been some compliance with the law and that he or she was in some manner, remotely or otherwise, involved in the incorporation of the company.

And where a company has already been incorporated and then there happens to be some irregularity affecting the articles of association, \textit{vis-à-vis} in regard to the manner in which the directors have a taken a particular decision that affects a \textit{bona fide} third party dealing with the company, the Supreme Court of Zambia, sitting in the case of \textit{Zambia Bata Shoe Company v Vin-Mas Limited},\textsuperscript{207} ruled:

\begin{quote}
In practice most people dealing with companies rely on the rule in \textit{Turquand}'s case and do not bother to inspect the articles. Applying the fiction of constructive notice both the vendor and the purchaser were aware of the need for a special resolution and the binding contract for sale was entered into on that basis. The company's authorised agents bound the company to comply with the contract and such liability cannot be avoided.\textsuperscript{208}
\end{quote}

It has been argued that, although the Zambian Companies Act 1994 does not have any statutory provisions requiring incorporators of a company under that piece of legislation to furnish the Registrar of Companies with a memorandum of association, in which document, as was the case under the repealed Companies Act 1921 of Zambia, the objects clause would be stipulated, the provision of such information by an incorporator in Form II of the Companies (Prescribed Forms) Regulations\textsuperscript{209} suffices for the purpose of stating the company's business in a simplified manner.\textsuperscript{210} In short, Form II, like Forms I, III and IV, respectively, is said to serve the same function that a statutory requirement for an objects clause in the memorandum of association would serve in those common law jurisdictions with such statutory provisions.\textsuperscript{211}

\textsuperscript{206} That is, Statutory Instrument 17 of 1995, issued pursuant to sec 400 of the Zambian Companies Act 1994.
\textsuperscript{207} [1994] ZR 136, cited in the Zambian case of \textit{Freshint Ltd} (n 197 above).
\textsuperscript{208} As above. See also \textit{Bank of Zambia v Chibote Meat Corporation Limited SCZ} judgment 14 of 1999.
\textsuperscript{209} As noted above, these regulations are contained in Statutory Instrument 17 of 1995, issued pursuant to sec 400 of the Zambian Companies Act 1994.
\textsuperscript{210} See e-mail response from Mr Tony Bwembya (n 201 above).
\textsuperscript{211} See e-mail from Mr Michael Musonda (n 101 above. The United Kingdom, as noted above, provides a leading example of a common law jurisdiction with such legislative requirements. Also, in Zambia, prior to the repeal of the Companies Act 1921, there was a statutory requirement in the 1921 Act placing an obligation on incorporators of a company to furnish the Registrar of Companies with memorandum of association that would contain, \textit{inter alia}, an objects clause.
There are a number of shortcomings associated with this approach. First, mindful that there is Form I, which deals with public companies, Form II deals only with private companies that have share capital. Yet, section 6 of the Companies Act 1994 allows also for the incorporation of companies limited by guarantee. Such companies can only be private companies since section 14 of the Companies Act 1994 and Form I in the Companies (Prescribed Forms) Regulations212 both stipulate that a public company must have share capital. In essence, what this means is that Form II does not cover a private company limited by guarantee. These companies are instead covered separately by Form III.

Secondly, Form II does not cover unlimited companies though such companies are required, like private companies with share capital, to have share capital and articles of association.213 Unlimited companies are, however, covered separately by Form IV.

Thirdly, the relevant section of Form II (including Forms I, III and IV, respectively) is drafted in such a way that a company can have a broad set of objects or multiple unrelated objects. The said section reads as follows:

(2) General nature of business:
(a) Principal business: ...
(b) Other business: ...
(3) *The articles do not restrict the business that the company may conduct OR
*The articles restrict the business that the company may conduct as follows: ...
*Delete whichever is not applicable

Here, the asterisk is a reflection of section 7(2) of the main statute, that is, the Zambian Companies Act 1994, which provides that ‘the articles may contain restrictions on the business that the company may carry on’. Additionally, section 22(1) of the Companies Act 1994 goes on to say that ‘a company shall have, subject to this Act and to such limitations as are inherent in its corporate nature, the capacity, rights, powers and privileges of an individual’.214 We saw earlier the view expressed by Sealy that there are some acts which in the nature of things a company, or any other kind of corporation, simply cannot

213 Companies Act 1994, sec 20(1).
214 See also telephone interview with Mr Michael Musonda (n 200 above).
This view is reflected in the said section 22(1) of the Zambian Companies Act 1994.216

Further, section 22(3) of the Zambian Companies Act 1994 provides that 'a company shall not carry on any business or exercise any power that it is restricted by its articles from carrying on or exercising, nor exercise any of its powers in a manner contrary to its articles'. Notwithstanding the foregoing, the provision for 'other business' in Form II in the Companies (Prescribed Forms) Regulations can, indeed, mean anything but illegal or unlawful objects. To that end, how are we to tell the extent of the limitation on the objects to which the company directors can commit the company if the relevant section of Form II on 'other business' refers to a whole range of issues and the articles of association do not even place a restriction on the objects? What would happen, if, without spelling out in the articles of association any limitations or restrictions on the objects or powers, a resourceful individual were to come up with a clause such as the following:

[t]o carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses (ie the 'principal' business) or the general business of the company.

And in terms of distinguishing between a power and an object, how easy is it for company directors to determine the extent of limitations on the power if the objects are so broadly defined and the articles do not even place restrictions on the powers? It would appear that, if there are no restrictions or limitations on the objects and the powers, it would not be easy to determine what objects could be deemed ultra vires the company or what power could be deemed exceeding the powers of the directors. In that sense, it is doubtful that the ultra vires doctrine can be invoked successfully under the circumstances stated above.

3.2 Thesis II

The second thesis is that where a public company is being incorporated, we should be mindful that Form I in the Companies (Prescribed Forms) Regulations bears great resemblance to Form II.

215 Sealy (n 127 above) 147.
216 However, sec 22(1) of the Zambian Companies Act 1994 does not apply to a statutory body corporate created under a separate piece of legislation from the Companies Act 1994. Unless provided for explicitly in that separate piece of legislation, such a statutory body corporate does not have the capacity, rights, powers and privileges that an individual enjoys.
And we have already discussed the said Form II. So, the arguments presented above, in relation to Form II, apply *mutatis mutandis* to Form I and in regard to public companies.

3.3 Thesis III

Thirdly, where a company limited by guarantee is being incorporated, Form III should be completed. And where an unlimited company is being incorporated, Form IV should be completed. Both these forms bear great resemblance to Form II. And since we have already discussed Form II, the arguments presented above in regard to Form II apply *mutatis mutandis* here.

3.4 Thesis IV

The fourth thesis is that those companies that were incorporated prior to the repeal of the Zambian Companies Act 1921 will continue to have a memorandum of association as well as an objects clause unless they decide to adapt to the framework of the Companies 1994, doing away with the memorandum of association and its attendant objects clause. On the one hand, where these companies retain their memorandum of association and the attendant objects clause, the *ultra vires* doctrine will apply as it did in the United Kingdom prior to the enactment of the English Companies Act 1985.

To illustrate, in a leading Zambian case, *JP Karnezos v Hermes Safaris Limited*, the plaintiff claimed from the defendant a sum of money for goods sold and delivered. By an oral agreement with the manager of the defendant company, the defendant agreed with the plaintiff to purchase burnt maize. Under the objects clause of the memorandum of association of the company, the goods the company could buy did not include burnt maize. It was contended by the defendant that the purchase of the burnt maize was not within the power of the company. Sakala J, sitting in the High Court of Zambia, ruled in favour of the defendant and observed as follows: (a) whether any given transaction is or is not within the powers of a company is a question of law depending on the construction to be placed on the objects clause of the memorandum of association; and, (b) in construing any memorandum of association in which there are general words, care must be taken to construe those general words so as not

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217 As above.
218 As above.
to make them a trap for unwary people.\textsuperscript{220} According to Sakala J, general words must be taken in connection with what are shown by the context to be the dominant or main objects of the company. In his ruling, Sakala J noted the following:

Before leaving this case, I wish only to observe that the facts of this case are a clear example of the hardship that the doctrine of \textit{ultra vires} may cause to an unsuspecting third party dealing with a large company. It is in cases of this nature that I entirely agree with the suggestion of the Jenkins Committee (Cmd 1949-1962) recommending the virtual abolition of the doctrine and protection to third parties who might have acted reasonably in the circumstances. I hope that any future changes to the Companies Act will take into account the hardships caused by the doctrine of \textit{ultra vires} and make provisions to modify it.\textsuperscript{221}

On the other hand, where a company that was incorporated under Zambia's Companies Act 1921 decides to adapt to the framework of Zambia's Companies 1994, doing away with the memorandum of association and its attendant objects clause, that company will have to abide by the requirements set forth either in Forms I, II, III or IV of the Companies (Prescribed Forms) Regulations, whichever is applicable. To that extent, the arguments presented under Thesis I above apply, \textit{mutatis mutandis}, here.

\section{4 Does the \textit{ultra vires} doctrine apply to banks and financial institutions in Zambia?}

Now that we have established the different circumstances under which the \textit{ultra vires} doctrine applies to company law in Zambia, can this analysis be extended to banks and financial institutions licensed under the Banking and Financial Services Act 1994, since most of these entities are legal persons incorporated under the Companies Act 1994?\textsuperscript{222} We pointed out at the beginning of this chapter that, for lack of space, we will not draw any analogies on whether banks in the United Kingdom are also affected by the \textit{ultra vires} doctrine in that country. The focus here, as established already, is on whether banks and financial institutions in Zambia, and not elsewhere, should have an objects clause given that the Zambian Companies Act 1994 does

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{220} See also the following English cases referred in the judgment pertaining to the Zambian case of J.P. Karnezos v Hermes Safaris Limited [1978] ZLR 197; Re German Date Coffee Company (1882) 20 Ch D 169; and Simpson v Westminster Palace Hotel Company (1860) 8 HLC 712.
\item \textsuperscript{221} JP Karnezos v Hermes Safaris Limited [1978] ZLR 197 200.
\item \textsuperscript{222} On the concept of a company being a 'legal person' under Zambia's Companies Act 1994, see Associated Chemicals Limited v Hill and Delamain Zambia Limited and Ellis and Company (Third Party) (Supreme Court of Zambia (SCZ) judgment 2 of 1998).
\end{itemize}
\end{footnotesize}
not require companies incorporated under that piece of legislation to have a memorandum of association.

Providing for the continuous existence of companies incorporated prior to the repeal of the Zambian Companies Act 1921, section 4 of the Zambian Companies Act 1994 states as follows:

Under the Subject to this Act, this Act applies to an existing company as if it had been duly incorporated under this Act as:

(a) a public company, if it was a public company under the former Act;
(b) a private company limited by shares, if it was a private company limited by shares under the former Act; or
(c) a company limited by guarantee, if it was a private company limited by guarantee former Act.  

Here, reference to the term 'former Act' points to the repealed Zambian Companies Act 1921. And to ensure that the articles of association of companies incorporated prior to the repeal of the Companies Act 1921 are not inconsistent with the provisions of the Zambian Companies Act 1994, section 391 of the said 1994 statute provides as follows:

(1) An existing company shall be deemed to have, on and from the commencement of this Act, articles consisting of:

(a) those provisions of the memorandum of association and articles of association of the company, within the meaning of the former Act, which regulate the operation of the company and are not inconsistent with the former Act; and

(b) any provisions of Table A of the former Act which, under the former Act, applied to the company; whether or not the articles so deemed are consistent with this Act.

The statutory provision then continues:

(2) The articles of an existing company under subsection (1) shall be valid, and this Act shall not apply to the company to the extent of any inconsistency with them, until:

(a) the company adopts new articles in accordance with subsection (3); or

Further, sec 390 through to sec 401 of the Zambian Companies Act 1994 contain 'transition provisions' for companies that were incorporated prior to the repeal of the Companies Act 1921, but which companies now exist under the Companies Act 1994.

The term 'former Act' is defined in sec 2 of the Zambian Companies Act 1994 as 'the Companies Act repealed by section four hundred and two; Cap 686 of the 1971 Edition'.

Companies Act 1994, sec 391.
(b) the last day of the first financial year of the company to commence after the commencement of this Act; whichever is earlier.

(3) An existing company shall, not later than the last day of the first financial year of the company to commence after the commencement of this Act, in accordance with section eight, adopt articles expressed in terms of and consistent with this Act.

(4) Where an existing company has lodged with the Registrar new articles for the purposes of subsection (3), the Registrar shall issue to the company:

(a) a replacement certificate of incorporation; and

(b) a replacement certificate of share capital, in the case of a company with share capital; worded to meet the circumstances of the case.

(5) An existing company shall not amend its articles unless, after the amendment, the articles are expressed in terms of and consistent with this Act.

(6) Until subsection (3) has been complied with, an existing company may satisfy the requirements of section twenty-nine in relation to the articles of the company and the certificate of share capital by supplying to a member a copy of its memorandum of association and articles of association within the meaning of the former Act.

(7) If an existing company fails to comply with subsection (3), the company, and each officer of the company in default, shall be guilty of an offence, and shall be liable on conviction to a fine not exceeding ten monetary units for each day that the failure continues.226

Turning back to the issue of a memorandum of association under the Zambian Companies Act 1994, we have already observed that the Companies Act 1994 neither forbids nor requires a company to have a memorandum of association. And it was pointed out that incorporators of a private company must file with the Companies Registry (PARCO) a completed Form II (or, in the case of a public company, a completed Form I) to incorporate the company.227 For those companies intending to obtain a banking license from the central bank, they have to furnish the Bank of Zambia with, inter alia, full particulars of the business that they propose to conduct under the authority of the banking licence being sought.228 Against this background, can a bank or financial institution be licensed to conduct banking business or financial services business even if such an entity does not have a memorandum of association? From an economic point of view, there is little incentive for an applicant of a banking licence to have a memorandum of association since the applicant’s line of business will already have been disclosed in Form II as well as in the

226 As above.
227 As above.
228 See Banking and Financial Services Act 1994, sec 4(2) (as amended through to 2000).
particulars furnished to the Bank of Zambia when applying for a banking license.\textsuperscript{229} Besides, Core Principle 2 of the Basel Core Principles for Effective Banking Supervision requires that 'the permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined'.\textsuperscript{230} That said, it should be noted that both the Companies Act 1994 and the Banking and Financial Services Act 1994 do not bar or prohibit a bank or financial institution from having a memorandum of association. Legally speaking, therefore, a bank or financial institution can be licensed to conduct banking business or financial services business whether or not it has a memorandum of association. What, then, are the implications of such innovations in Zambia’s company and financial services law?

One view here is that, since banks and financial institutions must be incorporated lawfully as companies before they can be licensed under the Banking and Financial Services Act 1994, these entities are under no statutory obligation under Zambia's Companies Act 1994 to have a memorandum of association. They are, therefore, less likely to have elaborately-stated objects than mere short ‘layman-like’ summary statements in Forms I, II, III or IV, whichever is applicable. That said, we are still left to look at Forms I, II, III or IV, depending on whether the entity is a private company, public company, company limited by guarantee or an unlimited company. Under Zambian company law, as noted already, the information spelt out in Forms I, II, III or IV, regarding the 'principal business' or the 'other business' of the company, cannot be presumed through constructive notice.\textsuperscript{231}

Prior to the enactment of the Banking and Financial Services (Amendment) Act 2000, an applicant for a banking licence under Zambia's Banking and Financial Services Act 1994 was required to provide particulars of its memorandum and articles of association.\textsuperscript{232} With the coming into force of the Banking and Financial Services (Amendment) Act 2000, that statutory requirement for an applicant of a banking licence to submit its memorandum of association has been dropped. Today, a company applying for a banking licence is required to furnish the Registrar of Banks and Financial Institutions

\textsuperscript{229} As above.
\textsuperscript{230} See Basel Committee (n 7 above) 2-5.
\textsuperscript{231} In many common law jurisdictions, including the United Kingdom, the memorandum and articles of association are public documents and, thus, give rise to the doctrine of ‘constructive notice’. In Zambia, by contrast, sec 24 of the Companies Act 1994 has abolished the common law doctrine of ‘constructive notice’. On the doctrine of ‘constructive notice’ generally, see Re Jon Beauforte (London) Ltd [1953] Ch 131. See also Re Airdale Co-op Worsted Society [1933] 1 Ch 639; Sinclair v Brougham [1914] AC 398, HL; Re Diplock [1948] Ch 465, CA; Agip (Africa) Ltd v Jackson [1991] Ch 547, CA.
\textsuperscript{232} Although the statutory requirement for a company applying for a banking licence to provide a memorandum of association to the Registrar of Banks and Financial Institutions has now been done away with, does that mean that the ultra vires doctrine has also been done away with?
with, inter alia, its articles of association; the physical and postal address of its head office and the permanent residential addresses of its directors, chief executive officers, managers and shareholders; the name and permanent residential address of every subscriber for any class or series of shares issued by the company in a number that will exceed one per centum of all the shares of that class or series, whether such shares carry the right to vote in all circumstances or not; the full particulars of the business the company proposes to conduct under the authority of the banking licence being sought; and the amount of that company’s capital.233

Elsewhere,234 and as shown above, I have argued that, while the Zambian Companies Act 1994 requires a company to provide articles of association at incorporation, that statute neither prohibits nor requires a company to provide a memorandum of association at any time. The legal implications of this seemingly purposeful omission have been explored at some length.235 Here, suffice it to say, between 1994 and 2000, the Banking and Financial Services Act 1994 required applicants for a banking or financial services licence to furnish the Registrar of Banks and Financial Institutions with, inter alia, their memorandum of association, yet the Companies Act 1994 did not require these companies to have a memorandum of association. This anomaly was only redressed in 2000 when the Banking and Financial Services (Amendment) Act 2000 was passed. So, prior to the enactment of the Banking and Financial Services (Amendment) Act 2000, the requirement for an applicant of a banking licence to provide a memorandum of association invited the following possible interpretations:

(1) Although the Companies Act 1994 was (and still is) silent on whether or not a company must furnish a memorandum of association at incorporation, the requirement under the Banking and Financial Services Act 1994 directed an applicant for a banking licence to prepare a memorandum of association solely for the purposes of licensing and supervision.

(2) Alternatively, it could be argued that the requirement under the Banking and Financial Services Act 1994 was meaningless since the Companies Act 1994, under which the company was incorporated, did not require a memorandum of association at incorporation or at anytime thereafter.

233 See Banking and Financial Services Act 1994, sec 4(2) (as amended through to 2000).
At close examination, it could be argued that the repealed licensing requirement that an applicant for a banking licence should provide a memorandum of association was solely meant for purposes of facilitating the licensing and supervision of banks. There are three main reasons that support this view. First, the Preamble of the Banking and Financial Services Act 1994 stresses the importance of providing safeguards for investors (which could take the form of licensing and supervision). Secondly, the Banking and Financial Services Act 1994 is an independent piece of legislation and cannot therefore be superseded by a competing statute which has no provisions of an overriding nature.\footnote{See sec 399 of Zambia's Companies Act 1994 which provides that "[n]othing in this Act shall abrogate or affect any special legislation relating to companies carrying on the business of banking, insurance or any other business", indicating that the statutory provisions of the Companies Act 1994 cannot override the provisions of such pieces of legislation as the Banking and Financial Services Act 1994.} Thirdly, and more convincingly, the Zambian Parliament has now amended the Banking and Financial Services Act 1994 and the statutory requirement that an applicant for a banking licence should furnish a memorandum of association has been removed.\footnote{See Banking and Financial Services Act 1994 (as amended through to 2000) sec 4.}

But, what are the consequences of this statutory amendment on the *ultra vires* doctrine in as far as banks and financial institutions are concerned? A consequence of permitting banks and financial institutions to be incorporated without a memorandum of association is that an investor might be misled to think that the Zambian Companies Act 1994 has done away with the statutory requirement for companies to have an objects clause. But, let us take a more reasoned look.

It would be interesting to find out what will happen to those banks and financial institutions that were incorporated before the Companies Act 1994 was enacted. We submit here that Thesis IV, as presented above, should apply. Further, is the repeal of the statutory requirement in the Banking and Financial Services Act 1994, requiring an applicant for a banking licence or a financial services license to provide a memorandum of association to the Registrar of Banks and Financial Institutions, tantamount to a statutory prohibition on all banks and financial institutions to desist from having a memorandum of association? And, what happens to the memoranda of association of banks and financial institutions that were licensed before the aforesaid statutory requirement was abolished? Should the law simply turn a blind eye to such matters or should the businesses of these banks and financial institutions be confined solely to the company's objects clause (which can be found in the memorandum of association)? What happens where actions of a bank's directors...
exceed powers of the bank as stipulated in the memorandum of
association? Can such bank directors evade the *ultra vires* doctrine by
hiding behind the concept of universal banking and claiming that,
after all, under the Banking and Financial Services Act 1994 (as
amended through to 2000) there is no need for any bank or financial
institution to have a memorandum of association? We are left to look
at the contents of each and every licence issued to a bank or financial
institution as well as the statutory definitions of a ‘bank’ and
‘financial institution’ in the Banking and Financial Services Act 1994
(as amended through to 2000) in order to determine the objects and
powers that are implicit in the legal and regulatory framework.

In a typical situation, such as that under the Zambian Companies
Act 1994, there is not much incentive for a bank or financial
institution to go beyond the letter of the statute and provide a
memorandum of association.238 Why would a bank or financial
institution do so if, by providing a memorandum of association, the
bank or financial institution would limit itself to the business
activities spelt out in the objects clause? Besides, as we have pointed
out above,239 Forms I, II, III and IV of the Companies (Prescribed
Forms) Regulations,240 like section 4(2) of the Banking and Financial
Services Act 1994,241 do make provision for a bank or financial
institution to state the nature of its business.

So, legally speaking, as already established, a company, such as a
bank, can, if it chooses, have a memorandum of association.242 There
is nothing illegal or unlawful about such a decision. Indeed, as pointed
out above, the Zambian Companies Act 1994 neither prohibits nor
requires a company to have a memorandum of association at any
time. In theory, it is up to the company itself to decide whether or not
to have a memorandum of association, although the introduction of
this document might not serve much purpose since a number of items
that should have been covered by the memorandum of association are
likely to be covered by the articles of association243 as well as by
Forms I, II, III or IV in the Companies (Prescribed Forms) Regulations.
Assuming that a company opts for a memorandum of association, in
addition to its articles, what would happen where the articles of
association and the memorandum of association are seen to be
inconsistent or contradict each other?

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239 As above.
240 As above.
241 As above.
242 As above.
243 See secs 7 & 8 of Zambia’s Companies Act 1994.
At common law, as held in the English case of Guinness v Land Corporation of Ireland,\textsuperscript{244} the general rule is that where there is a conflict between the terms of the memorandum of association and those of the articles of association, the terms of the memorandum of association should prevail.\textsuperscript{245} In the Guinness case,\textsuperscript{246} the memorandum of association stated that the objects of the company were the cultivation of lands in Ireland, and things incidental thereto, and that the capital of the company was £1 050 000 divided into 140 000 A shares of £5 each and 3 500 B shares of £100 each. The articles of association (by article 8) provided that the capital representing the B shares should be invested in a fund set up to guarantee the payment of a 5\% preferential dividend to the holders of the A shares. One of the B shareholders brought these proceedings against the company to test whether it was competent for the company to apply its funds in the manner prescribed by article 8. The Court of Appeal held that the articles of association could not modify the memorandum of association and that where there is some inconsistency between the two them, the terms of the memorandum should prevail.

In another English case, Re Duncan Gilmour & Co Ltd,\textsuperscript{247} the memorandum of association (as construed by the court) gave the company’s preference shareholders the right in a winding-up to a preferential return of their capital but nothing more, while the articles purported to give all the company’s shareholders a right to participate in any surplus assets on a pro rata basis. Wynn-Parry J held that the articles of association could not be referred to ‘to vary that which would be the result of the memorandum standing alone’.\textsuperscript{248}

In Zambia’s case, however, unlike the United Kingdom’s, the memorandum of association is not a statutorily mandated document under the Zambian Companies Act 1994. As established above, only the articles of association are required under this statute. Against this background, should we allow a document that is not premised on a legislative requirement to take precedence over a legal document mandated and required by legislation? It would appear that, in Zambia’s case, for those companies that are incorporated under the Zambian Companies Act 1994, the articles of association should take precedence over the memorandum of association where provisions of the two documents conflict or contradict one another. This approach could help also to resolve matters pertaining, say, to the alteration of the object’s clause where a company opts to have a memorandum of

\textsuperscript{244} (1882) 22 Ch D 349 (Court of Appeal).
\textsuperscript{245} See also Welton v Saffery (1897) AC 299.
\textsuperscript{246} Guinness v Land Corporation of Ireland (1882) 22 Ch D 349 (Court of Appeal).
\textsuperscript{247} [1952] 2 All ER 871.
\textsuperscript{248} See Re Duncan Gilmour & Co Ltd [1952] 2 All ER 871.
Applicability of the ultra vires doctrine of company law

association in addition to its articles. Then, for those companies that were incorporated prior to the repeal of the Zambian Companies Act 1921, the memorandum of association should take precedence over the articles of association in accordance with the common law.  

And in the case of a company incorporated under Zambia's Companies Act 1994 and having a memorandum of association, it is imperative that the objects clause in the memorandum of association is drafted closely in line with the summary statement, regarding the business of the company, as spelt out in Forms I, II, III or IV, whichever is applicable. However, given that the memorandum of association is not provided for (but also not prohibited) by the Zambian Companies Act 1994, can the objects clause in such a memorandum be altered without a special resolution of the company, or does the company, first, have to obtain a court order before it can alter the objects clause here? Or, is everything entirely up to the company itself to determine, either in the articles or the memorandum of association, including the procedure of altering the objects clause? And what happens where these provisions on the alteration of the objects clause turn out to be deliberately and purposely prejudicial to minority shareholders? Can the courts intervene and, if so, what would be the legal authority for such an intervention?  

In general, where a company, such as a bank or financial institution, has no memorandum of association, but has furnished the Registrar of Companies with a completed Form I or Form II, whichever is applicable, that company will not be expected to have a separate objects clause.  

5 Conclusion  

This chapter has examined the legal and policy bases for doing away with the statutory requirement for companies, such as banks and

249 As above.  
250 See Davies (n 111 above) 208, who argues that 'Professor Prentice had recommended that companies should be afforded the capacity to do any act whatsoever and should have the option of not stating their objects in their memoranda. Unfortunately, this straightforward solution was not adopted, notwithstanding the precedents for it in some other common law countries. Some of those countries, however, were not subject to two complications which arose here. First, our companies, as we have seen, are not necessarily “business corporations”; on the contrary, most of these limited by guarantee are formed to enable the advantages of corporate personality and limited liability to be obtained by those undertaking activities which are not the carrying on of business with a view for a profit ... The second complication (from which non-EC countries are free) was that the Second Company Law Directive requires that, in the case of public companies, the statutes or instruments of incorporation shall state the objects of the company. But total abolition of limitations on capacity was in no way dependent on abolition of objects clauses and, if the Directive precluded the latter, it certainly did not preclude the former.'
financial institutions, incorporated under the Zambian Companies Act 1994, to have a memorandum of association. It was pointed out that a notable consequence of permitting the incorporation of companies without a memorandum of association is that an investor could be misled to think that the Zambian Companies Act 1994 has done away with the statutory requirement for companies to have an objects clause or at least some form of objects clause. The chapter argued that, while the ultra vires doctrine continues to apply in Zambia, its significance has been watered down by the introduction of Forms I, II, III and IV in the Companies (Prescribed Forms) Regulations to replace the statutory requirement in the Companies Act 1994 for an objects clause in the memorandum of association. These legislative changes, it was observed, were meant not only to simplify the incorporation of companies, but also to abolish the ultra vires doctrine in Zambia's company law.

In general, as alluded to in chapter 1, banks and financial institutions in Zambia are subject to two main layers of regulation. The first layer relates to meeting the statutory requirements for a company to be incorporated under the Companies Act 1994. The second layer of regulation is the regulatory framework established under the Banking and Financial Services Act 1994, including the terms and conditions of licenses issued to banks and financial institutions.

The chapter highlighted four related theses regarding the ultra vires doctrine in Zambia. The first was that the ultra vires doctrine continues to apply in Zambia, since the requirements pertaining to Form II in the Companies (Prescribed Forms) Regulations require incorporators of a private company to submit to the Registrar of Companies a completed Form II bearing, inter alia, information on the ‘principal business’ of the company. It was argued that this approach assumes that the principal business will be defined reasonably well

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251 Davies (n 111 sabove) 204, examining the position in the United Kingdom, observes that, at some point, “[t]he courts sought to narrow the scope of the resulting vires by distinguishing between ‘objects’ (in the sense of types of business) and ‘powers’ and, applying the ejusdem generis rule of construction, ruling that the powers could be used only in relation to the objects. But that too was circumvented by the device of ending the ‘objects’ clause by stating that each of the specified objects or powers should be treated as independent and in no way ancillary or subordinate one to another, and, at a later date, by also inserting a power ‘to carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses or the general business of the company’.” See Cotman v Brougham [1918] AC 514. See also Introductions Ltd v National Provincial Bank [1970] Ch 199 CA; Bell Houses Ltd v City Wall Properties Ltd [1966] 2 QB 656 CA; Newstead v Frost [1980] 1 WLR 135 HL; Charterbridge Corporation Ltd v Lloyds Bank [1970] Ch 62; Pe Halt Garage Ltd [1982] 3 All ER 1016; Rolled Steel Ltd v British Steel Corp [1986] Ch 246; Brady v Brady [1988] BCLC 20 CA, revd [1989] AC 755 HL.

252 As above.
enough or that some restrictions or limitations on the objects and powers will be imbedded in the articles of association.

The second thesis was that, where a public company is being incorporated, we should be mindful that Form I in the Companies (Prescribed Forms) Regulations bears greater resemblance to Form II and that the arguments pertaining to Form I apply to Form II mutatis mutandis. The third thesis focused on unlimited companies and those companies limited by guarantee, arguing that, by parity of reasoning, some threads of the second thesis can be extrapolated and applied, mutatis mutandis, to Forms III and IV. The fourth thesis was that those companies that were incorporated prior to the repeal of the Companies Act 1921 of Zambia will continue to have a memorandum of association as well as an objects clause unless they decide to adapt to the framework of the Companies 1994 and thus do away with the memorandum of association and its attendant objects clause. However, where these companies retain their memorandum of association and the attendant objects clause, the ultra vires doctrine will apply as it did in the United Kingdom prior to the enactment of the English Companies Act 1985.
3 Regulation of Banks and Financial Institutions

1 Introduction

This chapter examines the efficacy of the legal framework for banking supervision under Zambia’s Banking and Financial Services Act 1994, as well as the efficacy of the legal framework for central bank independence under the Bank of Zambia Act 1996. Among other things, the chapter argues that, under Zambian law, the Bank of Zambia does not enjoy central bank independence, particularly with regard to the manner in which the law permits the executive arm of the State to meddle into affairs of the Bank of Zambia. Even the role of the central bank as lender of last resort, or the supervisory function of regulatory forbearance, can be compromised and abused if the executive, through the Republican President, has the unfettered power to hire and fire the Bank of Zambia Governor. Examining the role of a central bank as lender of last resort, the Asian Development Bank observes:

The goal of the traditional regulatory and supervisory process is simple on its face: the prevention and resolution of financial intermediary crises. Unfortunately, while the goal is simple, its achievement is anything but. At its most basic, the traditional formulation for preventing and resolving bank crises involves two sets of processes: ex ante and ex post crisis.253

According to the Asian Development Bank:

The ex ante measures focus on two related goals:

• supporting sound management and internal controls (a well-managed bank is less likely to be the subject either of a crisis or of contagion); and

regulation and supervision (bank management has short memories and needs to be given rules to follow; it also needs to be monitored to make sure that it in fact follows the rules).

Main issues relate to the administrative process and rule/discretion-based approaches (eg, prompt corrective action). The ex post measures focus on bolstering confidence, stemming contagion and resolving problem intermediaries. Immediate measures focus on suspension of accounts (never popular), the provision of support through the LoLR (lender of last resort) mechanism (to deal with illiquidity) and various mechanisms for depositor protection, of which deposit insurance is the most significant (to minimise the effect of the insolvency of banks to the depositors). In addition to the immediate measures, other ex post measures are required to deal with the insolvency of individual institutions. With respect to individual institution insolvencies, four key mechanisms exist:

(i) organisation of a rescue package;
(ii) provision of open assistance;
(iii) merger or acquisition (public or private);
(iv) liquidation and pay-off.  

In Zambia, the Banking and Financial Services Act 1994 is the legislative cornerstone for the regulation and supervision of banks and financial institutions.  

Among the notable amendments and additions to the Banking and Financial Services Act 1994 are definitions of terms such as 'board', 'chief executive officer', 'chief financial officer', 'common enterprise', 'company', 'court', 'deposit', 'director', 'financial institution', 'financial institutions' licence', 'financial service', 'foreign bank', 'foreign company', 'manager', 'money circulation scheme', 'primary capital', 'regulatory capital', 'representative office', 'tribunal', 'voting shares', 'merchant banking', and 'venture capital funding'. Also, the requirement that a company applying for a banking licence should provide a memorandum of association to the licensing authority has now been removed. The latter development is in line with the provisions of the Companies Act 1994, which do not require promoters or shareholders of a company, at incorporation or any time thereafter, to provide a memorandum of association to the Registrar of Companies. Thus, in the case of both the Banking and Financial Services Act 1994 and the Companies Act 1994, only articles of association are required.

An important objective to consider is the need to develop a stable banking system which allocates credit on a market basis. The development of such a banking system can be achieved, in part, through the establishment of an efficient and effective regulatory framework for banking and financial services supervision. This type of framework, it must be observed, should be in place even before capital markets are liberalised. It has been argued, for example, that:

Costly financial crises have taught the lesson that liberalisation must not proceed until prudential standards are in place, supervisors are capable of over-seeing bank activities, banks are adequately capitalised, and banks have the ability to operate profitably and prudently. Advice is to begin with banks since banks underpin the rest of the financial system and are the fundamental source of finance for most firms. Hold off on development of securities markets, but the nature of privatisation will affect this advice. For example, an approach that distributes shares or vouchers widely will require relatively quick development of securities markets.

At the outset, it must be pointed out that this chapter is concerned mainly with those aspects of the Zambian Banking and Financial Services Act 1994 relating to pre-insolvency operations of banks and financial institutions. Aside from providing the main legislative framework for banking supervision and regulation, this statute also...

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258 See also ‘Zambia’s banking sector at cross-roads’ Zambia News Online (29) 31 October 1997 University of Pennsylvania Africa Studies Center, available at http://www.africa.upenn.edu/Newsletters/zno29.html (accessed 14 March 2009): ‘Commercial banks in Zambia have come under a renewed threat of extinction. Not necessarily because of poor management but because of diminishing confidence in them by potential depositors. The latest wave of scepticism on the abilities of local banks has been triggered by the closure of Prudence Bank... For many, the closure of Prudence Bank did not come as a surprise. Rather, it sent warning signals among some depositors on the capabilities of fledgling banks to withstand the stiff competition in the financial sector. It also rekindled the question of whether or not Zambia's economy was big enough to accommodate a flurry of banks that have been shooting up... The liberalizing of the economy in 1991, when the MMD came into power, encouraged many businessmen to establish banks. With only K20 million (about US$ 20 000) required for one to open a bank, several sprang up. But developments in the sector... have increasingly pointed to too many banks chasing too few customers resulting in the small banks failing to cope with the tough competition.’


260 The bulk of the law on insolvency of banks in Zambia is found in ch VII of the Banking and Financial Services Act 1994 and the Companies Act 1994. That aspect of the law is not the focus of this chapter. We will examine legal aspects of bank insolvency in ch 8. Here, suffice it to say, for further readings on recent developments relating to insolvency of banks, see the following seminar papers: TMC Asser ‘Regulatory treatment of banks In distress’ (Washington DC IMF 1999); and M Waxman & N Annamalia ‘Systemic bank insolvency: A legal framework for early crisis containment’, (Washington DC The World Bank, 1999). Both Mr Asser’s paper and Ms Waxman and Ms Annamalia’s papers were presented at a conference on ‘Building effective insolvency systems’ hosted by the World Bank in Washington DC, 14-15 September 1999.
spells out safeguards for investor protection in the banking sector.\textsuperscript{261} Closely related to the Banking and Financial Services Act 1994 is the Bank of Zambia Act 1996. The latter statute sets out the governance framework of the Bank of Zambia, and we will therefore also examine it.

In general, as noted in chapter 1, the Banking and Financial Services Act 1994 applies to all banks and financial institutions, whether or not constituted by any Act of parliament.\textsuperscript{262} The requirements of the Banking and Financial Services Act 1994 are, however, not binding on the Bank of Zambia, except in so far as the Act expressly imposes a duty on that institution.\textsuperscript{263} Prior to the enactment of the Banking and Financial Services (Amendment) Act 2000, a similar analogy akin to that of the Bank of Zambia here applied to statutory bodies such as the Development Bank of Zambia and the Export and Import Bank.\textsuperscript{264} We have explored this issue at length in chapter 1.\textsuperscript{265} Suffice it to say, for the purposes of the present chapter, we ought to know whether a particular entity that has gone bust is a bank or a financial institution. This determination is vital in guiding us to the appropriate rules and principles of corporate insolvency law.

2 Money laundering and deposit-insurance

Apart from the coming into force of the Banking and Financial Services Act 1994,\textsuperscript{266} legislation on money laundering has also been introduced in Zambia.\textsuperscript{267} And we will examine in greater detail in chapters 4 and

\textsuperscript{261} See Preamble of the Banking and Financial Services Act 1994, and sec 131 of that statute.
\textsuperscript{262} Banking and Financial Services Act 1994, sec 3.
\textsuperscript{263} As above.
\textsuperscript{264} n 264 above, secs 3(c), (d) & (e), which has now been repealed and replaced with sec 3 of the Banking and Financial Services (Amendment) Act 2000.
\textsuperscript{265} See also generally KK Mwenda ‘Legal construction of the term “bank”: A comparative study’ (2000) 8 Tilburg Foreign Law Review; and Mwenda (n 6 above) 1-9.
\textsuperscript{266} And the coming into force of the Banking and Financial Services (Amendment) Act 2000.
\textsuperscript{267} Although it is important that a modern legal framework for bank supervision regulates against money laundering, this chapter highlights only salient features of money laundering since a meaningful discussion of money laundering can only be dealt with more appropriately in a separate dissertation altogether. See eg WC Gilmore (ed) International efforts to combat money laundering (1992); R Bosworth-Davies & G Saltmarsh Money laundering: A practical guide to the new legislation (1994); and J Dane Criminal law in the company context (1995) 105-127. Under international law, the UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention) 1988 calls on state signatories to criminalise money laundering, to assure that bank secrecy is not a barrier to criminal investigations, and to promote the removal of legislative impediments to investigation, prosecution, and international co-operation.
5 the Zambian legal framework for combating money laundering. As the Bank of Zambia observes:

There is a growing global concern over money laundering, and Zambia is no exception. Explained in simple terms, money laundering is the ‘washing of dirty money’ into the financial system thereby legitimising proceeds of illegal activities such as drug trafficking. Money laundering not only undermines public confidence in the financial system; it also causes distortions in the economy in terms of significant influence on key economic variables such as money supply which do not derive from economic activity. As there is no law against money laundering at present (that is, at the time when this report came out), a committee (on which the Bank of Zambia has a representation) has been established with the objective of drafting legislation to outlaw money laundering.268

The much-awaited Prohibition and Prevention of Money Laundering Act was enacted in 2001. There is a prevailing view from some sections of the public that a major factor that delayed the enactment of the Prohibition and Prevention of Money Laundering Act 2001 was that some money laundering activities in Zambia were being

268 The Bank of Zambia at http://www.boz.zm (accessed 11 August 2000). In a World Bank study, WP Ofosu-Amaah et al Combating corruption: A comparative review of selected legal aspects of state practice and major international initiatives (1999) 53-55 define money laundering as follows: ‘Money laundering is the process of transformation of the form or usage of ill-gotten proceeds of economic crimes, with a view to obscuring the source or origin of such proceeds. The term “money laundering” has traditionally been associated with drug-trafficking offences. Today, however, money laundering has come to be regarded as an essential element in the fight against corruption. Its scope has been extended to apply generally to all economic crimes, including corruption offences. As in the case of drug trafficking, the purposes of money-laundering legislation is to ensure that crime does not pay, and that no amnesty is provided after the fact to perpetrators of serious economic crimes ... In the United Kingdom, legislation creating money-laundering offences in connection with drug trafficking was first introduced in 1986. But it was not until the Criminal Justice Act of 1993, amending the Criminal Justice Act of 1988, that money-laundering provisions were extended generally to cover other forms of criminal conduct ... The Swiss Criminal Code now makes it an offence for anyone to commit an act the effect of which is to impede the identification of the source, discovery, or confiscation of assets that he knows, or should have known, came from a crime ... The offence is punishable in Switzerland, even if the underlying crime has been committed abroad, provided, of course, that the set of circumstances that constitute the underlying crime amounts to a crime under both Swiss law and the foreign law.’ See EU Directive on Money Laundering, adopted on 10 June 1991, which provides in art 1 that the offence of money laundering involves ‘(a) conversion or transfer of property in the knowledge such property is derived from criminal activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in committing such crime to evade the legal consequences of his action; (b) concealment or disguise of the nature, source, location, disposition, movement, rights with respect to or ownership of property in the knowledge that such property is derived from criminal activity or from an act of participation in such crime; (c) the acquisition, possession or use of property in the knowledge, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such crime; and (d) participation in, association or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions established in the previous paragraphs’. 

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perpetrated by some senior Zambian government officials and some politically well-connected individuals.\textsuperscript{269} But with changes in the international political arena to combat international crime, the forces of globalisation and the attendant call for good governance have somewhat led the Zambian government to enact legislation on money laundering. Although initially a bill on money laundering had been presented before parliament, that bill was, at some point, withdrawn from the legislative chamber. Later, the discussion on a possible money laundering law re-surfaced in parliament and a law was passed.

There have been some efforts, too, to introduce legislation on deposit insurance in Zambia.\textsuperscript{270} As the Bank of Zambia observes:

\textit{Deposit Insurance Scheme}: It is evident from past experience, particularly the failure of three banks in 1995, that banking instability can have serious adverse effects on a nation’s economy because it can impair a nation’s payments mechanism, reduce the nation’s savings rate, diminish the financial intermediation process, and inflict serious harm on small savers. To prevent these adverse effects, the government has created a variety of institutional arrangements designed to preserve banking stability. These arrangements have included banking laws and regulations that set the ground rules for bank operations and attempt to constrain undue bank risk-taking; the laws and regulations are intended to provide a framework for the supervision and examination of banks to ensure compliance with laws and regulations and lender of last resort facilities designed to prevent temporary bank liquidity problems from turning into insolvency. In addition to these more traditional arrangements, the government is in the process of developing and setting up a deposit insurance scheme. The primary purpose of the scheme is to preserve public confidence in the banking system, provide the government with a formal mechanism for dealing with failing banks, and ensure that small depositors are protected in the event of bank failures.\textsuperscript{271}

And a report on the banking sector in the Eastern and Southern Africa region indicates:

A deposit insurance system can contribute to the stability of the financial system and protect small depositors, [then] Bank of Zambia (BoZ) deputy governor Abraham Mwenda … said. Addressing the first meeting of bank supervisors in Common Market for Eastern and Southern Africa (COMESA), Mwenda said a well-constructed deposit insurance system would achieve these objectives by significantly reducing the risk of bank runs and the disruptive breakdown of essential banking activities that accompany such runs. Mwenda said the system would contribute to

\textsuperscript{269} See generally KK Mwenda \textit{Legal aspects of combating corruption: The case of Zambia} (2007).

\textsuperscript{270} The Bank of Zambia at \url{http://www.boz.zm} (accessed 11 August 2000).

\textsuperscript{271} As above.
the smooth functioning of the payments system and credit mechanisms and facilitate the exit of problem banks face. The Zambian government has not yet established a deposit insurance system despite various bank closures which result in loss of money by depositors. The five-day meeting has been convened to, among other things, enable banking supervisors benefit from an outreach session on deposit insurance in order to create a deposit insurance system in COMESA member states ... a major challenge was the strengthening of supervisory capacity and skills in the region in order to cope with the challenges of the banking industry which is becoming increasingly sophisticated ... the meeting would come up with recommendations that would enable member countries harmonise bank supervision and regulation because as COMESA becomes more integrated, there would be increased cross-border investment including cross-border banking. On bank supervision, Mwenda said the Bank of Zambia undertakes on-site examination of banks at least once a year or more frequently if the supervision department sees it fit while the off-site supervision was undertaken through use of monthly statistical and prudential returns. He said one of the major challenges for the bank in coming years was to minimise external interference in the regulatory and supervisory process.272

An underlying premise in the design and establishment of a sound deposit insurance system is that a well-designed system should advance the vitality and stability of the banking sector while minimising the informational asymmetries that are often associated with insurance programmes: moral hazard, adverse selection and agency problems.273 Researchers have sought to create models that guide the development of effective deposit insurance systems by identifying specific best practices.274 One such model, proposed by Garcia, is said to have been adopted by the IMF authorities for use by countries that are considering the establishment of a deposit insurance system.275 Alsalem argues that the Garcia-IMF model is flawed because it is based only on the lessons from the post-1991

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274 As above.
275 As above. See also GG Garcia ‘Deposit insurance and crisis management’ (Washington DC International Monetary Fund Working Paper WP/00/ 57, 2000). Garcia argues that a well-designed deposit insurance system (DIS) will provide incentives for citizens to keep the financial system sound. However, a poorly designed DIS can foster a financial crisis. Garcia, therefore, makes recommendations for creating and running a limited, incentive-compatible DIS. Her paper also examines factors in the decision to grant, temporarily, a comprehensive guarantee, and the design of that guarantee, should a systemic financial crisis nevertheless occur. It concludes with guidance on the removal of that guarantee.
period in the United States and recent experiences in other countries. According to Alsalem, the model omits the long and rich pre-1991 experiences of the Federal Deposit Insurance Corporation (FDIC), the individual US states, the failed Federal Savings and Loan Insurance Corporation (FSLIC), and the National Credit Union Share Insurance Fund (NCUSIF). Alsalem makes use of this richer history to identify and incorporate additional institutional features that have proven successful in the past. He then shows that his modified Garcia-IMF model better addresses the fundamental problems of operating a deposit insurance system.

Closely related to Alsalem’s study, Demirgüç-Kunt and Detragiache observe evidence in 61 countries between 1980 and 1997. They argue that explicit deposit insurance tends to increase the likelihood of banking crises, the more so where bank interest rates are deregulated and the institutional environment is weak. According to Demirgüç-Kunt and Detragiache, the adverse impact of deposit insurance on bank stability tends to be stronger the more extensive is the coverage offered to depositors, where the scheme is funded, and where it is run by the government rather than the private sector.

In 2001, Demirgüç-Kunt and Kane carried out research pertaining, in part, to several financial and banking crises that occurred in the late 1990s around the globe. As a result of these crises, a growing number of developing countries had been seeking advice about designing and adopting an explicit deposit insurance system. According to the authors, previous research delineated not only the well-known trade-off between banking stability and moral hazard, but also the interaction between deposit insurance design features and country-specific elements of a country’s financial and governmental contracting environment. Demirgüç-Kunt and Kane documented the extent of cross-country differences in deposit insurance design and reviewed also the empirical evidence on how particular design features affected private market discipline, banking stability, financial development, and the effectiveness of crisis resolution.

See generally Alsalem (n 275 above).
277 As above.
278 As above.
279 As above.
281 As above.
282 As above.
284 As above.
285 As above.
The authors' findings suggested that countries with institutionally weak informational, legal, and supervisory environments should refrain from adopting an explicit deposit insurance system until they assess and remedy any weaknesses in their environments.\textsuperscript{286}

Later, in 2002, Demirgüç-Kunt and Kane observed that deposit insurance is not always good or always bad.\textsuperscript{287} The authors argued that deposit insurance can be a useful part of a country’s financial safety net.\textsuperscript{288} However, the authors further postulated that in institutionally weak environments, designing a deposit insurance scheme that will not increase the probability and depth of future banking crises is hard to do.\textsuperscript{289} Hartley, thus, asks the question whether government bank deposit insurance should be scrapped in favour of a system of bank cross-guarantees.\textsuperscript{290} In his findings, Hartley argues that some proponents claim to have found successful cross-guarantees among the banks of antebellum Indiana, Ohio and Iowa, but a closer examination suggests otherwise.\textsuperscript{291}

Analysing shortcomings of the International Association of Deposit Insurers (IADI), Kane argues that because of cultural differences among regulators, the IADI cannot effectively consolidate deposit insurers.\textsuperscript{292} He finds that the IADI could be more successful in its mission of preventing cross-country spillovers of crisis pressure and improving the exchange of regulatory information if it organised a public market in deposit-reinsurance derivatives.\textsuperscript{293} Such a market, according to Kane, would ultimately give signals about which insurance structures were optimal.\textsuperscript{294} Thus, individual countries would have an incentive to improve their own deposit insurance structure frequently, not only during a financial crisis.\textsuperscript{295}

Martin and Maimbo have argued, in turn, that experience has shown that one major weakness of existent banking regulation is ‘regulatory forbearance’—that is, the failure of bank regulators to enforce regulations properly and to intervene promptly when banks become distressed.\textsuperscript{296} According to the authors, one method of constraining regulatory forbearance has been the implementation of

\textsuperscript{286} As above.
\textsuperscript{287} A Demirgüç-Kunt & EJ Kane 'Deposit insurance around the globe: Where does it work?' (2002) 16 Journal of Economic Perspectives 175-95.
\textsuperscript{288} As above.
\textsuperscript{289} As above.
\textsuperscript{290} JE Hartley 'Mutual deposit insurance' (2001) 6 The Independent Review 235-252.
\textsuperscript{291} As above.
\textsuperscript{293} As above.
\textsuperscript{294} As above.
\textsuperscript{295} As above.
rules that automatically trigger regulatory action, such as the prompt corrective action (PCA) rules adopted in the United States in 1991. Martin and Maimbo examine the potential benefits and the feasibility of incorporating PCA-type rules into banking regulations in developing countries. They conclude that such rules can improve bank regulation in developing countries if the rules are part of a more comprehensive set of institutional reforms that strengthen the operational independence of the bank regulators, improve their on-site examination authority, and strengthen accounting standards.

In general, a number of governments do insure liabilities of major banks in a crisis. Such deposit insurance is important because the closure of these banks or even an interruption in their supply of credit would be too costly to the economy. Put simply, these banks could be too big to fail. As one commentator observes:

People know this (that these banks are too big to fail) and believe that the liabilities of these banks are effectively insured. This is implicit deposit insurance. Such beliefs may be supported by past actions of the government and are supported by the actions of other countries.

A further view is advanced that, given this situation, it is better to introduce explicit deposit insurance. It is thus argued:

- Implicit insurance of liabilities of TBTF (too-big-to-fail) banks gives them a competitive advantage over small banks, reducing competition in the banking system.
- It is better to collect insurance premiums in stable periods to build up a fiscal reserve to help meet the expense of covering the liabilities of failed banks.
- Incentive problems will be minimised if the system is explicit and unambiguous.

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297 As above.
298 As above.
300 See seminar materials by J Caskey 'Deposit insurance' at a World Bank/IMF seminar course on Overview of Financial Sector Issues and Analysis (Washington DC World Bank, 12 January 2000).
301 As above.
302 As above.
303 As above. See also GG Kaufman & SA Seelig 'Post-resolution treatment of depositors at failed banks: Implications for the severity of banking crises, systemic risk, and too-big-to-fail' (Washington DC International Monetary Fund Working Paper WP/ 01/ 83, 2001).
More recently, conventional wisdom has come to realise that some 'big banks are too big to rescue', especially if a bank rescue would involve costs which could outweigh the benefits. A detailed and methodological risk analysis is helpful here in determining whether the rescue operation should proceed.

In spite of the many arguments that are advanced in favour of deposit insurance, there are also some shortcomings to such insurance systems. And we have highlighted some of these shortcomings above. Here, suffice it to say, deposit insurance can expose a government to significant contingent expenses. The insurance of deposits entails that insured depositors have very little incentive to monitor banks for risks. As a result thereof, banks can, and often do, take on greater risks. This feature is called the 'moral hazard' problem. However, sound banking supervision should endeavour to reduce moral hazard that arises from the role of the central bank as lender of last resort as well as from other safety-net systems, namely deposit insurance. Also, constructive ambiguity that arises from the absence of statutory provisions on, or in the lack of codification of, the role of the central bank as lender of last resort helps to reduce moral hazard since creditors are not made explicitly aware that the central bank has such a function. Be that as it may, another shortcoming of using deposit insurance is that banking regulators have limited means to supervise risk taking by banks. In addition, as Singh observes, the issue of moral hazard is exacerbated by the policy of intervening with financial support if the institution is considered 'too-big-to-fail'.

Some banks may indeed be too-big-to-fail. But it is better to leave some ambiguity about whether or not the government will insure the liabilities of these banks for this provides some element of market discipline, reducing the moral hazard problem. Such a policy is referred to as constructive ambiguity ... countries that do not adequately regulate and supervise banks ought not to offer generous deposit insurance. They might consider much more limited deposit insurance that lowers the risk of a large loss to the government.

Sleet and Smith consider issues concerning the design of a banking system 'safety net' when both a deposit insurer and a lender of last resort are present. In their model, both entities have a role to play.

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304 For an elaborate discussion on this, see seminar materials by Caskey (n 302 above) 2.


306 Singh (n 307 above) 7.


308 See Singh (n 307 above) 7.

309 Caskey (n 302 above) 2.

Moreover, issues related to deposit insurance pricing are considered relatively unimportant in this context, whereas issues related to discount window access and pricing are not. The two authors discuss when and why (or why not) a lender of last resort should lend liberally but charge high rates of interest.\(^{311}\) And, they raise the possibility that a discount window policy may enhance or reduce the scope for a multiplicity of equilibria.\(^{312}\) It is against this background that the Zambian government should make an informed choice on whether or not to introduce deposit insurance in Zambia. This is more likely the case in the light of developments such as the following:

The negative effects on the local banking sector began to show in 1992 when the Meridien Bank, then Zambia's fourth largest bank, went under. The collapse of what then seemed to be Zambia's most promising bank caught many Zambians off-guard. Although most of the bank's branches around the world were closing not many thought that the bank's headquarters in Zambia would also collapse. The confidence in Meridien Bank staying afloat was heightened by the government promising depositors that their money was safe. After the rumours that the Bank would close because of its huge debts, government pumped in some K300 million to keep it running. The Bank of Zambia sent its experts to run the institution but when government realised that the bank was too deep in financial trouble to keep it running, they were forced to close it. Depositors, however, were promised that they would be given their money after appointed liquidators collected other money owed to the bank and after its assets were sold ... the depositors are still struggling to get their dues. Most have now taken the matter to court.\(^{313}\)

The report continues:

The Meridien Bank case has taught many depositors not to take government's promises for granted nor to ignore whatever little pointers there may be on a bank headed for doom. For many, a rumour is good enough reason for them to close their accounts and transfer their money into other banks that seem safer. This, coupled by slow business and the sometimes financial indiscipline in some banks, has led to the closure of up to five banks in under four years. These included a government-run agriculture loans lending bank, the Lima Bank. In the past year, however, the Bank of Zambia has begun to monitor banks more closely. The central bank has also prepared a Bill aimed at stiffening the Banking Act, with a key section on money laundering. Despite all these steps, many banks in Zambia are still vulnerable to closure and depositors have become more alert in their own monitoring of the trends. In September, when a fire burnt down the head office of Prudence Bank and a few days later the Bank of Zambia said it had sent its experts to help run the bank, many depositors promptly reacted by closing their accounts. Within weeks, the Bank of Zambia announced that the Prudence Bank

\(^{311}\) As above.

\(^{312}\) As above.

\(^{313}\) See Zambia News Online (n 260 above).
had closed to business until further notice. To many, this has been interpreted as the end of Prudence Bank. The Bank of Zambia has announced that efforts are being made to reopen the bank for normal business and that the interests of the depositors would be 'looked into'. But given past experiences not many will believe this statement. When the Co-operative Bank was closed, similar assurances were given. ... months on the Co-operative Bank is still closed. Already, another bank, the Credit Africa Bank, is feeling the effects of speculation that it too is in problems and some depositors have begun closing their accounts. As a preventive measure against closures, the Bank of Zambia in December last year (1996) increased the minimum capital requirement for the establishment of a bank to K2 billion (about US $1.7 million). But this same measure has put some small banks in difficulties as they have not quite been able to get such an amount to meet the requirement. Some economists have suggested that it would be best for the small banks to merge so that they survive the stiff competition. But Bank of Zambia spokesman ... said recently that the BOZ has no mandate to effect such a merger. Government has stressed that no bank will be treated with kids' gloves and each of the institutions must learn to stand on its own. Deputy Finance Minister ... said recently that government would maintain strict regulations and that it was up to the banks to boost waning customer confidence. The Economic Association of Zambia also believes the public confidence in banks is on the decline especially for small banks. EAZ chairman ... fears that this could lead to a monopoly of the sector by the big banks. An economist ... says that the collapsing of some of the banks has been inevitable because the Zambian economy has not been strong enough to sustain it. He notes that with interest rates on borrowing high but low on savings, it has always been unlikely that the Banks would attract the kind of clientele to sustain their operations. Prudence bank, for instance, is said to be owed up to K23 billion (about US $19 million), most of which has accrued in interest ... For now, however, most small banks may just have to survive on the shoestring goodwill of a few faithful clients. For the large established banks, like the Zambia National Commercial Bank, Barclays Bank and the Standard Chartered Bank, the discomfort the small banks are in is just fine because it means more clients for them.  

3 The role of the central bank as lender of last resort

What is the policy basis for a country's central bank, such as the Bank of Zambia, to serve as the lender of last resort in the banking sector? The Asian Development Bank postulates that the high cost to society of the collapse of the banking system is a principal reason why authorities in virtually all developed countries provide some sort of a safety net for depositors. According the Asian Development Bank,
this resulted in the development of the theory for the need for a lender of last resort.\footnote{As above.} The lender of last resort, it is argued, would provide liquidity support in order to allow banks to meet depositors' demands and avoid closure, thereby supporting confidence and stemming potential systemic collapse.\footnote{As above.} This may involve the potential outlay of public funds in the event that the stability of the banking system is threatened.\footnote{As above.} An argument is made that this arrangement creates moral hazards because it holds open the prospect that stakeholders will be at least partially indemnified from losses from failing intermediaries.\footnote{As above.} A moral hazard, it is submitted, has two components: (i) potential incentives to management to take additional, perhaps excessive, risks due to the promise of a government bailout; and (ii) the consequent risk to the public funds due to the potential cost.\footnote{As above.} These problems, the Asian Development Bank observes, were most clearly illustrated by the United States savings and loan crisis of the 1980s and have been, and in many cases continue to be, a feature of recent banking weaknesses.\footnote{As above.}

Discussing the concept of lender of last resort, Fischer argues that the lender of last resort role of the central bank is associated with the prevention and mitigation of financial crises.\footnote{S Fischer 'On the need for an international lender of last resort' paper prepared for delivery at the joint luncheon of the American Economic Association and the American Finance Association, New York, 3 January 1999 available at http://www.imf.org/external/np/speeches/1999/010399.HTM (accessed 24 February 2009).} According to Fischer, a financial crisis is a typically sudden actual or potential breakdown of an important part of the credit system,\footnote{As above.} and that financial crises and panics have been taking place for centuries. They are associated with a loss of confidence in thestanding of some financial institutions or assets, and

because the chain of credit is based on tightly interlinked expectations of the ability of many different debtors to meet payments, can spread rapidly, contagiously, through the financial system, and if unchecked, have significant effects on the behavior of the real economy.\footnote{As above.}

In economic theory, Fischer argues, panics can be modelled as cases of multiple equilibria, possibly dependent on herd behaviour.\footnote{As above.} Surprisingly, as Fischer notes also, there is no accepted definition of the term 'lender of last resort', and there are also important
disagreements about what the lender of last resort should do.\textsuperscript{326} That said, Fischer continues:

We are all of course familiar with the classic contribution of Bagehot (1873). The most famous lesson from Bagehot is that \textit{in a crisis, the lender of last resort should lend freely, at a penalty rate, on good collateral}. But thinking on this issue neither started with Bagehot—for as many have pointed out, Henry Thornton’s 1802 analysis of monetary policy and the role of lender of last resort is remarkably sophisticated—nor did it end with him. In particular, contributions in the last two decades by among others, Benston \textit{et al} (1986), Garcia and Flautz (1988), Goodhart (1995), Goodhart and Huang (1998), Holmstrom and Tirole (1998), Kindleberger (1978), Meltzer (1986), Mundell (1983), Schwartz (1988) and Solow (1982) have sought to build on and develop the analysis of the role of lender of last resort. In the international context, following Kindleberger’s work two decades ago, recent contributions by Calomiris (1998), Calomiris and Metzler (1998), Capie (1998) and Giannini (1998) discuss the potential role of the IMF as a lender of last resort, with Capie arguing that its inability to create money makes it impossible for the Fund to operate as lender of last resort.\textsuperscript{327}

But focusing on Bagehot’s thesis alone, and leaving aside the potential difficulties in assessing solvency in real time, we note that the formula advanced by Bagehot leaves open two important questions. First, what is ‘good’ collateral? Secondly, what is an appropriate rate of interest? Although we will not stray into a discussion of these two issues at length, since such a discussion falls outside the scope of this study, it is useful still to reflect on the issues. Meltzer observes, however, that the central bank is called the lender of last resort because it is capable of lending—and to prevent failures of solvent banks must lend—in periods when no other lender is either capable of lending or willing to lend in sufficient volume to prevent or end a financial panic.\textsuperscript{328} He outlines five main points, the first four derived from Bagehot, namely (a) the central bank is the only lender of last resort in a monetary system such as that of the United States; (b) to prevent illiquid banks from closing, the central bank should lend on any collateral that is marketable in the ordinary course of business when there is no panic; (c) central bank loans, or advances, should be made in large amounts, on demand, at a rate of interest above the market rate; (d) the above three principles should be stated in advance and followed in a crisis; and (e) insolvent financial institutions should be sold at the market price or liquidated if there are no bids for the firm as an integral unit.\textsuperscript{329} In paragraph (e) above,

\textsuperscript{326} As above.  
\textsuperscript{327} As above.  
\textsuperscript{329} As above.
the losses should be borne by owners of equity, subordinated debentures, and debt, uninsured depositors, and the deposit insurance corporations, as in any bankruptcy proceeding.\footnote{As above.}

Fischer argues that Meltzer's statement for the most part agrees with other formulations, but does not emphasise the view, summarised for instance by Humphrey (1975) and attributed to Thornton, that the overriding objective of the lender of last resort should be to prevent panic-induced declines in the money stock, and that there is thus no conflict between its monetary control and its duties as lender of last resort.\footnote{Fischer (n 324 above).}

According to Fischer, in some more recent formulations this view has been extended to the precept that in the event of a panic, the central bank should provide liquidity to the market, but not to individual institutions.\footnote{As above.} So, what is the way forward for a central bank, such as the Bank of Zambia? Among other matters to consider, the lender of last resort should seek to limit moral hazard by imposing costs on those who have made mistakes by lending, say, at a penalty rate.

Against this background, we will now proceed to examine the efficacy of the legal framework for banking supervision in Zambia under the Banking and Financial Services Act 1994. But before doing so, let us first highlight some aspects of the independence of the Bank of Zambia.\footnote{See generally the Bank of Zambia Act 1996. See also generally AAK Mwape 'Bank governance and regulation in East and Southern African countries' unpublished PhD thesis, SOAS, University of London, 2006.} This analysis is useful in providing us with a fuller understanding of the constraints, challenges or successes encountered or scored by the Bank of Zambia over the years. Elsewhere, I have examined the issue of unified financial services supervision in Zambia, highlighting, \textit{inter alia}, the importance of the concept of the independence and accountability of a financial services regulator as well as some notable differences in the roles of various financial sector regulators such as the Bank of Zambia, the Securities and Exchange Commission and the Pensions and Insurance Authority.\footnote{See generally KK Mwenda \textit{The legal administration of financial services in common law jurisdictions: With special attention to the dual regulation system in Zambia} (2006); and Mwenda (n 5 above). See also generally M Quintyn & M Taylor \textit{Regulatory and supervisory independence and financial stability} IMF Working Paper WP/02/46 (Washington DC International Monetary Fund, 2002); and Singh (n 307 above) 25-31.} To avoid superfluity, that discussion will not be repeated here, although only some highlights will be fleshed out regarding the independence of the Bank of Zambia.\footnote{See below.}
4 The independence of the Bank of Zambia

The concept of independent regulation, as argued in my previous work, has come to be associated more with the service sector than with the goods sector. Examining the idea of central bank independence, Nobel laureate Joseph Stiglitz, former Chief Economist of the World Bank, puts it succinctly:

An independent central bank focused exclusively on price stability has become a central part of the mantra of ‘economic reform’. Like so many other policy maxims, it has been repeated often enough that it has come to be believed. But bold assertions, even from central bankers, are no substitute for research and analysis. Research suggests that if central banks focus on inflation, they do a better job at controlling inflation. But controlling inflation is not an end in itself: It is merely a means of achieving faster, more stable growth, with lower unemployment. These are the real variables that matter, and there is little evidence that independent central banks focusing exclusively on price stability do better in these crucial respects. The economic analysis of Clinton’s Council of Economic Advisers turned out to be right; the models of the IMF (and the Fed) were wrong.

Although section 3 of the Bank of Zambia Act 1996 provides that the Bank of Zambia is a body corporate, with perpetual succession and a seal, capable of being sued and suing in its corporate name, and with power to do all such things as a corporate body may by law do or perform, SADC Bankers.org (ie the Committee of Central Bank governors in SADC) observes that the Bank of Zambia, as a central bank, is not independent. The aspect of independence we are looking at here does not concern itself exclusively and narrowly with a focus on price stability, but rather on the broader aspects of political interference in the decision-making processes of the central bank. To a large extent, the Bank of Zambia operates under the influence of the executive arm of the state, yet Core Principle 1 of the Basel Core Principles for Effective Banking Supervision requires that every banking regulator, such as the Bank of Zambia, should enjoy ‘operational independence, transparent processes, sound governance and adequate resources, and be accountable for the

336 Mwenda (n 5 above) 19.
340 See also generally M Quintyn & MW Taylor Should financial sector regulators be independent? (34 Economic Issues 6), (Washington DC International Monetary Fund, 2004).
discharge of its duties'.\textsuperscript{341} The issue of the compromised independence of the Bank of Zambia is a moot one that may not be readily acceptable in certain quarters of the Bank of Zambia. In spite of the glaring absence of evidence pointing to policy dispositions by the Bank of Zambia that it is, indeed, an independent regulator, the view espoused above that the Bank of Zambia is not independent is likely to be met with some resistance and denials from certain sections of the central bank. This reaction is expected because such rebuttals are often predicated on some self-interest agenda. But in its Financial Sector Development Plan (2004-2009), the Bank of Zambia admits:

The major challenge facing the central bank and other regulatory authorities is the need to achieve adequate operational autonomy. In the case of the central bank, this autonomy would be enhanced through a robust institutional and legally binding mechanism of securing the tenure of office for the central bank governor. Under the current legal framework, the operational independence of the regulatory authorities is not fully assured. In this regard, the enactment of new legislation for the BoZ, which is presently pending, must be expedited.\textsuperscript{342}

Strengthening our view that the central bank enjoys only limited and constrained autonomy, a recent media report reads as follows:\textsuperscript{343}

BANK of Zambia (BoZ) Governor Caleb Fundanga says the tenure of office of the bank governor should not run concurrently with the term of office of a particular government to enhance professionalism and remove patronage. Dr Fundanga also says the Republican President should continue appointing the Central Bank governor who should only take office after ratification by parliament. This is contained in Dr Fundanga's written submissions to the Constitution Review Commission (CRC) made available in Lusaka yesterday. Dr Fundanga submitted that the removal of a governor from office should be by a tribunal constituted by the Chief Justice. He said currently, there was no mechanism for removing a non-performing governor and submitted that it should be clarified in the reviewed laws. The governor's term of office could be curtailed involuntarily only for dereliction of duty, misconduct in office or physical or mental incapacity.\textsuperscript{344}

The Bank of Zambia Governor's submissions here are on firm ground. However, when it comes to adopting such recommendations, the drafters of the Republican Constitution should be mindful that the Constitution may not be the best document in which to repose the

\textsuperscript{341} See Basel Committee (n 7 above) 2-5.
\textsuperscript{344} As above.
powers to appoint and dismiss a central bank governor and his or her deputies. We contend that matters of this nature are best dealt with through an amendment to the Bank of Zambia Act 1996.

Further arguments advanced by the Governor of the Bank of Zambia in his submission to the Constitutional Review Commission include the following:

In order to ensure accountability, the Governor should pursue objectives set by government and the law should specify how the governor would be accountable. Dr Fundanga said the appointment of deputy-governors at the Central Bank should be done by the board and not the President as was the case now. He said the current arrangement of appointing board members by the minister should continue because a system of appointing directors by a management consulting team was not appropriate. And the Bank of Zambia has submitted that the capitalisation of the bank be increased to not less than K50 billion from the current K10 billion. 'We believe that adequate capitalisation of the bank is a pre-requisite for meaningful independence of the bank as it guarantees financial autonomy', Dr Fundanga said.

At present, the overarching managerial powers of the Bank of Zambia, under the Bank of Zambia Act 1996, are vested in the Board of the Bank of Zambia. The Board is responsible for policy formulation and general administration of the Bank of Zambia. Section 4 of the Bank of the Zambia Act 1996 spells out that:

1. The Bank shall formulate and implement monetary and supervisory policies that will ensure the maintenance of price and financial systems stability so as to promote balanced macro-economic development.
2. Without prejudice to the generality of subsection (1) and subject to the other provisions of this Act the Bank shall:
   a. license, supervise and regulate the activities of banks and financial institutions so as to promote the safe, sound and efficient operations and development of the financial system;
   b. promote efficient payment mechanisms;
   c. issue notes and coins to be legal tender in the Republic and regulate all matters relating to the currency of the Republic;
   d. act as banker and fiscal agent to the Republic;
   e. support the efficient operation of the exchange system; and
   f. act as advisor to the government on matters relating to economic and monetary arrangement.

In addition, the Minister of the Finance can convey or delegate to the Governor of the Bank of Zambia such general powers of particular

345 As above.
346 Bank of Zambia Act 1996, secs 12(1) & (2).
government policies as would affect the conduct of the affairs of the Bank of Zambia, and the Bank of Zambia will have to implement and give effect to such policies. But in the absence of effective checks and balances on the use of such discretionary powers by the Minister, there is a high likelihood that the said powers can be abused for political ends by the state, especially where the country is faced with presidential and general elections. Such abuses can, in turn, compromise the independence of the central bank. Elsewhere, I do show, for example, that in nearly every major financial crisis of the past decade—from East Asia to Russia, Turkey and Latin America—political interference in financial sector regulation made a bad situation worse. 

Ruth de Krivoy, former President of the Venezuelan Central Bank, commenting on the Venezuela banking crisis of 1994, cites ineffective regulation, weak supervision and political interference as factors that weakened banks in Venezuela in the period leading up to the crisis. In Indonesia, banking sector weaknesses stemmed from poorly-enforced regulations and from the reluctance of supervisors to take action against politically well-connected banks, especially those linked to the Suharto family. When the crisis hit, central bank procedures for dispensing liquidity support to troubled banks were overridden, it was claimed, on the direct instructions of the President. Even after Suharto’s fall, political interference continued to undermine the bank restructuring effort. The intrusive interventions of Indonesia's Financial Sector Action Committee, which was composed of several heads of economic ministries and chaired by the co-ordinating minister, undermined the credibility of the Indonesian Bank Restructuring Agency’s work.

In Zambia, the Bank of Zambia should be commended for retaining a cadre of highly professional men and women. Not only do these individuals hold coveted professional and academic credentials from some of the best universities and institutions in the world, including several PhDs among them, but also the performance of the Zambian central bank, in comparison to that of other central banks in Africa,
has been exemplary.\textsuperscript{355} To illustrate, the current Bank of Zambia Governor, Dr Caleb M Fundanga, a former academic and former senior official of the Zambian government as well as the African Development Bank, and who arguably ranks as the best central bank governor that Zambia has ever had since independence, has been elected and awarded several esteemed international awards as the best central bank governor for the entire African continent.\textsuperscript{356} A recent media report captures one of these international awards as follows:

Bank of Zambia (BoZ) governor, Caleb Fundanga, has won the Best Central Bank Governor of the Year for Africa award for 2007 conferred by the London-based publication Emerging Markets. The award was announced during the just-ended International Monetary Fund (IMF)/World Bank meetings in Washington DC and is based on the BoZ’s achievements in bringing down inflation to single digit levels in 2006, for the first time in 30 years. In the same year, Zambia extended the domestic yield curve to maturities of seven years and above and oversaw the largest ever bank privatisation, which attracted a strategic foreign investor. According to a press statement released by BoZ head of public relations, Penelope Mapoma, yesterday, winners were chosen after careful consultation with bankers, analysts and experts on each regional emerging market.\textsuperscript{357}

An outstanding leader and technocrat, Dr Fundanga and his team at the central bank, together with colleagues at the Ministry of Finance, have performed exceedingly well in fighting inflation as they continue to bring the Zambian economy back to its feet.\textsuperscript{358} And the financial sector in Zambia remains one of the most robust and sound financial sectors in sub-Saharan Africa.\textsuperscript{359}

Under the Bank of Zambia Act 1996, the Republican President is vested with legal authority to appoint, subject to ratification by parliament — a ‘person with recognised professional qualifications and experience in financial and economic matters to be Governor of the Bank’ — the Governor of the Bank of Zambia for a renewable contract period of five years.\textsuperscript{360} Here, parliamentary ratification provides effective checks and balances on the President so that he or she acts reasonably and does not abuse his or her discretionary powers of determining the appropriate qualifications of a candidate for the position of the Bank of Zambia Governor.

\textsuperscript{355} As above.
\textsuperscript{356} As above.
\textsuperscript{358} As above.
\textsuperscript{359} As above.
\textsuperscript{360} Bank of Zambia Act 1996, secs 10(1) & (2).
The Governor of the Bank of Zambia can, however, be relieved of his duties by the President whenever he (the President) deems it fit.\textsuperscript{361} This unfettered political power of the President to remove the central bank Governor, whenever he (the President) deems it fit, compromises the political independence of the Bank of Zambia. Unlike the case of appointing the Governor, there are no checks and balances to control the President’s discretionary powers here.

Compounding this weight of political bias, it would be difficult for a politically-appointed governor to act entirely apolitical and out of purely professional considerations, without worrying about what the Republican President is thinking. Indeed, how can we stop the President or the Minister of Finance from ‘phoning’ the central bank Governor, whether at midnight or during broad daylight? It is even worse if the political directives coming from such phone calls are predicated on uninformed, misguided and unenlightened views, such as was the case at some point in Uganda during the late Idi Amin’s reign.\textsuperscript{362} Although a number of years have gone by since the Amin days, such developments cannot be dismissed easily as things of the past. In Africa, like everywhere else, history has a tendency of repeating itself. It has been reported of Amin:

For those who were around during Idi Amin’s regime (1971-79) this may not sound strange: the burying a Chief Justice and a Bank of Uganda Governor in one grave. At Luzira prisons near Murchison Bay, there lie the remains of the two great Ugandan men, Joseph Mubiru and Benedict Kiwanuka, who are believed to have been murdered by then President of Uganda, Idi Amin Dada, and buried by his notorious Uganda Army. Maurice Kagimu Kiwanuka, the newly-nominated Minister in the incoming President Yoweri Museveni’s cabinet, says he was 11 years old when his father, Benedict Kiwanuka, was shot twice in the head by Amin himself. In an interview with Ultimate Media, Kagimu revealed of how his father was followed by the soldiers, picked and taken to military cells. He explains it vividly as if he was driving with him when the soldiers chased his car from home to the High Court where he was arrested and later killed at Nakasero State House. The woes that led to Kiwanuka’s death started after he presided over a case involving an English man, one Stuart, who was found in possession of printed materials, which condemned the government of Amin over human rights violations. All the judges feared to handle the case and as Chief Justice, Benedict Kiwanuka, decided to take it on. ‘My father decided to handle the case and he released the white man after the trial,’ says Kagimu who has been MP for Bukomansimbi in Masaka district. Kagimu is convinced that the release of Stuart was the main cause of Kiwanuka’s death. ‘On that evening of the ruling, Amin called my father on the phone and said, ‘You said I have no powers to arrest the white man,’ reminisces Kagimu. Kiwanuka pleaded with Amin saying the government

\textsuperscript{361} Bank of Zambia Act 1996, sec 10(7).
\textsuperscript{362} See below.
had powers to arrest but the man was bailed out and would always report to the court. Amin banged the phone on the table and hung up on Kiwanuka.363

The report continues:

After two days, as he was leaving his home in Rubaga, going to Wandegeya where he (Kiwanuka) was building some houses, four Peugeots came following him. ‘They tried to chase him but the Peugeots could not match his Benz,’ says Kagimu. When Kiwanuka reached home in Rubaga, his friends told him to flee to Rwanda but he refused. The following day when he went for work at the High Court, the soldiers grabbed him from his car at the court’s entrance and took him to their car. ‘As they were forcing him to enter the car, one slapped him,’ Kagimu says with a somber face. The soldiers drove via today’s Sheraton Hotel, turned to Lubiri, and from there to Makindye barracks where he was put in cells. ‘While he was still at Makindye cells, the President of Kenya, Jomo Kenyatta, called Amin and told him to release the Chief Justice,’ Kagimu says. Then Amin allegedly fabricated a document that Tanzanians had abducted Kiwanuka but the Ugandan Army rescued him, trying to cover up Kwanuka’s unlawful detention. Amin ordered Kiwanuka to sign the document but he refused. It was sent to him twice in Makindye cells and he consistently refused. The soldiers picked him from Makindye, took him to Nakasero State House, and told Kiwanuka to sign the document in the presence of Amin, and he again refused. ‘Amin removed his pistol and shot him twice in the head,’ says Kagimu who was told about his father’s predicaments by the mother and family friends who were working with Amin. Kiwanuka’s body was buried in Luzira in the same grave with then Governor of Bank of Uganda, Joseph Mubiru, who was also allegedly killed by Amin. Little is known about Mubiru’s death but Kagimu says he was killed after he refused to print more money as President Amin had ordered. His death forced many Bank of Uganda workers to flee into exile, including the current President General of the Democratic Party, John Ssebaana Kizito. Kagimu says they have plans of exhuming the remains of his father but there is yet to come someone to tell exactly where Kiwanuka and Mubiru were buried. Kagimu says people who know where the ‘grave’ is, fear thinking Ugandans would see them as ones who participated in the murder and burial of the former Chief Justice.364

Against this background, it is no academic exercise that we are raising the issue of the importance of central bank independence. Admittedly, such independence should come with the accountability of the central bank within the confines and limits of the law. But then, for Zambia, is the Republican President or the Minister of Finance vested with legal authority to phone and direct the central bank


364 As above.
Governor to print more money or to issue central bank guarantees against, say, the indebtedness of a company that the President or the Minister has an interest in? And should the central bank Governor be forced to accept and work with a deputy-governor of the central bank appointed by the Republican President after such an appointee has been lobbying aggressively to the President for the appointment? How safe would it be for the central bank governor to accommodate such an individual without having to look constantly over his shoulder? Although developments of the nature may not have occurred in Zambia, they can still happen. And, by law, is the central bank governor obligated to implement or carry out such politically charged directives? Also, can the central bank governor decline to carry out the directives, especially that these directives are coming from the authority that put him or her in office, and that that authority has the unfettered discretionary power to fire the central bank governor?

As a recommendation to improve the legal and regulatory framework in Zambia, the Bank of Zambia Act 1996 should repose in the legislature the powers to appoint and dismiss the Governor of the Bank of Zambia, spelling out clearly the grounds upon which a central bank governor can be appointed or relieved of his or her duties. The President and the Minister of Finance should only be allowed to nominate individuals that parliament can then consider for appointment as Governor of the Bank of Zambia. Such an approach would build into the legal and institutional framework an element of political independence of the Bank of Zambia.

Closely related to the foregoing, but extending now to the collective body of the central bank’s senior management, the law on anti-corruption in Zambia can visit a public officer, such as any employee of the Bank of Zambia, who engages in corrupt practices of arranging for the central bank to employ a relative, son or daughter of some politically-connected person, or a family friend or fellow tribesman, at the expense of not employing better qualified candidates, especially where such corrupt practices result in some form of private advantage or benefit to the said public officer. The same applies where, in exchange for some gratification, a bank supervisor willfully or intentionally shuts his eyes to a regulatory breach committed by the bank or financial institution he is supervising. Section 3 of Zambia’s Anti-Corruption Commission Act 1996 defines the term ‘corrupt’ as ‘soliciting, accepting, obtaining, giving, promising or offering of a gratification by way of a bribe or other personal temptation or inducement, or the misuse or abuse of a public office for private advantage or benefit’. Elsewhere, I have

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examined in greater detail the law on anti-corruption in Zambia.\textsuperscript{366} Here, there is no need to lay out specific examples of accusations pertaining to corruption in the human resources management function of the Bank of Zambia since public notice already attaches firmly to the lack of transparency in the recruitment procedures of most public institutions in Zambia.\textsuperscript{367} For the Bank of Zambia, what should matter most is that, to avoid suffering any reputational risks, the organisational function of human resource management at the Bank of Zambia should be free of unwarranted interference from senior management and the state political machinery.

Further, as a matter of best practice in corporate governance, it is difficult to understand why the Governor of the Bank of Zambia is the Chairperson of the Board. Section 10(3) of the Bank of Zambia Act 1996 clearly spells out that the Governor of the Bank of Zambia is the chief executive officer of the central bank, and that he is responsible to the Board for the execution of the policy and management of the central bank. Yet, section 13(1)(a) of that same statute presents a paradox by stating that the Governor of the Bank of Zambia “shall be the Chairman of the Board”. How can the chief executive officer of an organisation be made accountable to a Board of which he is the Chairperson? Should there not be a distinction between managerial powers, on the one hand, and the role and functions of a non-executive board, on the other?

The idea of political appointments and dismissals is repeated when it comes to appointing a good number of board members of the Bank of Zambia. The Minister of Finance has statutory powers to appoint the majority of members of the board.\textsuperscript{368} The Minister appoints these board members taking into account their ‘professional and academic experience in business and financial matters and who are not employees or officials of Bank of Zambia’.\textsuperscript{369} The Minister can, in terms of the Bank of Zambia Act 1996, appoint no more than six members of the board. A board member appointed by the Minister can, however, be relieved of his or her duties whenever the Minister deems it fit.\textsuperscript{370} As in the case of weaknesses in the law pertaining to the removal of the Bank of Zambia Governor by the Republican President, the Bank of the Zambia Act 1996 does not spell out the specific grounds upon which a board member can be dismissed by the Minister. Neither does the statute provide that parliament should ratify ministerial appointments of board members. This shortcoming

\textsuperscript{366} See generally KK Mwenda \textit{Legal aspects of combating corruption: The case of Zambia} (2007).
\textsuperscript{367} As above.
\textsuperscript{368} Bank of Zambia Act 1996, sec 13(1)(b).
\textsuperscript{369} As above.
\textsuperscript{370} Bank of Zambia Act 1996, sec 14(2).
means that the Minister has, and can use, unfettered discretionary powers to interpret, as he wishes, the statutory phrase 'individuals with professional and academic experience in business and financial matters'. In short, the Minister can appoint whoever he wants to appoint, purporting that the appointment is that of an individual who he deems as having appropriate 'professional and academic experience in business and financial matters'. And it would be difficult, conceptually, for such a politically-appointed board member to act apolitical and out of purely professional considerations, without worrying about what the Minister is thinking. There is often a tendency for most political appointees to appease the appointing authorities as a way of retaining and consolidating their power-bases.

Be that as it may, the Bank of Zambia has its own budget and it decides on its own finances. The SADC Bankers.org observes:

The Bank formulates its monetary policy through the broad guidelines of the Enhanced Structural Adjustment Programme. The government formulates fiscal policy. The government and the bank meet thrice a week to harmonise policy. The bank acts as banker to banks and fiscal agent of the government. Through the Minister of Finance, the bank acts as adviser to the government on monetary matters. The bank is also the official depository of government funds and is mandated to issue and manage government loans on terms and conditions determined by the Minister of Finance. The government is the sole subscriber to the bank's capital. The Bank of Zambia is no longer involved in matters relating to development financing.

In articulating monetary policy, the Bank of Zambia focuses on the banks' liquidity conditions, reserve money, money market interest rates as well as foreign exchange rates as the principal indicators of monetary conditions. As the SADC Bankers.org observes, 'broad money', defined as including foreign exchange deposits of commercial banks (M3), is the intermediate target of monetary policy and is compiled as follows: (a) currency with non-bank public institutions; (b) demand deposit; (c) bills payable; (d) time and savings deposits; and (e) foreign exchange deposits of commercial banks.

The Bank of Zambia is responsible for determining the exchange rate policy in conjunction with the Ministry of Finance. At present, the exchange rate is fully market-determined. The rate tends to float depending upon supply and demand conditions. And the Bank of

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372 SADC Bankers (n 341 above).
373 As above.
374 As above.
375 As above.
376 As above.
Zambia is responsible for the foreign exchange reserves, and will only intervene in the market for purposes of either purchasing foreign exchange to build up reserves or to sell to smoothen out any violent swings in the exchange rate. This approach prevents misalignment of the exchange rate in the medium to long term. Indeed:

There is no exchange control on current account or capital account transactions. The currency is fully convertible regionally and internationally... The Bank of Zambia is mandated to manage government's external debt. The Bank of Zambia handles maintenance of debt records and debt servicing. The Bank also advises the government on the debt strategy that should apply in such negotiations as Heavily Indebted Poor Countries (HIPC).

5 The competent authority for regulating banks and financial institutions

Although the Banking and Financial Services Act 1994 of Zambia deals with the legal aspects of supervising banks and financial institutions in chapter VI of that statute, we examine in this chapter not only chapter VI of the said statute, but other relevant parts as well.

In Zambia, as observed in chapter 1 of this book, the Registrar of Banks and Financial Institutions, in consultation with the Minister of Finance, authorises companies to conduct banking or financial services business. And since the Registrar of Banks and Financial Institutions is based at the central bank and carries out his or her functions as an employee of the central bank, the Bank of Zambia is, for all intents and purposes, the competent authority for regulating...
and supervising banks.\footnote{381} As a general rule, a person is not allowed to conduct or offer to conduct banking business unless that person holds a licence for that purpose.\footnote{382} Similarly, a person other than a licensed bank or a licensed financial institution is prohibited from conducting or offering to conduct financial services business.\footnote{383} Banks and financial institutions are only permitted to engage in business covered by a banking or financial services licence or by the Banking and Financial Services Act 1994.\footnote{384} But what about other types of business covered by the objects clause in the bank’s memorandum of association but not reflected on the banking licence? Can the bank carry out such other business activities, in addition to those stipulated on the banking licence, without facing the risk of the central bank revoking the said banking licence? The Banking and Financial Services Act 1994 is silent on such matters.

5.1 Banking and financial services licences

In general, as established in chapter 2, an application for a banking or financial services licence must be in such form and accompanied by such fees as prescribed by regulation.\footnote{385} In spite of this broad and seemingly open-ended requirement, an applicant for a banking
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licence, in contrast to one for a financial services licence, is expected to provide, as we have established in chapter 2, at least the following particulars:

(a) articles of association of the company;
(b) the physical and postal address of its head office and the permanent residential addresses of its directors, chief executive officer, managers and shareholders;
(c) the name and permanent residential address of every subscriber for any class or series of shares issued by the company in a number that will exceed one per centum of all the shares of that class or series, whether such shares carry the right to vote in all circumstances or not;
(d) the addresses of each branch proposed to be opened by the company and, in the case of a mobile office, the area proposed to be served;
(e) full particulars of the business it proposes to conduct under the authority of the licence;
(f) the amount of its capital; and
(g) such assurances and evidence of the foregoing as the Registrar may require to be given by the applicant.

Clearly, for purposes of consolidated supervision, an applicant should provide information on the physical and postal address of its head office and the permanent residential addresses of its directors, chief executive officer, managers and shareholders. Under the Basel Core Principles for Effective Banking Supervision, Core Principle 24 provides that 'an essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide'. In addition, Core Principle 25 adds as follows:

Cross-border consolidated supervision requires co-operation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.

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386 See the explanation above on what constitutes financial services and how that differs, if any, from authorised activities of a bank. Yet, the statute does not spell out the same type of requirements in the case of an application for a banking licence or a financial services licence. Sec 10 of the Banking and Financial Services Act 1994, dealing with applications for financial services licences, has no stringent requirements akin to those for a banking licence.

387 Banking and Financial Services Act 1994 (as amended by the Banking and Financial Services (Amendment) Act 2000), secs 4(2)(a), (b), (c), (d), (e), (f) & (g).

388 See Basel Committee (n 7 above) 2-5.

389 As above.
Section 9 of the Banking and Financial Services Act 1994 allows for banks in Zambia to operate branches outside the country once they obtain clearance from the Bank of Zambia. And every applicant for a banking or financial services licence in Zambia should provide information on any other related matter such as the names of the shareholders.

5.2 Grounds upon which the Registrar may refuse to grant a licence

In deciding whether or not to grant a banking or financial services licence, and in deciding what conditions should be attached to such a licence, the Registrar of Banks and Financial Institutions 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 of persons proposing to be concerned in the management of the business to be undertaken under the authority of the licence; the convenience and needs of the community intended to be served by that business; and the prospects for profitable operation of that business. The Banking and Financial Services Act 1994 also 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.

Chapter VIII of the Banking and Financial Services Act 1994 is examined in the later parts of this chapter. Here, suffice it to say, no act, matter or thing done by any officer or person employed by the Bank of Zambia or by any other person in the exercise or performance or purported exercise or performance, in good faith, of any power or function under the Banking and Financial Services Act 1994 will give rise to an action, claim, liability, suit or demand against the officer or person concerned. We have already examined the term ‘good faith’ in chapter 2. The protection afforded to the Bank of Zambia employees in carrying out statutory duties under the Banking and Financial Services Act 1994 can help to promote the impartiality, independence and professionalism of these individuals. But, where such individuals engage in what one might arguably call ‘gross
negligence’, or they are found guilty of criminal conduct, while acting in the course of business, it is doubtful that such conduct can be treated as having been carried out in good faith for gross negligence, though more commonly cited in civil law jurisdictions, imports serious carelessness. And where gross negligence is cited in a common law jurisdiction, it often entails conduct or a failure to act that is so reckless that it demonstrates a substantial lack of concern for whether an injury will result.

5.3 Duration of licences and some of the terms to be found in licences

Under the Banking and Financial Services Act 1994, a licence granted to an applicant remains in force until it is revoked by the Registrar of Banks and Financial Institutions. Furthermore, a licence is subject to such conditions as the Registrar thinks fit to specify in the licence when it is granted. Where the conditions are varied under the Banking and Financial Services Act 1994, the licence is subject to

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393 In the English case of Armitage v Nurse [1998] Ch 241, 253, Millet LJ, dismissing the concept of ‘gross negligence’, ruled as follows: ‘It would be very surprising if our law drew the line between liability for ordinary negligence and liability for gross negligence. In this respect English law differs from civil law systems, for it has always drawn a sharp distinction between negligence, however gross, on the one hand, and fraud, bad faith and wilful misconduct, on the other. The doctrine of the common law is that “Gross negligence may be evidence of mala fides, but is not the same thing”: See Goodman v Harvey (1836) 4 A & E 870 876, per Lord Denman C.J. But while we regard the difference between fraud, on the one hand, and mere negligence, however gross, on the other, as a difference in kind, we regard the difference between negligence and gross negligence as merely one of degree. English lawyers have always had a healthy disrespect for the latter distinction. In Hinton v Dibbin (1842) 2 QB 646 Lord Denman C.J doubted whether any intelligible distinction exists; while in Grill v General Iron Screw Collier Co (1866) LR 1 CP 600, 612 Willes J famously observed that gross negligence is ordinary negligence with a vituperative epithet. But civilian systems draw the line in a different place. The doctrine is culpa lata dolo aequiparatur; and although the maxim itself is not Roman the principle is classical. There is no room for the maxim in the common law; it is not mentioned in Broom’s Legal Maxims, 10th ed. (1939).’

394 See the following US court cases decided in the state of Michigan: Tallman v Markstrom 180 Mich App 141; 446 NW2d 618 (1989); Vermilya v Dunham 195 Mich App 79; 489 NW2d 496 (1992); Jennings v Southwood 446 Mich 125; 521 NW2d 230 (1994); and Burnett v City of Adrian, 414 Mich 448; 326 NW2d 810 (1982).


396 Banking and Financial Services Act 1994, sec 13(1).
conditions attached to it for the time being. Without limiting the generality of this requirement, conditions of a licence could:

(a) contain such restrictions as to the nature and scope of the business to be conducted by the licensee as the Registrar thinks fit to impose;
(b) provide for the payment, on such terms and calculated in such manner as the conditions may specify, of annual or other periodic licence fees; and
(c) in relation to a licence for a subsidiary of a foreign bank, a foreign financial institution or a representative office, require the foreign bank or financial institution to allow access by the Registrar to the offices and records of the bank or financial institution outside Zambia for the purpose of enabling the Registrar to assess compliance with this Act by the subsidiary or the representative office.

Where conditions, such as those spelt out in paragraph (c) of the above statutory provision, are included in a licence, it is clear that bank supervisors get a better claim and legal pedigree to pursue goals of consolidating supervision. That said, there is no property in a licence, and a licence is not capable of being bought, sold, leased, mortgaged or in any manner transferred, demised or encumbered. An exception is, however, provided where, in the event of an amalgamation of banks under the Banking and Financial Services Act 1994, and on such terms and conditions as the Bank of Zambia may approve, a licence can be transferred from one party to another. Interestingly, though, it is not clear why under this exception the Bank of Zambia should take over from the Registrar the role of setting conditions of licences.

5.4 Grounds upon which the Registrar can revoke a licence

As a general rule, the Registrar of Banks and Financial Institutions can revoke a licence if it appears to the Registrar that the application for the licence was fraudulent or contained a materially false
A licence can also be revoked where the licensee has failed to comply with any condition or qualification of its licence or with any order of the Bank of Zambia under the Banking and Financial Services Act 1994. Further still, a licence can be revoked where the licensee is seriously or persistently in breach of any provisions of the Banking and Financial Services Act 1994. Revocation of a licence can also occur where the licensee is seriously or persistently in breach of a regulatory statement, regulations under the Banking and Financial Services Act 1994, conditions of the licence, or where the licensee fails to commence to conduct business authorised by the licence within a period of 12 months following the grant of the licence or ceases or announces its intention to cease to conduct that business. When a licence is revoked, the licensee is required to surrender to the Registrar each and every other copy of the licence that is on display in every place of business of the licensee and the Registrar will, as soon as practicable, publish notice of the revocation in a government gazette and in a newspaper of general circulation in Zambia, and may take additional steps which, in his opinion, are necessary to inform the public of the revocation. The underlying policy objective is to retain investor confidence in the banking system through the making of such transparent and timely disclosures.

5.5 Appeals against decisions of the Registrar

An applicant for a banking licence whose application has been refused by the Registrar of Banks and Financial Institutions or the Bank of Zambia has the right to make his or her case in writing to the said Registrar or the Bank of Zambia to reconsider the decision over the granting of a licence. The Banking and Financial Services Act 1994 does not say, however, what would happen in the case of the Registrar or the Bank of Zambia refusing to grant a licence for financial services. Be that as it may, the decision of the Registrar or the Bank of Zambia on the refusal to grant a banking licence remains in force until reversed by the Registrar or the Bank of Zambia, as the case may

401 Bank and Financial Services Act 1994, sec 16(1). Elsewhere, I have examined the issue of what constitutes 'materiality': See KK Mwenda 'Zambia's Securities Act 1993 on trial: The case of insider dealing' (1997) 18 Statute Law Review 157. See also SEC v Texas Gulf Sulphur Co 401 F 2d 833; and Cady Roberts & Company 40 SEC 907 911. In the Cady Roberts case, the principle in American securities law that a fact is material if it would, were it known, affect the investment judgement of those with whom the insider is dealing was criticised by Commission Cary. He argued that the principle produced uncertainty and confusion, and suggested the direct effect of the market value of securities as a test in addition to the 'investment judgment' principle.

402 See Banking and Financial Services Act 1994, sec 16(1).
403 As above.
404 As above.
405 Bank and Financial Services Act 1994, sec 16(3).
be, or set aside by the Appeal Tribunal on appeal or by a court.

This procedure applies mutatis mutandis to appeals against decisions of the Registrar or the Bank of Zambia regarding the revocation of licences. If, after receipt of any representations from the applicant or person affected by its decision, the Registrar or the Bank of Zambia reaffirms its decision, the applicant or other person may, within seven days of receipt of the notice reaffirming the decision, notify the Minister that he or she desires to appeal against the decision. It must be noted that:

The decision of the Registrar or of the Bank of Zambia, as the case may be:

(a) does not take effect until the expiry of the period limited by subsection ... for giving notice of an appeal; and

(b) where a notice of appeal is lodged within that time, is further stayed pending the outcome of the appeal ...

113. Within seven days after receipt of a notice under subsection (1) of section one hundred and twelve, the Minister shall appoint an Appeal Tribunal, consisting of a Chairman who is an advocate of the High Court of not less than seven years’ standing and two other persons having such qualifications and experience in relation to the matters involved in the appeal.

In carrying out its functions, the Appeal Tribunal has powers to determine its own procedure and is not bound by rules of evidence. The Tribunal determines an appeal on its merits, having regard to provisions of the Banking and Financial Services Act 1994 and the public interest. A decision of the Registrar or the Bank of Zambia can be varied or quashed by the Tribunal. The decision of the Tribunal is therefore final and binding on the parties to the appeal except as to any point of law. In cases where the appeal is allowed, it is the duty of the Registrar or the Bank of Zambia, as the case may require, to give effect to the decision of the Tribunal.

407 See below on the Appeal Tribunal.
408 Banking and Financial Services Act 1994 (as amended by the Banking and Financial Services (Amendment) Act 2000), sec 111(2).
409 n 410 above, sec 16(2).
410 n 410 above, sec 112(1).
411 n 410 above, secs 112 & 113.
412 n 410 above, sec 114(2).
413 n 410 above, sec 114.
414 n 410 above, sec 115.
415 As above.
6 Directors and managers of banks and financial institutions

While the Registrar of Banks and Financial Institutions authorises persons to conduct banking and financial services business, the granting of such licence *per se* does not automatically entitle a licensee to act as director or manager of a bank or a financial institution. Section 31 of the Banking and Financial Services Act 1994 clearly states that:

1. Notwithstanding anything to the contrary in the Companies Act or any other written law, a person shall not be qualified to be elected as director or to be appointed a chief executive officer, chief financial officer or manager of a bank if that person:
   a. is not a fit and proper person to hold the relevant office in relation to integrity and professional expertise;
   b. is not above the age of twenty-one years;
   c. is an undischarged bankrupt;
   d. has been convicted of a felony or any offence involving dishonesty;
   e. has been declared or otherwise adjudged in any official proceedings to be mentally incompetent to manage one's own affairs;
   f. is under suspension or has been removed from office under this Act; or
   g. has been a director, chief executive officer, chief financial officer or manager of a company which has been adjudged insolvent, entered into a composition with creditors, gone into liquidation, declared bankrupt or has entered into any other arrangement with creditors or taken any other action with similar effect in Zambia or elsewhere unless that person shows that the person was not responsible for the insolvency, liquidation, composition with creditors, bankruptcy, other arrangement with creditors or other action with similar effect in Zambia or elsewhere.

2. Any person who is director, chief executive officer, chief financial officer or manager concerned in the management of a bank or financial institution shall forthwith cease to hold office upon:
   a. becoming bankrupt, suspending payments or compounding or proposing a compromise with that person's creditors generally;
   b. being charged with a felony or any offence involving dishonesty;
   c. being declared or otherwise adjudged in any official proceedings to be mentally incompetent to manage affairs; or
   d. being suspended or removed from office by order of the Bank of Zambia under this Act.

3. A person who has been a director, a chief executive officer, a chief financial officer or a manager concerned in the management of a licensee whose licence has been revoked shall not, without the approval
of the Bank of Zambia, act or continue to act as a director or be directly concerned in the management of any bank or financial institution.

In spite of the above statutory provision, a major derogation from the black letter law became a common feature in the mid to late 1990s.\textsuperscript{416} In an earlier study carried out by this author, it was revealed that a major constraint facing the regulatory framework for banking supervision in Zambia included the inability of the Bank of Zambia to extricate itself from political pressure and interference.\textsuperscript{417} For example, it was noted that, whilst it was the view of the Bank of Zambia that under the Banking and Financial Services Act 1994, a person who was a director of a bank that had since collapsed could not be appointed as a director of another bank or financial institution — without being cleared by the Bank of Zambia — there were cases in Zambia where the law was flagrantly disregarded. Indeed, some ineligible individuals were 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.\textsuperscript{418} Whether such departures from the law could be treated as 'regulatory forbearance' or not is an issue that is fraught with political overtones and illogical difficulties. As one commentator observed:

Only investors and people with reputable and honourable backgrounds should be allowed to venture into banking to avoid the continued closure of banks... the Bank of Zambia was to blame for the many bank closures in the country because it allowed people with questionable characters to operate banks. 'It is the Bank of Zambia which has allowed characters with obscure, even dubious, backgrounds to establish banks quite often on the basis of political considerations... The people of Zambia should not be used as guinea pigs on whom those experimenting on banking should do their research.'\textsuperscript{419}

It is interesting to note further that section 31(4) of the Banking and Financial Services Act 1994 adds: 'A person shall not be a director of more than one bank or financial institution.'

At close examination, it is clear that this statutory provision does not only address directors' qualifications. It also provides important safeguards against possible insider lending to directors who could be

\textsuperscript{416} See below.  
\textsuperscript{417} Interview with Mr Marshall Mwansompelo, Senior Inspector, Financial System Supervision, Bank of Zambia, Lusaka, 8 October 1999.  
\textsuperscript{418} As above.  
holding the position of director in related banks and financial institutions.\textsuperscript{420} As one report shows:

Heavy insider borrowing, failure to meet banking and financial regulations and failure by the biggest borrowers, some of whom serve on the board, to pay back huge loans on time led to Union Bank (Zambia) Limited's closure.

According to The Monitor's investigations, the bank was declared 'non-operational' almost six months ago by the Banks Supervision Department of the Bank of Zambia and placed under curatorship, but the central bank did not make that public.\textsuperscript{421}

A further instructive report reads:

The closure of Union Bank will erode customer confidence in the banking system, Stanbic Bank general manager Larry Kalala told The Monitor ... Kalala, however, said closures of banks happen even in stronger economies adding that the closure of Union Bank was not peculiar ... He also attributed some bank closures to political situations and gave an example of Zimbabwe where farmers withdrew all their life savings from banks. 'If the political climate is not good it is normal to see such situations.' Kalala said though customer confidence would be lost, slowly clients would begin to realise which are stronger banks and bank their trust with these. And commenting on why clients like saving in

\textsuperscript{420} Also, sec 35(1) of the Banking and Financial Services Act 1994, dealing with disclosure of interests, places a further obligation on fiduciaries such as directors not to benefit unfairly from their insider position: ' (1) A director shall declare in writing to the board annually, the names and addresses of the director's associates and full particulars of every material interest. (2) A director, chief executive officer, chief financial officer or manager of a bank who: (a) is a party to, or has a material interest in, a contract or a proposed contract with the bank; (b) has an interest in, or a material relationship to, a party or prospective party to a contract or a proposed contract with the bank, shall disclose in writing to the bank the nature and extent of the interest or relationship. (3) The disclosure required by subsection (2) shall be made forthwith after the contract or proposed contract comes to the knowledge of the person who has to make it. (4) At any meeting of the board, a director who has a material interest or material relationship within the scope of this section shall leave the meeting at which the contract concerned is discussed, and shall refrain from voting on any matter related thereto which becomes the subject of action by the board of the bank, but such departure from the meeting shall not disqualify the interested person for the purposes of constituting a quorum. (5) Where a director, chief executive officer, chief financial officer or manager fails to disclose a material interest in accordance with this section: (a) the court shall, on the application of the bank concerned or of any of its shareholders or of the Bank of Zambia, set aside the contract on such terms as it may determine; and (b) the Bank of Zambia may suspend the director, chief executive officer, chief financial officer or manager from office in writing addressed to the person so suspended.'

‘small’ unstable banks, Kalala said they (small banks) tend to woo a lot of customers because of personalised service.422

Closely related to the issue of insider lending by banks,423 section 35 of the Banking and Financial Services Act 1994, as amended by the Banking and Financial Services (Amendment) Act 2000, dealing with disclosure of interests, places a statutory obligation on fiduciaries such as directors not to benefit unfairly from their insider position. The statutory provision reads:

(1) A director shall declare in writing to the board annually, the names and addresses of the director’s associates and full particulars of every material interest.

(2) A director, chief executive officer, chief financial officer or manager of a bank who:

(a) is a party to, or has a material interest in, a contract or a proposed contract with the bank;

(b) has an interest in, or a material relationship to, a party or prospective party to a contract or a proposed contract with the bank, shall disclose in writing to the bank the nature and extent of the interest or relationship.

(3) The disclosure required by subsection (2) shall be made forthwith after the contract or proposed contract comes to the knowledge of the person who has to make it.

(4) At any meeting of the board, a director who has a material interest or material relationship within the scope of this section shall leave the meeting at which the contract concerned is discussed, and shall refrain from voting on any matter related thereto which becomes the subject of action by the board of the bank, but such departure from the meeting shall not disqualify the interested person for the purposes of constituting a quorum.

(5) Where a director, chief executive officer, chief financial officer or manager fails to disclose a material interest in accordance with this section:

(a) the court shall, on the application of the bank concerned or of any of its shareholders or of the Bank of Zambia, set aside the contract on such terms as it may determine; and

(b) the Bank of Zambia may suspend the director, chief executive officer, chief financial officer or manager from office in writing addressed to the person so suspended.


Although subsection (4) of the above statutory provision, like other sections in the Banking and Financial Services Act 1994, was meant to strengthen safeguards for investor protection, it does not explain what would happen in a case where an 'interested' party agrees to leave the meeting, but decides secretly to vote through a proxy. There is simply no prohibition on such matters. However, for purposes of the above statutory provision, the Banking and Financial Services Act 1994 provides that an interest is material if it is material with reference to the wealth, business or family interests of the person having the interest and, without limiting the generality of the foregoing, a person has a material interest in:

(i) any company of which he owns, directly or indirectly, more than ten per centum of any class of the voting shares, or of which he is a director; and

(ii) any partnership in which the person is a partner; and

(b) persons have a material relationship with each other if, by virtue of paragraph (b) of subsection (3) of section two, they are associates.424

Clearly, the concept of being 'associated' here relates simply to cases involving two persons only. Section 2(3)(b) of the Banking and Financial Services Act 1994 provides that two persons are associated if:

(i) one person is a company of which the other person is an officer or director;

(ii) one person is a company that is controlled de jure or de facto by the other person;

(iii) one person is a partnership of which the other person is a partner;

(iv) both partners are members of a voting trust or other arrangement relating to the shares of a share issuer; or

(v) one person is the spouse, parent, child, brother or sister of the other person, or of the other person's parent, child, brother or sister.

On the one hand, the Banking and Financial Services Act 1994 distinguishes an 'associate' relationship from an 'affiliate' one. On the other hand, the statute also spells out a definition of a subsidiary company. In the case of an 'affiliate' relationship, two or more persons are affiliated if all are companies that are controlled, de jure or de facto, by the same person.425 And in the case of a subsidiary, a company is a subsidiary of another company if more than fifty per centum of the issued voting shares of the company (except any

425 n 426 above, sec 2. See below for a discussion on de jure and de facto control.
qualifying director's shares) are owned directly or indirectly by the other company.\textsuperscript{426}

7 Further efforts to legislate against insider lending

In addition to Statutory Instrument 97 of 1996, titled 'The Banking and Financial Services (Insider Lending) Regulations, 1996,'\textsuperscript{427} regulating matters such as the concept of credit-worthiness, limits on lending to insiders, limits on lending to partnerships, and renewal of loans or the extension of credit, the Banking and Financial Services Act 1994 has other provisions prohibiting insider lending. For example, the Banking and Financial Services Act 1994 provides that a majority of the members of the board of directors of a bank should be persons who are not officers or employees of the bank.\textsuperscript{428} The importance of this provision is that — at least, on paper — it allows employees the freedom to act diligently by not getting intimidated into advancing loans to directors. To buttress this safeguard, the Banking and Financial Services Act 1994 codifies a number of common law duties of directors by requiring every director, chief executive officer, chief financial officer or manager concerned in the management of a bank, in exercising the powers and discharging the duties of that person's office, to '(a) act honestly and in good faith and in the best interests of the bank; and (b) exercise due care, diligence and skill'.\textsuperscript{429}

The common law position is further reflected in section 36 of the Banking and Financial Services Act 1994 which deals with the liability of directors and other officers for issuing false or misleading statements.\textsuperscript{430} The section covers the liability of bank directors, bank

\begin{itemize}
\item \textsuperscript{426} See Banking and Financial Services Act 1994, sec 2.
\item \textsuperscript{427} Passed by the Minister of Finance pursuant to secs 73 & 124 of the Banking and Financial Services Act 1994.
\item \textsuperscript{428} See Banking and Financial Services Act 1994, sec 32(1). It is not clear whether, as in sec 33 of the Banking and Financial Services Act 1994 (as amended by the Banking and Financial Services (Amendment) Act 2000), the word 'officer' should be replaced with 'chief executive officer', 'chief financial officer' or 'manager'. Indeed, the Banking and Financial Services (Amendment) Act 2000 is silent on this matter.
\item \textsuperscript{429} Banking and Financial Services Act 1994, sec 33. For further readings on duties of directors at common law, see generally DD Prentice 'Creditor's interests and director's duties' (1990) 10 Oxford Journal of Legal Studies 265; R Pennington Directors' personal liability (1987); P Loose et al The company director: Powers and duties (1993); and KK Mwenda & A Wiseberg 'Corporate law safeguards against oppression of minority shareholders' (1999) 1 SA Mercantile Law Journal.
\item \textsuperscript{430} See Caparo Industries plc v Dickman [1990] 1 All ER 568. The Caparo case has been followed at first instance in Morgan Crucible Co plc v Hill Samuel Bank Ltd & Others [1990] 3 All ER 330. See also Derry v Peek (1889) 14 App Cas 337; and Hedley Byrne & Co v Heller & Partner Ltd [1964] AC 465. In the Hedley Byrne case, liability was said to arise because the defendant assumed a duty to speak, and therefore to speak carefully.
\end{itemize}
Regulations of banks and financial institutions

Chief executive officers, bank chief financial officers, bank managers, bank employees, agents of the bank, accountants, legal advisers or any adviser of the bank who:

(a) negligently or with intent to deceive, makes any false or misleading statement or entry or omits any statement or entry that should be made in any book, account, report or statement of the bank;

(b) or obstructs or endeavours to obstruct:

(i) the proper performance by an auditor of the auditor's duties in accordance with the provisions of this Act; or

(ii) a lawful inspection of the bank by a duly authorised inspector appointed by the Bank of Zambia, commits an offence and is liable on conviction to a fine ... or to imprisonment for a term not exceeding one year, or to both.

However, it is not easy to appreciate the extent to which this statutory provision would apply to directors and officers who have ceased to operate as directors or officers after obstructing an audit examination, or after issuing false or misleading statements. Further, the statutory provision that provided indemnity to directors, former directors and other officers of the bank or financial institution against costs, charges and expenses, including any amount paid to settle an action or satisfy a judgment, has now been repealed.\textsuperscript{431} The indemnity no longer applies.\textsuperscript{432} Here, the charges and expenses would cover such costs that were reasonably incurred, in good faith and in the interests of the organisation. And they extended to costs incurred by a person in respect of any civil, criminal or administrative action or proceeding to which the person was made a party by reason of being or having been a director or officer, or having acted at the request of the bank as a director or officer of a company of which the Bank is or was a shareholder.\textsuperscript{433} The indemnity provision did not, however, cover actions by or on behalf of the bank or institution

\textsuperscript{431} Sec 34 of the Banking and Financial Services Act 1994 has been repealed by sec 27 of the Banking and Financial Services (Amendment) Act 2000.

\textsuperscript{432} Some explanatory notes prepared by the Ministry of Legal Affairs, Lusaka, Zambia, 1998, on the interpretation of the Bill leading to the Banking and Financial Services (Amendment) Act 2000 provide an interesting view here. The notes postulate a 'theory of deterrence' in dealing with corporate crime and tortuous liability. Indeed, on page 11 of the said explanatory notes, it is argued: 'While the Banking and Financial Services Act 1994 included a provision on the indemnity for directors and others as an encouragement for upright men and women to accept the responsibility of becoming directors and officers of banks and financial institutions that Zambia requires in order to continue to develop its market-based economy, the Bill has done away with that provision. The indemnity has been removed because experience has shown that directors have been lax in carrying out their duties and have not provided the much needed independent check on the executive directors and management. The risk of personal liability will encourage them to take an active role in the management of banks or financial institutions.'

\textsuperscript{433} Banking and Financial Services Act 1994, sec 34.
concerned or the Bank of Zambia to procure a judgment in its favour. 434

8 Anti-competitive conduct

As a general rule, the Banking and Financial Services Act 1994 prohibits a bank or financial institution from making arrangements with another bank or financial institution with respect to the rate of interest on a deposit by any person. 435 The Act also prohibits such arrangements with respect to the rate of interest or charge on a loan to any person, the amount of any charge to any person for the provision of a financial service, the provision of, or refusal to provide any financial service to, any person, or the provision of financial services in a manner that restricts competition. 436 One exception here is that banks and financial institutions can enter into the following agreements:

(a) for the performance of a financial service by one bank or financial institution to another;

(b) evidencing a syndication or other agreement for the provision of credit and other banking or financial services to a person by two or more banks or financial institutions;

(c) for the underwriting or distribution of any security by a bank, financial institution or a group of persons including a bank or a financial institution; or

(d) for the exchange of statistics or audit information, the development and use of systems, forms, methods, procedures and standards, the use of common facilities, joint research and development or any matter in connection therewith. 437

Prior to the enactment of the Banking and Financial Services (Amendment) Act 2000, the above prohibitions applied only to banks. Now, the prohibitions apply to both banks and financial institutions. And, in providing financial services, goods or other services, both banks and financial institutions are prohibited from requiring persons to engage in collateral contracts as a precondition to enter into contracts with the bank or financial institution. 438

434 As above.
435 Banking and Financial Services Act 1994 sec 40(1).
436 As above.
437 Banking and Financial Services Act 1994, sec 40(3).
438 Banking and Financial Services Act 1994, sec 41.
9 Chapter VI of the Banking and Financial Services Act 1994

In Zambia, the core statutory rules governing banking and financial services supervision, and prudential regulation, are found in chapter VI of the Banking and Financial Services Act 1994. Under these rules, a bank or financial institution is required to maintain a reserve account and before declaring any dividends, it must transfer to its reserve account, out of the net profits of each year after due provision has been made for taxation, the minimum amount prescribed by the Bank of Zambia.439 The Bank of Zambia may regulate the amount required to be transferred to the reserve account, the method of computing that amount, the form of the reserve account and any other matter it considers necessary to give effect to the foregoing.440

It must be observed that, in general, no bank or financial institution is allowed to declare, credit or pay any dividend or make any transfer from surplus if to do so would result in an impairment of the capital adequacy requirements of the Banking and Financial Services Act 1994.441 However, with the approval of the Bank of Zambia, a bank or financial institution can declare, credit or pay any dividend or make any transfer from surplus even if such act were to impair the reserve account requirements.442 Here, it must be stressed, first, that there has to be approval of the Bank of Zambia and, secondly, that the affected requirements relate to the reserve account and not provisions on capital adequacy. Indeed, the Bank of Zambia may permit a reduction of the reserve account when the relevant payment or transfer is made for the purpose of increasing the capital, and when the Bank of Zambia is satisfied that that is the only practicable means of preventing an impairment of the bank’s or financial institution’s capital or of enabling the bank or financial institution to make provisions that the Bank of Zambia considers to be necessary.443

9.1 Liquid assets

As a further safeguard, banks — and presumably financial

439 Banking and Financial Services Act 1994, sec 69(1).
440 Banking and Financial Services Act 1994, sec 69(2).
441 Banking and Financial Services Act 1994, sec 69(3). See below on capital adequacy requirements.
443 Banking and Financial Services Act 1994, sec 69(5).
institutions—"are required at all times to maintain liquid assets amounting to not less than such percentage of its total liabilities to the public in Zambia as the Bank of Zambia may by instrument in writing prescribe specifically for it or, in default of such prescription, as the Minister of Finance, on the recommendation of the Bank of Zambia, may by regulation prescribe for banks of its class or description." This requirement applies provided that:

(a) the percentage in either manner prescribed shall not be greater than fifty per cent;

(b) the distribution of amounts between the various classes of liquid assets may be made at the discretion of each bank; and

(c) no bank may be required to maintain any higher percentage than any other bank of the same class or type.

(2) Any variation in a regulation made for the purposes of subsection (1) shall take effect:

(a) if it provides for a decrease, immediately; or

(b) if it provides for an increase, only after reasonable notice thereof has been given in writing to each bank affected by the variation, and only if the variation does not increase the liquid asset requirement of any bank by more than fifteen per cent.447

Towards the end of 1997, the Bank of Zambia reduced the core liquid assets ratio from 38.5% to 35.5% in a bid to increase investible resources of commercial banks.448 The Banking and Financial Services (Amendment) Act 2000 now adds that the assets and liabilities for the

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444 Although the Banking and Financial Services (Amendment) Act 2000 is silent on whether this statutory provision also applies to financial institutions.

445 Sec 70(3) of the Banking and Financial Services Act 1994 provides that liquid assets are 'assets that are transferable free of any charge or lien whatsoever and that are of the classes described in the Second Schedule to this Act'. The Second Schedule then stipulates: 'The prohibition in section 73(1)(a) of this Act does not apply to the following transactions: (1) A transaction—(a) secured by a pledge of bills of exchange or promissory notes that have been issued for the price of goods purchased and sold in the ordinary course of trade; and (b) having an original term to maturity no greater than one hundred and eighty-two days or such longer period as may be prescribed by regulation. (2) A transaction having an original term to maturity not greater than two hundred and seventy days and which is—(a) secured by readily marketable assets, covered to their insurable value by all perils insurance and having an ascertainable market or other value, as security, as found in good faith by an officer of the bank concerned, of at least fifty per centum more than the amount of the obligations thereby secured; (b) secured in some other manner satisfactory to the Bank of Zambia; or (c) a loan made to or guaranteed by the government, a board or agency of the government or a local authority that is enforceable by the bank within sixty days after demand following default.'

446 See Banking and Financial Services Act 1994, sec 70(1). See also Fixed Assets Investment Regulations (effective 31 March 1996). The aim of these regulations is to control investment in fixed assets by banks. The regulations are in response to the need to restrict banks from making excessive investments in fixed assets as these do not directly contribute to the core business of banking.

447 See Banking and Financial Services Act 1994, secs 70(1) & (2).

448 n 421 above.
computation of the prudential liquidity ratio for the categories of financial institutions set out in the First Schedule shall be as set out in the Third Schedule'.\textsuperscript{449} The Third Schedule provides as follows:

Classes of assets and liabilities that constitute the computation of the prudential liquidity ratio for financial institutions for the purposes of this Act.

1 Numerator:
(a) notes and coins constituting the currency of Zambia and such foreign exchange in the form of currency notes as may from time to time be prescribed by the Bank of Zambia for the purposes of this paragraph;
(b) treasury bills and other government securities issued by the government and with an original term of maturity of not more than ninety days;
(c) deposits with banks or other financial institutions;
(d) confirmed lines of credit with banks and financial institutions;
Provided that such lines of credit comply with the large loans exposures and/or insider lending limits;
(e) confirmed lines of credit from foreign banks and financial institutions acceptable to the bank of Zambia;
(f) other assets prescribed from time to time by the bank of Zambia.

2 Denominator:
(a) deposits or deposit-like instrument such as debentures or certificates of deposit with maturities of up to ninety days;
(b) overdrafts with banks or financial institutions;
(c) short-term bank loans payable within ninety days; and
(d) Other liabilities as may be prescribed by the Bank of Zambia from time to time.

However, where the liquid assets of a bank are, or the prudential liquidity ratio of a financial institution is, less than the amount for the time being prescribed in respect of it, the Bank of Zambia may order the bank or financial institution to pay to the Bank of Zambia, as a fine, interest on the amount of the deficiency, with respect to each day or part of a day that the deficiency continues, at an annual rate not exceeding the highest annual rate fixed, at the time of the deficiency, by the Bank of Zambia under the Bank of Zambia Act for any of its operations.\textsuperscript{450}

\textsuperscript{449} Banking and Financial Services Act 1994 (as amended by the Banking and Financial Services (Amendment) Act 2000), sec 70A.
\textsuperscript{450} n 451 above, sec 71.
Further, additional safeguards for investor protection can be found in other parts of the Banking and Financial Services Act 1994. One of these safeguards provides as follows:

A bank or financial institution shall not:

(a) mortgage, charge or grant security to any person over any asset of the bank or financial institution otherwise than:

(i) in the ordinary course of business; or

(ii) to the Bank of Zambia to secure short-term liquidity advances made by it under the Bank of Zambia Act; or

(b) acquire an asset that is subject to a mortgage, charge or other security interest in favour of any person, except to satisfy a debt or other liability to it.451

The Banking and Financial Services Act 1994 provides further safeguards by placing some limitations on the grant of advances.452 A number of these limitations relate to matters such as a bank or financial institution cannot, indirectly or directly, except as provided in the Fourth Schedule453 to the Banking and Financial Services Act 1994, grant any advance, or make any guarantee of the debts of any person or common enterprise so that the total value of any such advances and guarantees with or in respect of any one person or common enterprise is at any time more than twenty-five per centum of the regulatory capital454 of the bank or financial institution. The Banking and Financial Services Act 1994 defines 'regulatory capital' as:

... the instruments which comprise capital resources of a bank or financial institution, and the total of which is used by the Bank of Zambia for determining compliance by a bank or financial institution

451 n 451 above, sec 72.
452 n 451 above, sec. 73.
453 The Fourth Schedule reads as follows: 'The prohibition in sections 73(1) of this Act does not apply to the following transactions: (1) A transaction –(a) secured by a pledge of bills of exchange or promissory notes that have been issued for the price of goods purchased and sold in the ordinary course of trade subject to the Bank of Zambia's approval; and (b) having an original term to maturity not greater than one hundred and eighty two days or such longer period as may be prescribed by the Bank of Zambia. (2) A transaction having an original term of maturity not greater than two hundred and seventy days and which is – (a) secured by readily marketable assets, covered to their full insurable value by all perils insurance and having an ascertainable market or other value, as security, as found in good faith by an officer of the bank concerned, of at least fifty per centum more than the amount of the obligations thereby secured; (b) secured in some other manner satisfactory to the Bank of Zambia; or (c) a loan made to or guaranteed by the government, a board or agency of the government or a local authority that is enforceable by the bank within sixty days after demand following default.'
454 Banking and Financial Services Act 1994, sec 73(1).
with the minimum capital standard and for assessing capital adequacy, calculated in a manner prescribed by the Bank of Zambia.\textsuperscript{455}

Additionally, the financial 'sickness' of a bank borrower or group of related borrowers can have serious implications on a bank creditor if that borrower or group of related borrowers represent a large concentration of risk to the bank creditor. In recognition of such risks, the Banking and Financial Services (Large Loans Exposures) Regulations 1996\textsuperscript{456} were issued with the primary aim of limiting the concentration of loans to a single borrower or a group of related borrowers, thereby minimising the effect of loss to a bank in the event of failure of such borrowers.\textsuperscript{457} These regulations are reflective of Core Principles 10 and 11 of the Basel Core Principles for Effective Banking Supervision, which provide as follows:

Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counter-parties or groups of connected counter-parties ... In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.\textsuperscript{458}

Further still, under the Zambian legal framework, banks and financial institutions are prohibited from indirectly or directly granting advances against the security of their own shares.\textsuperscript{459} Also, a bank or financial institution is not allowed, whether transacting directly or indirectly, except with the approval of the Bank of Zambia, to grant or permit to be outstanding any secured or unsecured advances to its directors (whether such advances are obtained by them jointly or severally), persons having \textit{de jure} or \textit{de facto} control of the bank or

\textsuperscript{455} Banking and Financial Services Act 1994, sec 2.
\textsuperscript{456} Statutory Instrument 96 of 1996 passed by the Minister of Finance pursuant to secs 73 & 124 of the Banking and Financial Services Act 1994.
\textsuperscript{458} See Basel Committee (n 7 above).
\textsuperscript{459} Banking and Financial Services Act 1994 (as amended by the Banking and Financial Services (Amendment) Act 2000), sec 73(2).
financial institution, partners, managers, agents, or other insiders such as shareholders. Here, the threshold for which lending is prohibited is an aggregate amount in excess of twenty-five per centum of the bank's or financial institution's primary capital. In addition, if a bank or financial institution would like to provide unsecured lending to or allow the staggering of existing and outstanding unsecured debts that are owed by its chief financial officer, chief executive officer, manager or employee, it must first obtain the authorisation of the Bank of Zambia. The threshold on prohibited loans here is any loan which in the aggregate would exceed the respective annual remuneration of the borrower. In general, however, to obtain a waiver on a number of these limitations a bank or financial institution must first seek the approval of the Bank of Zambia.

Other exceptions to the limitations are found in the Second Schedule to the Banking and Financial Services Act 1994. The Second Schedule has already been examined above. Here, suffice it to say, while section 73 of the Banking and Financial Services Act 1994 spells out in great detail the list of these limitations, the Second Schedule provides exceptions to the limitations.
9.2 Lifting of the corporate veil

An interesting development in the jurisprudence of banking and financial services supervision in Zambia can be found in section 73(9) of the Banking and Financial Services Act 1994. This section codifies and strengthens the common law position which permits the lifting of the corporate veil where bodies corporate engage in co-mingled activities to perpetrate, say, fraud. Section 73(9) of the Banking and Financial Services Act 1994 now provides that the Bank of Zambia can lift the veil of incorporation of a bank or financial institution under similar circumstances. The statutory provision reads 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 person 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 indebtedness of a single person: Provided that a bank or financial institution shall not be taken to have contravened subsections (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.

9.3 Equity investments and abandoned funds

As a general rule, a bank or deposit-taking financial institution is prohibited from investing in equity interests in any person (such as a company), property or undertaking in an amount exceeding fifteen

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467 Sec 2 of the Banking and Financial Services Act 1994 defines a 'deposit-taking financial institution' as a 'financial institution that in addition to carrying on financial service business accepts deposits'. The term 'deposits' is then defined in the same section as 'an amount of money paid to a bank or financial institution in respect of which – (i) an equal amount or any part thereof is conditionally or unconditionally repayable, with or without a premium, on demand or at specified or unspecified dates or in terms agreed to, by, or on behalf of, the person making the payment and the bank or financial institution receiving it; and (ii) no interest is payable on the amount so paid or interest is payable thereon at specified or unspecified intervals, notwithstanding that the payment is limited to a fixed amount or that a transferable or non-transferable certificate or other instrument providing for the repayment of the amount referred to in subparagraph (i) or the interest referred to in this subparagraph is issued in respect of that amount or interest'.

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per centum of the total of all equity interests in the said person, property or undertaking.\textsuperscript{468} Equity interests are defined as:

'Equity interests in a person' means:
(a) 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
(b) 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;

'Equity interests 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.\textsuperscript{469}

In addition to the limitation on both banks and deposit-taking financial institutions to invest in equity interests, there are further limitations on a bank and deposit-taking financial institution not to acquire an equity interest in any single person, property or undertaking in which an insider has a related interest that exceeds ten per centum of the bank's or deposit-taking financial institution's regulatory capital.\textsuperscript{470} However, the limitation prohibiting banks and deposit-taking financial institutions from investing in an equity interest in excess of fifteen per centum of the total value of the equity interest does not apply to investment(s) by a bank or deposit-taking financial institution in the shares of its subsidiary, if the aggregate of all investments by the bank or deposit-taking financial institution does not exceed twenty five per centum of its regulatory capital.\textsuperscript{471} The same applies where a bank or deposit-taking financial institution acquires an equity interest in the realisation of a part of a collateral provided to the bank or deposit-taking financial institution in a credit transaction with any person, if the bank or deposit-taking financial institution, within two years following that acquisition or such longer period as the Bank of Zambia may allow, disposes of any equity interest in excess of the limits imposed by the Banking and Financial Services Act 1994.\textsuperscript{472}

Where there are funds held by a bank or financial institution which are presumed to be abandoned, the bank or financial institution, as a constructive trustee, is required by law to report and relinquish such

\textsuperscript{468} Banking and Financial Services Act 1994 (as amended by the Banking and Financial Services (Amendment) Act 2000), sec 75(1).
\textsuperscript{469} Banking and Financial Services Act 1994, sec 75(8).
\textsuperscript{470} Banking and Financial Services Act 1994, sec 75(4).
\textsuperscript{471} Banking and Financial Services Act 1994, sec 75(5).
\textsuperscript{472} Banking and Financial Services Act (as amended by the Banking and Financial Services (Amendment) Act 2000), sec 75(7). For limits imposed by the statute, see above.
funds to the Bank of Zambia.\(^{473}\) The bank or financial institution must not only report to the Bank of Zambia on the amount and nature of such funds, but it must also relinquish these funds to the Bank of Zambia upon the expiration of a time limit set by the law.\(^{474}\) To enforce such prudential rules, the Bank of Zambia may cause an inspection to be made of a bank or financial institution to determine whether it is in a sound financial condition and operating safely and that the requirements of the Banking and Financial Services Act 1994, the Bank of Zambia Act 1985 and other laws of Zambia have been complied with in the conduct of its business.\(^{475}\) Further, it must be noted that:

(2) When, in conducting an inspection of a bank or financial institution ... the Bank of Zambia considers it necessary to do so, the Bank of Zambia may at the same time cause a like inspection to be made of any other company in Zambia that is a subsidiary, associate or affiliate of the bank or financial institution concerned.

79 (1) A bank or financial shall:

(a) produce, and cause each company that is a subsidiary, affiliate or associate of the bank or financial institution to produce, for the inspection of any inspector appointed by the Bank of Zambia, at such times as the inspector specifies, all books, accounts and records relating to its business in Zambia or elsewhere; and

(b) supply all information concerning its business in Zambia or elsewhere as may reasonably be required by the inspector within such time as the inspector specifies.\(^{476}\)

9.4 Disciplinary measures

Where a bank or financial institution refuses to comply with an order or directive of the Bank of Zambia under the Banking and Financial Services Act 1994, or refuses to permit an inspection to be made, or has otherwise obstructed such an inspection, the Bank of Zambia can take supervisory action. Although supervisory action would involve any one or more of the following, it need not necessarily be limited to these actions:

\(^{473}\) Banking and Financial Services Act (as amended by the Banking and Financial Services (Amendment) Act 2000), sec 76(3).

\(^{474}\) n 475 above, sec 76(2).

\(^{475}\) n 475 above, sec 78(1).

\(^{476}\) n 475 above, secs 78 & 79.
(a) taking possession of the bank or financial institution;\textsuperscript{477}

(b) suspending the bank's or financial institution's licence for a period not exceeding six months;

(c) restricting the bank's or financial institution's licence; and

(d) revoking the bank's or financial institution's licence.\textsuperscript{478}

Equally, the Bank of Zambia may take supervisory action where it is of the opinion that an authorised inspection shows:

(i) that the bank or financial institution concerned conducts its business in breach of any written law or engages in a course of conduct that is unsafe and unsound;\textsuperscript{479} or

(ii) that for any reason the bank or financial institution is unable, or is likely to become unable, to continue its operations in the ordinary course of its business.\textsuperscript{480}

However, before the Bank of Zambia can take any supervisory action, it is required by law to inform the Minister of Finance in writing regarding the state of affairs of a bank or financial institution in respect of which it intends to take supervisory action. This requirement, as one might argue, interferes with the independence of the central bank. What would happen if the Minister advises the central bank against closing down a bank or financial institution, which, although financially distressed, is the hub of major investment activities by senior government officials? Both the principal statute

\textsuperscript{477} Previously, under the repealed sec 81(2)(a) of the Banking and Financial Services Act 1994, as part of its supervisory powers, the Bank of Zambia had powers to appoint a person (ie a curator) who in its opinion had proper training and experience, to advise the financially distressed bank on the implementation of such measures as would have been specified by the Bank of Zambia to rectify the matter (and whose remuneration, as fixed by the Bank of Zambia, had to be paid by the bank concerned). The juxtaposition in which the curator found himself or herself raised a number of issues. Although the curator was appointed by the Bank of Zambia, he or she was essentially an agent of the distressed bank and thus occupied a position akin to that of an administrator under the English Insolvency Act 1986 (now superseded by provisions of the new UK Bank Insolvency Regime, the Special Resolution Regime (SRR), pursuant to the UK Banking Act 2009). The curator owed fiduciary duties to the distressed bank to act honestly, competently and in good faith and, further, to take into account interests of the various stakeholders. At the same time, the curator had to observe, with due diligence, written instructions from the Bank of Zambia. For a good discussion on the juxtaposition facing an administrator (appointed by a court) under the UK Insolvency Act 1986, see generally RM Goode Principles of corporate insolvency law (1997).

\textsuperscript{478} Banking and Financial Services Act 1994, (as amended by the Banking and Financial Services (Amendment) Act 2000), sec 81(2).

\textsuperscript{479} There is no statutory definition of 'unsafe and unsound' practices under the Banking and Financial Services Act 1994. This leaves wide discretionary powers to the Bank of Zambia to determine what is 'unsafe and unsound' practice. However, as noted earlier, in a society where corruption is rife or where politicians often interfere in the operations of a regulatory authority, such statutory provisions could provide for a leeway for some politicians to punish banks whose shareholders and directors are unpopular with the government.

\textsuperscript{480} Banking and Financial Services Act 1994, sec 81(1)(c).
and the Banking and Financial Services (Amendment) Act 2000 are silent on this issue. It is such *lacunae* in the law that affect the efficacy of the legal framework.

And what is the level of duty of care that the Bank of Zambia should exercise in the administration of the estate of a financially distressed bank or financial institution? The Banking and Financial Services Act 1994 and the Banking and Financial Services (Amendment) Act 2000 are both silent on this matter, as well. Again, such omissions present *lacunae* in the law. It is argued, however, that the Bank of Zambia should act honestly and in good faith—in a like manner that a supervisory body of its standing would competently and diligently act[^461]—in what it reasonably believes to be the best way to restore a bank or financial institution to sound financial and operating conditions.

10 Capital adequacy and special reserve or liability insurance

Before the enactment of the Banking and Financial Services (Amendment) Act 2000, the minimum required capital for every class or description of bank was set by the Minister of Finance on the recommendation of the Bank of Zambia and in line with internationally-accepted guidelines and the nature of the bank's business[^482]. Accordingly, Statutory Instrument 184 of 1995, titled the 'Banking and Financial Services (Capital Adequacy) Regulations, 1995', was passed by the Minister of Finance on 13 November 1995, pursuant to sections 83 and 84 of the Banking and Financial Services Act 1994. Under Core Principle 6 of the Basel Core Principles for Effective Banking Supervision:

> Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.[^483]

As at December 1996, the Zambian capital adequacy regulation required commercial banks and all other deposit-taking institutions to


[^483]: See Basel Committee (n 7 above).
have a minimum regulatory capital of ZK 2 billion.\textsuperscript{484} To illustrate, Royalty Bank (Z) Limited was licensed in November 1994 by the Bank of Zambia as a bank under the then Zambian Banking Act (CAP 700) which required banks to commence operations with a minimum regulatory capital of ZK 20 million.\textsuperscript{485} A month later, in December 1994, the Zambian Banking and Financial Services Act 1994 was enacted. The new requirement was that banks maintain a minimum regulatory capital of ZK 2 billion. Royalty Bank (Z) Limited took out an interim injunction (\textit{ex parte}) to restrain the Bank of Zambia from effecting the requirements of the Banking and Financial Services Act 1994.\textsuperscript{486} The court discharged the interim injunction and no further steps to prosecute the action were taken.\textsuperscript{487} Later, the Bank of Zambia revoked Royalty Bank (Z) Limited's licence for banking business.\textsuperscript{488}

By contrast, non-deposit-taking financial institutions were required to have a minimum regulatory capital of up to ZK 250 million.\textsuperscript{489} On 19 August 2004, the Bank of Zambia issued CB Circular 05/2004, stating that:

\begin{quote}
Since December 18, 2000, the Bank of Zambia has been disaggregating commercial banks' shortfalls on the minimum requirements on both statutory reserves and core liquid assets ratios into two parts on which two different penalty rates have been applied ... Effective immediately the Bank has made modifications to both the way the shortfall is calculated and the applicable penalty rate. Henceforth the Bank of Zambia will instead only take the respective net shortfall positions (i.e. the net combined position of shortfalls and surpluses to the extent that this is negative) during the compliance period on both Kwacha and foreign currency statutory reserves as well as on the core liquid asset
\end{quote}


\textsuperscript{485} Unreported Zambian case whose holding was available at the Bank of Zambia website \url{http://www.boz.zm} (accessed 11 August 2000).

\textsuperscript{486} As above.

\textsuperscript{487} As above.

\textsuperscript{488} As above.

requirements. The measure is expected to ... positively affect commercial banks' overall cost structure, which should enable commercial banks to pass on this benefit to their customers.\textsuperscript{490}

In 2006, the Bank of Zambia issued CB Circular 04/2006, giving notice to all commercial banks that the core liquid assets ratio would be \textit{9\%} of commercial banks' total liabilities to the public, instead of the then prevailing \textit{35\%}.\textsuperscript{491} In addition, the Bank of Zambia directed that eligible assets would exclude government securities with an original term of maturity in excess of 182 days.\textsuperscript{492} It was the view of the Bank of Zambia that the reduction in the core liquid assets ratio would allow commercial banks greater and essential flexibility in managing their balance sheets.\textsuperscript{493} It was also hoped that the reduction would trigger a reduction in the cost of funds to the private sector so as to support economic growth.\textsuperscript{494} And, in 2007, the Bank of Zambia issued CB Circular 06/2007, advising all commercial banks that the minimum statutory reserve ratios on both the Kwacha and foreign currency deposit liabilities to the public would be reduced to \textit{8\%} from \textit{14\%}.\textsuperscript{495} The reduction in the statutory reserve ratios, it was argued, was primarily to realign monetary policy tools from direct to market-based instruments.\textsuperscript{496} The action was also intended to contribute to the lowering of the high cost of loanable funds in the banking system.\textsuperscript{497}

Overall, the coming into force of the Banking and Financial Services (Amendment) Act 2000 ushered in some major regulatory changes. The Bank of Zambia now has the power to prescribe the minimum required primary capital for banks and every category of financial institution.\textsuperscript{498} In doing so, the Bank of Zambia need not even consult the Minister of Finance. And every bank or financial institution must maintain primary capital in an amount at least equal to the minimum amount prescribed by the Bank of Zambia.\textsuperscript{499} On 3 January 2007, the Bank of Zambia issued an official statement to all heads of commercial banks in Zambia that the minimum start-up capital for banks had been revised from ZK 2 000 000,000 to ZK 12 000 000 000
with effect from 2 January 2007.\textsuperscript{500} The revision is also contained in Zambian Government Gazette 682 of 2006, titled ‘The Banking and Financial Services (Capital Adequacy) Notice, 2006’.

Furthermore, as part of the safeguards for investors in banks and financial institutions, the Banking and Financial Services Act 1994 requires banks and financial institutions to maintain a special reserve account, to an amount which the Bank of Zambia considers adequate, reserved exclusively for the purpose of making good any loss resulting from the negligence or dishonesty of any of its directors, chief executive officer, chief financial officer, manager or employees.\textsuperscript{501} The Act also requires a bank or financial institution to insure itself against such loss, to an amount which the Bank of Zambia considers adequate, with a person approved by the Bank of Zambia carrying on insurance business or the business of guaranteeing against such loss, or to undertake such other commitment as the Bank of Zambia may consider acceptable.\textsuperscript{502}

11 Conclusion

This chapter has examined the efficacy of the legal framework for banking supervision, as contained in the Banking and Financial Services Act 1994, as well as the efficacy of the institutional framework for the governance structure of the Bank of Zambia. Shortcomings in the law were highlighted and proposals were spelt out to redress the anomalies. It was noted, for example, that the Bank of Zambia does not enjoy central bank independence, particularly with regard to the manner in which the law permits the executive arm of the state to meddle into the affairs of the Bank of Zambia. An argument was made that even the role of the central bank as lender of last resort, or the central bank’s supervisory function of regulatory forbearance, can be compromised and abused if the executive, through the Republican President, has the unfettered power to hire and fire the Bank of Zambia Governor.

The legal and policy issues examined in the chapter provided perspectives which are of wider application to many other jurisdictions. An underscoring theme in the chapter was that, in undertaking bank reforms, an important objective to consider is the need to develop a stable banking system which allocates credit on a market basis. The development of such a system, it was observed,

\textsuperscript{500} See letter from Mr Chisha Mwanakatwe, Director, Bank Supervision Department, Bank of Zambia, ‘Revision to minimum start-up capital for banks’ to all heads of commercial banks, dated 3 January 2007.

\textsuperscript{501} Banking and Financial Services Act 1994, sec 82(a).

\textsuperscript{502} Banking and Financial Services Act 1994, secs 82(b) & (c).
could be achieved, in part, through the establishment of an efficient and effective regulatory framework for banking and financial services supervision.

The chapter noted further that, apart from the coming into force of the Banking and Financial Services Act 1994, as well as the enactment of the Banking and Financial Services (Amendment) Act 2000, legislation on money laundering has also been introduced in Zambia. In addition, to bolster and strengthen intermediation in the financial sector, the issue of whether or not to introduce deposit insurance in Zambia has previously been considered. However, the extent to which such efforts are expected to result in the actual enactment of a deposit insurance law remains to be seen. Be that as it may, the Bank of Zambia postulates that, as a recommendation to strengthen the legal and institutional framework for banks and financial institutions in Zambia, ‘[e]stablishing a credit reference bureau and a Deposit Protection Scheme for banks and deposit-taking financial institutions to help enhance credit culture and instill confidence in the financial system’. 503

Notwithstanding arguments such as those pertaining to moral hazard, the introduction of a deposit insurance law, it was argued, is important because the closure of some troubled banks or even an interruption in their supply of credit would be too costly to the economy. As a corollary, and also to attract more foreign capital to Zambia, the Zambian government is pursuing actively a sovereign credit rating for the country. 504 However, plans to get this sovereign credit rating in 2009 have been suspended temporarily mainly due to the effects of the global financial crisis. 505

503 See Bank of Zambia (n 344 above) 66.
505 As above.
1 Introduction

This chapter examines the role of the Bank of Zambia, as a banking regulator and supervisor, in preventing and fighting money laundering in the banking sector. To that end, the chapter focuses on the Bank of Zambia Anti-Money Laundering Directives 2004, since these directives constitute the backbone of the regulatory framework for anti-money laundering in the banking sector. Complementing the Bank of Zambia Anti-Money Laundering Directives, Core Principle 18 of the Basel Core Principles for Effective Banking Supervision stipulates that supervisors must be satisfied that banks have adequate policies and processes in place, including strict know-your-customer rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.\(^{506}\)

In line with that dictate, the Bank of Zambia Anti-Money Laundering Directives 2004 were passed by the Bank of Zambia pursuant to section 12(4) of Zambia's Prohibition and Prevention of Money Laundering Act 2001. The said section 12(4) provides as follows:

> A Supervisory Authority shall issue such directives as may be approved by the Unit (i.e. the Anti-Money Laundering Investigations Unit) which may be necessary for the regulated institutions to prevent and detect money laundering.

This chapter highlights some shortcomings of the Zambian regulatory framework with a view to pointing out areas of possible improvement. And the simplistic view that money laundering is a simple crime that occurs in three successive stages—that is, placement, layering and integration—is discredited. The chapter fleshes out shortcomings of

\(^{506}\) See Basel Committee (n 7 above) 2-5.
this view, highlighting possible ways in which the regulatory framework can be strengthened.

At the outset, it is important to define the term ‘money laundering’. What is money laundering? Money laundering can be defined in a number of ways. The Bank of Zambia observes that:

... [t]here is a growing global concern over money laundering, and Zambia is no exception. Explained in simple terms, money laundering is the ‘washing of dirty money’ into the financial system thereby legitimising proceeds of illegal activities such as drug trafficking. Money laundering not only undermines public confidence in the financial system, it also causes distortions in the economy in terms of significant

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influence on key economic variables such as money supply which do not derive from economic activity.508

In chapter 5, we will look more closely at the statutory definition of money laundering under Zambia’s Prohibition and Prevention of Money Laundering Act 2001. Worldwide, a number of countries subscribe to the definition of money laundering adopted by the UN in the Vienna Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 1988. Article 3(b) of that treaty points out that money laundering involves:

(a) the conversion or transfer of property, knowing that such property is derived from any [drug trafficking] offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offence or offences to evade the legal consequences of his actions; or,

(b) the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offence or offences or from an act of participation in such an offence or offences.

Article 3(c)(i) of the same treaty adds that money laundering includes the acquisition, possession or use of property, knowing at the time of receipt that such property was derived from an offence or offences, or from an act of participation in such an offence or offences. Closely related to this definition, Ofosu-Amaah et al define money laundering as the process of transformation of the form or usage of ill-gotten proceeds of economic crimes, with a view to obscuring the source or origin of such proceeds.509 These authors argue that although the term ‘money laundering’ has traditionally been associated with drug-trafficking offences,510 money laundering has now come to be regarded as an essential element in the fight against corruption.511 Its scope, they argue, has been extended to apply generally to all

508 The Bank of Zambia at http://www.boz.zm (accessed 11 August 2000). See EU Directive on Money Laundering, adopted on 10 June 1991, which provides in art 1 that the offence of money laundering involves: ‘(a) conversion or transfer of property in the knowledge such property is derived from criminal activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in committing such crime to evade the legal consequences of his action; (b) concealment or disguise of the nature, source, location, disposition, movement, rights with respect to or ownership of property in the knowledge that such property is derived from criminal activity or from an act of participation in such crime; (c) the acquisition, possession or use of property in the knowledge, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such crime; and (d) participation in, association or conspiracy to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions established in the previous paragraphs’.  
510 As above.  
511 As above.
economic crimes, including corruption offences.\textsuperscript{512} Ofosu-Amaah \textit{et al} argue further that, as in the case of drug trafficking, the purposes of money laundering legislation are to ensure that crime does not pay and that no amnesty is provided after the fact to perpetrators of serious economic crimes.\textsuperscript{513} In the United Kingdom, for example,

\ldots legislation creating money-laundering offences in connection with drug-trafficking was first introduced in 1986. But it was not until the Criminal Justice Act of 1993, amending the Criminal Justice Act of 1988, that money-laundering provisions were extended generally to cover other forms of criminal conduct \ldots The Swiss Criminal Code now makes it an offence for anyone to commit an act the effect of which is to impede the identification of the source, discovery, or confiscation of assets that he knows, or should have known, came from a crime \ldots The offence is punishable in Switzerland, even if the underlying crime has been committed abroad, provided, of course, that the set of circumstances that constitute the underlying crime amounts to a crime under both Swiss law and the foreign law.\textsuperscript{514}

In general, the 'staged' interpretation of money laundering,\textsuperscript{515} as is often seen in the literature on anti-money laundering, is superficial and has its roots in a time when money laundering was a crime that was often committed only in relation to proceeds of drug trafficking, which by virtue of the fact that all drugs are sold on the streets for cash, generated large volumes of cash.\textsuperscript{516} As the International Compliance Association observes:

Drug money has to be 'placed', 'layered' and, eventually, 're-integrated'. As a result, much of what has been written and taught about money laundering focuses on the three stages of the money laundering process. The staged interpretation is, however, not always borne out in reality and could be accused of being a little simplistic, particularly when viewed in the context of crimes that do not generate cash. The staged interpretation of money laundering assumes that:

- all crime generates cash, which is then deposited or infused in some way into the financial system. This is not true. There are a number of crimes, including almost all financial crimes and frauds, which result

\textsuperscript{512} As above.
\textsuperscript{513} As above.
\textsuperscript{514} As above.
\textsuperscript{515} This approach postulates that the process of money laundering is a simple one and it occurs in three successive stages, namely, placement, layering and integration. Placement involves the introduction of proceeds of crime into the economy. Then, layering involves different techniques used by launderers to disguise the source of the money. It could involve several small and repetitive money transfers or engaging in sham transactions to confuse the audit trail. The third stage is integration and it involves the re-integration of laundered funds back into the launderer's economic domain so that these funds appear as if they have come from a legitimate source.

directly in benefits within the financial system, thus, obviating
the need for the benefit to be 'placed'.

- there is a distinct line between the 'layering' and 'integration'
stages of the process. In fact, these stages can be virtually impossible to
distinguish. The way in which laundered funds are 're-integrated'
often entails the completion of further 'layers'.

The overriding objective of any money-laundering process is to
disguise the source of ill-gotten wealth so that it cannot be attributed
to predicate criminality. In order to achieve this primary objective,
a launderer must first achieve a number of secondary laundering
objectives, including (a) disguising their own identity; (b) concealing
the fact that they own the property; (c) concealing the fact that they
may, in fact, manage and control the property; and (d) placing as
much distance between themselves and the property, both physically
and ‘on paper’. A good anti-money laundering programme should,
therefore, provide for an early warning system, covering effective
and efficient risk management and compliance to deter and counter
money laundering activities. Such a system must involve the use of
internal control measures, like know your customer, due diligence,
know the counter partners, know your business, recognise suspicious transactions, and continuous
education and training. All in all, the policy objectives
underpinning a good anti-money laundering programme are premised
on the following:

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517 As above.

518 Discussing the meaning of the term ‘predicate offence’, the Canadian Supreme
Court, ruling on a criminal matter, R v De Sousa [1992] 2 SCR 944, 956, available
the ambit of s 269, an accused must have committed an underlying unlawful
offence (otherwise referred to as the predicate offence) … For liability to be
imposed … , the harm caused must have sufficient causal connection to the
underlying offence committed (see R v Wilmot (1940) 74 CCC 1 (Alta CA) 17 26-
27, appeal dismissed for other reasons [1941] SCR 53).’

519 See International Compliance Association (n 518 above) 73.

520 For further readings on measures to deter and counter money laundering, see D
Lyman 'Corporate practices manual on extortion and bribery: Money laundering'
(written for the IOC’s Standing Committee on Extortion and Bribery – 17 February
1999), available at http://www.tillekeandgibbins.com/ Publications/Articles/
corporate/ money.htm (accessed 10 February 2005).

521 See CM Fundanga ‘The role of the banking sector in combating money laundering
paper presented at a seminar organised by the C and N Centre for Advanced
(accessed 4 February 2005). See also J McDowell ‘The consequences of money
laundering and financial crime’ (2001) 6 Economic Perspectives: An Electronic
Journal of the US Department of State 7-8 available at http://usinfo.state.gov/
journals/ites/ 0501/ijee/state1.htm; and http://usinfo.state.gov/journals/ites/
(a) Money laundering undermines legitimate private sector initiatives by extending finance and credit to front companies that are used by launderers, thereby making it difficult for other companies to compete with these front companies on a fair and level playing field.

(b) Money laundering can lead to a government’s loss of control over economic policy when proceeds of crime continue to dwarf the government’s budget.

(c) Money laundering can also affect currencies and interest rates since launderers tend to reinvest their funds where their schemes are less likely to be detected rather than where rates of return are higher.

(d) Money laundering can lead to economic distortion and instability since launderers are often not interested in profit generation from their investment but rather in concealing their identity and protecting the proceeds of crime (money launderers usually invest their laundered funds in activities that are not necessarily economically beneficial to the country, but which promise them concealment of the source of funds and the identity of the launderers).

(e) Money laundering can lead to loss of government revenue where tax evasion, as a predicate offence, is rampant in the country.

(f) Money laundering can lead to risks to privatisation programmes since money launderers often have the financial power to out-bid legitimate investors.

(g) Money laundering can expose a recipient country to reputation risk, resulting in the erosion of investor confidence in that country’s financial market.

(h) Money laundering can lead to a legal risk to banks in cases where banks are subjected to all sorts of lawsuits resulting from a bank’s failure to observe the ‘know your customer’ standards or from failure to practise ‘due diligence’ in customer evaluation and acceptance.

(i) Money laundering can compromise the corporate governance structure of a bank, especially in the case of small banks and their approach to deposit mobilisation and customer selection.

(j) Money laundering sometimes provides fuel for terrorists, while draining its ‘milk’ from such predicate offences as drug dealing, animal poaching, tax evasion, the running of illegal brothels, illegal arms dealing, illegal trafficking in children and women, and corrupt practices by public officials.

2 Setting the discussion in context

As noted in chapter 3, Zambia introduced principal legislation to fight money laundering in 2001. However, for lack of space in this chapter, we will only examine Zambia’s Prohibition and Prevention of Money Laundering Act 2001 more fully in the next chapter.

Money laundering in the banking sector

Prior to 2001, the repealed section 22 of the Narcotics Drugs and Psychotropic Substances Act 1993 was the only statutory provision dealing with the criminalisation of money laundering in Zambia. But, with the coming into force of the Prohibition and Prevention of Money Laundering Act 2001, section 22 of the Narcotics Drugs and Psychotropic Substances Act 1993 was repealed. And today, in addition to the Prohibition and Prevention of Money Laundering Act 2001, the Bank of Zambia Anti-Money Laundering Directives 2004 also provide for the criminalisation of money laundering. We will examine below the Bank of Zambia Anti-Money Laundering Directives 2004.

In Zambia, until the emergence of small privately-owned banks, money laundering rarely took place outside the realm of drug trafficking. But a number of these tiny banks that were set up by some dubious and unscrupulous foreign investors around the 1990s went into liquidation. Even some big banks, such as Meridien Bank, also collapsed. And some directors and shareholders of these small banks have faced court cases and have been convicted of money laundering offences, showing that a number of the small banks were engaging in money laundering activities. As one report shows:

Lusaka magistrate's court yesterday jailed four former defunct United Bank of Zambia (UBZ) managers for 12 months with hard labour for externalising about $117 million Kwacha to the United States of America. Magistrate Mwamba Chanda jailed Benedict Ashley d'Souza, 49, a former operations manager, Rajesh Kaushik, 33, a former branch manager in Ndola, Manoj Gupta, 41, a former operations manager and Pindalika Shenoy, 55, a former UBZ managing director after they were convicted on 48 counts of forgery. Magistrate Chanda also fined the quartet K15 million each on four counts of money laundering and further fined Shenoy K5 million for flouting the Bank of Zambia regulations...

According to the statement of offence, in the first count, the quartet, while acting together in Ndola, did open and maintain a fictitious account number 5100167001 in the name of Lesley Mulenga using fraudulently obtained documentation with the actual intention to conceal the source of funds in the account and externalised from Zambia US$130,364 to Pearstrand, a company based in New York City without the knowledge of Lesley Mulenga. The quartet, in another count, opened

524 As noted above, the Bank of Zambia Anti-Money Laundering Directives 2004 were passed by the central bank pursuant to sec 12(4) of the Prohibition and Prevention of Money Laundering Act 2001.
525 See below.
527 As above.
and maintained another fictitious account number 5100122008 in the name of Justine Sakata using fraudulently obtained documentation with the actual intention to conceal the source of funds in the account and externalised from Zambia US $925 989 to Pearstrand company based in New York City without the knowledge of Justine Sakata. Shenoy was also charged for failing to comply with the Bank of Zambia (BOZ) directives between November 19, 1997 and February 27, 2001. Shenoy was alleged to have directly entered into a lease agreement with Trais Investment Limited to make periodical payments of rentals of US $5 000 per month and made a total payment of US $191 000 for an empty building not used by UBZ but owned by Shenoy himself without written approval of BOZ.\footnote{529}

Passing the sentence, Magistrate Chanda said it was important for the courts in Zambia to punish offenders who committed such serious crimes as the quartet had been found guilty of.\footnote{530} Magistrate Chanda observed that a lot of foreigners were flouting Zambian laws and regulations and that, in response to this escalating problem, she was compelled to jail the quartet for 12 months so that the stiff sentence serves as a warning to would-be offenders.\footnote{531} In her ruling, Magistrate Chanda noted:

> Considering the extenuating circumstances, a lot of money was remitted or externalised, hence it has contributed to weakening the economy. I, therefore, sentence you to 12 months' imprisonment with hard labour.\footnote{532}

From the foregoing, it is clear that some money laundering cases in Zambia have nothing to do with drug trafficking. On the contrary, an increasing number of cases have to do with fraud which is principally financial sector-based. It could explain why the Zambian government found that section 22 of the Narcotics Drugs and Psychotropic Substances Act 1993, on its own, was not adequate to constitute the legislative framework for combating money laundering in Zambia, and that a separate piece of legislation was needed to fight money laundering more effectively. Elsewhere, I have highlighted some international instruments, covenants and initiatives that also inspire the fight against money laundering in Zambia.\footnote{533} Some of these instruments are applicable to Zambia while others are not. For example, in the banking sector in Zambia, the Basel Principles on the Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering (1988), the Basel Committee on Banking Supervision's Guide on Customer Due Diligence for Banks (2001), and the Wolfsberg Group Global Anti-Money Laundering Guidelines for

\footnote{529}{As above.}
\footnote{530}{As above.}
\footnote{531}{As above.}
\footnote{532}{As above.}
Private Banking (2000) all provide important sources of the law for fighting and preventing money laundering in Zambia.

Modern financial systems, as McDowell observes, in addition to facilitating legitimate commerce, also allow criminals to order the transfer of millions of dollars instantly using personal computers and satellite dishes. According to McDowell, because money laundering relies to some extent on existing financial systems and operations, the criminal's choice of money laundering vehicles is limited only by his or her creativity. Indeed, money is laundered through currency exchange houses, stock brokerage houses, gold dealers, casinos, automobile dealerships, insurance companies, trading companies, private banking facilities, offshore banking, shell corporations, free trade zones, wire systems, and trade financing. The various techniques used by money launderers can be placed into three main categories: (a) banking; (a) non-bank institutions; and (c) non-financial businesses.

In the banking sector, which is our main concern in this chapter, the common techniques used for laundering money include (i) large deposits and transfers; (ii) false name accounts and accounts of friends, relatives and cronies; (iii) smurfing (electronic structured transactions of electronic cash); (iv) shell and front companies, usually offshore, for layering transactions; (v) lawyers, accountants, consultants, trustees, fiduciaries; (vi) collection accounts; (vii) acquiring compliant banks; (viii) payable through accounts; (ix) loan back arrangements; (x) telegraphic transfers; (xi) bank drafts, money orders, cashier's cheques; (xii) cash deposits and withdrawals, business transactions, smuggling across borders; (xiii) travellers' cheques; and (xiv) internet banking and electronic purse accounts.

Before we dissect intricate aspects of Zambia's Prohibition and Prevention of Money Laundering Act 2001, let us take a closer look at provisions of the Bank of Zambia Anti-Money Laundering Directives 2004 since the focus of this chapter is on the central bank's role in preventing and fighting money laundering in the banking sector.

3 The Bank of Zambia Anti-Money Laundering Directives 2004

In response to the Sani Abacha money laundering and corruption scandal that erupted in August 2000, 11 international banks agreed,
in October 2000, to special anti-money laundering guidelines for private banking, known as the Wolfsberg Principles. Guidance for dealing with ‘Politically Exposed Persons’ was also issued, in October 2001, by the Basel Committee on Banking Supervision, in its report ‘Customer Due Diligence for Banks’.539

The above quote shows the magnitude of international efforts to fight money laundering all over the world, whether it be money laundering perpetuated by a culture of bank secrecy,540 or money laundering in secrecy jurisdictions,541 or money laundering through the use of private banking,542 or money laundering in jurisdictions that have lax anti-money laundering controls. In Zambia, in compliance with the statutory requirement in section 12(4) of the Prohibition and Prevention of Money Laundering Act 2001, the Bank of Zambia, as a central bank and as a Supervisory Authority under the Prohibition and Prevention of Money Laundering Act 2001,543 has passed the Bank of Zambia Anti-Money Laundering Directives 2004.

540 See below on ‘bank secrecy’.
541 See below on ‘secrecy jurisdictions’. Examples of secrecy jurisdictions include jurisdictions such as Switzerland where bank secrecy is common.
542 According to the FreeDictionary.com (see Farlex TheFreeDictionary.com available at http://encyclopedia.thefreedictionary.com/Private+banking (accessed 24 February 2005), ‘private banking is a term which covers ‘...services which banks give to individuals usually with liquid wealth of above 1 million dollars, and also the division of that entity which does checking, savings, and loans for that clientele. The word "private" in private banking is mostly a reference to minimising taxes via careful allocation of assets. Offshore bank accounts can be used for this purpose. Also it alludes to private equity, which is essentially share ownership of a company not available for the general public to buy in a stock market. Private banking clients are usually given special opportunities to invest in these, along with special IPO opportunities. Originally, however, the use of the word “private” as in “private client” comes from the fact that originally these type of services were sold by major intuitional and investment banks, who usually did not work with private individuals (instead normally working with public corporations). Private banking usually combines trust services, investment services, banking services, and tax services. The largest private bank is Union Bank of Switzerland. The most profitable private bank is the private banking division of Merrill Lynch. As of 2000, the amount on deposit with private banks in the world was about US $13 trillion. To put that in perspective, the amount of assets that the largest United States bank has was about $1.3 trillion, and the total amount of printed cash in the United States at the time was $6 trillion. Switzerland is the major location of private banking. As of 2003, it has about 2 trillion in assets under management, which is about one third of all offshore money.’
543 See the Prohibition and Prevention of Money Laundering Act 2001, sec 2. The Registrar of Banks and Financial Institutions, appointed under the Banking and Financial Services Act 1994, as a Supervisory Authority in the banking industry, operates through (and is housed at) the Bank of Zambia. In short, the Bank of Zambia is, in principle, a Supervisory Authority. For an elaborate discussion regarding the appointment and powers of the Registrar of Banks and Financial Institutions, see KK Mwenda ‘Legal aspects of banking and financial services
Section 12(4) of the Prohibition and Prevention of Money Laundering Act 2001 places a statutory obligation on all organisations that qualify as a supervisory authority under section 2 of that Act to issue anti-money laundering directives. These directives may be shared with the Anti-Money Laundering Investigations Unit so that the Anti-Money Laundering Investigations Unit vets and approves them, since all institutions regulated by the Supervisory Authority are bound by the said directives.\textsuperscript{544} And the directives serve as tools for preventing and detecting money laundering.\textsuperscript{545} Directive 23 of the Bank of Zambia Anti-Money Laundering Directives 2004 states, for example, that any person who contravenes any of the directives under the Bank of Zambia Anti-Money Laundering Directives 2004 shall be guilty of an offence under section 13 of the Prohibition and Prevention of Money Laundering Act 2001. The penalty in section 13 of the Prohibition and Prevention of Money Laundering Act 2001 is a fine not exceeding 200 000 penalty units.

As a general rule, the Bank of Zambia Anti-Money Laundering Directives 2004 apply only to banks and financial institutions regulated and supervised by the Bank of Zambia.\textsuperscript{546} This means that other supervisory authorities, such as the Registrar of Building Societies, the Registrar of Co-operatives, the Registrar of Insurance, the Securities and Exchange Commission, the Registrar of Companies, the Commissioner of Lands, the licensing authority for casinos, and any other body established by law as a supervisory authority, should promulgate their own anti-money laundering directives.\textsuperscript{547}

3.1 Customer due diligence and other obligations

Under the Bank of Zambia Anti-Money Laundering Directives 2004, a regulated institution falling under the supervisory mandate of the Bank of Zambia\textsuperscript{548} is required to have in place anti-money laundering measures and to adopt such practices as are necessary for the detection and prevention of money laundering.\textsuperscript{549} Further, a regulated institution must request its individual customers, when they are opening an account, establishing business relations, or conducting


\textsuperscript{544} See the Prohibition and Prevention of Money Laundering Act 2001, sec 12(4).

\textsuperscript{545} As above.

\textsuperscript{546} See the Bank of Zambia Anti-Money Laundering Directives 2004, directives 3 & 4.

\textsuperscript{547} See the exact wording of sec 12(4) of the Prohibition and Prevention of Money Laundering Act 2001.

\textsuperscript{548} See generally Mwenda (n 545 above).

\textsuperscript{549} Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 5.
business transactions with it, to produce the following documents for identification purposes:

(a) in the case of a Zambian national, a national registration card or valid passport or driver’s licence; or

(b) in the case of a foreign national, a national registration card and a valid passport with, where applicable, a duly issued visa. 550

However, some of the problems associated with this directive include the fact that, in the case of a Zambian national, it is not clear whether the term ‘national registration card’ refers to a Zambian national registration card or a foreign national registration card. It is very possible that a Zambian national can lawfully acquire a foreign national registration card, say, where he or she is a fixed-term resident or a permanent resident in a foreign country. The Zambian citizen need not renounce his or her Zambian citizenship to acquire the status of a fixed-term resident or a permanent resident in a foreign country. So, what type of a national registration card are we talking about here? The same reasoning applies to the term ‘a driver’s licence’. Are we talking about a Zambian driver’s licence or a foreign driver’s licence? And would it not be helpful if the directive were to specify also that the driver’s licence should be valid? Can an individual rely on an expired driver’s licence as proof of his or her identity?

When it comes to a foreign national, again, it is not clear whether the term ‘national registration card’ refers to a national registration card issued by the Zambian government to a foreigner residing in Zambia or to a foreign national registration card issued by a foreign government. The Bank of Zambia Anti-Money Laundering Directives 2004 should have stated precisely which of the two positions is being referred to. Furthermore, should the ‘duly issued visa’, in the case of a foreign national, be a visa to enter Zambia or one to enter a foreign country? It is not enough to state simply that a foreign national must have a duly issued visa. Indeed, what is a ‘duly issued visa’ for purposes of customer identification? What about the case if the visa was duly issued by a country other than Zambia, and meant for the visa holder to enter that country? And what about the case if the visa was duly issued for the visa holder to enter Zambia, but the visa has since expired? It is matters such as these which present themselves as constraints on the regulatory framework for combating money laundering in Zambia. The Bank of Zambia Anti-Money Laundering Directives 2004 should have stated the name of the visa issuing country—that is, Zambia, in this case. Secondly, the directives should have provided that the visa, irrespective of whether or not it

550 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 6(1).
was duly issued, should not have expired at the time the customer identification is being carried out.

Directive 6(2) of the Bank of Zambia Anti-Money Laundering Directives 2004 points out that when a regulated institution, in the course of its business relationship with a customer, has doubts as to the identity of the customer, the regulated institution should require the customer to renew his or her identification or to provide further identification documents. And with the exception of a bureau de change, any institution regulated by the Bank of Zambia should identify the beneficial owner of an account opened with it and any person using remittance and safe custody facilities. Where such regulated institution fails to ascertain the identity of a beneficial owner of an account opened with it or the identity of a person using remittance and safe custody facilities, the regulated institution should make a report to the Anti-Money Laundering Investigations Unit. Further, with the exception of a bureau de change, any institution regulated by the Bank of Zambia should establish clear procedures on how to identify a customer who applies to open an account through the internet or other electronic means, and should not permit a customer to establish a business relationship through this means unless the identity documents of the customer have been verified or confirmed. Here, it is not clear who bears the responsibility of verifying and confirming these documents. Is it the Bank of Zambia or the regulated institution itself that should bear the responsibility of confirming and verifying the documents?

Generally, in a number of cases that require institutions regulated by the Bank of Zambia to verify individual customers' names and addresses, bureau de change institutions are exempt from complying with such requirements. As a general rule, all institutions regulated by the Bank of Zambia, other than bureau de change institutions, should verify the names and addresses of their individual customers by any one or more of the following methods:

(a) obtaining a reference from a professional, an employee of the individual customer, a known customer of the regulated institution, or a customary authority that knows the applicant, all of whom should have known the applicant for not less than one year;

551 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directives 6(3) & 6(5).
552 As above.
553 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directives 6(4) & 6(5).
554 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 7A.
555 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 7B.
556 The term 'customary authority' is defined in directive 2 of the Bank of Zambia Anti-Money Laundering Directives (n 548 above) as a body with whom a person has or had business dealings as a customer of that body.
(b) in the case of non-residents, obtaining references from the individual customer's foreign banks, where possible;
(c) conducting a credit reference agency search;
requesting an original or certified true copy of recent council or applicable rates or utility bill receipt;
(d) using one of the address validation or verification services on offer; or
(e) in addition to one or more of the above, doing all things that the regulated institution may deem necessary to verify the documentation submitted by the applicant.

Here, a bank's over-reliance on third parties that it knows very well to introduce clients to it, or on these introductions to be made by existing customers and other banks, can be dangerous, especially where the third parties have, themselves, very lax internal controls of screening the clients that they introduce to the bank. Although a bank may choose to rely on third-party introductions, the onus of verifying the particulars of the client being introduced to the bank by a third party rests with the bank itself. To mitigate risks, we propose that banks and other financial institutions should establish a risk management system that vets the 'know your customer' and 'due diligence' standards of the introducer. In short, the introducer's internal controls and risk management system should be acceptable to the bank. That way, there will be less likelihood of the introducer being complacent or less diligent in screening the clients it introduces to the bank.

As a general rule, where a corporate body opens an account with an institution regulated by the Bank of Zambia, and the regulated institution is not a bureau de change, then that regulated institution should verify the legal existence of the corporate body and identify the directors, the beneficial owners and the management of that corporate body.557 The regulated institution should also obtain the following information and documentation from the corporate body before allowing it to open an account:

(a) a certified copy of the certificate of incorporation or equivalent, details of the registered office and the place of business;
(b) details of the nature of the corporate body's business, the reason for the account being opened, an indication of the expected turnover, the source of funds, and a copy of the last available accounts, where applicable;
(c) where there is more than one signatory to the account, satisfactory evidence of the identity of all the signatories;

557 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 8(1).
(d) a certified copy of the resolution of the Board authorising the account signatories;
(e) a certified copy of powers of attorney, or any other authority, affecting the operation of the account, given by the directors in relation to the corporate body; and
(f) such other additional documents as the regulated institution may deem necessary for this purpose. 558

Where a corporate body intends to establish a business relationship or conduct a specific business transaction with an institution regulated by the Bank of Zambia — with the exception of business relationships or business transactions with a bureau de change — the regulated institution should obtain the following information and documentation from the corporate body prior to establishing the business relationship or business transaction:

(a) the corporate body’s certificate of incorporation or equivalent;
(b) details of the registered office and the place of business of the corporate body;
(c) details of the nature of the corporate body’s business,
(d) the source of funds of the corporate body, and a copy of the last available accounts, where applicable; and,
(e) such other documents as the regulated institution may deem necessary for this purpose. 559

Further, there is a general obligation on all institutions regulated by the Bank of Zambia, except bureau de change institutions, that whenever a person is opening an account for and on behalf of a trust, a regulated institution should endeavor to know and understand the structure of the trust and identify the trust owners sufficiently so as to determine the provider and source of funds and the controlling authority of the funds. 560 Where an account is opened or a business transaction is conducted on behalf of a trust, the regulated institution should request:

(i) the same information that is required in the case of verifying corporate bodies’ names and addresses, 561 with ‘necessary modifications’;
(ii) details which prove to the satisfaction of the regulated institution, the identity of the beneficial owner or owners; and,

558 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 8(2).
559 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 8(3).
560 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 9(1).
561 See above.
(iii) such other information as may be required to demonstrate the provider and source of funds and the controlling authority of the funds in respect of the trust. 562

It is, however, not clear what is meant by 'necessary modifications'. Who determines what constitutes 'necessary modifications'? And is there any objective standard by which we can distinguish what is 'necessary modifications' from what is not?

Suffice it to say, all institutions regulated by the Bank of Zambia, including bureau de change institutions, should maintain a business transaction record for a period of ten years after termination of the business transaction with the customer. 563 We have already examined the statutory definition of a 'business transaction', as provided for in section 2 of the Prohibition and Prevention of Money Laundering Act 2001. That same statutory provision goes on to say a 'business transaction record,' in relation to a business transaction,

includes (a) the identification record of all the persons party to that transaction; (b) a description of that transaction sufficient to identify its purpose and method of execution; (c) the details of any bank account used for that transaction, including bank, branch and sort code; and, (d) the total value of that transaction.

Further, all institutions regulated by the Bank of Zambia, including bureau de change institutions, are required to keep copies of identification records for a period of ten years after termination of the business transaction with the customer. 564 Identification records are defined, under the Prohibition and Prevention of Money Laundering Act 2001, as follows:

(a) Where the person is a corporate body, the details of -

(i) the certificate of incorporation;

(ii) the most recent annual return to the Supervisory Authority; or

(b) In any other case, sufficient documentary evidence to prove to the satisfaction of a financial institution that the person is who that person claims to be; and for these purposes 'person' shall include any person who is a nominee, agent, beneficiary or principal in relation to a business transaction. 565

563 As above.
564 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 10(1).
As a general rule, all institutions regulated by the Bank of Zambia, including *bureau de change* institutions, are required to keep the records described above by way of original documents in the form of hard copies or by using electronic storage devices.\(^{566}\) Where these records relate to an ongoing investigation or business transaction, which has been the subject of a disclosure, the regulated institution should retain those records, after the ten year period, until, in the case of an ongoing investigation, the law enforcement agencies confirm that the investigation has been closed or completed, as the case may be, or, in the case of an on-going business transaction, the regulated institution confirms that the business transaction has been completed.\(^{567}\) The two records referred to above will be sufficient to permit a reconstruction of individual business transactions, including the amounts and types of currency involved, if any, so as to provide, if necessary, evidence for prosecution of criminal conduct.\(^{568}\)

3.2 Reporting suspicious activities and suspicious transactions

As a general rule, all institutions regulated by the Bank of Zambia, including *bureau de change* institutions, are under an obligation to report to the Anti-Money Laundering Investigations Unit any suspicious transactions or suspicious activities by any of its customers.\(^{569}\) And if the Anti-Money Laundering Investigations Unit requests more information, the reporting institution should provide it with copies of the relevant documents while retaining the originals.\(^{570}\)

Interestingly, the Bank of Zambia Anti-Money Laundering Directives 2004 do not define what amounts to 'suspicious activities', but merely allude to examples of suspicious activities in the First Schedule to the Directives. By contrast, the term 'suspicious transactions' is defined in Directive 2 of the Bank of Zambia Anti-Money Laundering Directives 2004 as

\[\text{a transaction which is inconsistent with a customer's known legitimate business or personal activities or with the normal business for the type of account which the customer holds, and includes, but is not limited to, the activities listed in the First Schedule hereto.}\]

In essence, this means that the definition of suspicious transactions is broader in scope and includes examples of suspicious activities listed in the First Schedule to the Bank of Zambia Anti-Money Laundering

\(^{566}\) Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 10(2).
\(^{567}\) Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 10(3).
\(^{568}\) Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 10(4).
\(^{569}\) Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 11(1).
\(^{570}\) As above.
Directives 2004. The First Schedule to the Directives details out some examples suspicious activities, listing them under the following 11 sub-headings: (a) suspicious customer behaviour; (b) suspicious identification circumstances; (c) suspicious cash transactions; (d) suspicious wire transfer transactions; (d) suspicious safe deposit box activity; (e) suspicious activity in credit transactions; (f) suspicious commercial account activity; (g) suspicious trade financing transactions; (h) suspicious investment activity; (i) suspicious deposits; (j) miscellaneous suspicious customer activity; and (k) suspicious employee activity.

As a general rule, a person making a suspicious transaction report should not disclose to any unauthorised person that such a report is being, has been, or is about to be made. This directive reinforces section 11 of the Prohibition and Prevention of Money Laundering Act 2001 which, as we saw earlier, deals with the offence of tipping off a third-party or a suspected money launderer. The offence of tipping off covers also situations where a statement is issued to the public media, resulting in the tipping off of a suspect. Thus, regulated institutions should exercise care and reasonable skill in the manner in which they respond to public media inquiries on money laundering matters. It is a requirement of the Bank of Zambia that all employees of institutions regulated by the Bank of Zambia should swear an oath of secrecy administered by a commissioner of oaths. The underlying objective behind this directive is to reduce the prospects or likelihood of employees tipping off suspected money launderers.

Furthermore, an employee of an institution regulated by the Bank of Zambia should not disclose to a customer that the customer is being, has been or is about to be investigated for money-laundering activities. This directive also reinforces the statutory rule against tipping off suspected money launderers. But, then, the employee can go ahead and report to a principal officer of the regulated institution or the Anti-Money Laundering Investigations Unit any money-laundering offence in which the employee himself is involved. However, let us take a more reasoned look at this directive. What happens if the employee makes suspicious transactions report or a suspicious activities report, and then the principal officer decides to sit on the report because he (ie the principal officer) realises that he is implicated in the report? Should the principal officer be allowed to frustrate such reports? Or should the principal officer be allowed to intimidate employees from making these reports if the principal officer realises that the report, if made, would implicate either him

571 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 11(2).
572 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 11(3).
573 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 20.
574 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 21.
(i.e., the principal officer), other senior managers, a prominent client, a notable business partner, or individuals falling in the definition of politically exposed persons (PEPs),[575] such as a Cabinet Minister or a son of the President? Our proposal here is that a policy or directive which not only permits, but also encourages employees to report directly to either the Money Laundering Reporting Officer of the regulated institution or the Anti-Money Laundering Investigations Unit, any suspicious activities or suspicious transactions, should be developed. Apart from seeking a normal day-to-day business clarification on a particular transaction or a series of transactions or activities, the reporting employee need not inform his line manager or any other senior officers in the regulated institution that he intends to submit a suspicious transaction report or a suspicious activities report to the relevant authorities. Further, a policy or directive

575 The term PEPs refers to individuals who are or have been entrusted with prominent public functions in a particular country. The Financial Action Task Force on Money Laundering (FATF), which is an international organisation, has issued a revised set of enhanced measures meant to target specifically the risk posed by PEPs. See FATF Report on Money Laundering and Terrorist Financing Typologies 2003-2004, (Paris, FATF 2004) 18, available Online at http://www1.oecd.org/fatf/pdf/TF2004-en.PDF (accessed 20 February 2005). Examples of PEPs include heads of state, heads of government, cabinet ministers, senior politicians, senior government officials, judicial or military officials, senior executives of state owned enterprises, important political party officials, and family members or close associates of PEPs. The FATF Report observes (18): 

"Because of the special status of PEPs—politically within their country of origin or perhaps diplomatically when they are acting abroad—there is often a certain amount of discretion afforded by financial institutions to the financial activities carried out by these persons or on their behalf. If a PEP becomes involved in some sort of criminal activity, this traditional discretion given to them for their financial activities often becomes an obstacle to detecting or investigating crimes in which they may be involved ... the sources of funds that a PEP may try to launder are not only bribes, illegal kickbacks and other corruption-related proceeds but also may be embezzlement or outright theft of state assets or funds from political parties and unions, as well as tax fraud. Indeed, in certain cases PEPs may be directly implicated in other types of illegal activities such as organized crime or narcotics trafficking ... Besides the use of third parties, PEPs involved in moving or concealing illegal proceeds generally do so by funneling the funds through networks of shell companies or offshore banks in locations outside his or her country of origin that are not likely to divulge details of relevant transactions. In other cases, financial operations may be concealed behind various other types of opaque legal arrangements such as trusts. Again, the ability of a financial institution to conduct full customer due diligence and apply know your customer principles in this instance is severely restricted ... According to one FATF member, there are two principal ways in which to detect the illegal financial activities of a PEP. The first is when there is a change in government in the home country of the PEP and his or her illegal activities are revealed by the successor regime. While this may be clearest available indicator, it is not completely reliable. In some instances, accusations of illegal or corrupt practices by the new government represent a 'political settling of scores.' The second way that a PEP's illegal financial operations might be detected is through suspicious or unusual transactions in which persons acting on his or her behalf may be involved ... Sometimes investigations may be hampered by specific factors associated with PEPs. The most important of these, according to one of the participating experts, is the lack of necessary 'political support', especially when the investigation appears to show connections between the foreign PEP and senior officials in the government where the investigation is taking place.
should be developed to protect the privacy and identity of the whistleblower so that he or she is saved from possible vengeful acts or malicious retribution at the hand of the accused persons.

3.3 The Money Laundering Reporting Officer

We have already defined the term Money Laundering Reporting Officer. Here, suffice it to say that, although there are not many banks and financial institutions in Zambia that have Money Laundering Reporting Officers, Directive 12(1) of the Bank of Zambia Anti-Money Laundering Directives 2004 directs that a Money Laundering Reporting Officer should be a person at management level in the regulated institution. The importance of this directive lies in the fact that for a Money Laundering Reporting Officer to be effective and independent and, also, so that he or she can be protected from possible intimidation and harm from culpable members of the management team, the position of Money Laundering Reporting Officer should be at management level.

That said, there are not many individuals in Zambia with professional credentials or academic qualifications in matters of money laundering. Although a handful of ambitious accountants, bank supervisors, financial services regulators, economists and lawyers have jumped on the band wagon, pretending to be experts on anti-money laundering, most of these individuals do not possess the requisite knowledge and expertise regarding matters of anti-money laundering. Besides, most of them do not even have internationally recognised professional certifications in anti-money laundering matters and are, thus, learning the hard way, plodding the dark in search of elusive answers about complex issues of anti-money laundering. There is a need for supervisory authorities and regulated institutions in Zambia to engage their employees in more training on matters of anti-money laundering. To this end, it is expected that this chapter will serve as a lasting and authoritative text on matters of anti-money laundering in Zambia and also other regions.576 As noted in the preface, this chapter is certainly the first chapter on Zambia to

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576 The author of this book is a member of two leading international bodies responsible for professional training in anti-money laundering matters: the International Compliance Association, based in the United Kingdom, and the Association of Certified Anti-Money Laundering Specialists, based in the United States. He also holds, in addition to a Higher Doctorate degree in law (LLD), a PhD in law, and several scholarly publications in the area of financial services regulation, a number of professional qualifications in the area of anti-money laundering and compliance. He is, therefore, well placed to put across the views
bring out such critically and analytically incisive perspectives, with fresh and original contributions, on the jurisprudence relating to crimes of money laundering.577

Under Directive 12(2) of the Bank of Zambia Anti-Money Laundering Directives 2004, a Money Laundering Reporting Officer in an institution regulated by the Bank of Zambia, including a Money Laundering Reporting Officer in a bureau de change, if at all one ever exists in Zambia, is required:

(a) to keep a register of all reports made by employees of the regulated institution and of all reports that the officer makes to the Anti-Money Laundering Investigations Unit;

(b) on written request by the law enforcement agencies,

(i) to give them an acknowledgment receipt of the reports, from the Anti-Money Laundering Investigations Unit;

(ii) to make available to the law enforcement agencies copies of the reports he/she made to the Anti-Money Laundering Investigations Unit and those made to the Money Laundering Reporting Officer by employees of the regulated institution; and,

(c) after receiving a report in terms of Directive (13),578 to evaluate promptly whether or not there are reasonable grounds for believing that a customer has been engaging in illegal activities or crime, and if after such evaluation, the Money Laundering Reporting Officer finds that such grounds exist, the Money Laundering Reporting Officer should report the case immediately to the Anti-Money Laundering Investigations Unit, using a form prescribed in the Second Schedule to the Bank of Zambia Anti-Money Laundering Directives 2004.

As a general rule, Directive 13 of the Bank of Zambia Anti-Money Laundering Directives 2004 requires an employee of an institution regulated by the Bank of Zambia, including any bureau de change, to


578 See below.
report promptly to a Money Laundering Reporting Officer of that institution all cases where:

(a) the employee becomes aware, has knowledge or suspects or has reasonable grounds to believe, that a customer has been or is involved in an illegal activity or crime; or

(b) a customer in respect of whom the employee becomes aware, has knowledge or suspects or has reasonable grounds to believe, that another customer has been engaging in illegal activities or crime, deposits, transfers or seeks to invest funds or obtain credit against the security of funds obtained from such illegal activities or crime.

In the next chapter, when we examine provisions of the Prohibition and Prevention of Money Laundering Act 2001, we will look more closely at the judicial interpretation of words such as knowledge and suspects as well as phrases such as reasonable grounds to believe. Here, suffice it to say, an institution regulated by the Bank of Zambia, including a bureau de change, should ensure that all employees concerned with the holding, receipt, transaction and or investment of funds, whether in cash or otherwise, obtained or suspected to have been obtained from illegal activities or crime, or the making of loans against the security of such funds are aware of the procedures set out in the Bank of Zambia Anti-Money Laundering Directives 2004.  

3.4 Co-operation with law enforcement agencies

As a general rule, all institutions regulated by the Bank of Zambia are required to co-operate with law enforcement agencies to facilitate the exchange of information relating to money laundering.  

Also, these institutions should abide by any law requiring the provision of information to law enforcement agencies to assist the agencies in conducting investigations. However, no act, matter or thing done by a director, a principal officer or an employee of an institution regulated by the Bank of Zambia or an act or matter or thing done by any other person in the exercise or performance or purported exercise or performance, in good faith, of any power, duty or function under the Bank of Zambia Anti-Money Laundering Directives 2004 will give rise to legal action, a claim, a liability suit or demand against the person concerned.  


581 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 15(1)(b).

582 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 15(2).
we saw earlier, grants judicial immunity to officers reporting, investigating or prosecuting cases of money laundering.

3.5 Obligations of the board, the Money Laundering Reporting Officer and principal officers of institutions regulated by the central bank

The board and principal officers of any institution regulated by the Bank of Zambia are required to put in place an anti-money laundering programme consisting of anti-money laundering measures and practices that should be used to detect and prevent the offence of money laundering.\textsuperscript{583} And all other employees of the regulated institution should be made familiar with the anti-money laundering programme so that they, too, can comply with the programme.\textsuperscript{584} The anti-money laundering measures and practices must cover, among other things, the following:

(a) the development of internal policies, procedures and controls with due regard to the risks posed by money laundering;

(b) the establishment of ‘know your customer’ procedures, which should include knowing the customer’s business, establishing systems that would recognise suspicious activities and having in place internal reporting procedures of suspicious transactions;

(c) the appointment of Money Laundering Reporting Officers;

(d) the establishment of a sound anti-money laundering compliance policy which should be reviewed by the regulated institution annually and approved by the Bank of Zambia;

(e) procedures to be followed by directors, principal officers, officers and employees of a regulated institution in the conduct of business of the regulated institution;

(f) instructions given to directors, principal officers, officers and employees of a regulated institution on the prevention of the use of the regulated institution for the purpose of engaging in activities of money laundering; and

(g) training of directors, principal officers, officers and employees of a regulated institution for the purpose of enabling them to identify business transactions which may relate to the commission of the offence of money laundering.\textsuperscript{585}

The anti-money laundering measures and practices listed above constitute the minimum and mandatory requirements that an institution regulated by the Bank of Zambia should include in its anti-

\textsuperscript{583} Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 16(1).
\textsuperscript{584} As above.
\textsuperscript{585} Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 16(2).
money laundering programme. Indeed, the use of the word 'shall', and not the word 'may', in Directive 16(2), which directive reads in part '[t]he measures and practices ... shall include', points to an obligation. However, an institution regulated by the Bank of Zambia can, in addition to addressing these mandatory measures and practices, tailor its anti-money laundering programme to suit the needs of that regulated institution, depending on the size, the resources available and the type of business the regulated institution undertakes.  

Be that as it may, the fulfilment and implementation of the mandatory measures presupposes a culture of promoting acceptable ethical business standards. And a major tool of achieving this goal would be the introduction and implementation of effective and sustainable training programmes to build institutional capacity in both the regulated institutions and the regulator. Also, since the above anti-money laundering measures and practices constitute the mandatory requirements of any anti-money laundering programme under Directive 16(2) of the Bank of Zambia Anti-Money Laundering Directives 2004, each and every institution regulated by the Bank of Zambia, including bureau de change institutions, should, among other things, appoint a Money Laundering Reporting Officer. Any person who contravenes any of the directives postulated in the Bank of Zambia Anti-Money Laundering Directives 2004 will be guilty of a statutory offence under section 13 of the Prohibition and Prevention of Money Laundering Act 2001.

Overall, the functions of a Money Laundering Reporting Officer include preparing for the board of the regulated institution an annual compliance report relating to but not limited to:

(a) changes in legislation or industry rules on money laundering issues;
(b) compliance deficiencies in relation to money laundering; and
(c) the number of internal reports received on money laundering and the percentage of reports that have been submitted to law enforcement agencies.

3.6 Staff training and other obligations

Directive 18 of the Bank of Zambia Anti-Money Laundering Directives 2004 directs all institutions regulated by the Bank of Zambia to train their employees, irrespective of the level of seniority of a particular employee, on what money laundering is and the importance of reporting any suspicious transaction to the Money Laundering Reporting Officer of the regulated institution. And in pursuing this goal, the regulated institution should seek assistance on training from

586 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 19(3).
587 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 17.
the Anti-Money Laundering Investigations Unit.\textsuperscript{588} Also, the regulated institution should draw up a programme for the training of its employees.\textsuperscript{589} The training programme should include, as a minimum, the following mandatory components:

(a) indicators that may give rise to suspicion and the procedures to be adopted when a business transaction is considered to be suspicious;

(b) the training of staff of a regulated institution on how to make a report on suspicious activities;

(c) the identification and prevention of money laundering for employees of the regulated institution who have contact with clients and compliance personnel;

(d) instructions, covering all aspects of money laundering procedures, to those with the responsibility for supervising or managing staff; and

(e) an in-depth training for the money laundering reporting officer on all legislation relating to money laundering and the regulated institution's internal policies on money laundering.\textsuperscript{590}

As in the case of an anti-money laundering programme, in addition to accommodating the mandatory training components noted above, an institution regulated by the Bank of Zambia can tailor its training programme to suit the needs of that regulated institution, depending on the size, the resources available and the type of business the regulated institution undertakes.\textsuperscript{591} The regulated institution should also hold courses at regular intervals of at least annually for its principal officers so as to remind such officers of their responsibilities in relation to money laundering and to raise awareness changes in the anti-money laundering measures and internal procedures.\textsuperscript{592}

3.7 External auditors and gatekeepers

As part of its goal to maintain a safe and sound banking system, the Bank of Zambia postulates that it can invite independent external auditors to conduct a special audit of any institution regulated by the Bank of Zambia on the adequacy of that institution's anti-money laundering measures, practices and the enforcement thereof.\textsuperscript{593} Such a special audit would be conducted at the expense of the regulated institution.\textsuperscript{594} It is, however, not clear what professional or academic qualifications the external auditors should possess. We pray here that accounting and auditing firms, with unknown expertise in matters of

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\textsuperscript{588} Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 18.
\textsuperscript{589} As above.
\textsuperscript{590} Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 19(1).
\textsuperscript{591} Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 19(3).
\textsuperscript{592} Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 19(2).
\textsuperscript{593} Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 22(1).
\textsuperscript{594} As above.
\end{flushleft}
anti-money laundering, should not be allowed to extend their usual business predator appetite, masquerading as they often do, as appropriate and suitable consultants on all matters of business management. That said, the external auditors should report in writing to the Bank of Zambia any finding resulting from any audit, or any finding resulting from any contact by a person with the regulated institution which suggests the commission of the crime of money laundering by that person in the regulated institution. And where such a crime has been or is suspected to have been committed, the Bank of Zambia should take all necessary action to prosecute the crime.

But what would happen in a case of suspected money laundering involving gatekeepers such as accountants and lawyers? Does the Prohibition and Prevention of Money Laundering Act 2001 or the Bank of Zambia Anti-Money Laundering Directives 2004 say anything about such issues? Both the Act and the Directives are largely silent on the need to regulate gatekeepers against money laundering. Indeed, accountants do serve as financial advisers and investment advisers of many banks, financial institutions and individuals. Also, accountants and lawyers do provide trusts and company services to many business houses and these services include company formation and incorporation, providing advice on how to avoid and optimise tax situations, and carrying out powers of attorney on behalf of a customer. But, then, what happens in a situation where accountants or lawyers assist in the commissioning of the offence of money laundering while they are providing such advice to customers or while they are carrying out their usual business functions on behalf of a customer? Should accountants and lawyers be protected by the law in cases where they deliberately and deceivingly choose to hide behind the veil of immunity from prosecution and that against judicial compulsion to disclose confidential client information on the grounds that these accountants or lawyers are carrying out professional functions when, in fact, they are facilitating a scheme of money laundering? Indeed, should an accountant or a lawyer be allowed

595 Bank of Zambia Anti-Money Laundering Directives (n 548 above) directive 22(2).
596 As above.
597 See Patton v United States 281 US 276, 306, 74 L Ed 854, 867 (1930); Funk v United States 290 US 371, 385, 78 L Ed 369, 377 (1933); Williams v Chapman 118 NC 943, 945, 24 SE 810, 811 (1896); and Locke v Alexander 8 NC 412, 417 (1821). In this regard, and specifically with respect to the attorney-client privilege, the United States Supreme Court (see Zolin, 491 US 562, 105 L Ed 2d 484 (quoting Fisher v United States 425 US 391, 403, 48 L Ed 2d 39, 51 (1976))) has stated that 'since the privilege has the effect of withholding relevant information from the fact-finder, it applies only where necessary to achieve its purpose'. See also Ex parte Lipscomb 111 Tex 409, 415, 239 SW 1101, 1103 (1922); Russell v Second Natl Bank of Paterson 136 NJL 270, 278, 55 A 2d 211, 217 (1947); and State v Murvin 304 NC 523, 284 SE 2d 289. At common law, the duty of confidentiality
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to provide financial or legal advice, as the case may be, that facilitates a statutory offence of money laundering by, say, directors of a bank or financial institution without facing any legal sanctions whatsoever? What about criminal funds that have been placed in a client account run by a lawyer on behalf of his client? Can such funds be reached by the Anti-Money Laundering Investigations Unit, or should the lawyer be allowed to protect the funds under the argument that the funds, together with any other information and document in the custody of the lawyer, are protected by a fiduciary duty of confidentiality and the lawyer-client privileged position? What does the Law Association of Zambia (LAZ) have to say, as the mother body of the legal profession and also as the professional body responsible for the regulation of professional ethics in the legal profession? Let us take the example of a recent UK court ruling relating to communications between a lawyer and his client is not absolute. Eg, the privilege does not apply where a client is seeking advice from the attorney in order to commit a crime or to aid someone to commit a crime. If it were, every criminal would first discuss his intentions with his lawyer in order to work out a flawless plan before committing the crime. Without this limitation, the lawyer would not be able to turn in such criminals. However, the lawyer should, in fact, to report such a person's intent to commit a crime. While a lawyer should report future intended crimes by a client, the lawyer cannot and is prohibited from reporting past completed crimes.

598 See In re Grand Jury Proceedings Under Seal 947 F 2d 1188, 1189-91 (4th Cir 1991). In this American case, an accountant was initially hired to provide business and tax assistance. Later, the accountant worked with a client in presenting relevant information to the attorney. The court held that the communications between the client and the accountant, in preparation for communications with the attorney, were protected by the attorney-client privilege. Similar rulings were passed in In re Beiter Co 16 F 3d 929, 939-40 (8th Cir 1994) (holding that communications between an independent consultant hired by a client and a client's lawyer were protected by the attorney-client privilege where the purpose of the communication was to seek legal advice), and McCaugherty v Siffermann 132 FRD 234, 239 (ND Cal 1990) (holding that communications between a client's accountant and a consultant hired by the client were protected by attorney-client privilege). See also United States v Louisville & Nashville Railroad Co 236 US 318 (1915); and PR Rice 'Attorney-client privilege: The eroding concept of confidentiality should be abolished' (1998) 47 Duke Law Journal 853 available at http://www.law.duke.edu/journals/dlj/articles/dlj47p853.htm (accessed 20 February 2005). Also, the International Compliance Association (n 518 above) argues that "...lawyers are attractive because they can offer launderers and their communications with them the protection of legal professional privilege (sometimes referred to as "attorney-client privilege"). Legal professional privilege, which has its foundations in English common law, provides that no legal adviser can be compelled, without the express consent of his client, to disclose statements made to him by his client in professional confidence or to produce documents made in the same circumstances. The attraction of legal professional privilege to money launderers is obvious." See Scott Paper Co v United States 943 F Supp 489, 499-500 (ED Pa 1996) (denying the defendant's claim of attorney-client privilege because it was unclear whether documents for which the defendant sought privilege 'were maintained in files subject to open review by all members of the IRS or whether they were maintained with an expectation of confidentiality'); United States v Kelsey-Hayes Wheel Co 15 FRD 461, 465 (ED Mich 1954) ('It is difficult to be persuaded that these documents were intended to remain confidential in the light of the fact that they were indiscriminately mingled with the other routine documents of the corporation and that no special effort to preserve them in segregated files with special protections was made.').
regarding the plunder of national resources in Zambia and how some British lawyers are alleged to have facilitated the laundering of these funds to foreign bank accounts.

Two London law firms, including one run by Nelson Mandela’s personal UK lawyer, were involved in a conspiracy to launder part of $46m (£23m) ‘plundered’ by a former African president, a high court judge ruled yesterday at the end of a secret four-month trial. 599

The report goes on to say:

Both firms are under investigation by the Serious Fraud Office and the City of London police for handling the proceeds of crime. One insider has described the investigation as the ‘flagship corruption case for sub-Saharan Africa’. In a damning 220-page judgment Mr Justice Peter Smith accused ex-president Frederick Chiluba of Zambia, who left office in 2001, of shamelessly defrauding his people and flaunting his wealth with an expensive wardrobe of ‘stupendous proportions’. The judge reserved his most abrasive remarks for Chiluba, whose corruption trial in Zambia has been repeatedly postponed because of his ill health. He refused to give evidence to the court. Mr Justice Smith singled out as ‘the most telling example of corruption’ his $500 000 purchase of hundreds of suits and monogrammed shirts from an exclusive boutique in Switzerland, as well as 72 pairs of handmade, high-heel shoes to extend his 5ft stature. ‘This was at a time when the vast majority of Zambians were struggling to live on $1 a day and many could not afford more than one meal a day. The people of Zambia should know that whenever he appears in public wearing some of these clothes, he acquired them with money stolen from them.’ 600

Listing the names of other law firms and lawyers allegedly involved in the financial scam to defraud the Zambian government and people, the report provides as follows:

The lead defendant in the London case is the central London law firm of Meer Care & Desai who handled $10m of the stolen money, which was used to fund lavish lifestyles for Chiluba’s family and friends. Iqbal Meer is Nelson Mandela’s lawyer in London who handled the business end of his best selling autobiography, Long walk to freedom. During the course of the trial Mr Mandela provided a character reference. He is also a trustee, along with David Attenborough, of the Mandela Statue Fund, which last month was given permission to erect the 9ft bronze in Parliament Square. Tony Blair heads the list of honorary patrons. The judge concluded that Meer, despite his ‘long and distinguished career’, must have known that the money was tainted. ‘I am satisfied that no honest solicitor in his position would have done what he did.’ His


600 As above.
unquestioning acceptance of the money – transferred to a London bank account by the Zambian intelligence service – was ‘classic blind eye dishonesty’. After the judgment hearing, which was unusually broadcast by video link to the High Court in Lusaka, Meer’s lawyers said: ‘Mr Meer is disappointed with the outcome. He maintains that he acted honestly at all times and he is consulting with his legal advisers regarding an appeal.’ His partner, Naynesh Desai, is the lawyer of choice for a stellar list of international cricketers, including Ian Botham and Allan Lamb in their libel action against Imran Khan in 1996, the Pakistan all-rounder Wasim Akram, Mark Ramprakash and Mohammed Azharuddin. Mr Desai was not accused as a conspirator and the judge found him an honest witness. But he was made equally liable with Meer under the Partnership Act. The second law firm, Cave Malik & Co, of Edgware, North London, which handled $3m, is run by Bimal Thaker, a British citizen and a close associate of the Chiluba circle who had previously practised in Zambia. The judge described Thaker as ‘a thoroughly dishonest witness’. The case, which was brought by the Zambian government against Chiluba and 19 of his associates, was held entirely in private on the judge’s orders. He made the unusual ruling in order not to prejudice a parallel criminal trial in Zambia where Chiluba and three others are charged with corruption. Part of the Zambian case was funded from a $2m grant for anti-corruption work from the UK’s Department for International Development. The minister, Hilary Benn, hailed the decision ‘an historic victory for the people of Zambia’. The judge was giving judgment in civil proceedings, brought by the Attorney-General of Zambia. Details of precisely how much is recoverable from each defendant will be decided at a later date.601

Let us now turn to the accounting profession. What does the Zambia Institute of Certified Accountants (ZICAS) have to say, as the mother body of the accounting profession and also as the professional body responsible for the regulation of professional ethics in the accounting profession? Are there any standards or codes of practice relating to anti-money laundering for accountants in Zambia?602 As in the case of lawyers in Zambia, where LAZ has not promulgated any major standards or codes of practice relating to anti-money laundering, ZICAS, too, has failed to promulgate major standards or codes of practice relating to anti-money laundering for accountants in Zambia. Both LAZ and ZICAS have not done much in this area when they should have been doing more and taking the lead.

601 As above.
What about the case of financial intermediaries such as stockbrokers and dealers? They also need to be provided with directives or a code of conduct to guide them against committing offences of money laundering. And what about banks and the issue of confidentiality over customer accounts and customer information, especially where examples are cited pointing to practices in jurisdictions such as Switzerland where arguments in favour of non-disclosure are quite strong. How does the Prohibition and Prevention of Money Laundering Act 2001 or the Bank of Zambia Anti-Money Laundering Directives 2004 deal with such matters? Again, both the Act and the Directives are largely silent on the matters at hand. That said, section 50 of the Banking and Financial Services Act 1994 provides as follows:

(1) A bank or financial institution and every director, chief executive officer, chief financial officer, manager and employee thereof shall maintain the confidentiality of all confidential information obtained in the course of service to the bank or institution and shall not divulge the same except:

(a) in accordance with the express consent of the customer, or the order of a court;

(b) where the interest of the licensee itself requires disclosure; or

(c) where the Bank of Zambia, in carrying out its functions under this Act, so requests.

(2) For the purposes of this section, confidential information about a person includes information that is not public, concerning:

(a) the nature, amount or purpose of any payment made by or to the person;

(b) the recipient of a payment by the person;

Art 28 of the Swiss Civil Code protects a bank account holder's right to privacy. This statutory provision codifies the concept of bank secrecy in Switzerland. In that country, the bank account holder's right to privacy over his account extends to both individual account holders as well as businesses. An exception to bank secrecy is, however, made where a report is required pursuant to anti-money laundering legislation in Switzerland. But, bank secrecy in Switzerland will not be lifted for tax evasion even upon the receipt of a request from a foreign government. As the International Compliance Association (n 518 above) 60 points out: 'The Swiss Supreme Court has ruled that article 28 and the right therein imposes an obligation upon Swiss banks to maintain the privacy of customers. A number of consequences can flow from the violation of the right: a client may sue for damages; a bank may suffer administrative consequences, including the possibility of the loss of its licence, and the bank officer concerned may be criminally prosecuted under article 162 of the Swiss Criminal Code ... Enormous political pressure is now being brought to bear upon Switzerland, where bank secrecy is a product of the peculiarities of both Swiss history and Swiss law, for the country to repeal secrecy laws. In June 2002, the G7 Group of Nations issued a formal warning to Switzerland threatening economic sanctions ... if the laws are not repealed. A restatement by FATF in recommendation 4 of the revised FATF 40 provides that countries should ensure that financial institution's secrecy laws do not inhibit the full implementation of all of the FATF recommendations.'
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(c) the assets, liabilities, financial resources or financial condition of the person; 
(d) the business or family relations of the person; or 
(e) any matter of a personal nature that the person disclosed to the bank in confidence.

(3) Notwithstanding the provisions of any law to the contrary, in any case where evidence of commission of an offence is to be found in the books, accounts or records or a bank or financial institution, such evidence shall not be sought or obtained from the bank or institution otherwise than in accordance with the provisions of any other written law.

From the foregoing, it is clear that a bank or financial institution can be compelled to divulge confidential information regarding its client's bank accounts or business conduct where the client himself or herself has given express consent for the bank to make such disclosure, where there is a court order to that effect, or where the Bank of Zambia, in carrying out its functions under the Banking and Financial Services Act 1994, so requests. But can the Anti-Money Laundering Investigations Unit, as a separate statutory body created by the Prohibition and Prevention of Money Laundering Act 2001, also require a bank or financial institution to divulge such confidential information about the bank's or financial institution's client on the pretext that the Anti-Money Laundering Investigations Unit is carrying out its functions under the Prohibition and Prevention of Money Laundering Act 2001? Here, the Anti-Money Laundering Investigations Unit is not carrying out functions under the Banking and Financial Services Act 1994, but under the Prohibition and Prevention of Money Laundering Act 2001. Clearly, the relevant statutory provisions for banks and financial institutions to disclose client confidential information apply only to situations falling under the Banking and Financial Services Act 1994, but not under any other statute. Further, this statutory requirement for the disclosure of a client's confidential information applies only to situations where there is a court order for such disclosure, where the client himself or herself has given express, but not implied, consent for the bank's disclosure, or where the central bank is carrying out its statutory duties under the Banking and Financial Services Act 1994.

So, what would happen if a credit rating agency or a credit bureau were set up in Zambia? First of all, would such an agency or bureau

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604 See ch 5. 
605 The International Finance Corporation (IFC) Credit bureau knowledge guide (2006) 5 defines a credit bureau as follows: 'A credit bureau is an institution that collects information from creditors and available public sources on a borrower's credit history. The bureau compiles information on individuals and/or small firms,
be situated in the private sector or should it be located in the public sector? And who would own the credit bureau or the credit rating agency, and does such an institution need to be independent from political interference where, say, there are highly indebted politicians who do not want their credit history to be exposed? Likewise, who would own the data that the credit bureau or the credit rating agency collects? Would a bank that provides such data to the credit bureau, for example, claim ownership over the data, or would a consumer whose credit history is being reported to the credit bureau claim ownership? By parity of reasoning, can the credit bureau itself claim ownership over the data? These are some of the thorny legal and policy issues that come with the setting up of a credit bureau or a credit-rating agency.

Generally, any country can have as many credit reporting systems as possible. The fundamental point, however, lies in the soundness, safeness and usefulness of such systems. Closely related to this point, different countries can have different laws for consumer protection and data protection. Also, regarding the issue of where the credit rating agency or the credit bureau should be located, it would all depend on how the agency or bureau is set up and the costs associated with the organisational structure and the location of the bureau or agency as well as the goals and objectives for setting it up.606

In a workshop paper presented at the World Bank in Washington DC on 5 May 2009 (F Montes & S Sankaranarayanan Financial and private sector development: Credit reporting: overview (2009)).5, Montes & Sankaranarayanan observe that while a great number of credit reporting systems are not supervised, this number is increasing lately and banking supervisory authorities and data protection authorities are playing a relevant role. Based on the IFC’s Doing Business 2009 Report, covering a sample of 74 countries, Montes & Sankaranarayanan argue that, where public registries are in existence, the oversight role of credit reporting systems is limited to data protection compliance. However, some countries show a coordinated oversight between different authorities.
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Zambia, the Bank of Zambia observes in its Progress Report on the Implementation of the Financial Sector Development Plan (FSDP) (2004-2009) that the idea of a credit rating agency should be a private sector initiative driven by the Bankers Association of Zambia. But, then, who would supervise the credit rating agency? Should it be left to the market under self-regulation? And would banks and financial institutions be obligated to provide confidential client information to the credit bureau or to the credit rating agency or can these banks and financial institutions decline to do so, citing issues of confidentiality of client information?

Incidentally, the first credit rating bureau to be licensed by the Bank of Zambia to provide credit referencing services in Zambia, the Credit Reference Bureau Africa Limited (CRBAL), was formally launched on 11 January 2007 in Lusaka, Zambia. All commercial banks in Zambia have since signed the Service Level Agreement (SLA) with CRBAL. And the Bank of Zambia issued a directive on 10 December 2008, in order to enhance the usage of the CRBAL, compelling all credit providers to provide credit data to CRBAL and not to grant new loans without reference to the CRBAL. This directive, according to the Bank of Zambia, has resulted in increased


608 In some countries, credit reporting systems are supervised by a government line ministry, such as a Ministry of Trade and Commerce, while in other countries the supervision of credit reporting systems is carried out by institutions such as data protection agencies, banking supervisors or other organisations. See Montes & Sankaranarayanan (n 608 above) 5.

609 According to Montes & Sankaranarayanan (n 608 above) 3, different approaches obtain in different countries regarding the legal framework for credit-reporting systems. While civil law countries have often adopted cross-sector laws, many common law countries tend to rely heavily on contractual and self-regulatory arrangements. According to Montes & S Sankaranarayanan (n 608 above), from around 2002 there has been a proliferation of ad hoc laws on credit reporting systems in the 74 countries covered by the IFC's Doing Business Report 2009. Harmonisation of laws in these countries has been missing and this actually presents a challenge to cross-border data transfer.

610 Some countries have strong bank secrecy laws that can constrain a bank's ability to share credit information on a borrower with a credit bureau or a credit rating agency. To overcome such constraints, the use of 'consent' clauses in agreements between the credit bureau/credit rating agency and the bank would mitigate or eliminate such risks. There are also cases where some jurisdictions restrict data flows to another jurisdiction. In such cases, the restriction could be imbedded in the laws of the data-originating country, or it could be conditioned by certain requirements in the destination country. See Montes & S Sankaranarayanan (n 608 above) 5.

611 See Bank of Zambia Progress Report (n 609 above) 14. The Credit Reference Services (Licensing) Guidelines and the Credit Data (Privacy) Code were gazetted on 30 January 2006, as an interim measure before a substantive law is developed to govern credit reference services.

612 As above.

613 As above.
levels of usage of the CRBAL by all banks and non-bank financial institutions supervised by the Bank of Zambia.\textsuperscript{614}

However, let us step back a bit and assume that the Bank of Zambia did not issue any directives to credit providers as noted above. What would have happened? As a general rule, in situations where a credit rating agency is set up under a secondary piece of legislation, such as under a statutory instrument enacted pursuant to the Banking and Financial Services Act 1994, and the Bank of Zambia has a statutory function under the Banking and Financial Services Act 1994 pertaining to the operations of the credit rating agency, then the Bank of Zambia can require a bank or financial institution to disclose the confidential information about its client. But where the credit rating agency is set up outside the ambit of the Banking and Financial Services Act 1994, or where the Bank of Zambia has no statutory function under the Banking and Financial Services Act 1994 pertaining to the operations of the credit rating agency, then, unless a specific law is passed to provide explicitly for banks and financial institutions to disclose confidential client information to the credit rating agency, or unless some 'consent' clause is imbedded in the relevant agreement between the credit bureau/credit rating agency, on the one hand, and the banks and financial institutions, on the other, it would not be easy to compel these banks and financial institutions to disclose such information.

At common law, the duty of confidentiality owed by banks to their customers, as well as exceptions to this duty, were set out in the case of \textit{Tournier v National Provincial \\& Union Bank of England}.\textsuperscript{615} In that case, it was ruled that banks owe their customers a fiduciary duty of confidentiality, extending at least to information concerning account transactions. This duty of confidentiality extends beyond the date when the banker-customer contract terminated. And exceptions to the duty can be seen where the disclosure is under compulsion of the law, or where there is a duty to the public to disclose, or where interests of the bank require such a disclosure, or where the disclosure is made with the express or implied consent of the customer.\textsuperscript{616} It could be argued, therefore, that section 14 of Zambia’s Prohibition and Prevention of Money Laundering Act 2001, which reads ‘It shall not be unlawful for any person to make any disclosure in compliance with this Act’, falls under one of the

\textsuperscript{614} As above.

\textsuperscript{615} [1924] KB 461.

\textsuperscript{616} As above.
exceptions to the general rule in the Tournier case.\footnote{617} However, it is doubtful if at all this statutory provision can be used to compel a lawyer to divulge information that is protected by the lawyer-client privileged position. Indeed, section 14 does not create a statutory duty on a person to disclose information, but merely offers legal protection where such a person decides, in compliance with the Prohibition and Prevention of Money Laundering Act 2001, to disclose relevant information to the investigating and prosecuting authorities.

4 Conclusion

This chapter has examined the efficacy of the regulatory framework under the Bank of Zambia Anti-Money Laundering Directives 2004. The chapter alluded to problems of money laundering in a number of small banks in Zambia, citing evidence of some court cases that have been decided in Zambia. And, interestingly, on 5 September 2008, the Bank of Zambia issued CB Circular 7 of 2008 to all commercial banks, regarding its policy for ‘Enhanced Security Measures for Bulk Cash Transactions’, covering issues such as access to the Bank of Zambia by

\footnote{617 In the American case of El du Pont de Nemours & Co v Forma-Pack, Inc (Case C-97-36415), No 99 of September Term 1997, available at http://lw.bna.com/lw/19981027/99.htm (accessed 20 February 2005), a US Court of Appeal in the State of Maryland ruled: ‘The attorney-client privilege as applied in judicial proceedings is narrowly construed, whereas the work product doctrine is broader in scope. Leonen v Johns-Manville 135 FRD 94, 96 (D NJ 1990). Indeed, even though it is often referred to as a privilege, the work product doctrine is not a privilege at all, but is ‘merely a requirement that very good cause be shown if the disclosure is made in the course of a lawyer’s preparation of a case.’ City of Philadelphia v Westinghouse Electric Corp 210 F Supp 483, 485 (ED Pa 1962). Second, the work product doctrine is ‘historically and traditionally a privilege of the attorney and not that of the client’. Radiant Burners Inc v American Gas Association 207 F Supp 771, 776 (ND Ill 1962). In contrast, it is the client who is the holder of the attorney-client privilege. Trupp v Wolff 24 Md App 588, 609, 335 A 2d 171, 184 (1975). See also Lynn McLain, Maryland Evidence para 503.1 481-82 (1987) (footnotes omitted). ‘The work product doctrine protects from discovery the work of an attorney done in anticipation of litigation or in readiness for trial. The United States Supreme Court’s decision in the seminal case of Hickman v Taylor 329 US 495, 67 S Ct 385, 91 L Ed 451 (1947), has guided the work product doctrine in both the state and federal courts. When confronted with the work product doctrine, courts must balance the need for efficient litigation through liberal disclosure against the attorney’s responsibility to be a zealous and protective advocate for his or her client. The Hickman court acknowledged the tension of these competing interests when it stated that ‘the discovery provisions are to be applied as broadly and liberally as possible.’ Hickman 329 US 506, 67 S Ct 391, 91 L Ed 460, while also noting that ‘discovery ... has ultimate and necessary boundaries’. 329 US 505, 67 S Ct 392, 91 L Ed 460. With the touchstone of the work product doctrine being that the materials must have been created in preparation for trial, the Hickman court also discussed two different types of attorney work product, fact and opinion. Regarding fact work product, the court stated: ‘No longer can the time-honoured cry of fishing expedition serve to preclude a party from inquiring into the facts underlying his opponent’s case. Mutual knowledge of all the relevant facts gathered by both parties is essential to proper litigation. To that end, either party may compel the other to disgorge whatever facts he has in his possession.’}
Further, the chapter examined the importance of banks and financial institutions instituting anti-money laundering programmes in their workplaces as well as the importance of drawing a distinction between what could be considered privileged information under the common law rule of confidentiality of client information and what simply is criminal conduct. In addition, the 'know your customer' and 'due diligence' dictates of the Bank of Zambia were laid out. It was also pointed out that, in the case of a bank over-relying on third parties that it knows very well to introduce clients to it, or on these introductions to be made by existing customers and other banks, that could be dangerous, especially where the third parties have, themselves, very lax internal controls of screening the clients that they introduce to the bank. A submission was made thus that, although a bank can choose to rely on third-party introductions, the onus of verifying the particulars of the client being introduced to the bank by a third party rests with the bank itself.

The chapter also observed that, although many banks and financial institutions do not yet have Money Laundering Reporting Officers, there is still a need for a pro-active approach to introduce policies and regulations for the protection of whistleblowers who report suspicious transactions or suspicious activities of money laundering to Money Laundering Reporting Officers or the Anti-Money Laundering Investigations Unit. And an inquiry was made on whether accountants or lawyers should be allowed to provide financial or legal advice that facilitates the commission of a statutory offence of money laundering by, say, directors of a bank or financial institution without facing any legal sanctions. Related to this issue was the issue whether criminal funds that have been placed in a client account run by a lawyer on behalf of his client can be shielded from the reach of the Anti-Money Laundering Investigations Unit under the argument that these funds, together with any other information and document in the custody of the lawyer, are protected by the fiduciary duty of confidentiality and the lawyer-client privileged position. The chapter noted that Law Association of Zambia, as the mother body of the legal profession and also as the professional body responsible for the regulation of professional ethics in the legal profession, has not promulgated any meaningful standards on anti-money laundering for the legal profession. Similarly, the Zambia Institute of Certified Accountants (ZICAS), as the mother body of the accounting profession and also as the professional body responsible for the regulation of

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618 See CB Circular 07/2008 signed and issued by Dr Denny Kalyalya, Deputy-Governor, Bank of Zambia, on 5 September 2008.
professional ethics in the accounting profession, has also not promulgated any meaningful standards on anti-money laundering for the accountancy profession. There is an urgent need for these professional bodies to emulate developments in other jurisdictions where anti-money laundering codes have been prepared to regulate the business conduct of the legal and accountancy professions.
LEGISLATIVE FRAMEWORK FOR ANTI-MONEY LAUNDERING UNDER THE PROHIBITION AND PREVENTION OF MONEY LAUNDERING ACT 2001

1 Introduction

This chapter examines the efficacy of the legislative framework for combating and preventing money laundering in the banking sector of Zambia. The chapter is a corollary to the discussion in the preceding chapter, chapter 4, on the efficacy of the Bank of Zambia Anti-Money Laundering Directives 2004. An evaluative and exploratory study is undertaken in this chapter, identifying some weaknesses in the legislative framework. And proposals are made to strengthen the said framework, especially with regard to its applicability to the banking sector. To illustrate, an argument is made that, in the case of money laundering, Zambia should consider introducing techniques such as shifting the burden of proof from the prosecution to the accused and lowering the standard of proof from beyond reasonable doubt to the preponderance of probability.

Although focusing primarily on Zambia, the chapter also examines critical aspects of the common law, as they apply to many other common law jurisdictions, in the fight against money laundering. Zambia's Prohibition and Prevention of Money Laundering Act 2001 provides for the country's principal legislative framework for combating and preventing money laundering.619 This statute also provides for the constitution of the Anti-Money Laundering Authority and the Anti-Money Laundering Investigations Unit.620 Other areas covered by the statute include the disclosure of information pertaining to a suspicion of money-laundering activities by supervisory authorities and regulated institutions; the forfeiture of property of persons convicted of money laundering; international cooperation in investigations, prosecution and other legal processes of prohibiting and preventing money laundering; and, matters connected with or incidental to the foregoing.621 Under the

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620 As above.
621 As above.
Prohibition and Prevention of Money Laundering Act 2001, property that can be caught up by statutory provisions against money laundering include 'moneys and all other property, real or personal, movable or immovable including things in action and other intangible or incorporated property wherever situated and includes any interest in such property'.

2 Supervisory authorities and regulated institutions

Whereas the definition of 'regulated institutions' in the Prohibition and Prevention of Money Laundering Act 2001 refers to an institution regulated by a supervisory authority, such a bank or financial institution, the definition of a 'supervisory authority', under the same statute, refers to the Bank of Zambia through the office of the Registrar of Banks and Financial Institutions as well as to the Registrar of Building Societies, the Registrar of Co-operatives, the Registrar of Insurance, the Commissioner of the Securities and Exchange Commission, the Registrar of Companies, the Commissioner of Lands, the licensing authority for casinos in Zambia, and any other authority that may be established by law as a Supervisory Authority.

3 The Anti-Money Laundering Authority

The Anti-Money Laundering Authority, established under section 3 of the Prohibition and Prevention of Money Laundering Act 2001, is composed of the following eight members: (a) the Attorney-General (who is the Chairperson); (b) the Inspector-General of the Zambia Police Force; (c) the Commissioner of the Anti-Money Laundering Investigations Unit; (d) the Director-General of the Anti-Corruption Commission; (e) the Governor of Bank of Zambia; (f) the Commissioner-General of Zambia Revenue Authority; and (g) two other persons. Each of the eight members is appointed by the Minister pursuant to statutory powers vested in the Minister under the Prohibition and Prevention of Money Laundering Act 2001.

A thin statute, laid out in 14 pages, the Prohibition and Prevention of Money Laundering Act 2001 does not explain whether a member of the Anti-Money Laundering Authority can be asked to step down in cases where he or she is found guilty of gross misconduct or having

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623 As above.
624 As above.
626 As above.
committed serious offences such as money laundering or corruption. Neither does the statute spell out the professional and academic qualifications of the other two persons that the Minister can appoint as members of the Anti-Money Laundering Authority. What about the remuneration of each of the eight members of the Anti-Money Laundering Authority? Are they to be paid salaries or are they to be paid sitting allowances? And where does the budget for such remuneration come from? All these matters are not covered in the Prohibition and Prevention of Money Laundering Act 2001. And who chairs meetings of the Anti-Money Laundering Authority when the Chairperson is absent? The Prohibition and Prevention of Money Laundering Act 2001 is silent on such issues. The statute provides only for the position of Chairperson, and not that of Vice- or Deputy-Chairperson. And the statute is silent on how the Anti-Money Laundering Authority is supposed to conduct its meetings and how it should arrive at decisions when faced with a deadlock of votes.

In general, the main functions of the Anti-Money Laundering Authority are twofold. First, the Authority provides general or specific policy directives to the Commissioner of the Anti-Money Laundering Investigations Unit and the Commissioner gives effect to such directives. Secondly, the Authority advises the Minister on measures required to prevent and detect money laundering in Zambia. A report on efforts to combat money laundering in Zambia reads in part:

The Bank of Zambia (BOZ) and the Drug Enforcement Commission (DEC) are increasingly concerned that money laundering is rampant in the banking industry. They have proposed tightening banking standards through legislative action. The government publicly denounces drug trafficking and supports the ongoing efforts of the autonomous DEC. The DEC has used strengthened narcotics laws this year to confiscate the property of traffickers. The head of the DEC collaborates with his counterparts in the sub-region to improve regional anti-trafficking efforts. Zambia ratified the 1988 UN Convention in 1993. The DEC has increasingly used its legal authority to confiscate property of suspected drug traffickers and money launderers. The courts have not, however, always sustained these confiscations. The DEC and the Ministry of Legal Affairs co-operate with their counterparts in the Southern African Development Council (SADC). The DEC has received training from British anti-narcotics teams and works closely with their British counterparts. Germany, South Africa, and the US have also provided limited assistance to the DEC. Zambia's anti-narcotics master plan was developed in cooperation with the United Nations drug control programme. The Zambian Anti-Corruption Commission (ACC) investigates allegations of

corruption, some of which has touched even the ministers of the government ... corruption allegations have focused on embezzling state funds and not on narcotics related corruption. It is alleged that drug traffickers are taking advantage of the weak enforcement of banking laws and launder drug money in a number of banks and foreign exchange houses. 630

Increasingly, the scourge of money laundering is becoming notorious in Zambia. As another report shows:

The Zambian Drug Enforcement Commission’s investigations have revealed the use by drug traffickers of bank accounts opened with fictitious identity documents to facilitate outgoing laundering. The case of The People v De Souza and Others (unreported) (CCR SSP/8/2001) revolves around the opening of several bank accounts using a false name, between 1 January 1999 and 28 February 2001. The prosecution alleged that, acting in concert, the accused opened several bank accounts in Kitwe and Ndola on the Copper Belt, using fraudulently obtained documentation. Using these accounts, the accused externalised a total of US$1 158 533.20 to the USA and Taiwan. 631

4 The Anti-Money Laundering Investigations Unit

The Anti-Money Laundering Investigations Unit shares the same commissioner with the Drug Enforcement Commission. 632 And the Anti-Money Laundering Investigations Unit comprises the commissioner and officers appointed by the said commissioner. 633 However, the Drug Enforcement Commission is itself a department within the Ministry of Home Affairs of the Republic of Zambia. 634

Section 4 of the Narcotics Drugs and Psychotropic Substances Act 1993 provides:

(1) The Drug Enforcement Commission established under the Dangerous Drugs (Forfeiture of Property) (Special Organisations) (Drug Enforcement

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634 See Narcotics Drugs and Psychotropic Substances Act 1993, sec 4.
Commission) Regulations, 1989, is hereby continued as if established under this Act.

(2) The Commission shall be a department in the Ministry responsible for home affairs and shall be under the control and supervision of the Minister responsible for Home Affairs.

Typologies of how to structure a financial intelligence unit (FIU), such as Zambia’s Anti-Money Laundering Investigations Unit, or where to locate the FIU have differed from one country to another, depending on a host of factors, including the legal system of a country, the size and state of the financial sector, the politics and political climate in a country, the most common predicate offence leading to the offence of money laundering, the availability of financial resources, the availability of housing to accommodate the FIU, the availability of information technology, the availability of properly qualified personnel to run the FIU, and the policy objectives underpinning the regulatory and institutional framework for fighting money laundering. Also, in many countries, the powers and functions of FIUs have differed significantly. Some FIUs only have powers to investigate. Thereafter, the FIU will report any case of money laundering to a law enforcement agency so that the latter institution can prosecute. Such FIUs have no powers to prosecute. Other FIUs have both investigative and prosecuting powers, and a few FIUs end up with administrative powers only or with a hybrid of administrative and investigative powers. FIUs can also have functions which relate to a supervisory and regulatory role, or a consulting and training role.

In some countries, an FIU may be housed within the Ministry of Justice, whereas in other countries, the FIU may be housed within the Ministry of Home Affairs or within the central bank. Various countries have adopted different models. In Zambia, the FIU,

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635 PA Schott Reference guide to anti-money laundering and combating the financing of terrorism (2003) VII-3, observes that the Egmont Group adopted the following definition of an FIU in November 1996: ‘A central, national agency responsible for receiving (and, as permitted, requesting), analysing, and disseminating to the competent authorities, disclosures of financial information (i) concerning suspected proceeds of crime, or (ii) required by national legislation or regulation, in order to counter money laundering.’ The Egmont Group is an informal organisation of financial intelligence units named after the location of the group’s first meeting at the Egmont-Arenberg Palace, Brussels. The goal of the group, as Schott observes, is to provide a forum for FIUs to improve support to their respective national anti-money laundering programmes.

636 See J Thony ‘Various FIU models’ a power-point presentation at a World Bank conference, Building a Financial Intelligence Unit to Meet International AML/CFT Standards, Moscow, Russia, 3-5 December 2002).

637 As above.

638 As above.

639 Schott (n 637 above) VII-7 VII-9.

640 Thony (n 638 above).

641 As above.
though operating somewhat like an affiliate of the Drug Enforcement Commission, has its own investigative and prosecuting powers.642 Generally, the four common models of FIUs recognised by the Egmont Group are as follows: the Law Enforcement Model; the Judicial Model; the Administrative Model; and the Hybrid-Administrative Model.643

In Zambia, as noted earlier, the Commissioner of the Anti-Money Laundering Investigations Unit is also the Commissioner of the Drug Enforcement Commission.644 But why should the Commissioner of the Drug Enforcement Commission serve also as Commissioner of the Anti-Money Laundering Investigations Unit?645 It is clear that, while the Drug Enforcement Commission is regulated by a separate statute from that which regulates the Anti-Money Laundering Investigations Unit and that, while the Drug Enforcement Commission, unlike the Anti-Money Laundering Investigations Unit, falls under the administrative wing of the Minister of Home Affairs, the Anti-Money Laundering Investigations Unit is regulated by a different statute and does not fall under the administrative wing of the Minister. That said, under the Narcotics Drugs and Psychotropic Substances Act 1993, the Commissioner of the Drug Enforcement Commission is appointed by the Republican President.646 But then, by simple cross-referencing, section 2 of the Prohibition and Prevention of Money Laundering Act 2001 states that the Commissioner of the Anti-Money Laundering Investigations Unit is 'the person appointed as Commissioner under the Narcotics Drugs and Psychotropic Substances Act'. It is not, however, clear, under the Narcotics Drugs and Psychotropic Substances Act 1993, what qualifications the Commissioner should hold. The Prohibition and Prevention of Money Laundering Act 2001 does not spell out the minimum professional and academic qualifications of the Commissioner of the Anti-Money Laundering Investigations Unit or the grounds upon which the Commissioner can be removed from office. It is not good enough to state simply that, since the Commissioner of the Anti-Money Laundering Investigations Unit is also the Commissioner of the Drug Enforcement Commission and is appointed by the President under the Narcotics Drugs and Psychotropic Substances Act 1993,647 that statute reposes the powers to define and determine qualifications and terms of appointment of the Commissioner in the Republican President. What happens if the President, in his 'infinite wisdom', appoints a crooked relative of his to the position of Commissioner of the Drug Enforcement Commission?

642 See above. See also the Prohibition and Prevention of Money Laundering Act 2001, sec 6(1).
643 See World Bank (n 638 above).
645 As above.
646 See Narcotics Drugs and Psychotropic Substances Act 1993, sec 4. See also the First Schedule to the Narcotics Drugs and Psychotropic Substances Act 1993.
Should such an abuse of power extend to the Anti-Money Laundering Investigations Unit so that the appointee proceeds, without question, to head the Anti-Money Laundering Investigations Unit? And who can question the powers of the President to appoint, and on what grounds, especially if parliament, with the ratification powers, consists mainly of members of the ruling party?

It should not be forgotten here that our main concern is with qualifications and terms of appointment of the Commissioner of the Anti-Money Laundering Investigations Unit. Although the person serving as the Commissioner of the Anti-Money Laundering Investigations Unit is the same person serving as the Commissioner of the Drug Enforcement Commission, these two roles, as noted above, are regulated by two different statutes. Should the Commissioner, in his role as head of the Anti-Money Laundering Investigations Unit, serve also, like the Commissioner of the Drug Enforcement Commission, at the pleasure of the Republican President? The First Schedule to the Narcotics Drugs and Psychotropic Substances Act 1993 provides as follows:

(1) There shall be a Commissioner of the Commission (ie the Drug Enforcement Commission), whose office shall be a public office, and who shall be appointed by the President on such terms and conditions as the President may determine.

(2) The Commissioner shall not, while he holds the office of Commissioner, hold or discharge the duties of any other office of emolument in the Republic.

(3) The Commissioner may resign upon giving three months’ notice, in writing, to the President or may resign with immediate effect upon paying to the government three months’ basic salary in lieu of notice and the President may, subject to the same conditions, terminate the services of the Commissioner.

(4) The Commissioner may resign upon giving three months’ written notice to the President or paying one month’s salary in lieu of notice.

Paragraphs 2 and 3 of the First Schedule go on to establish the offices of Deputy Commissioner and Acting Commissioner of the Drug Enforcement Commission.

2 Deputy Commissioner

(1) There shall be a Deputy Commissioner of the Commission (ie the Drug Enforcement Commission), whose office shall be a public office and who shall be appointed by the President on such terms and conditions as the President may determine.

(2) Subject only to the powers of the Commissioner, paragraph 1 of this Schedule shall apply, with necessary modifications, to the Deputy Commissioner.
3 Acting Commissioner

(1) If the office of Commissioner falls vacant or the Commissioner is absent from duty or is unable for any reason to perform the functions of his office, the Deputy Commissioner shall act as Commissioner.

(2) If both the Commissioner and the Deputy Commissioner are absent from duty or are unable for any reason to perform the functions of their offices, the President may appoint any other senior officer of the Commission to act as Commissioner or Deputy Commissioner: Provided that, where it is in the public interest, the President may appoint any person who is not an officer of the Commission to act as Commissioner or Deputy Commissioner.

But how can the Anti-Money Laundering Investigations Unit, acceptable as it may be that the Anti-Money Laundering Investigations Unit should co-ordinate and collaborate with the Drug Enforcement Commission, be independent of the Drug Enforcement Commission? Should the Anti-Money Laundering Investigations Unit be piggybacking on resources of the Drug Enforcement Commission, especially that there are no statutory provisions in the Prohibition and Prevention of Money Laundering Act 2001 on the funding of the Anti-Money Laundering Investigations Unit? And would the absence of these statutory provisions not affect the independence of the FIU since the government can use this legal and institutional weakness to manipulate the Anti-Money Laundering Investigations Unit? These are some of the thorny issues that present themselves as lacunas in the institutional and regulatory framework.

Schott observes that countries must assure the independence of their FIUs from political influence, as well as from the competent or other supervisory authority in deciding which transactions to analyse or what information to disseminate. 648 In Zambia, the Anti-Money Laundering Investigations Unit does not have much political independence since, by close association with the Drug Enforcement Commission, it somewhat shelters under the umbrella of the Ministry of Home Affairs. Although the concept of independence is not that absolute but relative, the independence of a regulatory body should be accompanied by the regulatory body’s accountability. 649 The independence of an FIU should provide a measure of protection against the abuse or misuse of financial disclosures. 650 In turn, such developments will ensure the trust between the FIU and the reporting financial institutions and banks in the prevention and detection of money laundering and terrorist financing. 651 And to strengthen the

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648 Schott (n 637 above) VII-15.
649 See generally Mwenda (n 5 above).
650 Schott (n 637 above) VII-15.
651 Schott (n 637 above) VII-16.
regulatory and institutional framework for fighting money laundering in Zambia:

On 18 June 2004, the Bank of Zambia Anti-Money Laundering Directives were approved by the Anti-Money Laundering Investigations Unit of the Drug Enforcement Commission as per the requirement of section 12(4) of the Prohibition and Prevention of Money Laundering Act of 2001. The Bank of Zambia is in the process of distributing the Directives to all stakeholders, and commercial banks should expect to receive their copies ... The challenge is now on the banking sector, and indeed all other sectors affected by these Directives, to fully implement them. The Bank of Zambia is available for consultation on how to proceed with the implementation of the Directives.652

Generally, whenever the Anti-Money Laundering Authority requests a periodical or other business-related report from the Anti-Money Laundering Investigations Unit, the Commissioner of the Anti-Money Laundering Investigations Unit is required to make such report available to the Authority concerning activities of the Anti-Money Laundering Investigations Unit.653 However, without specifying whether officers or employees of the Anti-Money Laundering Investigations Unit can be held liable for wrongs, acts or omissions they commit while in the course of business, though acting in good faith, the Prohibition and Prevention of Money Laundering Act 2001 goes on to spell out the following statutory functions of the Anti-Money Laundering Investigations Unit:

(a) to collect, evaluate, process and investigate financial information including that from regulated institutions and Supervisory Authorities, relating to financial and other business transactions suspected to be part of money laundering for the purpose of preventing and suppressing money laundering offences;

(b) to conduct investigations and prosecutions of money laundering offences;

(c) to liaise with other law enforcement agencies in the conduct of investigations and prosecutions of money laundering offences;

(d) to supervise the reporting requirements and other administrative obligations imposed on regulated institutions and Supervisory Authorities under the Prohibition and Prevention of Money Laundering Act 2001;

(e) to assist in developing training programmes for use by regulated institutions and Supervisory Authorities in the implementation of the Prohibition and Prevention of Money Laundering Act 2001; and

(f) to co-operate with law enforcement agencies and institutions in other jurisdictions responsible for investigations and prosecution of money laundering offences.654

Expounding on offences of money laundering reflected in section 2 of the Prohibition and Prevention of Money Laundering Act 2001,655 Part IV of that very statute spells out various wrongs that constitute offences of money laundering. These wrongs include offences committed by a body of persons; attempts, or aiding and abetting, or conspiring to commit the offence of money laundering, falsification of relevant documents, and divulging relevant information to unauthorised persons.656 Let us now take a closer look at offences of money laundering under the Prohibition and Prevention of Money Laundering Act 2001.

5 Statutory offences of money laundering

In Zambia, statutory offences of money laundering are covered by the Prohibition and Prevention of Money Laundering Act 2001.657 Where an individual, such as a bank employee, after the coming into force of the Prohibition and Prevention of Money Laundering Act 2001, engages in money laundering, he or she will be guilty of an offence and liable, upon conviction, to a fine not exceeding 170 000 penalty units or to imprisonment for a term not exceeding ten years or both.658 The term 'money laundering' is defined in the Prohibition and Prevention of Money Laundering Act 2001 as (a) engaging, directly or indirectly, in a business transaction that involves property acquired with proceeds of crime; (b) receiving, possessing, concealing, disguising, disposing of or bringing into Zambia, any property derived or realised directly or indirectly from illegal activity; or (c) the retention or acquisition of property knowing that the property is derived or realised, directly or indirectly from illegal activity.659 In essence, there are three types of activities that can lead to money laundering, and these are spelt out above. But, then, what are 'proceeds of crime'?
Section 2 of the Prohibition and Prevention of Money Laundering Act 2001 defines ‘proceeds of crime’ as ‘any property, benefit or advantage, within or outside Zambia realised or derived, directly and indirectly from illegal activity’. This definition brings us to an inquiry on the meaning of illegal activities. We shall examine the statutory definition of illegal activities in a moment. Here, suffice it to say the statutory definition of proceeds of crime is very broad. Indeed, all the three categories of money laundering noted above stress the fact that there should be evidence of some underlying illegal activity for there to be the offence of money laundering. Two possible interpretations are possible here. First, it could be argued that the offence of money laundering covers all benefits derived from any illegal activity, irrespective of whether the benefits are located abroad or in Zambia. Sections 2 and 7 of the Prohibition and Prevention of Money Laundering Act 2001 stress only that there should be some illegal activity. Where this illegal activity takes place is not covered in the statute. Section 2 simply adds that the term illegal activity means ‘any activity, whenever and wherever carried out which under any written law in the Republic (of Zambia) amounts to a crime’. In essence, this means that Zambia has an ‘all crimes’ criteria of determining predicate offences of money laundering. Anything and everything falling within the statutory definition of illegal activity can predicate the offence of money laundering in Zambia.

While the word whenever, in the definition of illegal activity under section 2 of the Prohibition and Prevention of Money Laundering Act 2001, is qualified by section 7 of the Prohibition and Prevention of Money Laundering Act 2001—that is, qualified by the phrase that reads, ‘a person who, after the coming into force of the Prohibition and Prevention of Money Laundering Act 2001, engages in money laundering — and it points only to offences that were committed anytime after the coming into force of the Prohibition and Prevention of Money Laundering Act 2001, the word wherever is not qualified. The only qualification in section 2 is that the illegal activity should be seen to be illegal by reference to Zambian law even if the activity took place outside Zambia. Again, this confirms that Zambia has an ‘all crimes’ criteria of determining predicate offences of money laundering. Elsewhere, I have examined the issue of extraterritorial criminal jurisdiction in the fight against money laundering. Here, suffice it to say, section 25 of Zambia’s Prohibition and Prevention of Money Laundering Act 2001 provides that an offence under the said statute is deemed to be an extraditable offence under provisions of the Extradition Act (Cap 94) of Zambia. It matters less, under the Prohibition and Prevention of Money Laundering Act 2001, that the proceeds of crime were obtained in an indirect manner or that the

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660 See Mwenda (n 535 above) 35-43.
As long as the underlying activity, whether it took place abroad or in Zambia, is illegal when viewed under the microscope of Zambian law then the proceeds of crime will be caught by the Zambian law on money laundering. A good example here is bringing into Zambia money derived from the sale of marijuana in a country such as The Netherlands where the sale and use of marijuana is legal, or bringing into Zambia money derived from prostitution or pornography from a country where such practices are legal. Admittedly, the 'single criminality' test applies in Zambia. The Financial Sector Compliance Advisers Ltd observes that:

A single or dual criminality test: A dual criminality test requires a client's actions to be recognised as a crime both in the country where it is committed and the country where a possible laundering offence takes place. A single criminality test simply requires the country in which the laundering activity takes place to regard the activity that generated the relevant property as criminal irrespective of whether it is criminal in the country where it took place. In practice, almost all serious crimes including drug trafficking, terrorism, fraud, robbery, prostitution, illegal gambling, arms trafficking, bribery, corruption, and in some cases tax evasion, are capable of predicating money laundering offences.

The single criminality test applies also in countries such as the United Kingdom, Bermuda, the Isle of Man, Jersey and Guernsey. Arguably, in Zambia, one school of thought postulates that the Prohibition and Prevention of Money Laundering Act 2001 does not restrict itself to offences of money laundering whose predicate offences transpired in Zambia only. The illegal activity could have been committed anywhere in the world, but if that same activity would constitute a criminal offence if it were committed in

661 See above.
664 In the United Kingdom, the test of 'single criminality' still applies under the new law against money laundering, the Proceeds of Crime Act 2002. However, this test of single criminality is no longer limited by reference to indictable offences, but has been expanded to include all offences recognised under the laws of the United Kingdom. The Proceeds of Crime Act 2002 has overhauled the previous distinction between drug-related and 'all crimes' money laundering offences, although the Terrorism Act 2000 continues to regulate the laundering of money relating to the funding of terrorist activities.
665 See Bermuda’s Proceeds of Crime Act 1997 of Bermuda, sec 3.
666 See Isle of Man’s Criminal Justice Act 1990, sec 17.
668 See the Criminal Justice (Proceeds of Crime)(Bailiwick of Guernsey) Law 1999, sec 1(1).
Zambia then the conduct can predicate an offence of money laundering in Zambia irrespective of whether or not it is deemed lawful elsewhere. A useful analogy here could be drawn from the US Patriot Act 2001, regarding the extension of extraterritorial criminal jurisdiction of the United States of America over any person outside of the United States' jurisdiction who engages in any act which, if it had been committed in the United States, would constitute an offence.669 The International Compliance Association observes:

The provisions extending the long arm civil jurisdiction and extraterritorial criminal jurisdiction of the United States within the Patriot Act could, however, have severe consequences for institutions and employees outside of the United States, even where such institutions do not have a physical or representative presence within the United States. Section 317 of the Patriot Act amends the pre-existing money laundering offences in the United States under sections 1956 and 1957 of Title 18 of the United States Code. Sections 1957 has been broadened such that jurisdiction is now granted over any foreign person, including any financial institution authorised under the laws of a foreign country in circumstances where such a person commits any offence under Section 1957 involving a financial transaction that occurs either in whole or in part in the United States. This means that any foreign person who conducts a transaction involving US dollars is subject to the jurisdiction of the US courts in respect of US anti-money laundering offences within Sections 1956 and 1957 of Title 18 of the US Code. Given that the US dollar is used in the majority of the world's financial transactions, the risks posed by these provisions of the Patriot Act are significant.670

In Zambia, a second school of thought supports the 'single criminality' test, but argues instead that the predicate offence should have been committed in Zambia and must be illegal by reference to Zambian law only. Indeed, if an approach were taken that the predicate offence should be illegal in Zambia, and by reference to Zambian law, and that the predicate offence should also be illegal in a foreign country in which the offence was committed, and by reference to the law of that country, then Zambia would be applying a 'dual criminality' test. But such is not the case in Zambia. As noted above, Zambia applies a 'single criminality' test, and the 'all crime' criteria of determining a predicate offence of money laundering rests in the broad definition of illegal activity.671 The only question outstanding is: Which of the two schools of thought on the single criminality test applies in Zambia? It would appear that, in the absence of words such as 'in Zambia' after the phrase 'illegal activity', and given the growing acquiescence of many states in the state practice of the United States regarding

669 See International Compliance Association (n 518 above) 27.
670 As above.
671 As above.
extraterritorial criminal jurisdiction,\footnote{At least, there is not much evidence of ‘persistent objectors’ to this norm. Although it is possible in some instances for a state to object persistently to a rule of customary international law (or state practice), and thus not be subject to it, successful persistent objection is rare and can be a high standard in terms of required action for a state to meet. See DA Colson ‘How persistent must the persistent objector be?’ (1986) 61 Washington Law Review 957 967.} the first school of thought is more persuasive. Moreover, section 29 of Zambia’s Prohibition and Prevention of Money Laundering Act 2001 puts it clearer and resolves the polemics by stating:

\begin{quote}
29 Any act:
(a) carried out by a citizen of Zambia anywhere; or
(b) carried out by a person on a ship or aircraft registered in Zambia;
shall, if it would be an offence by that person on the land in the Republic, be an offence under this Act.
\end{quote}

\begin{quote}
30 A person who commits an offence under this Act, for which no penalty is provided shall be guilty of an offence and shall be liable upon conviction to a fine …or to imprisonment for a term …or to both.
\end{quote}

5.1 What constitutes ‘knowing’ in the statutory definition of money laundering?

Whereas the first two offences of money laundering listed in section 2 of the Prohibition and Prevention of Money Laundering Act 2001 — that is, (a) engaging, directly or indirectly, in a business transaction that involves property acquired with proceeds of crime; and (b) receiving, possessing, concealing, disguising, disposing of or bringing into Zambia, any property derived or realised directly or indirectly from illegal activity — do not import the subjective test of ‘knowing’, the third activity, ‘the retention or acquisition of property knowing that the property is derived or realised, directly or indirectly from illegal activity’ retains that test. But how can we determine if a person knowingly retained or acquired the property derived or realised from an illegal activity? And should we apply a criminal law standard or a civil law standard in defining the term knowing? In Zambia, money laundering is a criminal offence.\footnote{As above.} Therefore, the term knowing should be understood from a criminal law point of view.

Although no statute can be readily cited as an example of a foreign piece of legislation in which the term ‘knowledge’ has been fully defined, that argument alone does not defeat the view that clarity in the law, regarding the meaning of terms such as knowing, would facilitate a smooth interpretation of the statute. In Zambia, the term knowing is not defined anywhere in the Prohibition and Prevention of
Money Laundering Act 2001. However, in *Selanghor v Craddock (No 3)*, Ungoed-Thomas J, defining the term ‘knowledge’ in a civil law case, was of the view that ‘knowledge’ meant ‘circumstances which would indicate to an honest and reasonable man that such design was being committed, or would put him on inquiry’. The test applied by Ungoed-Thomas J is an objective test of a ‘reasonable’ man. In *Re Montagu’s Settlements*, another civil law case, it was held that ‘knowledge’ is not confined to actual knowledge, but includes actual knowledge that would have been acquired but for shutting one’s eye to the obvious, or wilfully and recklessly failing to make such inquiries as a reasonable man would make. Again, the objective test of a ‘reasonable’ man is applied here. And in *Baden Delvaux and Lecuit v Societe Generale*, a civil law case, it was pointed out that:

... knowledge can comprise any one of five different mental states...:

(i) actual knowledge;
(ii) wilfully shutting one’s eye to the obvious;
(iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make;
(iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man;
(v) knowledge of circumstances which would put an honest and reasonable man on inquiry.

The ruling in *Baden Delvaux and Lecuit v Societe Generale* imports both an objective test and a subjective test of ‘knowledge’. To satisfy the subjective test, unlike in the objective test, the intention of the accused to launder money must be proved. Paragraphs (i) and (ii) relate to the subjective test which requires the prosecution to show that the accused had ‘actual knowledge’ or that he ‘wilfully shut his eyes to the obvious’. By contrast, paragraphs (iii), (iv) and (v) relate to the objective test of how a *reasonable man*, when placed under similar circumstances, would be expected to act. Some commentators have argued, however, that money laundering offences containing objective

674 [1968] 2 All ER 1073.
677 *Per Gibson J* [1983] BCLC 325.
678 See below.
elements of *mens rea* impute a civil 'negligence' based test into the
determination of criminal offences.\(^\text{679}\)

In contrast to the civil law position, the criminal law position was
spelt out in *Nelson v Larholt*\(^{680}\) where it was held that 'knowledge'
meant more than constructive knowledge in the sense of shutting one's
eyes to the obvious. In *Warner v DPP*,\(^{681}\) Lord Reid held that knowledge
could include 'willfully shutting one's eyes to the truth'. Willful, on the
other hand, could mean deliberate or reckless acts or omissions.\(^\text{682}\)
In the American case of *US v Jewell*,\(^{683}\) Jewell drove, into the United
States, a car containing a substantial cargo of marijuana. The
argument there was that if the circumstances suggested the
probability of the presence of marijuana and Jewell purposely
refrained from investigating in order not to know, then Jewell was
guilty of 'knowingly' importing a controlled substance, and
'knowingly' possessing with intent to distribute a controlled
substance. However, the mere fact that circumstances suggested the
presence of marijuana was not enough. Jewell could not be convicted
of 'knowingly' importing, and so forth, on the basis that Jewell should
have known because a reasonable person would have known. But if
the circumstances made Jewell aware of the probability of the
presence of marijuana, and Jewell deliberately 'shot his eyes', so to
speak, in order not to see what was there to be seen, then Jewell had
the *mens rea* concept,\(^{684}\) which goes under the name of 'knowledge'.
The English may have a 'corner' on the label *wilful blindness*, but the
underlying doctrine is as firmly established in the United States of
America as in England.\(^{685}\) Indeed,

\[\text{[a] doubtful suggestion ... is this: 'One problem with the willful blindness}\
\text{doctrine is its bias towards visual means of acquiring knowledge.' Such}\
\text{phrases as 'deliberately shutting his eyes' and 'wilful blindness' have}\
\text{always been employed as metaphors to indicate a conscious effort to}\
\text{...}\]

\(^{679}\) See International Compliance Association (n 518 above) 198.

\(^{680}\) [1948] 1 KB. 339 344.

\(^{681}\) (1968) Cr App 373 398.


\(^{683}\) 523 F.2d 697 (9th Cir 1976), as reproduced by A Bowie 'Criminal law outline
lecture two: chapter 7' available at http://www.professorbowie.com/
Lecture%20Two.htm (accessed 7 February 2005). See also *US v Hayden* 64 F.3d 126
(3d Cir 1995); *US v Caminos* 770 F.2d 361 (3d Cir 1985); *US v Rodriguez* 983 F 2d
455, 457 (2d Cir 1993); *Johnson & Towers* 741 F 2d 670-671; *US v Self* 2 F 3d 1071
(10th Cir 1993).

\(^{684}\) The term *mens rea* is a Latin expression, meaning 'guilty mind'. In criminal law,
except in cases of strict liability, often the *mens rea* must be accompanied by an
*actus reus* if there has to be a crime committed. In short, *mens rea* means 'guilty
mind' and *actus reus* means the 'thing done'. Generally, a crime is committed
when a person commits a guilty act accompanied by a guilty mind. In the United
States of America, eg, the US Model Penal Code does not use the Latin terms
*mens rea* and *actus reus*. The Code uses the following terms to describe a
culpable person's state of mind: (a) purpose; (b) knowledge; (c) recklessness; or
(d) negligence.

\(^{685}\) Bowie (n 685 above).
avoid learning the truth, by whatever means knowledge is to be obtained. In a case that illustrates this point, *State v Farnes*, 171 Mont 368, 558 P 2d 472 (1976), the defendant was convicted of theft of a horse for having 'knowingly' sold it for the purpose of depriving the owner of his property. The state statute provides that 'when knowledge of the existence of a particular fact is an element of an offence, such knowledge is established if a person is aware of a high probability of its existence'. There was evidence to the effect that the defendant was aware of a high probability that the horse was stolen. This was held sufficient to support the conviction.686

6 Other offences relating to money laundering

6.1 Offences committed by a body of persons such as a company or partnership

As a general rule, where an offence under provisions of the Prohibition and Prevention of Money Laundering Act 2001 is committed by a body of persons, whether corporate or unincorporated, such as a bank or financial institution, that body is guilty of an offence and liable upon conviction to a fine.687 Also, every person who, at the time of the offence, acted in an official capacity for or on behalf of such a body of persons, whether as a director, manager, secretary or other similar capacity, or was purporting to act in such capacity and who was involved in the commission of that offence is guilty of the said offence and liable, upon conviction, to a fine or a term of imprisonment, or both.688

The above statutory rule covers both shadow directors and *de facto* directors in Zambia. Under Zambia's Companies Act 1994, 'a person not being duly appointed director of a company, on whose directions or instructions the duly appointed directors are accustomed to act shall be deemed to be a director for the purposes of all duties and liabilities imposed on directors'.689 The statutory provision in the Zambian Companies Act 1994 introduces the concept of a shadow director in that country. Under the repealed Zambian Companies Act 1921, which preceded the Zambian Companies Act 1994, the concept of shadow director was not covered to the same extent as it is covered under English law.690 Goode observes that a shadow director, in contrast to a *de facto* director, normally acts through someone.691

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686 As above.
687 See the Prohibition and Prevention of Money Laundering Act 2001, sec 8(a).
689 Companies Act 1994, sec 203(4).
690 See the English Companies Act 1985, sec 741(2) on shadow director.
facto director, on the other hand, holds out and acts in person. While the concept of de facto director, based on the common law, has always been there in Zambia, the Zambian Companies Act 1994 has made improvements to the law by introducing a statute-based concept of shadow director in Zambia.

6.2 Attempts, aiding and abetting or conspiring to commit an offence

In general, any person who attempts, aids, abets, counsels or procures the commission of the offence of money laundering is guilty of an offence and liable, upon conviction, to a fine or a term of imprisonment, or to both. And any person who conspires with another to commit the offence of money laundering is guilty of an offence and liable, upon conviction, to a fine or a term of imprisonment, or to both. Does this therefore cover the position of lawyers and accountants who, allegedly acting in a professional capacity, end up aiding, abetting, counseling, conspiring or procuring a client to commit an offence of money laundering? The Prohibition and Prevention of Money Laundering Act 2001 is silent on such matters.

A further weakness of the Prohibition and Prevention of Money Laundering Act 2001 can be seen in the absence of statutory provisions to protect whistle blowers such as employees of a bank or financial institution who confide in the institution’s Money Laundering Reporting Officer about suspicious transactions and suspicious activities. Whistle blowers must be protected to save them from possible vendettas from law offenders and to provide whistle blowers with some confidence and trust that their execution of duty is not only supported by the law, but by management as well. And although the Prohibition and Prevention of Money Laundering Act 2001 does not define the term ‘Money Laundering Reporting Officer’, a Money Laundering Reporting Officer is often understood as a senior officer within the regulated institution whose duty includes, among things, receiving reports from fellow employees regarding suspicious transactions and suspicious activities. Where a good case exists to report these suspicions to the FIU, the Money Laundering Reporting Officer should prepare and transmit to the FIU a suspicious transactions report or a suspicious activities report. Also, the Money Laundering Reporting Officer could have other functions which include compliance and risk management and the preparation and

692 As above.
693 Companies Act 1994, sec 203(4).
implementation of an anti-money laundering training and awareness programme for the institution.

6.3 Falsification of documents

As a general rule, any person who knows or suspects that an investigation into money laundering has been, is being or is about to be conducted, falsifies, conceals, destroys or otherwise disposes of, causes or permits the falsification of material which is likely to be relevant to the investigation of the offence, is guilty of an offence and liable, upon conviction, to a fine or a term of imprisonment, or to both.\textsuperscript{696} The question here is: What constitutes knows or suspects? We have already examined the jurisprudence underpinning the word knowing. But, what does the word suspect mean? Lord Devlin in the English Court of Appeal decision in Hussein v Chong Fook Kam\textsuperscript{697} defined suspicion as follows: 'Suspicion in its ordinary meaning is a state of conjecture or surmise where proof is lacking: "I suspect but I cannot prove."'\textsuperscript{698}

Suspicion must not be confused with speculation or a hunch, or gut feeling, because suspicion may sometimes take a while to formulate and it falls only short of proof based on firm evidence.\textsuperscript{699} It seems that, in the case of suspicion, there must be a factual basis upon which it can be founded.\textsuperscript{700} But, of course, there is a subjective test and an objective test of suspicion. The objective test is usually formulated as where a person has reasonable grounds to suspect.\textsuperscript{701} Akin to the objective test of knowing or knowledge, the objective test of suspect or suspicion imports the concept of a reasonable man and how this reasonable man would have reacted. In the American case of USv Arvizu,\textsuperscript{702} decided in 2002, the United States Supreme Court held as follows:

Considering the totality of the circumstances and giving due weight to the factual inferences drawn by Stoddard and the district court judge, Stoddard had reasonable suspicion to believe that the respondent was engaged in illegal activity. Because the 'balance between the public interest and the individual’s right to personal security', United States v Brignoni-Ponce 422 US 873, 878, tilts in favour of a standard less than probable cause in brief investigatory stops of persons or vehicles, the

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\textsuperscript{697} [1970] AC 942 948.
\textsuperscript{698} As above.
\textsuperscript{699} International Compliance Association (n 518 above) 118.
\textsuperscript{700} As above.
\textsuperscript{701} n 518 above, 119.
Fourth Amendment is satisfied if the officer's action is supported by reasonable suspicion to believe that criminal activity 'may be afoot', *United States v Sokolow* 490 US 1, 7. In making reasonable-suspicion determinations, reviewing courts must look at the 'totality of the circumstances' of each case to see whether the detaining officer has a 'particularised and objective basis' for suspecting legal wrongdoing. See, eg, *United States v Cortez*, 449 US 411, 417-418. This process allows officers to draw on their own experiences and specialised training to make inferences from and deductions about the cumulative information available.\(^{703}\)

The United States Supreme Court noted further:

The Ninth Circuit's methodology departs sharply from these teachings, and it reached the wrong result in this case. Its evaluation and rejection of certain factors in isolation from each other does not take into account the 'totality of the circumstances,' as this Court's cases have understood that phrase. The court appeared to believe that each of Stoddard's observations that was by itself susceptible to an innocent explanation was entitled to no weight. *Terry v Ohio* 392 US 1, however, precludes this sort of divide-and-conquer analysis. And the court's view that it was necessary to clearly delimit an officer's consideration of certain factors to reduce troubling uncertainty also runs counter to this Court's cases and underestimates the reasonable-suspicion standard's usefulness in guiding officers in the field. The *de novo* standard for appellate review of reasonable-suspicion determinations has, *inter alia*, a tendency to unify precedent and a capacity to provide law enforcement officers the tools to reach the correct decision beforehand. *Ornelas v United States* 517 US 690, 691, 697, 698. The Ninth Circuit's approach would seriously undermine the 'totality of the circumstances' principle governing the existence *vel non* of 'reasonable suspicion'. Here, it was reasonable for Stoddard to infer from his observations, his vehicle registration check, and his border patrol experience that respondent had set out on a route used by drug smugglers and that he intended to pass through the area during a border patrol shift change; and Stoddard's assessment of the reactions of respondent and his passengers was entitled to some weight. Although each of the factors alone is susceptible to innocent explanation, and some factors are more probative than others, taken together, they sufficed to form a particularised and objective basis for stopping the vehicle.\(^{704}\)

On the other hand, and closely matching the subjective test of *knowing* or *knowledge*, the subjective test of *suspicion* or *suspects* requires the prosecution to prove that the accused *actually suspected*\(^{705}\) that an investigation into money laundering had been, was being or was about to be conducted, but chose instead to falsify, conceal, destroy or otherwise dispose of, cause or permit the

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\(^{703}\) *US v Arvizu* (00-1519) 534 US 266 (2002) 6-11.

\(^{704}\) As above.

\(^{705}\) See *International Compliance Association* (n 518 above) 117-119.
falsification of material which was likely to be relevant to the investigation of the offence.

6.4 Divulging information to an unauthorised person

As a general rule, any person who knows or suspects that an investigation into money laundering has been, is being or is about to be conducted, without lawful authority, divulges that fact or information to another person, is guilty of an offence and liable, upon conviction, to a fine or a term of imprisonment or both.\(^{706}\) We have already examined the meaning of the terms knows and suspects. So, an employee of a bank who knowingly tips a suspected bank customer that some law enforcement officers have been to the bank to ask questions about suspicious activities relating to his bank account is only inviting the wrath of the law. The statutory rule here introduces the offence of tipping off a suspected money launderer.\(^{707}\) In many jurisdictions, the requirement to report suspicious transactions or suspicious activities is of not much use if the suspected person is tipped off to the fact that he or she is under investigation.\(^{708}\) Thus, in order to preserve the integrity of an investigation, the offence of 'tipping off' usually occurs where

information or any other matter which might prejudice the investigation is disclosed to the suspect of the investigation (or anyone else) by someone who knows or suspects ... that: a police investigation into money laundering has begun or is about to begin, or the police have been informed of suspicious activities, or a disclosure has been made to another employee under internal reporting procedures.\(^{709}\)

In the United Kingdom

It is an offence to tell —or 'tip off' —a suspect that a report is being made (or has been made). This could happen when an individual tips off a suspect in a way that would prejudice an investigation, when they know or suspect that an internal or external report has been made or will be made in the case of terrorism offences. The tipping off could

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\(^{707}\) See also Royal Brunei Airlines v Philip Tan Kok Ming [1995] 2 AC 378; C v S & Others The Times 5 November 1998.

\(^{708}\) See, eg, in Scotland, secs 36(1) & (2) of the Criminal Law (Consolidation) (Scotland) Act 1995, and sec 17 of the Prevention of Terrorism (Temporary Provisions) Act 1989, (as amended by sec 50 CJA93).

take the form of a direct statement or more indirectly, a hint.\textsuperscript{710}

So, banks and financial institutions should be very careful when providing information, say, to the media or other public relations outlets regarding a suspicious transaction or activity. If not properly handled, the issuance of statements here could lead to the tipping-off of a suspect.

In the United Kingdom, unlike in Zambia, the legal framework provides also for the offence of failure to disclose a suspicion or knowledge of money laundering.\textsuperscript{711} Failure to disclose the suspicion or knowledge of money laundering is, by itself, an offence.\textsuperscript{712} This English law statutory rule establishes a mandatory 'defensive' requirement for disclosure on all parties affected by the requisite knowledge or suspicion. What this means is that employees of banks and financial institutions in the UK are under a statutory obligation not to fail to report their knowledge or suspicion of a suspicious transaction or activity pertaining to a bank customer or fellow employee. However, where the employee should have reported but had no knowledge or suspicion and was not provided with 'specified' training by his employer, he or she has a defence for not making the disclosure of the suspicious transaction or activity.\textsuperscript{713} The 'specified' training referred to here is the training required to be provided under regulation 5(1)(c) of the Money Laundering Regulations 1993 of the United Kingdom. Regulation 5(1)(c) requires that a person carrying out relevant financial business must provide employees whose duties include the handling of relevant financial business with training from time to time in the recognition and handling of transactions carried out by, or on behalf of, any person who is, or appears to be, engaged in money laundering. The only defence to the offence of failure to disclose applies where the employee does not actually know or suspect that another person is engaging in money laundering.\textsuperscript{714} But, the employee will be liable if he is found to have had reasonable grounds for knowing or suspecting that another person was engaged in money laundering.\textsuperscript{715}


\textsuperscript{711} See the Proceeds of Crime Act 2002 of the United Kingdom, sec 330.

\textsuperscript{712} As above.


\textsuperscript{714} As above.

\textsuperscript{715} n 713 above.
6.5 Obstructing an authorised officer, and failure or refusal to disclose information to the authorised officer

Under Zambia's Prohibition and Prevention of Money Laundering Act 2001, it is a criminal offence for any person to:

(a) obstruct, assault, hinder or delay an authorised officer in the lawful exercise of any powers conferred upon the officer by any law;

(b) refuse to furnish to an authorised officer, on request, any particulars or information to which the authorised officer is entitled to by or under the Prohibition and Prevention of Money Laundering Act 2001;

(c) fail to comply with any lawful demand of an authorised officer under the Prohibition and Prevention of Money Laundering Act 2001;

(d) wilfully or recklessly give to an authorised officer any false or misleading particulars or information with respect to any fact or particulars to which the authorised officer is entitled to by or under the Prohibition and Prevention of Money Laundering Act 2001;

(e) fail to produce, conceal or attempt to conceal any property, document or book in relation to which there is reasonable ground to suspect that an offence has been or is being committed under the Prohibition and Prevention of Money Laundering Act 2001, or which is liable to seizure under the Prohibition and Prevention of Money Laundering Act 2001;

(f) before or after any seizure, destroy anything to prevent the seizure or securing of that property or article; or

(g) wilfully fail or refuse to disclose any information or to produce any accounts, documents or articles to an authorised officer during an investigation into an offence under the Prohibition and Prevention of Money Laundering Act 2001.

In all but the offence listed in paragraph (g) above, the Prohibition and Prevention of Money Laundering Act 2001 prescribes only the sanction of imprisonment without the option of a fine. Only in situations covered under paragraph (g), which involve the wilful failure or refusal to disclose information or to produce accounts, documents or articles to an authorised officer during an investigation, does the Prohibition and Prevention of Money Laundering Act 2001 provide sanctions that cover a fine and/or a term of imprisonment.

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716 See the Prohibition and Prevention of Money Laundering Act 2001, secs 26 & 27.
717 As above.
718 As above.
7 Can tax evasion by banks lead to the offence of money laundering?

To start with, what is tax evasion and how does it differ from tax avoidance? Dishonesty is often present in tax evasion schemes, which either involves some form of deliberate misrepresentation or deceitful concealment. Tax evasion schemes may either be a specific statutory criminal offence within the tax laws of a particular jurisdiction, or be capable of constituting a common law offence of fraud or forgery, false accounting or cheat. By contrast, the traditional approach to tax avoidance in many common law jurisdictions was summarised in a decision of Lord Tomlin in *IRC v the Duke of Westminster*. The principle established in that case, now popularly known as the Duke of Westminster principle, is contained in the following words of Lord Tomlin:

> Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however inappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

In some countries, such as Belgium, Finland, France, Ireland, Italy, The Netherlands, New Zealand, Norway, Spain, Sweden and the United Kingdom, violations of tax laws are considered a predicate offence of money laundering. In Austria, only customs fraud and evasion of import and export duties are considered a predicate offence of money laundering. In Germany, tax evasion constitutes...

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719 In general, tax evasion, unlike tax avoidance, is a criminal offence (and sometimes a civil wrong as well) in many countries. Tax evasion can be described as the intentional avoidance of tax payment usually by inaccurately declaring taxable income. By contrast, tax avoidance entails the minimisation of tax liability by lawful methods. However, in some countries, including New Zealand, Australia and the United Kingdom, the modern approach to tax avoidance has shifted somewhat with the enactment of a number of anti-avoidance provisions that are designed to strike down any arrangements that have no commercial benefit other than the avoidance of tax. See, eg, the following cases: *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311; *Oakey v FCT* (1984) ALR 291; *WT Ramsay Ltd v IRC* [1982] AC 300; *Margin v CIR* [1971] 591 PC; *CIR v BNZ Investments Ltd* [2002] 1 NZLR 450 CA; *CIR v Peterson* [2003] 2 NZLR 77 CA; *Aspro Ltd v CT* [1932] AC 683 PC. See also H Flight 'Taxation and money laundering: A personal view' (2002) 5 Journal of Money Laundering Control. 323-324.

720 International Compliance Association (n 518 above) 53.

721 As above.

723 As above, 19-20.


725 As above.
a predicate offence of money laundering if it is committed by a member of a criminal association.\textsuperscript{726} Turkey considers only tax fraud as a predicate offence of money laundering, while countries such as Australia, Brazil, Canada, Denmark, Japan, Luxembourg, Portugal, Singapore, Switzerland and the United States of America do not consider tax offences as serious offences of money laundering.\textsuperscript{727}

For many years, tax evasion has been excluded from the legislative framework for fighting money laundering in several countries.\textsuperscript{728} However,

...taking conscience of the entanglement of the criminal activities and the use of sophisticated techniques to hide and launder the proceeds, international bodies and national governments changed their position on this matter. Many do recognise that money laundering is associated with all types of crime, tax evasion included. Given the fact that criminals often commit tax crimes in connection with their other illegal activities, drawing the line between both would be quite artificial. There is no moral difference between drug trafficking and other serious offences as the risks from both are great and this applies as much to tax offences as to any other crime. The ‘tax loophole’, if it existed, could only have a serious negative impact on the fight against money laundering, generally.\textsuperscript{729}

But, how is tax evasion treated under Zambia’s legal framework for combating money laundering? Given that the offence of money laundering, as established earlier, involves either (a) engaging, directly or indirectly, in a business transaction that involves property acquired with \emph{proceeds of crime}; (b) receiving, possessing, concealing, disguising, disposing of or bringing into Zambia, any property derived or realised directly or indirectly from \emph{illegal activity}; or (c) retaining or acquiring property knowing that the property is derived or realised, directly or indirectly, from \emph{illegal activity} – and that tax evasion is, by itself, an \emph{illegal activity} in Zambia (including the fact that \emph{proceeds of crime}, as we saw earlier, arise from \emph{illegal activity}), there is no doubt that tax evasion will predicate the offence of money laundering in Zambia. Indeed, since Zambia subscribes to the ‘all crimes’ approach in determining

\textsuperscript{726} As above.  
\textsuperscript{727} As above.  
\textsuperscript{728} As above.  
\textsuperscript{729} Spreutels (n 726 above) 2. See also P Burrell ‘Preventing tax evasion through money laundering legislation’ (2000) 3 Journal of Money Laundering Control 304-308.
predicate offences of money laundering,\textsuperscript{730} tax evasion by banks and financial institutions will, therefore, not be spared.

7.1 Tax evasion of foreign taxes

At common law, the starting point for a sound analysis of the treatment of foreign tax evasion is the principle enunciated in the English case of \textit{Government of India v Taylor}.\textsuperscript{731} In that case, the Court of Appeal confirmed the legal position that an English court will not entertain any action brought in England to collect taxes that are owed by an accused person to a foreign government.\textsuperscript{732} This principle is based on the common law and on the public international law doctrine of state sovereignty.\textsuperscript{733}

Although the aforesaid common law position applies in Zambia, like in many other common law jurisdictions, section 29 of Zambia’s Prohibition and Prevention of Money Laundering Act 2001 has made some \textit{adjustments} to the rule in \textit{Government of India v Taylor}. We explained earlier that Zambia applies a ‘single criminality’ test. And we observed that section 29 of the Prohibition and Prevention of Money Laundering Act 2001 stipulates clearly that any act carried out by a Zambian citizen, whether in Zambia or outside Zambia, or any act carried out by any person on a ship or an aircraft registered in Zambia, is considered an offence under the Prohibition and Prevention of Money Laundering Act 2001 if such an act would constitute an offence by that person in Zambia. Let us take a more reasoned look at this statutory provision.

\textsuperscript{730} As noted above, the definition of illegal activity in sec 2 of the Prohibition and Prevention of Money Laundering Act 2001 is so wide that it includes any crime. The term ‘illegal activity’ is defined as any activity, whenever and wherever carried out, which under any written law in Zambia amounts to a crime. So, where a person commits a crime not covered by the Prohibition and Prevention of Money Laundering Act 2001, and that crime is proven to predicate the offence of money laundering, he or she will be liable for money laundering under the Prohibition and Prevention of Money Laundering Act 2001. Indeed, the statutory definition of illegal activity shows that Zambia has an all-crimes approach to controlling money laundering. And since tax evasion is a crime too, it is captured as a predicate offence of money laundering in Zambia.

\textsuperscript{731} [1955] AC 491.

\textsuperscript{732} As above.

\textsuperscript{733} In \textit{Regazzoni v KC Sethia (1944) Ltd}, [1956] 2 QB 490, 515-516 (CA) aff’d, [1957] 3 All ER 287, (HL), Lord Denning explained: ‘These courts will not enforce [revenue or penal] laws at the instance of a foreign country. It is quite another matter to say that we will take no notice of them. It seems to me that we should take notice of the laws of a friendly country, even if they are revenue laws or penal laws or political laws, ... at least to this extent, that if two people knowingly agree to break the laws of a friendly country or to procure some one else to break them or assist them in the doing of it, then they cannot ask this court to give its aid to the enforcement of their agreement.’
In the first scenario, the accused person must be a Zambian citizen. The accused need not be a foreigner who, although housed in Zambia, is evading taxes in a foreign country. Foreign tax evasion by foreigners is not the concern of section 29 of the Prohibition and Prevention of Money Laundering Act 2001. That said, it matters less that the accused Zambian committed the offence of tax evasion within or outside Zambia. Equally, it is immaterial that the act in question was lawful in the jurisdiction where it took place. As long as the act would have constituted a crime in Zambia, even though it took place outside Zambia, section 29 of the Prohibition and Prevention of Money Laundering Act 2001 will be triggered. In short, where a predicate offence of foreign tax evasion takes place in a foreign jurisdiction, and that act when examined under the tax laws of Zambia (the assumption here is that the offence is taking place in Zambia) turns out to be tax evasion in the Zambian context, then section 29 of the Prohibition and Prevention of Money Laundering Act 2001 is triggered. But it is doubtful that the Zambian courts will go so far as to order that the accused should pay the foreign taxes he or she owes to a foreign sovereign because legislation in Zambia has not reversed the common law position enunciated in the Government of India v Taylor case. The accused may simply face criminal sanctions under the Prohibition and Prevention of Money Laundering Act 2001. To that extent, the reasoning in Government of India v Taylor is retained in Zambia.

In the second scenario, any act carried out by any person, whether or not he or she is a Zambian, on a ship or an aircraft registered in Zambia is an offence under the Prohibition and Prevention of Money Laundering Act 2001 if such an act would constitute an offence by that person in Zambia. So, an act of tax evasion taking place on any ship or aircraft registered in Zambia, irrespective of whether the ship is in foreign waters or the aircraft is in foreign air space, and irrespective of whether the tax evader is a Zambian citizen or a foreigner, will be caught up by section 29 of the Prohibition and Prevention of Money Laundering Act 2001. But, here, these two statutory rules apply only to offences under the Prohibition and Prevention of Money Laundering Act 2001.

In the American case of Attorney-General of Canada v RJR Tobacco Holdings Inc, an action was brought before the US 2nd Circuit Court of Appeals by the Attorney-General of Canada (Canada) on behalf of the government of Canada for damages based on lost tax revenue and additional law enforcement costs. Canada alleged that these damages resulted from a scheme facilitated by defendants to

avoid various Canadian cigarette taxes by smuggling cigarettes across the United States-Canadian border for sale on the Canadian black market. Under the Racketeer Influenced and Corrupt Organisations Act (RICO) 18 USC paragraphs 1961 et seq, Canada sought to recover revenue that it lost 'from the evasion of tobacco duties and taxes', and from the '[d]efendants' conduct [that] compelled [Canada] to rollback duties and taxes', as well as monies spent 'seeking to stop the smuggling and catch the wrongdoers'. The Court ruled as follows:

The revenue rule is a longstanding common law doctrine providing that courts of one sovereign will not enforce final tax judgments or adjudicated tax claims of other sovereigns. It has been defended on several grounds, including respect for sovereignty, concern for judicial role and competence, and separation of powers ... Although the United States Supreme Court and this Circuit have not ruled on the precise scope of the rule, they have acknowledged its continuing vitality in the international context. See Sun Oil Co v Wortman 486 US 717, 740 (1988) (Brennan, J concurring) (noting the rule's continued existence in the nation-to-nation setting); Banco Nacional de Cuba v Sabbatino 376 US 398, 413-14 (1964) (noting the view that many courts in the United States have adhered to the principle that 'a court need not give effect to the penal or revenue laws of foreign countries'); Oklahoma v Gulf, Col & Santa Fe Ry Co 220 US 290, 299 (1911) ('the rule that the courts of no country execute the penal laws of another applies not only to prosecutions and sentences for crimes and misdemeanors, but to all suits in favour of the state for the recovery of pecuniary penalties for any violation of statutes for the protection of its revenue or other municipal laws, and to all judgments for such penalties') (quoting Wisconsin v Pelican Ins Co of New Orleans 127 US 265, 290 (1888), overruled in part by Milwaukee County v ME White Co 296 US 268, 278 (1935)); United States v First Nat'l City Bank, 321 F.2d 14, 23-24 (2d Cir 1963) ('It has long been a general rule that one sovereignty may not maintain an action in the courts of another state for the collection of a tax claim.'), rev'd on other grounds, 379 US 378 (1965); United States v Pierce 224 F.3d 158, 167 (2d Cir 2000) (describing this aspect of Trapilo). The rule has its origin in eighteenth-century English court decisions seeking to protect British trade from the oppressiveness of foreign customs. In Boucher v Lawson 95 Eng Rep 53 (KB 1734) (Lord Hardwicke, CJ), the court specifically acknowledged that its concerns with promoting British trade led it to uphold a transaction that violated Portuguese export laws. Chief Justice Lord Hardwicke stated that to do otherwise 'would cut off all benefit of such trade from this kingdom, which would be of very bad consequence to the principal and most beneficial branches of our trade'. Since then, the rule has entered United States common law, international law and the national law of other common law jurisdictions. We note that the international acceptance of the revenue rule extends to Canada's Supreme Court and provincial courts ... In defence of the revenue rule, some courts have observed that the rule prevents foreign sovereigns from asserting their
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sovereignty within the borders of other nations, thereby helping nations maintain their mutual respect and security.735

Against this background, we now turn to examine the burden of proof in cases of money laundering in Zambia.

8 The burden of proof in offences of money laundering

Which party should shoulder the burden of proof in money laundering cases under the Prohibition and Prevention of Money Laundering Act 2001, and what is the required standard of proof? Let us first take a look at some related developments in Hungary.

In 2000, the government of Hungary established a criminal investigation bureau within the Tax and Financial Inspection Service to help spur tax and money laundering prosecutions.736 According to the US Department of State, the government of Hungary initiated ten money laundering investigations in 2003 and only two individuals were apprehended and arrested, resulting in two prosecutions — one acquittal and one conviction.737 In these cases, the predicate offense was fraud.738 However, recent legislative changes, including one that clarifies that money laundering convictions can be obtained without conviction on the predicate offence, are expected to increase the number of money laundering prosecutions and convictions.739

In June 2003, a money laundering scandal broke involving a Hungarian subsidiary of a Dutch-owned bank.740 A broker apparently skimmed funds from some clients in order to pad the returns of other, more favoured clients. Money was laundered through several banks as well as some foreign nationals.741 Hungary’s FIU, the Anti-Money Laundering Section (AMLS), was, by March 2004, still investigating the case, which had expanded to 12 suspects with financial damages estimated at US$45 million. As one report shows:

With the organisational changes in AMLS, it is unclear how long it will take to conclude the investigation. It also is not clear whether Hungary’s financial regulatory body, the Hungarian Financial Supervisory Authority

735 As above.
737 As above.
738 As above.
739 As above.
740 As above.
741 As above.
(PSzAF), could be held responsible for improper reporting, as it warned the bank of improper recording procedures as early as 2000. The prosecution has denied the AMLS request to call the Head of PSzAF as a witness and has not responded to repeated requests for supporting evidence. Act CXXI of 2001 provides for reversal of the burden of proof in cases of confiscations from persons part of a criminal organisation; however, this provision has not been used in practice. Hungary's confiscation regime is also defined by Act CXXI of 2001, which came into force on April 1, 2002, and considers all benefits or enrichment originating from a criminal act to be illegal. The present provision in force contains no reference to the knowledge of the origin of assets as a condition of asset confiscation from third parties, although assets obtained by a third party in a bona fide manner may not be confiscated.  

In Zambia, like many other common law jurisdictions, the burden of proof in criminal law cases, including offences of money laundering, lies on the prosecution. In other words, if someone accuses you of committing the offence of money laundering, the burden of proof requires them (i.e. the prosecution team) to prove that you have, indeed, violated the law and committed the offence in question. The general rule is that ‘he who asserts must prove’. And the standard of proof here is such that the prosecution must prove beyond reasonable doubt that you have committed the offence. By contrast, although the burden of proof in civil law cases, like in criminal law cases, still lies on the party bringing an action, the standard of proof is lighter and only requires the plaintiff to prove against the defendant on the balance of probabilities.

The problems associated with a higher standard of proof in criminal law cases and with the requirement that the burden of proof should fall on the prosecution inevitably point to a subtle necessity that the prosecution should comprise a team of competent and professional lawyers and investigators if they have to get a good chance at winning the case. In Zambia, the chambers of the Director

742 As above.
743 Woolmington v DPP [1935] AC 462; Rex v Stoddart (1909) 2 Cr App R 217 244; Rex v Davies (1913) 29 Times LR 350; 8 Cr App R 211; Rex v Abramovitch (1914) 31 Times LR 88; Rex v Aubrey (1915) 11 Cr App R 182; Rex v Grinberg (1917) 33 Times LR 428; Rex v Sanders (1919) 14 Cr App R 11; Lawrence v The King. [1933] 699, 706; Rex v Burgess (1913) 9 Cr App R 120; Rex v Davies (1913) 29 Times LR 350; 8 Cr App R 211; Rex v Hopper (1915) 11 Cr App R 136; Rex v Brain (1918) 13 Cr App R 197. See Rex v Oliver Smith (1910) 6 Cr App R 19, where it was stated that, as an exception to the rule that the burden of proof lies on the prosecution, where insanity is relied upon, the defendant must establish that defence. See also M'Naughten's case (1843) 4 St Tr (NS) 847.
744 See Woolmington v DPP [1935] AC 462.
745 As above.
746 See Miller v Minister of Pensions (1947), 2 All ER 372.
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of Public Prosecution (DPP) and the Attorney-General’s chambers, though having very well-qualified professional lawyers, are understaffed. There is a need to attract more lawyers to the public service. Most young lawyers prefer practising law in small mushrooming law firms to serving in the DPP’s or the Attorney-General’s chambers. There are also not enough lawyers on the bench and in such public offices as the Anti-Money Laundering Investigations Unit. It is issues like these that pose a great challenge to the efficacy of the regulatory and institutional framework for fighting money laundering in Zambia. Law policing and law enforcement arms, together with the judiciary, should be allocated more resources if they are to attract adequate numbers of well-qualified people. It is worth noting that, even if there are very good laws in the statute books, as long as the implementation of those laws is weak, partly due to weak enforcement and weak investigative measures, the fight against money laundering will remain a pipedream. A possible way out of this conundrum, we propose, would be to introduce legislative changes that shift the burden of proof from the prosecution to the accused so that the accused should now prove beyond reasonable doubt how, where and when he acquired his seemingly dubious wealth. Indeed, the accused should show that he amassed his wealth in a lawful and legal manner. This proposal has in it a deterrent element. The idea is that the law offender and all would-be offenders should be discouraged from ever committing money laundering offences. And once the burden of proof has been shifted to the defence, it would no longer be a question for the prosecution to prove beyond reasonable doubt that the accused committed the offence of money laundering. Rather, the accused would have to show, beyond reasonable doubt, that he or she legally and lawfully acquired the wealth and did not engage in any offence of money laundering.

Admittedly, if implemented, the above proposal would attract strong criticism. However, we are awake to this fact. A notable criticism here could be that implementing such a proposal would have disastrous effects on the rule of law and the constitutionally guaranteed presumption of innocence. Of course, there is a little

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749 See R v Wholesale Travel Group Inc (1991) 67 CCC (3rd) 193; Sagell v Attorney-General of the Western Cape & Others 1996 2 SACR 579 (CC); S v Coetzee, Coetzee, De Bruin & Marais 1997 3 SA 527 (CC); McKnight v NZ BioGas Industries Ltd [1994] 2 NZLR 664; Attorney-General of Hong Kong v Lee Kong-Kut [1993] AC 951 (Privy Council). Also, in the case of Constitutional Reference No 3 of 1978; Re Inter-Group Fighting Act 1977 [1978] PNGLR 421, the Papua New Guinea Supreme Court had to deal with a reverse onus of proof. In that case, sec 10(3) of the
water in this argument recognising that, in some cases, especially where the drafting of legislation is not properly carried out or where there is no due regard to the full spectrum of provisions in the Republican Constitution, shifting the burden of proof from the prosecution to the accused could be struck down by the courts (under judicial review of legislative action) as an unconstitutional measure.

But, then, is it not a precept of the law that to every general rule there can be an exception? Indeed, what wrong would there be in enshrining in the Republican Constitution an exception to the general rule, stating therein, unequivocally and explicitly, that, notwithstanding whatever is contained in the Bill of Rights, the exception applies only to offences of money laundering, corruption and drug trafficking? As the European Court ruled, in a matter involving continued pre-trial detention, such detention can only be justified ‘if there are specific indications of a genuine requirement of public interest which, notwithstanding the presumption of innocence, outweighs the rule of respect for individual liberty’. 750

A second proposal for law reform would be to lower the standard of proof in criminal law cases of money laundering from beyond reasonable doubt to the civil law standard of balance of probabilities.

Inter-Group Fighting Act 1977 provided that ‘[a] person charged with an offence against this section is guilty of that offence unless he proves to the satisfaction of the Court that he did not take part in the actual fighting’. But sec 37(4) of the Constitution of Papua New Guinea provided for a presumption of innocence in the following words: ‘A person charged with an offence: (a) shall be presumed innocent until proved guilty according to law, but a law may place upon a person charged with an offence the burden of proving particular facts which are, or would with the exercise of reasonable care be, peculiarly within his knowledge.’ In deciding over this case, the Supreme Court of Papua New Guinea examined, inter alia, whether the participation in an inter-group fight was, within the language of the Constitution, ‘peculiarly’ within the knowledge of the person charged. By a majority, it was found that the provision violated the constitutional presumption of innocence. The Supreme Court observed that the statutory provision could not be severed so as to retain the rest of the section. One of the judges, among the majority, observed: ‘It might be thought that as all that sub-section 11(3) does is to provide a bonus by enabling an accused person to secure his acquittal if he can prove that he did not take part in the actual fighting that there has been no serious erosion of the right to the protection of the law. I am of the opinion, however, that it is a bad precedent, the thin end of the wedge. The Supreme Court has been appointed the guardian of the people’s fundamental rights and freedoms as defined in the Constitution. It should be vigilant to ensure that there is not the slightest infringement of any of these rights and freedoms’ (431). Commenting on this ruling, D Freestone ‘The burden of proof in natural resources legislation: Some critical issues for fisheries law’ FAO Legislative Study 63 (Rome: FAO, 1998) 17) observes as follows: ‘Although it (the Supreme Court) did not determine the matter conclusively for the purposes of the meaning of the term in the Papua New Guinea Constitution, it was recognised that the term “peculiarly within the knowledge of” the accused had acquired a certain meaning in the common law, referring to such circumstance as requiring the accused to prove that he or she possessed a licence, etc. The decision is a straightforward illustration of what can be expected in countries with a system of constitutionally-guaranteed fundamental rights which include the presumption of innocence.’

Such a measure would remove the onerous and strenuous task on the prosecution — especially given the fact that law policing and criminal investigation offices in Zambia are understaffed and have limited resources at their disposal — to prove beyond reasonable doubt that the accused committed the offence of money laundering. Indeed, there are a number of cases in Zambia where an individual cannot even account for the wealth he or she has amassed over a relatively short period of time. Zambia has seen a number of poverty-stricken individuals enter politics and suddenly emerge as some of the wealthiest citizens of that country. However, given the rigidity in the law, insisting on the presumption of innocence as an absolute and fundamental right, and requiring that ‘he who asserts must prove’ beyond reasonable doubt, such individuals have never been charged or prosecuted. And where prosecutions have been instigated, these individuals have often been acquitted by the courts partly due to the unprofessional manner in which the prosecution has handled some of these cases.

9 Civil liability in cases of money laundering

Under the Prohibition and Prevention of Money Laundering Act 2001, civil liability of money launderers arises mainly in regard to statutory provisions dealing with the seizure and forfeiture of property. That said, caution should be exercised when applying concepts of civil liability to cases of money laundering. As Burrell and Cogman observe:

A recent decision of the Commercial Court considers the position of institutions which suspect that funds in their possession are the proceeds of crime. *Amalgamated Metal Trading Ltd v City of London Police Financial Investigation Unit and Others* [2003] EWHC 703 (Comm) is a warning of the pitfalls of adopting the wrong procedural route when attempting to resolve the conflicts between the money laundering regime and the imposition of civil liability. It also adopts the theme, notable in the earlier Bank of Scotland decision, that institutions must bear some of the commercial risks that arise when money laundering is suspected ... There are a number of options open to financial institutions when faced with a dilemma regarding possible money laundering. It is easier to deal with the criminal issues and avoid liability for tipping off than it is to avoid possible civil liability and legal costs. It is therefore important that in any such situation, a clear strategy is identified from the outset, so that costs are not wasted on unnecessary court applications.  

9.1 Seizure of property

As a general rule, an authorised officer is under a statutory duty to seize property which he has *reasonable grounds to believe* was derived or acquired from money laundering.\(^{752}\) We have already examined the concept of *reasonable grounds to believe* when we looked at the ruling of the United States Supreme Court in *US v Arvizu*.\(^{753}\) In that case, the test of *totality of the circumstances* and *factual inferences* was laid out. Here, the authorised officer cannot turn a blind eye if he has reasonable grounds to believe that the property in issue was either derived or acquired from money laundering activities. And section 2 of the Prohibition and Prevention of Money Laundering Act 2001 defines an *authorised officer* as an officer authorised by the Commissioner of the Anti-Money Laundering Investigations Unit to perform functions under the Prohibition and Prevention of Money Laundering Act 2001.

9.2 Release of seized property

Generally, where property is seized under the Prohibition and Prevention of Money Laundering Act 2001, the authorised officer who effected the seizure may, at any time before it is forfeited under that Act, order the release of the property to the person from whom the property was seized if the officer is satisfied that the property is not liable to forfeiture under the Prohibition and Prevention of Money Laundering Act 2001 and is not otherwise required for the purpose of any investigations or proceedings under the said statute or for the purpose of any prosecution under any written law.\(^{754}\) The officer effecting the release is required by law to record in writing, specifying in detail the circumstances of, and the reasons for, the release.\(^{755}\) And when the property is released, the officer who effected the seizure, or the state or any person acting on behalf of the state, will not be liable to any civil proceedings by any person unless it is proved that the seizure and the release were not done in *good faith*.\(^{756}\) But what is *good faith*?\(^{757}\) The concept of good faith may have different meanings to different people. However, in day to

\(^{754}\) Prohibition and Prevention of Money Laundering Act 2001, sec 16(1).
\(^{757}\) See Vallejo v Wheeler 98 Eng Rep 1012; Banque Financiere de la Cite SA v Westgate Insurance Co Ltd (unreported, Court of Appeal of England, 28 July 1988); Allen v Flood 1898 App Cas 1 46 (PC 1897); The ICC Arbitration Case 8611 of 1997.
day ordinary parlance, the term good faith may be understood as complying with some standards of decency and honesty.

Keily argues that good faith is not a principle which can be adequately defined and that it has been described vaguely as a rechristening of fundamental principles of contract law and a phrase with no general meaning but which operates to exclude various forms of bad faith. Good faith is also seen as a discretionary standard preventing parties from recapturing opportunities that were foregone when contracting. In addition, good faith has been compared with unconscionability, 'fairness, fair conduct, reasonable standards of fair dealing, decency, reasonableness, decent behaviour, a common ethical sense, a spirit of solidarity, community standards of fairness' and 'honesty in fact', indicating that good faith is an extremely versatile concept. Commenting on good faith, Keily observes:

[[Its versatility is an essential characteristic because, as stated by Aristotle, 'there are some cases for which it is impossible to lay down a law, so that a special ordinance becomes necessary. For what is itself indefinite can only be measured by an indefinite standard.' However, good faith is not an obligation to act altruistically. Regretfully, Lücke writes, 'one must leave the universal adoption of such a noble motive to some far-distant and much more enlightened age.' Good faith does not require the abandoning of self-interest as the governing motive in contractual relations. However, it may prevent a party from abusing a legal right ...]]

9.3 Forfeiture of property

As a general rule, any property which has been seized under the Prohibition and Prevention of Money Laundering Act 2001, and which is in the possession or under the control of a person convicted of a money laundering offence and which property is derived or acquired from proceeds of that crime, is liable to forfeiture by a court of law. Here, subject to any statutory limitations in the criminal procedural laws and the civil procedural laws of Zambia, the subordinate courts and the High Court, respectively, have jurisdiction.

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759 See Farnsworth (n 186 above) 59-61.
761 See generally Keily (n 760 above).
762 As above.
763 As above.
764 Prohibition and Prevention of Money Laundering Act 2001, sec 17(1)
to hear cases of forfeiture of property. 765 However, where a person whose property has been forfeited dies before or after the order of forfeiture by a court has been made, the order will have effect against the estate of the deceased. 766

Where property is seized and no prosecution for any offence under any written law is instituted with regard to the property, including where no claim in writing is made by any person and where no proceedings are commenced within six months from the date of seizure, the Commissioner of the Anti-Money Laundering Investigations Unit can apply to a court of law, upon the expiration of the six months period, for an order of forfeiture of the property. 767 The court will not make an order of forfeiture unless the Commissioner meets two statutory conditions: first, that he has given notice by publication in the Gazette and in one national newspaper that the seized property is liable to vest in the state if it is not claimed within three months, 768 and, secondly, three months after giving this notice the property remains unclaimed. 769

However, where a claim in writing is made by a person that is lawfully entitled to the property, indicating that the property is not liable to forfeiture under the Prohibition and Prevention of Money Laundering Act 2001, the Commissioner may order the release of the property to the claimant if satisfied that there is no dispute regarding the ownership of the property and that it is not liable for forfeiture. 770 By contrast, where a claim is made against property seized under the Prohibition and Prevention of Money Laundering Act 2001 and the Commissioner finds that there is a dispute over the ownership of the property, or that there is insufficient evidence to determine the ownership of the property, or that the Commissioner is unable to ascertain whether the property is liable to forfeiture or not, the Commissioner will refer the claim to the High Court. 771 Here, subordinate courts have no jurisdiction over such matters. 772

In determining whether any property belongs to, or is in the possession or under the control of any person — that is, a 'claimant' — the High Court can, upon an application by the Commissioner, make two types of orders. 773 These orders can either run concurrently or be sequential. The High Court can also choose to make one order only or

769 As above.
772 As above.
none at all. One order would require that any document relevant to (i) the identification, the location or the quantification of the property, or (ii) the identification or the location of any document necessary for the transfer of the property of the claimant be delivered to the Commissioner. The other order would direct a regulated institution to produce to the Commissioner all information obtained by that institution about any business transaction conducted by or for the claimant with the institution before or after the date of the order as the court may direct. 

However, where the Commissioner is satisfied that an individual or a person is failing to comply with, or is delaying, or otherwise obstructing the court order, an authorised officer can enter the premises of that person, search the premises and remove any material document or other thing therein for the purpose of executing the court order. And such premises include a workplace such as a bank or financial institution. Where property is forfeited, say, from a bank or financial institution, pursuant to provisions of the Prohibition and Prevention of Money Laundering Act 2001, it will vest in the state. And any person who tampers with that property or with seized property will be guilty of an offence and liable, upon conviction, to a fine or a term of imprisonment.

9.4 Investigations and power to arrest and search

As a general rule, every offence under the Prohibition and Prevention of Money Laundering Act 2001 is a cognisable offence for purposes of the Criminal Procedure Code. Thus, where a person arrested under the Prohibition and Prevention of Money Laundering Act 2001 is serving a sentence of imprisonment, or is in lawful custody, that person should, upon an order by a magistrate, be brought before that magistrate at such a place as would be specified in the order for the purpose of investigations into the matter in respect of which the

774 As above.
775 See above for the statutory definition of the term ‘regulated institution’, as provided for in sec 2 of the Prohibition and Prevention of Money Laundering Act 2001.
person is liable to be arrested under the Prohibition and Prevention of Money Laundering Act 2001.\textsuperscript{781}

Also, whenever an authorised officer has reasons to believe that there is \textit{reasonable cause to suspect}\textsuperscript{782} that in or on any premises there is concealed or deposited any property liable to seizure or forfeiture under the Prohibition and Prevention of Money Laundering Act 2001, or to which an offence under that Act is reasonably suspected to have been committed, or any book or document directly or indirectly relating to, or connected with, any dealing or intended dealing, whether within or outside Zambia, in respect of any property liable to seizure or forfeiture under the Act, or which would, if carried out, be an offence under the said Act, the authorised officer can, with a warrant issued by a court of competent jurisdiction, do any one or more of the following:

(a) enter the premises and search for, seize and detain any such property, book or document;

(b) search any person who is suspected or connected with the offence, in or on the premises, and take that person into custody in order to facilitate the investigations;

(c) arrest any person who is in or on the premises in whose possession any property liable for seizure or forfeiture under the Prohibition and Prevention of Money Laundering Act 2001 is found, or whom the officer reasonably believes to have concealed or deposited the property;

(d) break, open, examine, and search any premises, article, container or receptacle suspected or connected with the offence; or

(e) stop, search and detain any conveyance.\textsuperscript{783}

Again, this statutory provision applies to banks and financial institutions. An authorised officer can therefore have access to bank records or records of any financial institution regulated by the Bank of Zambia. Let us now turn to the statutory duties of supervisory authorities and regulated institutions complementing the Bank of Zambia Anti-Money Laundering Directives 2004.

10 Statutory duties of the Bank of Zambia in fighting money laundering

Under the Prohibition and Prevention of Money Laundering Act 2001, where a supervisory authority, such as the Bank of Zambia, obtains

\textsuperscript{781} Prohibition and Prevention of Money Laundering Act 2001, sec 22(2).

\textsuperscript{782} See above for an insightful discussion regarding the meaning of 'reasonable cause to suspect'.

\textsuperscript{783} Prohibition and Prevention of Money Laundering Act 2001, sec 23.
information that a business transaction indicates that a person has or may have been engaged in money laundering, the supervisory authority should disclose or cause to be disclosed that information to the Anti-Money Laundering Investigations Unit.\textsuperscript{784} Section 2 of the Prohibition and Prevention of Money Laundering Act 2001 defines a ‘business transaction’ as ‘any arrangement, including opening of a bank account, between two or more persons where the purpose of the arrangement is to facilitate a transaction between the two or more persons’.

As a general rule, a supervisory authority, such as the Bank of Zambia, should not obstruct any investigation into money laundering that may be instituted by the Anti-Money Laundering Investigations Unit.\textsuperscript{785} And any officer of the supervisory authority who is responsible for or causes such supervisory authority to obstruct the investigation will be guilty of a criminal offence and liable, upon conviction, to a fine or a term of imprisonment, or to both.\textsuperscript{786}

Also, supervisory authorities are required by law to issue such directives as may be approved by the Anti-Money Laundering Investigations Unit and which may be necessary for regulated institutions to apply in preventing and detecting money laundering.\textsuperscript{787} So far, only the Bank of Zambia has issued these directives.\textsuperscript{788} As argued below, other supervisory authorities should also issue directives and ensure that those directives are adhered to by the institutions they regulate. The issuance of such directives would help to strengthen the legal and regulatory framework for fighting money laundering in Zambia. Complex money laundering schemes, such as smurfing, cannot be easily captured by legislation alone. The Association of Certified Anti-Money Laundering Specialists observes:

Smurfing is a commonly-used money laundering method. It is a term widely used to describe a laundering scheme that involves criminals making multiple transactions of less than the reporting threshold in order to cause financial institutions to avoid filing currency transaction reports.\textsuperscript{789}

Given that the reporting threshold in different segments of the financial sector will obviously be different, and that these thresholds will normally be determined not only by legislation, but also by different types of regulations set by the respective regulators in the

\textsuperscript{784} Prohibition and Prevention of Money Laundering Act 2001, sec 12(1).
\textsuperscript{785} Prohibition and Prevention of Money Laundering Act 2001, sec 12(2).
\textsuperscript{786} Prohibition and Prevention of Money Laundering Act 2001, sec 12(3).
\textsuperscript{787} Prohibition and Prevention of Money Laundering Act 2001, sec 12(4).
\textsuperscript{788} See ch 4.
\textsuperscript{789} See Association of Certified Anti-Money Laundering Specialists (ACAMS) (n 541 above) 35.
respective segments of the financial sector, it is only best that the regulators themselves issue regulatory rules to fight sector-specific activities of money laundering. And these activities could involve smurfing. Relying solely on legislation as the only weapon to fight smurfing is not good enough. Indeed, the reporting thresholds in various segments of the financial sector tend to differ. For example, the banking sector may have different reporting thresholds from the insurance and pension fund sectors. Also, the securities industry may have its own reporting thresholds, as determined by the securities regulator. So, in addition to what is contained in principal and secondary legislation, supervisory authorities issue their own directives to fight such activities of money laundering as are related to the type of businesses and financial institutions they regulate.

11 Statutory duties of regulated institutions in the prevention of money laundering

In Zambia, there are two major statutory duties owed by an institution regulated by such supervisory authority as the Bank of Zambia. First, the regulated institution is under a statutory obligation to prevent offences of money laundering. In pursing this goal, the regulated institution should:

(a) keep an identification record and a business transaction record for a period of ten years after the termination of the business transaction so recorded;

(b) report to the Anti-Money Laundering Investigations Unit where the identity of the persons involved, the circumstances of any business transaction or where any cash transaction, gives any officer or employee of the regulated institution reasonable grounds to believe that a money laundering offence is being, has been or is about to be committed;

(c) comply with any directives issued to it by the supervisory authority with respect to money laundering activities;

(d) permit any authorised officer with a warrant, upon request to enter into any premises of the regulated institution during working hours and inspect records suspected of containing information relating to money laundering;

(e) permit an authorised officer with a warrant to make notes or take any copies of the whole or any part of the record referred to in paragraph (d) above; and

792 See ch 4, as well as below, on what constitutes an 'identification record'.
793 See ch 4, as well as below, on what constitutes a 'business transaction record'.
794 See above for a fuller discussion of the phrase 'reasonable grounds to believe'.
(f) designate an officer in each branch or local office to be responsible for reporting all transactions suspected of being related to money laundering.

Secondly, it is a requirement that a regulated institution should not obstruct any investigations into money laundering that may be instituted by the Anti-Money Laundering Investigations Unit. A regulated institution that does not abide by the two statutory duties will be guilty of an offence and liable, upon conviction, to a fine. Also, where a regulated institution is guilty of an offence under the Prohibition and Prevention of Money Laundering Act 2001 any officer or employee of the institution who is responsible for, or causes, the regulated institution to commit the offence will be guilty of an offence and liable, upon conviction, to a fine or a term of imprisonment, or to both. In determining whether a regulated institution, officer or employee of a regulated institution has complied with the two statutory duties described above, a court can take account of the directives issued by a supervisory authority and which directives apply to that regulated institution, officer or employee of the regulated institution.

Further, the statutory obligations spelt out above are also found in the Bank of Zambia Anti-Money Laundering Directives 2004, although the Bank of Zambia Directives, as noted in chapter 4, apply only to institutions regulated by the central bank. The Prohibition and Prevention of Money Laundering Act 2001 is, however, broader in scope and scale, though, like the Bank of Zambia Anti-Money Laundering Directives 2004, it also provides as follows:

A regulated institution shall, with the assistance of the Unit (Anti-Money Laundering Investigations Unit) provide employees with training:

(i) on the enactments and regulations on money laundering;
(ii) in mechanisms for preventing money laundering; and
(iii) in the recognition and handling of business transactions carried out by or on behalf of any person who is or appears to be engaged in money laundering.

See ch 4.
See above.
12 Conclusion

As a corollary to the discussion in the preceding chapter on the Bank of Zambia Anti-Money Laundering Directives 2004, this chapter has examined the efficacy of the main legislative framework for combating money laundering in Zambia. The chapter focused on Zambia's banking sector. The Anti-Money Laundering Investigations Unit was identified as the country's FIU. Zambia has an FIU typology which vests both investigatory and prosecuting powers in the FIU. And while the FIU shares the same commissioner with the Drug Enforcement Commission, the latter institution is part of the Ministry of Home Affairs of the Republic of Zambia. An argument was made that the FIU's independence might be compromised by this 'political' organisational set-up, especially that the Commissioner and Head of Zambia's Drug Enforcement Commission is also the Commissioner and Head of Zambia's Anti-Money Laundering Investigations Unit.

Following on the discussion in chapter 4, regarding the directives of the Bank of Zambia on combating money laundering, a submission was made that there is need for other supervisory authorities, including those organisations responsible for regulating gatekeepers, to issue directives on money laundering. Also, it was pointed out that, where banks or financial institutions engage in tax evasion, such conduct could trigger the offence of money laundering. Tax evasion, as an illegal activity, is a predicate offence of money laundering in Zambia. And there is also a need to specify in Zambia's Prohibition and Prevention of Money Laundering Act 2001 that officers or employees of that country's Anti-Money Laundering Investigations Unit should not be held liable for wrongs, acts or omissions committed in good faith while in the course of business.
1 Introduction

This chapter examines the concept of 'unsafe and unsound practice' in banking regulation in Zambia. The chapter focuses on banking jurisprudence in Zambia, drawing analogies from common law jurisdictions such as the United States of America and the United Kingdom. Although many jurisdictions, including Zambia and many parts of the United States of America, do not have a statutory definition of 'unsafe and unsound practice', the United States of America has had a number of court cases examine the term 'unsafe and unsound practice'. The judiciary in the United States of America has often deferred to the expertise of bank regulatory agencies the definition of what constitutes an 'unsafe and unsound practice', limiting their (ie the judiciary's) review to a determination of whether the regulatory agency's action was arbitrary, capricious, or otherwise unsupported by substantial evidence in the record. By contrast, Zambia has not had much experience with the term 'unsafe and unsound practice'.

The chapter argues that, although what constitutes an 'unsafe and unsound practice' depends on the facts of each case, the Bank of Zambia should consider spelling out an interpretation of 'unsafe and unsound practice' so as to promote the regulator's consistent and well-meaning enforcement of the law. And although no statutory definition of 'unsafe and unsound practice' can be cited readily in any jurisdiction, that argument alone does not defeat the view that the

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803 See below.

804 See generally n 804 above.
central bank, as the bank regulator in Zambia, should provide an interpretation of ‘unsafe and unsound practice’. The crucial point here is in distinguishing the word ‘definition’ from ‘interpretation’. While parliament should, in the ordinary course of things, provide a statutory definition of ‘unsafe and unsound practice’, the central bank can, however, give a policy interpretation of the meaning of ‘unsafe and unsound practice’, given the absence of a statutory definition. The initiative of the central bank can be done through legal opinions of the Bank Secretary, as head of the Legal Department, or through a policy statement, or through guidance notes, on what, according to the central bank, constitutes ‘unsafe and unsound practice’. While we recognise that it is not the primary responsibility of either the courts or the central bank to legislate a definition of ‘unsafe and unsound practice’, the central bank is not prohibited by any law from providing policy guidance on the meaning of the term ‘unsafe and unsound practice’. Indeed, 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’.

In the international community, it is a notorious fact that, as part of the duties and functions of a General Counsel of any international financial institution, the General Counsel will issue legal opinions which form a basis of interpreting business policies and practices of the financial institution. By parity of reasoning, is there no implied duty on the Bank Secretary, as the head of the Legal Department of the central bank, to provide management, banking supervisors and non-banking supervisors with a legal interpretation of ‘unsafe and unsound practice’? Some superficial cynics will readily warm up to arguments in favor of ‘constructive ambiguity’, agitating that providing a succinct interpretation of ‘unsafe and unsound practice’ could limit the scope of activities that the central bank can treat as ‘unsafe and unsound practice’, especially if some novel circumstances arise, leading to malpractices that are not covered within that interpretation. But let us take a more reasoned look. We are not arguing that the central bank should decree a definition of ‘unsafe and unsound practice’ to remedy the omissions of parliament. Rather, we are saying that the central bank should provide a policy interpretation of ‘unsafe and unsound practice’. An interpretation, unlike a definition, is more likely to provide the public with a less precise, but wider in scope understanding of what types of activities fall within the meaning of the term ‘unsafe and unsound practice’. Overall, an interpretation would lend more meaning to what the regulator can do and cannot do.
2 The concept of ‘unsafe and unsound practice’

After laying out the conceptual framework in which we should understand the term ‘unsafe and unsound practice’ in Zambia, the chapter distinguishes the offence of money laundering from unsafe and unsound practice, pointing out that in certain situations the offence of unsafe and unsound practice can predicate the offence of money laundering. An examination of whether an ultra vires act or course of conduct of a bank’s directors can constitute ‘unsafe and unsound practice’ in Zambia is presented, showing the complex legal implications of not having a legal interpretation of the term ‘unsafe and unsound practice’. Under Zambia’s banking law, the concept of ‘unsafe and unsound practice’ is spelt out in section 77 of the Banking and Financial Services Act 1994. This statutory provision is reflective of Core Principle 19 of the Basel Core Principles for Effective Banking Supervision. Core Principle 18 provides that

an effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.805

Then, section 77(1) of the said Banking and Financial Services Act 1994 reads, in turn:

Where, in the opinion of the Bank of Zambia, a bank or financial institution is committing or pursuing or is about to commit or pursue on behalf of the bank or financial institution any act or course of conduct that is considered by the Bank of Zambia as unsafe or unsound practice, the Bank of Zambia may enter into one or more written agreements with the bank or financial institution or its board of directors to establish a programme of action to counteract the unsafe or unsound practice and to establish or maintain safe and sound practices in the conduct of the business of the bank or financial institution.806

However, section 77(1) does not provide a definition of ‘unsafe and unsound practice’, but merely refers to the term ‘unsafe and unsound practice’ and highlights the steps that the Bank of Zambia should take whenever, in its discretion, it determines that an act or course of conduct of a particular bank or financial institution constitutes ‘unsafe and unsound practice’. Section 77(2) of the Banking and Financial Services Act 1994 goes on to say:

805 See Basel Committee (n 7 above) 2-5.
Where the Bank of Zambia is unable to obtain an agreement under subsection (1) within a time, and in a form and content, satisfactory to the Bank of Zambia, or where the Bank of Zambia considers that the need for prompt action makes the negotiating of such an agreement impractical, the Bank of Zambia may direct the bank or financial institution or any director, manager or other person concerned in its management to do either or both of the following:

(a) cease or refrain from doing the act or pursuing the course of conduct;

(b) perform such acts as, in the opinion of the Bank of Zambia are necessary to rectify the situation.

In particular, but without limiting the generality of subsection (2) above, the Bank of Zambia can:

(a) direct the culpable bank or financial institution to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way;

(b) impose any limitation on the bank's acceptance of deposits or the payment of interest thereon, the granting of credit, the making of investments or the payment of dividends;

(c) prohibit the bank or financial institution from soliciting deposits or the payment of the interest thereon either generally or from specified persons or classes or persons;

(d) prohibit the bank or financial institution from entering into any other transaction or class of transactions, or from commencing or continuing any activity which it is permitted under the Banking and Financial Services Act 1994 to carry on; or

(e) require the suspension or removal from office of any director, officer or other person.

Directions given by the Bank of Zambia under section 77 of the Banking and Financial Services Act 1994 are given by notice in writing to the bank or financial institution or person concerned and can, in like manner, be varied or revoked. Such directions are considered effective from the moment they are passed. The directions remain in effect in accordance with the terms on which they were passed unless they are discontinued on appeal.

As a general rule, any person who contravenes a provision of the agreement made or a direction given by the Bank of Zambia under section 77 of the Banking and Financial Services Act 1994 will be guilty
of an offence and liable, upon conviction, to a fine or a term of imprisonment, or to both.811 Although the Minister of Finance can, in consultation with the Bank of Zambia, prescribe subsidiary legislation that identifies certain acts or course of conducts of banks and financial institutions as 'unsafe or unsound practice',812 no such legislation has ever been enacted. The Banking and Financial Services Act 1994 simply prohibits any person from carrying out 'unsafe or unsound practice', but does not define the term 'unsafe and unsound practice'.813 And as a penalty for breach of this prohibition, any person who carries out unsafe or unsound practice commits an offence and is liable on conviction to a fine or a term of imprisonment, or to both.814 The uncertainty that comes with the absence of a statutory definition, or a regulatory norm, or some policy guidance interpreting 'unsafe and unsound practice' presents two choices: (a) The Bank of Zambia can exercise discretionary powers and capture incidents that were not contemplated as 'unsafe and unsound practices'; and (b) some banks, financial institutions and investors will become risk averse and avoid pursuing product innovation in the banking sector, fearing that if they did so, they will be caught up by section 77 of the Banking and Financial Services Act 1994 as engaging in 'unsafe and unsound practices'. And while the latter choice can affect investor confidence in the banking sector, the former choice could be abused, say, where there is political pressure from the state on the regulator to persecute a particular bank, financial institution or any of its directors for alleged acts or courses of conduct deemed as 'unsafe and unsound practice'. Again, such developments can affect investor confidence in the market. So, what is the way forward?

3 The Zambian case of Access Finance Services and Another v Bank of Zambia

An opportunity arose in 2003 for the High Court of Zambia to examine critically the concept of unsafe and unsound practice under Zambia's Banking and Financial Services Act 1994, but the High Court missed that opportunity.815 In the Zambian case of Access Finance Services

811 Banking and Financial Services Act 1994, sec 77(6).
812 Banking and Financial Services Act 1994, sec 77(8).
813 Banking and Financial Services Act 1994, sec 77(9).
814 Banking and Financial Services Act 1994, sec 77(10).
815 See below.
Limited and Access Leasing Limited v Bank of Zambia,\(^{816}\) the central bank, the Bank of Zambia (BoZ), took over possession of both Access Finance Services Limited (AFSL) and Access Leasing Limited (ALL) in early 2003.\(^{817}\) The two companies were alleged to have been involved in criminal activities that included unsafe and unsound practice.\(^{818}\) Contesting the decision of BoZ, the applicants, AFSL and ALL, applied for judicial review to the High Court of Zambia.\(^{819}\)

The applicants challenged the decision of BoZ to place them into compulsory winding up. BoZ argued that both AFSL and ALL not only breached the Banking and Financial Services Act 1994, including other written laws and, also, because they were insolvent.\(^{820}\) BoZ submitted before High Court judge Japhet Banda that the wording of sections 81, 84(B) and 101 of Zambia's Banking and Financial Services Act 1994 made it clear that parliament left it to BoZ to determine and establish facts that may compel BoZ to take its supervisory actions against any bank or financial institution.\(^{821}\) BoZ contended that the determination of insolvency or solvency of any financial institution and the determination of what action was necessary to enable it carry out its functions under Zambia's Banking and Financial Services Act 1994 was a matter that parliament entrusted BoZ to resolve.\(^{822}\) And BoZ was of the view that, as a supervisory agency, it had exercised its powers properly upon examining the business activities and financial books of AFSL and ALL. According to BoZ,

\(^{816}\) 2003/HP/359, unreported case in the High Court of Zambia (judgment delivered on 1 September 2004). See also the appeal to the Supreme Court of Zambia, Bank of Zambia v Chungu & Others (163/2005) [2008] ZMSC 12; SCZ 15 of 2008 (24 April 2008), which also did not fully address critically the concept of unsafe and unsound practice under Zambia's Banking and Financial Services Act 1994, but dealt instead with the issue of whether a solvent bank or financial institution can be placed under compulsory liquidation by the Bank of Zambia under the statutory provision relating to unsafe and sound practice even when the bank or financial institution was not insolvent.


\(^{818}\) See Bank of Zambia (n 819 above).

\(^{819}\) Access Finance Services Limited (n 819 above).


\(^{821}\) As above.

\(^{822}\) As above.
Unsafe and unsound banking practices

It is not open to the applicants under judicial review application to challenge the merits of BoZ's decision. All they could do is to call into question the decision making process that BoZ followed...

BoZ argued further that although, as a supervisory agency, it had not prescribed accounting systems and software packages to be followed by banks and financial institutions, AFSL and ALL did engage in obscure accounting practices designed to disguise sources of funds attributed to certain credit accounts and thereby obstructing the audit trail. According to BoZ, AFSL and ALL had been using journal vouchers to post receipt of funds to general accounts with confusing or misleading narrations, and this practice 'was obviously contrary to the spirit of Zambia's Banking and Financial Services Act'.

AFSL and ALL were quick to counter-argue that the alleged unsafe and unsound practices committed by AFSL and ALL were not defined anywhere in Zambia's Banking and Financial Services Act 1994. Indeed, section 77(1) of Zambia's Banking and Financial Services Act 1994 provides as follows:

Section 77(1), as reproduced above, does not provide a definition of 'unsafe and unsound practice', but merely refers to the term 'unsafe and unsound practice' and highlights the steps that BoZ should take whenever, in its discretion, it determines that an act or course of conduct of a particular bank or financial institution constitutes 'unsafe and unsound practice'. Against the foregoing, can the ultra

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823 As above.
824 As above.
825 As above.
826 As above.
827 Banking and Financial Services Act 1994, sec 77(1) (as amended through to 2000).
828 Sec 77(2) of Zambia’s Banking and Financial Services Act 1994 reads as follows: ‘Where the Bank of Zambia is unable to obtain an agreement under subsection (1) within a time, and in a form and content, satisfactory to the Bank of Zambia, or where the Bank of Zambia considers that the need for prompt action makes the negotiating of such an agreement impractical, the Bank of Zambia may direct the bank or financial institution or any director, manager or other person concerned in its management to do either or both of the following: (a) cease or refrain from
vi res act or conduct of a bank or financial institution be construed as ‘unsafe and unsound practice’?

Notwithstanding the submissions made by the parties to the case,\(^{829}\) not much thought was accorded by the court to the concept of ‘unsafe and unsound practice’ under Zambia’s Banking and Financial Services Act 1994. In the 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’, limiting their (ie the judiciary’s) review to a determination of whether the regulatory agency’s action was arbitrary, capricious, or otherwise unsupported by substantial evidence in the record.\(^{830}\)

By contrast, in the Zambian case of Access Finance Services and Another v Bank of Zambia,\(^{831}\) Judge Banda merely alluded to section 77 of Zambia’s Banking and Financial Services Act 1994 on pages J13 and J19 of his ruling, without explaining, obiter dictum, what would constitute, for example, arbitrary or capricious action by a regulatory agency such as BoZ, or what would otherwise constitute an action unsupported by substantial evidence in the record. Although an order for certiorari was granted, on the 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 two companies. And neither was the issue of whether BoZ, as the bank regulator, had acted arbitrarily or capriciously addressed in greater detail. What would happen if, for doing the act or pursuing the course of conduct; (b) perform such acts as, in the opinion of the Bank of Zambia are necessary to rectify the situation.’ In particular, but without limiting the generality of subsec (2) above, the Bank of Zambia can, in accordance with sec 77(3) of Zambia’s Banking and Financial Services Act 1994, (a) direct the culpable bank or financial institution to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way; (b) impose any limitation on the bank’s acceptance of deposits or the payment of interest thereon, the granting of credit, the making of investments or the payment of dividends; (c) prohibit the bank or financial institution from soliciting deposits or the payment of the interest thereon either generally or from specified persons or classes or persons; (d) prohibit the bank or financial institution from entering into any other transaction or class of transactions, or from commencing or continuing any activity which it is permitted under Zambia’s Banking and Financial Services Act 1994 to carry on; or (e) require the suspension or removal from office of any director, officer or other person.

\(^{829}\) Constant reference was made in the judgment to secs 81, 84, 86 and 101 of the Banking and Financial Services Act 1994.

\(^{830}\) See, eg, Eden 568 F 2d 611; Groos Nat’l Bank v Comptroller of the Currency 573 F 2d 889 897 (5th Cir 1978); La Marque 610 F 2d 1264. See also In re Franklin Nat’l Bank Securities Litigation 478 F Supp 210 221 (EDNY 1979); First Nat’l Bank of Eden v Department of the Treasury 558 F 2d 610 611 n 2 (8th Cir 1978) (per curiam); First Nat’l Bank of La Marque v Smith, 610 F 2d 1258 1265 (5th Cir 1980); and Briggs v Spaulding 141 US 132 165-66 (1891).

\(^{831}\) See n 819 above.
example, although having engaged in unsafe and unsound practices, AFSL and ALL had now ceased to do so? Would this fact alone exonerate AFSL and ALL from liability, since section 77(1) of the Banking and Financial Services Act 1994 talks only in the present and future tenses that 'where, in the opinion of the Bank of Zambia, a bank or financial institution is committing or pursuing or is about to commit or pursue on behalf of the bank or financial institution any act or course of conduct that is considered by the Bank of Zambia as unsafe or unsound practice'? These are some of the issues that should have been resolved by an obiter dictum of the court. Also, what would happen if, AFSL and ALL, for example, were to engage in unsafe and unsound practice solely for corrective purposes and in order to prevent future abuses? Could they still be held liable under section 77 of the Banking and Financial Services Act 1994?

No doubt, it would have been helpful if BoZ had in its policies or regulations promulgated some examples of 'unsafe and unsound practice'. Such examples could have included tax evasion, money laundering, anti-competitive banking practices, predatory lending, insider lending, and the payment of excessive management fees. BoZ should have made an effort to interpret the statutory term 'unsafe and unsound practice' through, say, a policy statement. And such a policy statement need not provide an exhaustive list of examples, but should allow for constructive ambiguity so that BoZ can, with time, be able to determine or include other incidents that are not listed as 'unsafe and unsound practice'.

Other illustrations of unsafe and unsound practice include operating a bank or financial institution with inadequate levels of capital protection for the quality and volume of assets held, recapitalising a bank largely by using the funds of its own depositors, maintaining an inadequate loan loss reserve, operating a bank with an excessive volume of poor quality loans and assets, a bank making inadequately secured loans, failing to provide supervision over the active officers of the bank adequate to prevent unsafe or unsound practices, as well as other offences listed in the Banking and Financial Services Act 1994, including some statutory offences under other pieces of Zambian legislation (for instance the offence of financial assistance by a company, such as a bank, in the acquisition of its shares under the Zambian Companies Act 1994 and the cooking up of books of accounts in contravention of prevailing accounting standards or any other acts or omissions prohibited by the Bank of Zambia Anti-Money Laundering Directives 2004). Thereafter, a general clause stating that these incidents are only examples and do not constitute an exhaustive list of prohibitions should have been promulgated. To illustrate, the Statement on Unsafe and Unsound Banking Practices issued by the Oklahoma State Banking Department provides as follows:
The concept of unsafe and unsound banking practices is one which touches upon the entire operation of a bank. It is impossible to create a single, all-inclusive definition of activities which would fall within its scope. Whether a particular activity is an unsafe or unsound banking practice must be determined in light of all relevant facts. The Oklahoma State Banking Department furnishes the following list as a guideline only. The activities described herein are not irrebuttably presumed to be unsafe or unsound. Conversely, not all practices which might under the circumstances be termed unsafe or unsound are mentioned here. (1) Operating with management whose policies and practices are detrimental to the bank or trust company and jeopardize the safety of the bank's or trust company's deposits. (2) Operating with total adjusted capital and reserves that are inadequate in relation to the kind and quality of the assets of the bank or trust company. (3) Operating in a way that produces a deficit in net operating income. (4) Operating with a serious lack of liquidity, especially in view of the asset and deposit structure of the bank or trust company. (5) Engaging in speculative and hazardous investment policies. (6) Paying excessive cash dividends. (7) Excessive reliance on purchased deposits. (8) Excessive reliance on letters of credit, either issued by the bank or accepted as collateral to loans advanced. (9) Excessive amounts of loan participations sold. (10) Paying interest on participations without advising participating institution that the course of interest was not from the borrower. (11) Selling participations without disclosing to the purchasers of those participations material, non-public information known to the bank. (12) Failure to limit, control and document contingent liabilities. (13) Engaging in hazardous lending and lax collection policies and practices, as evidenced by (a) an excessive volume of loans subject to adverse classification; (b) an excessive volume of loans without adequate documentation, including credit information; (c) excessive net loan losses; (d) an excessive volume of loans in relation to the total assets and deposits of the bank or trust company; (e) an excessive volume of weak and self-serving loans to persons connected with the bank or trust company, especially if a significant portion of these loans are adversely classified; (f) excessive concentrations of credit, especially if a substantial portion of this credit is adversely classified; (g) indiscriminate participation in weak and undocumented loans originated by other institutions; (h) failing to adopt written loan policies; (i) an excessive volume of overdue loans; and (j) failure to diversify the loan portfolio of the bank. (14) Permitting officers to engage in lending practices beyond the scope of their position. (15) Operating the bank with inadequate internal controls. (16) Operating the bank with excessive volume of out-of-territory loans. (17) Failure to heed warnings and admonitions of the supervisory authorities of the bank or trust company. (18) Continued and flagrant violation of any laws, rules, regulations or written agreements between the bank or trust company and the Bank Commissioner or the Banking Board, or orders of the Bank Commissioner or the Banking Board. (19) Any action likely to cause insolvency or substantial dissipation of assets or earnings of the bank or trust company or likely to seriously weaken the condition
of the bank or trust company or otherwise seriously prejudice the interest of its depositors.\textsuperscript{832}

The Hawaii Administrative Rules\textsuperscript{833} provide another example. These rules state as follows:

(a) The concept of an unsafe or unsound practice is one of general application which touches upon the entire field of operations of a financial institution. An unsafe or unsound practice encompasses any action or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would result in abnormal risk of loss or damage to an institution, its depositors, or its shareholders. An activity not necessarily unsafe or unsound in every instance may be so in a particular instance when considered in light of all relevant facts pertaining to that situation.

(b) An unsafe or unsound practice can result from either action or inaction by management. Although the law does not define the term unsafe or unsound practice, the division (ie in Hawaii) has established examples of such practices, some of which are listed below.

(c) Inaction by management which is deemed an unsafe or unsound practice includes, but is not limited to:

1. failure to provide adequate supervision and direction over officers of the institution;
2. failure to make provision for an adequate reserve for possible loan losses;
3. failure to post the general ledger promptly;
4. failure to keep accurate books and records;
5. failure to enforce programs for repayment of loans; or
6. failure to obtain or maintain on the premises evidence of priority of liens on loans secured by real estate.

(d) Action by management which is deemed an unsafe or unsound practice includes, but is not limited to:

1. operating with an inadequate level of capital for the kind and quality of assets held;
2. engaging in hazardous lending or lax collection practices such as: extending credit which is inadequately secured, extending credit without first obtaining complete and current financial information, extending credit in the form of overdrafts without adequate controls, and extending credit with inadequate diversification of risk;

\textsuperscript{832} US Oklahoma State Banking Department 'Statement on unsafe and unsound banking practices' available at http://www.state.ok.us/~osbd/Banks/Statutes/unsound.htm (accessed 25 April 2005).

\textsuperscript{833} The full title is Title 16, US Department of Commerce and Consumer Affairs, Chapter 27, Supervisory and Enforcement Action Relating to Financial Institutions.
(3) operating without adequate liquidity, in light of the institution's asset and liability mix;

(4) operating without adequate internal controls such as: failing to maintain controls on official checks and unissued certificates of deposits, failing to segregate duties of institution personnel, and failing to reconcile differences in correspondent bank accounts;

(5) engaging in speculative or hazardous investment policies; or (6) paying excessive dividends in relation to the institution's capital position, earnings capacity, and asset quality.

Following below is an examination of traditional theories on statutory interpretation that can guide the Bank of Zambia when interpreting the term 'unsafe and unsound practice'.

4 Statutory interpretation

There are various theories on rules of statutory interpretation. Let us take a reasoned look at some of them, as we examine the term 'unsafe and unsound practice' under Zambia’s Banking and Financial Services Act 1994. The literal rule implies giving the text its ordinary, everyday meaning, and applying it exactly as written. This rule came into prominence in the eighteenth century. The British Parliament was becoming increasingly significant as a source of law, usurping the common law and the royal prerogative. Until this time, the courts had tended to regard statutes as a device to plug holes in the common law. The golden rule, on the other hand, is best explained by referring to the usually cited authority of Lord Wensleydale in Grey v Pearson:

... the grammatical and ordinary sense of the words is to be adhered to, unless that would lead to some absurdity ... in which case the ordinary sense of the words may be modified so as to avoid that absurdity and inconsistency but no farther.

Probably the most famous application of the golden rule is in R v Allen, a case of bigamy. The wording of the legislation at the time defined bigamy as being married more than once. Since the second
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A more purposive approach to statutory interpretation can be found in the mischief rule. The rule itself is venerable; the name is taken from Heydon’s case,842 and in outline says that the job of the judge is to determine what defect in the common law the statute set out to remedy.843 A broader, and more usual, reading is that the judge should apply what is ascertained to be the intention of parliament.844 But, as Boone observes, courts do not always apply the mischief rule even when the ‘mischief’ is clear, and it would be plainly sensible to do so.845 For example, in Fisher v Bell,846 the prosecution of a shopkeeper for displaying flick-knives for sale failed because the wording of the English statute, the Restriction of Offensive Weapons Act 1951, used the term ‘offer for sale’. An offer for sale has the sense that if it is accepted a contract is formed then and there. Displaying goods in a shop is widely understood not to form an offer for sale in such terms: It is merely an ‘invitation to treat’. The court expressed dismay that it could not find according to the clear intention of parliament, and declined to apply the mischief rule. In the longer term, it could be argued, this was the right decision, because the statute was amended less than a year later to correct the defect in wording.847 The reality is that it is difficult to predict the interpretative approach that a court will adopt in a particular case.848

As early as 1938, Willis wrote:

[A] court invokes whichever of the rules produces a result that satisfies its sense of justice in the case before it. Although the literal rule is the one most frequently referred to in express terms, the courts treat all three as valid and refer to them as occasion demands, but, naturally enough, do not assign any reason for choosing one rather than another.849

Could we then say that the words ‘unsafe and unsound practice’ should be taken together and read as one, or that the word ‘unsafe’ should be distinguished and read separately from the word ‘unsound’? Here, the word ‘and’, standing between the words ‘unsafe’ and ‘unsound’, is a conjunction. Thus, unlike in jurisdictions that use the rubric ‘unsafe or unsound practice’, where an act or course of

841 As above.
842 (1584) 3 Co Rep 7a.
843 Boone (n 838 above).
844 As above.
845 As above.
847 Boone (n 838 above).
848 As above.
conduct that is either unsafe or unsound need not be both unsafe and unsound to constitute an offence, in Zambia the words 'unsafe' and 'unsound' should be read together as one. In short, the Zambian position is that if an act or course of conduct of a bank or financial institution is unsafe, yet sound, then no liability ensues. By parity of reasoning, if an act or course of conduct is unsound, yet safe, then no liability arises for 'unsafe and unsound practice'. The act or course of conduct in question is both unsafe and unsound for liability to arise under section 77 of Zambia's Banking and Financial Services Act 1994. But, then, the Banking and Financial Services Act 1994 does not provide any definitions of what constitutes 'unsafe practice', on the one hand, and 'unsound practice', on the other. So, how do we even begin to ponder on the mischief rule or the golden rule if we do not know the statutory meaning of the words 'unsafe' and 'unsound'? Let us turn to the United States of America to see how financial services regulators and the courts have approached the term 'unsafe and unsound practice.'

5 The treatment of 'unsafe and unsound practice' in the United States of America

In the United States of America, the Federal Deposit Insurance Corporation (FDIC) argues that the term 'unsafe and unsound practices' is a generic term, like 'negligence' or 'probable cause',

It could be argued, however, that the conjunction 'and', standing between the words 'unsafe' and 'unsound practice', in the title of sec 77 of Zambia's Banking and Financial Services Act 1994, is confined only to the title of that statutory provision. It is interesting to note that the actual wording of sec 77, in contrast to the title of that statutory provision, does not use the conjunction 'and'. By contrast, it uses the word 'or', and the wording of both secs 77 and 81(1)(c)(i) of the Banking and Financial Services Act 1994 adopts the phrase 'unsafe or unsound'. There is no use of a conjunction there. However, in an e-mail message to this author from the Bank of Zambia (dated 13 May 2005), commenting on a draft of this chapter, no objection was raised regarding the interpretation that the rubric or title 'unsafe and unsound practice' entails that an act or course of conduct must be both unsafe and unsound for liability to arise under sec 77 of Zambia's Banking and Financial Services Act 1994. This implicit acquiescence of the banking supervisors themselves confirms that the practice of banking supervision in Zambia favours the view that for liability to arise under sec 77 of the Banking and Financial Services Act 1994, an act or course of conduct must be both unsafe and unsound. Indeed, this is the view that we also subscribe to, and the view is further buttressed by the implicit acquiescence of the Bank of Zambia. We are, however, awake to possible arguments by some cynics that the title of a statutory provision per se does not say much about what the statutory provision intends to achieve and that reference should be made instead to the actual wording of the statutory provision. Convincing as this view may seem, it is the draftsman who did not give thoughtful consideration to the discrepancy between the title of sec 77 of the Banking and Financial Services Act 1994 and the actual wording of that statutory provision, including the wording in sec 81(1)(c)(i) of the Banking and Financial Services Act 1994. Therefore, to resolve the ambiguity here, recourse should be made also to the position of Bank of Zambia since it is the sole banking supervisory authority in Zambia.
having a central meaning that must be applied to constantly changing factual circumstances.\textsuperscript{851} An unsafe or unsound practice, FDIC argues, 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{852}

Section 8(b) of the US Federal Deposit Insurance Act\textsuperscript{853} refers to the term 'unsafe or unsound banking practices'. However, the statute does not define the phrase or specify what particular acts and conduct constitute such practices. As FDIC notes in its initial brief,\textsuperscript{854} the legislative history of the Financial Institutions Supervisory and Insurance Act of 1966 (which amended section 8 by adding, among other things, subsection (b)) provides some clarity as to what constitute unsafe or unsound banking practices. The Senate and the House both quoted with approval from a memorandum introduced during committee hearings by the then Chairperson of the Federal Home Loan Bank Board, John E Horne.\textsuperscript{855} The memorandum stated that the term 'unsafe or unsound practices' is a generic term, like 'negligence' or 'probable cause', having a central meaning which must be applied to constantly changing factual circumstances.\textsuperscript{856} Further, the memorandum provides that an 'unsafe or unsound practice' is

any action, or lack of action, which 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{857}

In the United States of America, the courts have adopted the same definition of the term 'unsafe or unsound' practices for cases falling under section 8(b) of the US Federal Deposit Insurance Act.\textsuperscript{858} In doing so, the courts have tended to defer to the expertise of the bank regulatory agencies in interpreting or defining what constitutes an

\begin{footnotesize}
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\item[852] As above.
\item[853] 12 USC para 1818(b).
\item[854] \textsuperscript{n 853 above.}
\item[855] 112 Cong Rec 24022 (daily ed 4 October 1966) (House); 112 Cong Rec 25416 (daily ed 13 October 1966) (Senate).
\item[856] As above.
\item[858] See First Nat'l Bank of Eden v Department of the Treasury 568 F 2d 610 611 n 2 (8th Cr 1978) (per curiam); First Nat'l Bank of La Marque v Smith 610 F 2d 1258 1265 (5th Cr 1980).
\end{itemize}
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'unsafe or unsound' practice, limiting their review to a determination of whether the agency's action was arbitrary, capricious, or otherwise unsupported by substantial evidence in the record. 859 And directors of banks are held to a standard of ordinary care and prudence in the administration of bank affairs. 860 The directors are entitled to delegate banking business to their duly authorised officers, but may be held liable for negligence if they fail to exercise reasonable supervision over the management. 861 For example, where a bank's directors exercise less than ordinary care by permitting loan and liquidity problems to steadily deteriorate after those problems are brought to their attention by the regulator, then the directors can be held liable for allowing the bank to engage in 'unsafe and unsound practices'. In Lippitt v Ashley, 862 the court held the directors of a bank liable for negligence in the failure of the bank due to the defalcations of its treasurer. The court stated that the directors had failed to exercise ordinary reasonable care in supervising the bank's officers, even though they had discharged their duty to select an operating officer, had diligently attended directors meetings, had met often informally to discuss the bank's business, had selected competent auditors and reviewed their work, and had made an inquiry of the dishonest officer as to the condition of the bank. Indeed, the board of directors of a bank has a duty to investigate where necessary to protect shareholders' interests, to supervise the bank's affairs, to have a general knowledge of its business, and to know to whom and upon what security its large lines of credit are given. 863

As a general rule, the plain language of section 8(b) of the US Federal Deposit Insurance Act indicates that unsafe or unsound practices need not be ongoing at the time a cease-and-desist order is issued. 864 Section 8(b)(1) of the Act provides, in pertinent part, 865 that a cease-and-desist order may be issued against any bank 'if upon the record made at any ... hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established ...'. 866 Further, judicial interpretations of the cease-and-desist powers of FDIC and other agencies support the view that a cease-and-desist order can be issued for unsafe or unsound practices a bank has committed for corrective purposes and

859 See, eg. Eden 568 F 2d 611; Groos Nat'l Bank v Comptroller of the Currency 573 F 2d 899 897 (5th Cir 1978); La Marque 610 F 2d 1264. See also In re Franklin Nat 1 Bank Securities Litigation 478 F Supp 210, 221 (EDNY 1979).
861 As above.
862 84 A 995 (Conn 1915).
863 DePinto v Provident Security Life Insurance Co 374 F 2d 37 46 (9th Cir), cert denied, 389 US 822 (1967); Gibbons v Anderson 80 F 345 349 (CC WD Mich 1897).
864 n 853 above.
865 12 USC para 1818(b) (my emphasis).
866 n 853 above.
in order to prevent future abuses.\footnote{See First Nat’l Bank of Bellaire v Comptroller of the Currency 697 F 2d 674 680-81 (5th Cir 1983); and Zale Corp and Corrigan-Republic Inc v FTC 437 F 2d 1317 1320 (5th Cir 1973).} And FDIC observes that such an approach is entirely consistent with the remedial and enforcement policies underlying section 8(b) of the US Federal Deposit Insurance Act.\footnote{n 853 above.} If cessation of prior unlawful activity were considered a sufficient defense to an action under section 8(b), a bank could engage in unsafe or unsound practices with virtual impunity, knowing that it could bring those practices to a halt when challenged by a bank regulatory agency. Indeed, the cessation of unsafe or unsound banking practices is not a defence. The bank will still be liable if, with virtual impunity, it engaged in unsafe and unsound practices, knowing that it could bring those practices to a halt before being challenged by a bank regulatory agency. So, what lessons can the Bank of Zambia draw from the position of the United States of America?

6 Legislative developments to counter unsafe and unsound practices in Zambia

The Bank of Zambia, in its directives on unpaid cheques, which became effective on 1 November 2002,\footnote{Bank of Zambia ‘Measures to curb high incidences of unpaid cheques’ available at http://www.boz.zm/NPS/new_measures_to_curb_the_high_in.htm (accessed 17 April 2005).} postulates that the high incidence of bouncing cheques has led to unsafe and unsound practices in the banking industry.\footnote{As above.} In the words of the central bank,

[t]he Bank of Zambia has noticed that the acceptance of cheques as a means of payment has remained disappointingly low, mainly on account of the numerous cheques that are issued against insufficiently funded accounts. This practice is both unsafe and unsound to the banking system.

In spite of the statement that the practice of bouncing cheques and that of not honouring cheques constitute both an unsafe and an unsound practice,\footnote{As above.} the central bank hardly makes any distinction between an unsafe practice, on the one hand, and an unsound practice, on the other. And does the concept of unsafe and unsound practice apply only to money transmitters? Failing to address these issues, the central bank simply goes on to say it is working with the Bankers’ Association of Zambia and has put in place measures to ensure that customers who issue cheques against insufficiently funded accounts are identified, penalised, and denied access to the banking

\footnote{\textit{n} 853 above.}
system on account of their bad standing. Further, the central bank warns:

Drawers of cheques are strongly advised to desist from issuing cheques that will be subsequently dishonoured. Punitive measures against offenders will include a standard minimum charge for every cheque or debit pull payment instrument that is dishonoured, account closure and blacklisting at all registered commercial banks. In addition, commercial banks that will be found to be accommodating habitual offenders will be liable to penalty charges and any other sanctions that the Bank of Zambia may deem appropriate.

In paragraph 7.1(g) of Part 6 of the Banking and Financial Services (Bureau de Change) Regulations 2003, the central bank adds that a license to operate a bureau de change shall be revoked where the licensee has engaged in unsafe and unsound practices or in malpractice or irregularities in the management of its affairs. Again, no definition of unsafe and unsound practices is provided. Similar reference to the term 'unsafe and unsound practice' is made in the proposed Bank of Zambia Micro-Finance Regulations, although, again, no definition is spelt out. Interestingly, the phrase 'unsafe and unsound practice' is also found in section 28 of Zambia's Pension Scheme Regulation Act 1996. The Pension Scheme Regulation Act 1996, referring to unsafe and unsound practices, simply states that:

Where in the opinion of the Registrar, the auditor, the actuary and the manager are pursuing any act or course of conduct that the Registrar considers an unsafe or unsound business practice, the Registrar shall direct the manager of such a pension scheme to refrain from adopting or pursuing a particular course of action.

Again, no definition of unsafe and unsound practices is provided. The Pension Scheme Regulation Act 1996 simply goes on to say directions of the Registrar shall be given by notice in writing to the manager of a pension scheme and can, in a like manner, be varied or revoked. And like the case of directions given by the central bank, directions of the Registrar of Pension Schemes are considered effective from the time they are passed and they remain in effect in accordance with the terms upon which they were passed. Against this background, we

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872 As above.
873 As above.
875 Pension Scheme Regulation Act 1996 of Zambia, sec 28(1).
876 Pension Scheme Regulation Act 1996 of Zambia, sec 28(3).
877 See above.
878 Pension Scheme Regulation Act 1996 of Zambia, sec 28(4).
now turn to examine the distinction between unsafe and unsound practice, on the one hand, and money laundering, on the other.

7 The difference between ‘unsafe and unsound practice’ and ‘money laundering’

Quite often, the offence of ‘unsafe and unsound practice’ is confused with or mistaken for the offence of money laundering. But what is the difference between the two? In Zambia, the offence of money laundering is covered by the Prohibition and Prevention of Money Laundering Act 2001\(^{879}\) and the Bank of Zambia Anti-Money Laundering Directives 2004, whereas the offence of unsafe and unsound practice in banking regulation law is covered by the Banking and Financial Services Act 1994.\(^{880}\)

Where an individual, after the coming into force of the Prohibition and Prevention of Money Laundering Act 2001, engages in money laundering, he or she will be guilty of an offence and liable, upon conviction, to a fine or a term of imprisonment, or to both.\(^{881}\) There are generally three categories of the offence of money laundering in Zambia and they all carry the same weight.\(^{882}\) These categories are contained in the statutory definition of ‘money laundering’ which reads as follows: (a) engaging, directly or indirectly, in a business transaction that involves property acquired with proceeds of crime; (b) receiving, possessing, concealing, disguising, disposing of or bringing into Zambia, any property derived or realised directly or indirectly from illegal activity; or (c) the retention or acquisition of property knowing that the property is derived or realised, directly or indirectly from illegal activity.\(^{883}\) So, if any act or course of conduct of a bank or financial institution is deemed by the Bank of Zambia as an ‘unsafe and unsound practice’, under section 77 of the Banking and Financial Services Act 1994, and such act or course of conduct is an illegal act generating property or whose proceeds of crime is used to acquire property, then the unsafe and unsound practice will predicate the offence of money laundering under the Prohibition and Prevention of Money Laundering Act 2001. This is, indeed, the cardinal link between ‘unsafe and unsound practice’ and ‘money laundering’. As an illegal act, and also given that the proceeds of crime gained from unsafe and unsound practice can be used to acquire property, unsafe and unsound practice can predicate the offence of money laundering.

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879 Prohibition and Prevention of Money Laundering Act 2001, secs 7, 8, 9, 10, 11, 12, 13, 21, 24, 26, 27, 29 & 30.
880 See above.
882 See below.
How we can determine what is ‘unsafe and unsound practice’ in the absence of a bank’s memorandum of association

We have already established that Zambia does not have a statutory definition of ‘unsafe and unsound practice’ in its banking regulation law. We also saw that in jurisdictions such as the United States of America, although many states do not have a statutory definition of ‘unsafe and unsound practice’, banking regulators have interpreted the term ‘unsafe and unsound practice’, with the courts limiting their judicial review to a determination of whether the regulator’s action was arbitrary, capricious, or otherwise unsupported by substantial evidence in the record.\textsuperscript{884} Indeed, the weight of case law in the United States of America has helped to develop a common law understanding of ‘unsafe and unsound practice’, whereas we have not had that many a court case in Zambia on the issue of ‘unsafe and unsound practice’. Exacerbating the situation in Zambia is the fact that banks and financial institutions, under the Banking and Financial Services Act 1994, may opt not to have — but are under no obligation to do so — a memorandum of association.\textsuperscript{885} Yet, it is in the memorandum of association that an objects clause of a company or bank is, customarily, enshrined, albeit the requirements of the statutory Forms I, II, III and IV discussed in chapter 2.

Does the omission of statutory obligations in the Zambian Companies Act 1994 for such incorporated persons as banks and financial institutions to provide a memorandum of association at incorporation entail that banks and financial institutions in Zambia are under no obligation to provide an objects clause?\textsuperscript{886} And what effect or impact does this have on the ultra vires doctrine\textsuperscript{887} and on the concept of unsafe and unsound practice in banking law? Does this

\textsuperscript{884} See the bulk of US case law cited in the sections above.
\textsuperscript{885} See above.
\textsuperscript{886} In the United Kingdom, there have been a number of law reform commissions that have been set up to examine, \textit{inter alia}, the prospects for either abolishing, retaining or refining the ultra vires doctrine. See eg the Cohen Committee 1945, Cmd 6659, para 12; the Jenkins Committee 1962, Cmd 1749, paras 35-42; and DD Prentice \textit{Reform of the ultra vires rules: A consultative document} (1986).
\textsuperscript{887} P Davies \textit{Gower's principles of modern company law} (1997) 204 observes that, at some point: ‘The courts sought to narrow the scope of the resulting vires by distinguishing between "objects" (in the sense of types of business) and "powers" and, applying the \textit{ ejusdem generis} rule of construction, ruling that the powers could be used only in relation to the objects. But that too was circumvented by the device of ending the "objects" clause by stating that each of the specified objects or powers should be treated as independent and in no way ancillary or
mean that banks and financial institutions can engage freely in all sorts of business activities so long as the activities are not prohibited by legislation, including the use of shrewd, but innovative and sometimes fraudulent or extortionate, business practices? In line with our submission in chapter 2, it would be plausible to argue that since the *ultra vires* has not been abolished in Zambia, then an *ultra vires* act or course of conduct of a bank’s directors can be construed as unsafe and unsound practice. However, if the *ultra vires* doctrine had been abolished successfully, then the parameters of determining unsafe and unsound practice would not have included the *ultra vires* doctrine.

9 Conclusion

This chapter has examined the concept of unsafe and unsound practice under the Banking and Financial Services Act 1994 of Zambia. The legal position in a number of jurisdictions was examined to lend more meaning to the term ‘unsafe and unsound practice’ in Zambia. We also looked at other pieces of legislation in Zambia that contain the phrase ‘unsafe and unsound practice’. It was argued that, while jurisdictions such as the United States of America have had a number of court cases lend more meaning to the term ‘unsafe and unsound practice’, and that bank regulators in a number of developed countries have been quick to provide policy guidance and interpretation of the term ‘unsafe and unsound practice’, in Zambia, we have not had that experience yet. Further, the chapter noted that although what constitutes an ‘unsafe and unsound practice’ depends on the facts of each case, the Bank of Zambia should consider spelling out an interpretation of ‘unsafe and unsound practice’ in order to promote the regulator’s consistent and well-meaning enforcement of the law. The interpretation of the Bank of Zambia could be codified in a manner like the Statement on Unsafe and Unsound Banking Practices issued by the Oklahoma State Banking Department and the Hawaii Administrative Rules. Indeed, policy guidance notes, legal opinions of the Bank Secretary of Bank of Zambia and subsidiary legislation, are all mediums through which the Bank of Zambia can provide an interpretation of the term ‘unsafe and unsound practice’.

subordinate one to another, and, at a later date, by also inserting a power “to carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses or the general business of the company.” See *Cotman v Brougham* [1918] AC 514. See also *Introductions Ltd v National Provincial Bank* [1970] Ch 199, CA; *Bell Houses Ltd v City Wall Properties Ltd* [1966] 2 QB 656, CA; *Newstead v Frost* [1980] 1 WLR 135, HL; *Charterbridge Corporation Ltd v Lloyds Bank* [1970] Ch 62; *Re Halt Garage Ltd* [1982] 3 All ER 1016; *Rolled Steel Ltd v British Steel Corp.* [1986] Ch 246; *Brady v Brady* [1988] BCLC 20, CA, revd [1989] AC 755, HL. Pursuant to the Banking and Financial Services Act 1994.

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The chapter also distinguished the difference between the offence of money laundering and that of unsafe and unsound practice. A nexus was drawn, pointing out that in certain situations the primary offence of unsafe and unsound practice, as an *illegal act*, can predicate a secondary offence of money laundering. The chapter then proceeded to examine the issue whether an *ultra vires* act or course of conduct of a bank's directors can be termed 'unsafe and unsound practice'. It was argued that, since the *ultra vires* has not been abolished in Zambia, an *ultra vires* act or course of conduct can be construed as unsafe and unsound practice. In conclusion, and as argued in chapter 2, a notable consequence of banks and financial institutions not having a memorandum of association is that an investor can be misled to think that the Zambian Companies Act 1994 has done away with the statutory requirement for all companies to have an objects clause. More likely than not, as already established in chapter 2, the legislative draftsman of the Zambian Companies Act 1994 did not give much thoughtful consideration to such issues.
INTRODUCTION

That so much has been said and written about the Basel Accord II since it was first promulgated, pointing to growing evidence of international best practice for risk management by banks and some financial institutions, and that a number of pundits have committed pen to paper ubiquitously on various aspects of corporate governance, especially those aspects relating to the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance and the Commonwealth Association of

889 See below.
890 See below.
891 The OECD observes that the main areas of the OECD Principles of Corporate Governance are as follows (See OECD ‘The OECD Principles of Corporate Governance’ 2, available at http://www.oecd.org/dataoecd/41/32/33647763.pdf (accessed 5 May 2009): ‘I. Ensuring the basis for an effective corporate governance framework. The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities. II. The rights of shareholders and key ownership functions. The corporate governance framework should protect and facilitate the exercise of shareholders’ rights. III. The equitable treatment of shareholders. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. IV. The role of stakeholders in corporate governance. The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. V. Disclosure and transparency. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. VI. The responsibilities of the board. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.’

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Corporate Governance (CACG) Principles of Corporate Governance,\textsuperscript{892} for many African countries the challenge remains, however, on how to structure and develop their own national frameworks for risk management and corporate governance. A few African countries, such as South Africa and Zambia, have taken a proactive lead in improving and strengthening their corporate governance systems and frameworks.\textsuperscript{893} The King Reports I, II and III detail out, for example, some of the areas for improving corporate governance in South Africa.\textsuperscript{894} In Zambia, the Institute of Directors is taking a visible role in matters of corporate governance. As one report shows:


- \textit{Principle 1} – exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity for the corporation and to act in the best interest of the business enterprise in a manner based on transparency, accountability and responsibility;
- \textit{Principle 2} – ensure that through a managed and effective process board appointments are made that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision-making process;
- \textit{Principle 3} – determine the corporation’s purpose and values, determine the strategy to achieve its purpose and to implement its values in order to ensure that it survives and thrives, and ensure that procedures and practices are in place that protect the corporation’s assets and reputation;
- \textit{Principle 4} – monitor and evaluate the implementation of strategies, policies, management performance criteria and business plans;
- \textit{Principle 5} – ensure that the corporation complies with all relevant laws, regulations and codes of best business practice;
- \textit{Principle 6} – ensure that the corporation communicates with shareholders and other stakeholders effectively;
- \textit{Principle 7} – serve the legitimate interests of the shareholders of the corporation and account to them fully;
- \textit{Principle 8} – identify the corporation’s internal and external stakeholders and agree a policy, or policies, determining how the corporation should relate to them;
- \textit{Principle 9} – ensure that no one person or a block of persons has unfettered power and that there is an appropriate balance of power and authority on the board which is, \textit{inter alia}, usually reflected by separating the roles of the chief executive officer and Chairman, and by having a balance between executive and non-executive directors;
- \textit{Principle 10} – regularly review processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times;
- \textit{Principle 11} – regularly assess its performance and effectiveness as a whole, and that of the individual directors, including the chief executive officer;
- \textit{Principle 12} – appoint the chief executive officer and at least participate in the appointment of senior management, ensure the motivation and protection of intellectual capital intrinsic to the corporation, ensure that there is adequate training in the corporation for management and employees, and a succession plan for senior management;
- \textit{Principle 13} – ensure that all technology and systems used in the corporation are adequate to properly run the business and for it to remain a meaningful competitor;
- \textit{Principle 14} – identify key risk areas and key performance indicators of the business enterprise and monitor these factors;
- \textit{Principle 15} – ensure annually that the corporation will continue as a going concern for its next fiscal year.

\textsuperscript{893} See King Reports I, II and III, respectively, on the following website of the Institute of Directors of South Africa: http://www.iodsa.co.za/king.asp (accessed 22 April 2009).

\textsuperscript{894} As above.
Following the initial work of the Zambian National Task Force on Corporate Governance in 1999 and the establishment in April 2000 of the Institute of Directors of Zambia (IoDZ), much of the subsequent work in corporate governance in Zambia has been assumed by the IoDZ. The IoDZ whose membership has grown significantly ..., is committed to promoting the practice of sound and effective corporate governance principles in all companies and organisations. IoDZ continuously monitors development in the field of corporate governance as well as issuing best practice guidelines as appropriate. This entails encouraging compliance with guidelines such as the King II. IoDZ’s main line of activity is director training with the following terms of reference:

(a) to design and organise various training programmes targeted at improving the capacity, knowledge and boardroom performance of directors in private and public companies and other organisations;

(b) to organise professional conferences and seminars aimed at promoting the practice of sound corporate governance principles;

(c) to work in conjunction with appropriate Institutions of higher learning with a view to developing and running specialised courses in corporate governance; and

(d) to liaise with the IoD (UK), towards introducing a programme leading to the award and qualification as a 'chartered director' in Zambia.895

In the United Kingdom, the Cadbury Report,896 published in 1992, provided much impetus to developments relating to corporate governance in that country, as did the Sarbanes-Oxley Act 2002897 in the US.898 Against this background, this chapter examines the efficacy of the legal framework for risk management and corporate governance by banks and financial institutions in Zambia. We will not examine, however, the international aspects of risk management by


896 Formally known as the Financial Aspects of Corporate Governance Report, the Cadbury Report, prepared by a committee chaired by Adrian Cadbury, sets forth recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures.

897 The Sarbanes-Oxley Act of 2002 (Pub L 107-204, 116 Stat 745, enacted 30 July 2002), covering issues such as corporate governance, internal control assessment, auditor independence and enhanced financial disclosure, is also referred to as the Public Company Accounting Reform and Investor Protection Act of 2002. This piece of legislation is a United States federal law. It was enacted on 30 July 2002, in response to a number of major corporate and accounting scandals, including those associated with Enron, Peregine Systems, WorldCom, Tyco International and Adelphia. The Sarbanes-Oxley Act sets new or enhanced standards for all US public company boards, management and public accounting firms. It does not, however, apply to companies that are privately held. The Act contains 11 titles, ranging from additional corporate board responsibilities to criminal penalties. Under this Act, the US Securities and Exchange Commission (SEC) is required to implement rulings on requirements to comply with the provisions of this law.

banks as well as the international aspects of corporate governance by banks, although these international aspects are helpful in serving as benchmarks for developing national systems. And the reason for such a purposeful omission is simple. Not only do the international aspects fall outside the scope of the chapter, but a lot of ink has already been expended on them.899

Focusing on Zambia, this chapter examines the Banking and Financial Services Risk Management Guidelines 2008, issued by the Bank of Zambia,900 and the Banking and Financial Services (Corporate Governance) Guidelines 2006, also issued by the Bank of Zambia.901 Notwithstanding that these two sets of guidelines are issued pursuant to a piece of legislation, they, unlike principal legislation (for instance an Act of Parliament) or subsidiary legislation (for instance a statutory instrument), are generally not legally binding documents since, strictly speaking, they do not have the same force of law as an Act of Parliament, a statutory instrument or a judicial precedent. Be that as it may, both the Banking and Financial Services Risk Management Guidelines 2008 and the Banking and Financial Services (Corporate Governance) Guidelines 2006 are a corollary to and form part of the legal and regulatory framework for banking supervision in Zambia.902 To that extent, banks and financial institutions are expected by the Bank of Zambia to comply with and adhere to the guidelines.903 And these guidelines, like principles or codes of conduct for financial regulation, when compared with the develop-


901 Pursuant to sec 125 of the Banking and Financial Services Act 1994, as amended through to 2000.

902 See Zambia's Code on Corporate Governance for Small and Medium-Size Enterprises issued by Zambia's Institute of Directors.

903 See below.
ment of customary international law,\textsuperscript{904} can arguably, through established practice and some form of \textit{opinio juris}\textsuperscript{905} crystallise into legally binding norms of customary law at the national level. In the \textit{North Sea Continental Shelf cases},\textsuperscript{906} the International Court of Justice ruled as follows:

Even if these instances of [delimitations using the equidistance principle] by nonparties to the Convention were much more numerous than they in fact are, they would not, even in the aggregate, suffice in themselves to constitute the \textit{opinio juris}; for, in order to achieve this result, two conditions must be fulfilled. Not only must the acts concerned amount to a settled practice, but they must also be such, or be carried out in such a way, as to be evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it.\textsuperscript{907}

At the national level, what happens where, for example, regulatory guidelines, such as the Banking and Financial Services Risk Management Guidelines 2008 and the Banking and Financial Services (Corporate Governance) Guidelines 2006, do not crystallise into binding norms of customary law and then some banks and financial institutions decide not to comply with the said guidelines? Can these banks and financial institutions be punished? Neither the Banking and Financial Services Act 1994 nor the Banking and Financial Services Risk Management Guidelines 2008, or the Banking and Financial Services (Corporate Governance) Guidelines 2006, provide any clear cut answers. It could be argued, however, that in such a case, the Bank of Zambia can impose some sanctions on the culpable banks and financial institutions for engaging in unsafe and unsound practice.\textsuperscript{908}

To succeed with such an argument, the Bank of Zambia should demonstrate that non-compliance with the provisions of either the Banking and Financial Services Risk Management Guidelines 2008 or the Banking and Financial Services (Corporate Governance) Guidelines 2006 constitutes unsafe and unsound practice under the Banking and Financial Services Act 1994.\textsuperscript{909} We have already explored the concept of unsafe and unsound practice under Zambia’s Banking and Financial Services Act 1994.\textsuperscript{910}


\textsuperscript{905} As above.

\textsuperscript{906} As above.

\textsuperscript{907} ICJ (n 906 above) para 77.

\textsuperscript{908} See Banking and Financial Services Act 1994 (as amended through to 2000), sec 77(1).

\textsuperscript{909} As above.

\textsuperscript{910} See ch 6.
An important point to note is that, although the Banking and Financial Services Risk Management Guidelines 2008 and the Banking and Financial Services (Corporate Governance) Guidelines 2006 might not have the force of law or might not be legally binding, a departure from or an abrogation of these guidelines could trigger liability for unsafe and unsound practice under the Banking and Financial Services Act 1994. As such, to avoid being caught up by the 'unsafe and unsound practice' provisions of the Banking and Financial Services Act 1994, banks and financial institutions have little option but to comply with the two sets of guidelines. Section 125 of the Banking and Financial Services Act 1994, under which the Banking and Financial Services Risk Management Guidelines 2008 and the Banking and Financial Services (Corporate Governance) Guidelines 2006 were prepared and issued, provides that the Bank of Zambia shall have power to prescribe and publish such guidelines, bulletins or other regulatory statements as the Bank of Zambia may consider necessary or desirable for the administration and execution of this Act (ie the Banking and Financial Services Act 1994).

The Banking and Financial Services Risk Management Guidelines 2008 were prepared in line with international best practices.911 While these Guidelines set the minimum requirements for risk management systems and frameworks that financial services providers (FSPs) are required to have,912 the Banking and Financial Services (Corporate Governance) Guidelines 2006 set forth a broad framework of fundamental corporate governance principles to guide the actions of the directors and managers of banks and financial institutions operating in Zambia.913 Here, examples of FSPs include banks and financial institutions licensed and/or regulated by the Bank of Zambia.914

911 See Bank of Zambia Banking and Financial Services Risk Management Guidelines 2008 (2008). 6. On international best practice pertaining to risk-management guidelines for banks, see Basel Accord II. The Basel II framework categorises risks as market risk (price risk), credit risk and operational risk. It also spells out the methods for calculating capital requirements for each of these types of risks. However, the response to Basel Accord II, worldwide, has not been fully consistent and uniform. A number of banks and financial institutions in developing countries consider Basel Accord II as a set of fairly complicated risk management models with complex data requirements. That said, in developed countries, some banks and financial institutions are supportive of Basel Accord II, as they are of the view that their superior technology and systems would easily make them Basel compliant and thus provide them with an edge in the competitive environment, in the form of lower regulatory capital. By contrast, in developing countries, a number of banks and financial institutions do not perceive any immediate value in Basel Accord II since they are globally insignificant with simple and straightforward balance sheet structures.

912 See Bank of Zambia (n 913 above) 6.


914 Bank of Zambia (n 913 above) 2-3.
The Bank of Zambia requires each FSP to put in place an independent risk management structure that concentrates fully on the risk management function and that it also develops its own comprehensive Risk Management Programme (RMP) tailored to its needs and circumstances.\(^{915}\) Closely related to the Banking and Financial Services Risk Management Guidelines 2008, the Banking and Financial Services (Corporate Governance) Guidelines 2006 promulgate that boards of directors and senior management of banks and financial institutions play key control functions in the Bank of Zambia’s supervisory framework.\(^{916}\) The effective oversight carried out by these directors and senior management is an essential element in the safe and sound functioning of banks and financial institutions.\(^{917}\) And it should be noted that the Banking and Financial Services (Corporate Governance) Guidelines 2006 apply to all banks and financial institutions operating in Zambia.\(^{918}\) Altogether, the effective implementation of the Banking and Financial Services Risk Management Guidelines 2008 and that of the Banking and Financial Services (Corporate Governance) Guidelines 2006, and the satisfactory compliance of banks and financial institutions with these sets of guidelines, can help to strengthen the soundness of the banking system in the country.

The first part of this chapter reviews the Banking and Financial Services Risk Management Guidelines 2008. The second part concentrates on the Banking and Financial Services (Corporate Governance) Guidelines 2006. But before we delve into the intricacies of the Banking and Financial Services Risk Management Guidelines 2008, let us first take a reasoned look at what is meant by ‘risk’. A number of theories and arguments pertaining to risk management by banks have been advanced by various writers.\(^{919}\) In this chapter, we stand back from such theoretical constructs. The Bank of Zambia postulates that the term ‘risk’ entails ‘the chance of something occurring that may have an impact on the achievement of the financial service provider’s desired statutory and strategic objectives, measured in terms of the impact of the event and likelihood of its occurrence’.\(^{920}\) This definition of the term ‘risk’ has an implicit indication that ‘risk’ centres on uncertainty and the probability of an event occurring or not occurring. Also implicit in the definition is the view that the impact of the event and the likelihood of its occurrence must be measurable. But, then, are all risk-related impacts measurable? And when we talk of ‘measurable’, does that not import

\(^{915}\) n 914 above.

\(^{916}\) See Bank of Zambia (n 913 above) 1-2.

\(^{917}\) As above.

\(^{918}\) Bank of Zambia (n 913 above) 3.

\(^{919}\) See Santomero (n 901 above) 83-115; Kwan & Eisenbeis (n 901 above) 117-131; Allen & Jagtiani (n 901 above) 159-73; Hess & Laisathit (n 901 above) 133-58.

\(^{920}\) See Bank of Zambia (n 913 above) 4.
the idea of a quantitative approach, as opposed to a qualitative approach which is often seen in evaluations and/or assessments? While an evaluation and/or assessment can also have some aspects of measurable results seen through quantitative data, such an approach will in most cases also include qualitative data. By contrast, where the focus is primarily on achieving measurable results, we become so fixated on number crunching to the exclusion of qualitative data. So, how do we reconcile this with the Bank of Zambia definition of 'risk' which tilts more towards measurable (quantitative) results?

Risk management, in general, should be understood as the discipline of identifying, monitoring and limiting risks. And risks can emanate from many different sources, including outsourcing, correspondent banking, technological gaps, weaknesses or lapses in internal controls and audits, political interference from the government, insider lending, money laundering, poor accounting standards and practices as well as poor record keeping. Other sources of risk include ultra vires acts of an FSP, unsafe and unsound practices of a bank or financial institution, inadequate screening of FSP employees at the time of recruiting them, lack of adequate or appropriate skills among FSP employees, lack of adequate training and staff development for FSP employees, improperly aligned compensation schemes or incentives, a lack of understanding of performance standards and expectations as well as a lack of adequate human resource controls (including supervision and segregation of incompatible duties). The Investment Dictionary, thus, defines 'risk management' as follows:

[1]he process of identification, analysis and either acceptance or mitigation of uncertainty in investment decision-making. Essentially, risk management occurs anytime an investor or fund manager analyses and attempts to quantify the potential for losses in an investment and then takes the appropriate action (or inaction) given their investment objectives and risk tolerance.

Simply put, risk management is a two-step process — determining what risks exist in an investment and then handling those risks in a way best-suited to your investment objectives. In some cases, a measurement can show that the acceptable risk in an FSP is near zero. Thus, strategies for managing risks in FSPs include, among others, transferring risk to another party, avoiding the risk, reducing

923 As above.
924 See generally Jones (n 923 above).
the negative effect of the risk, and accepting some or all of the consequences of a particular risk.\textsuperscript{925} Elsewhere, I have demonstrated how, for example, Chinese walls can be used to manage information risk through the effective segregation of confidential client information between two competing or interested corporate departments or between two competing or interested subsidiaries of a group company.\textsuperscript{926} In such a case, one department or subsidiary would be dealing, say, in securities while the other would have access to sensitive information pertaining to bank details of the client. Although the discussion on Chinese walls will not be repeated here, it suffices to say that the International Organisation for Standardisation identifies the following general principles of risk management:\textsuperscript{927}

- Risk management should create value.
- Risk management should be an integral part of organisational processes.
- Risk management should be part of decision making.
- Risk management should explicitly address uncertainty.
- Risk management should be systematic and structured.
- Risk management should be based on the best available information.
- Risk management should be tailored.
- Risk management should take into account human factors.
- Risk management should be transparent and inclusive.
- Risk management should be dynamic, iterative and responsive to change.
- Risk management should be capable of continual improvement and enhancement.

To place the discussion in context, we illuminate below, through a metaphor, the practical aspects of the term 'risk'. The discussion below will provide some helpful shades to the critical analysis of the Banking and Financial Services Risk Management Guidelines 2008. After that, we will then examine the Banking and Financial Services (Corporate Governance) Guidelines 2006.

\textsuperscript{925} As above.
2 A metaphorical understanding of the term 'risk'

The metaphor presented below relates to a true and real-life experience in some remote village in South Africa. The objective of using this metaphor lies in the fact that a metaphorical depiction of a concept can be a powerful and meaningful way in which to communicate to the audience the meaning behind the concept. A recent international media report carried a story of how some young South African students were forced to deal with some life-threatening risks just to get a formal education by swimming across a crocodile-infested river to get to and from school every day. The BBC News report provides as follows:

A South African village is demanding that a bridge be built across a crocodile-infested river to stop children swimming it to get to school. Students as young as seven have been making the crossing for two months since the community's boat was stolen. 'There are about 70 households on that side of the river but there are no buses and no one owns a car,' a KwaZulu-Natal local councillor said. To cross safely would require a 20km (12 miles) detour to get to the school. On school days, 150 children from Sahlumbe village in the heart of rural Zululand swim across the river in their underwear using rubber tyres and buckets to keep afloat and to keep their school uniforms and books dry. The older ones help the small ones who cling to the tyres. 'I worry all the time. There are dangerous animals in there, especially crocodiles,' says Thuthukani Primary School headmistress Hlengiwe Mthembu.928

For those who have never been exposed to serious risk, this is a good starting point for understanding what is meant by risk management. Although the South African kids in the above story appear not to be risk-averse, their bravery could be attributed in part to a lack of alternatives. Indeed, what else can they do? Through braving it out to swim the crocodile-infested waters, the kids have been managing risks associated with being attacked or eaten up by crocodiles. And, they do this on a daily basis. The BBC report continues:

The children, some of whom also attend Mabizela High School, often arrive tired and unable to concentrate, she says. 'They sit in class and shiver because of the cold and they can't study well because they are worrying about how they are going to get home. It is very hard for them. After heavy rains the river gets very full. It can take up to 10 minutes to cross.' Local councillor Sbusiso Ntaba says most of the families moved to the area three years ago after being evicted from the land they were on. He says many parents have no choice but to let their...

children make the dangerous crossing. ‘Not all the children can swim so some ride on the tires or their parents carry them across. The river is too deep for the adults to walk across and not all of them can swim,’ Mr Nbatha says. It is not only children who have to face the fast-flowing Tugela River. The only hospital in the area is also situated on the far bank. In 2003 a pregnant woman battling to reach the opposite bank drowned. In 2005, two children from the same family were also taken by the river and drowned. Mr Nbatha says even the stolen boat was not safe and he wants a bridge built in the area. ‘It was old and full of holes. There was only one boat and it was used by the whole community.’ He says he has pleaded with the Department of Transport for five years. ‘They just keep us waiting,’ he says. ‘It’s very frustrating. You can see the school from the opposite bank but you just can’t reach it.’

By contrast, in many developed countries, when there is a snow storm, a number of schools close down and the kids there do not go to school. Instead, the kids sit back, relax and watch television or play some computer games. This is the paradox of life. Some have it made while others are grappling with greater challenges of life. The magnitude and gravity of risk pertaining to being driven to school through a snow storm compared with that of swimming in a crocodile-infested river to get to school pose some challenging issues. It would be tempting to ask the following questions. What are the major threats or risks in driving to school through a snow storm? And are these risks that high compared to those of swimming across a crocodile-infested river to get to school? How many prayers, tears and fears do the South African kids need to get to school through those crocodile-infested waters? And how fast should they try to swim in order not to be eaten up by the crocs? Or should they just float off silently on the tyres, not making any noise or sounds that could attract the beasts? In any event, can the tyres protect the kids from the crocodiles and do the tyres mitigate the risks? And just how predictable is the safety of using these tyres in crossing the river? Can the kids control all the risks associated with crossing such waters or is this beyond their control? Additionally, just how much information do these kids and their parents have on whether it is safe to swim to school in these crocodile-infested waters? These are just a few of the type of questions that come to mind when we are faced with managing risk.

Drawing further analogies between swimming across crocodile-infested waters and driving to school in a snow storm, we might want to ask ourselves how much more information or what type of information do the kids and parents in the developed countries need to have in order to be able to drive through the snow storm safely to school. Unlike the South African case where there is a lot of
uncertainty regarding, say, information on the movement patterns or the maneuvers of the crocodiles, in the Western world many people do get regular information updates through a variety of media channels and some internet-related forums highlighting the weather patterns and forecasts. Indeed, a key element in managing risk is the availability of accurate, timely, reliable and sufficient information to help reach a well-informed decision. The availability of valuable and reliable information reduces uncertainties. The more useful information we can gather about any given scenario, the greater the probability that we can reach a well-informed decision for an optimally efficient outcome. But, then, information comes at a cost. Do we have the necessary resources and tools to gather such information?

3 Banking and Financial Services Risk Management Guidelines 2008

Setting forth provisions to deal with various types of risk, including credit risk, foreign exchange risk, interest rate risk, liquidity risk, market risk, operational risk, reputation risk, legal risk and strategic risk, the Banking and Financial Services Risk Management Guidelines 2008 were issued in line with the Bank of Zambia’s move towards fully implementing a risk-based approach to supervision of all financial services providers (FSPs). These Guidelines apply only to those FSPs, as defined in the said Guidelines, operating in Zambia. It is the Bank of Zambia’s view that the implementation of risk management processes, policies and systems should be commensurate with the size and complexity of the FSP.

According to the Bank of Zambia, under the risk-based approach to supervision, the supervisory focus is on ensuring that the management of all FSPs identifies, measure, control and monitor the levels and types of risks assumed. In situations where risk is not properly managed, the Bank of Zambia postulates that it will direct management to take appropriate corrective action, which may include reducing exposures, increasing capital, strengthening risk management processes and/or taking other prompt corrective measures. For institutions belonging to a group of companies, the Bank of Zambia will determine whether the risks at an individual

930 See Bank of Zambia (n 913 above) 3-4.
931 Bank of Zambia (n 913 above) 2.
932 Bank of Zambia (n 913 above) 5.
933 As above.
934 Bank of Zambia (n 913 above) 2.
935 As above.
institution are mitigated or increased by the activities and condition of the entire group.936

In essence, the objective underpinning the Banking and Financial Services Risk Management Guidelines 2008 is the assessment of the manner in which an FSP manages its risks, including operational risk, credit risk, market risk, reputational risk and legal risk exposures.937 Closely aligned to this is the need for an FSP to understand the driving forces behind the risks it faces as well as the importance of allocating capital against such risks, including identifying those trends internally and externally that would help predict the risks.938 The Banking and Financial Services Risk Management Guidelines 2008 are complemented by Core Principle 7 of the Basel Core Principles for Effective Banking Supervision which stipulates:

Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.939

The Banking and Financial Services Risk Management Guidelines 2008 promulgate further that the board of directors of an FSP is responsible for understanding the risks run by the FSP and ensuring that these risks are managed appropriately.940 The board is also required to approve the establishment of ‘limits’ by assessing the FSP’s risk and risk-bearing capacity.941 Here, it is not clear what is meant by the term ‘limits’. A possible interpretation is that ‘limits’ involves drawing a distinction between ultra vires and intra vires acts of the company, as discussed in chapter 2. It would have been helpful if the Bank of Zambia had spelt out more clearly what is meant by the term ‘limits’.

That said, the board of directors of an FSP is required also to ensure that the FSP has a Risk Management Function that reports

936 As above.
937 As above.
938 As above.
939 See Basel Committee (n 7 above). Core Principle 7 of the Basel Core Principles for Effective Banking Supervision is further strengthened by Core Principle 8 which provides that ‘[s]upervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counter-party risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.’
940 Bank of Zambia (n 913 above) 6.
941 As above.
directly to the board. The risk manager should be sufficiently independent of the business lines in order to ensure an adequate separation of duties and the avoidance of conflicts of interest. The Risk Management Committee or the risk manager should take full responsibility for evaluating the overall risks faced by the FSP and determining the level of risks that will be in the best interests of the FSP. The functions of the Risk Management Committee or the risk manager are to identify, measure, monitor, and control the risks undertaken by the FSP.

As noted above, each FSP should develop its own comprehensive Risk Management Programme (RMP) tailored to its needs and circumstances, and the RMP is expected to cover, at a minimum, operational risk, credit risk, strategic risk, liquidity risk, market risk, reputational risk and legal risk. Further, the RMP should include methods and procedures for risk identification, risk measurement, risk control and risk monitoring. Indeed, every product and service offered by an FSP has a unique risk profile composed of multiple risks. As such, risk identification should be a continuous process, and risk should be understood at both the transaction and portfolio levels.

In measuring risk, each risk should be viewed in terms of its three dimensions: size, duration and probability. The management team of the FSP should set the risk limits and put in place models for internal risk rating and stress testing. Accurate and timely measurement of risk is an essential element of a sound and effective risk management system. Once the risks have been identified and measured for significance, they may be controlled or their impact minimised by (a) avoiding or placing limits on certain activities/risks; (b) mitigating the risks; and/or (c) offsetting the risks. The Bank of Zambia postulates that it is a primary management function for an FSP to balance expected rewards against risks and the expenses associated with controlling risks. Thus, according to the Bank of Zambia, FSPs should establish and communicate risk limits through policies, standards and procedures that define responsibility and

942 As above.
943 As above.
944 As above.
945 As above.
946 As above.
947 Bank of Zambia (n 913 above) 6-8.
948 Bank of Zambia (n 913 above) 6.
949 Bank of Zambia (n 913 above) 6-7.
950 Bank of Zambia (n 913 above) 7.
951 As above.
952 As above.
953 As above.
954 As above.
And the management team of an FSP should put in place internal controls aimed at ensuring that risks, such as those pertaining to money laundering, are prudently managed. As the Bank of Zambia observes, the internal and external audit functions in an FSP, as well as the compliance function, are an integral part of the risk control process.

To monitor risk effectively, the FSP should have in place a management information system (MIS) that identifies and measures accurately risks at the inception of transactions and activities. The MIS of an FSP, the Bank of Zambia argues, should be capable of monitoring also significant changes in risk profiles. But it is not immediately clear what is meant by ‘significant changes’. A criterion has to be promulgated on how to determine significant changes in risk profiles.

In general, monitoring risks entails developing reporting systems that identify adverse changes in the risk profiles of significant products, services and activities and monitoring changes in controls that have been put in place to minimise adverse consequences. As such, FSPs should consider establishing risk management units or processes that monitor the level and nature of risk in the FSP. And the board of directors of an FSP should have an oversight function to set the overall strategy and framework for managing various types of risks facing the FSP, while senior management should be implementing such strategies and frameworks. Against this background, we now turn to examine the efficacy of the Banking and Financial Services (Corporate Governance) Guidelines 2006.

4 Banking and Financial Services (Corporate Governance) Guidelines 2006

To gain a deeper understanding of what is meant by ‘corporate governance’, we must first understand what ‘governance’ is all about. Secondly, we need to understand that the bulk of the law

955 As above.
956 As above.
957 As above.
958 As above.
959 As above.
960 As above.
961 See generally the Cadbury Report (n 898 above); Committee on Corporate Governance Report of the Committee on Corporate Governance (Hampel Report) (1998); W Rees Corporate governance and corporate control (1995); G Roctor & L Miles Corporate governance (2002). See also generally AAK Mwape ‘Bank
on corporate governance is imbedded in the principles of company law, especially the rights and duties of directors and shareholders. The reader is thus encouraged to explore the relevant literature on company law,\textsuperscript{962} as well as to consider the relevant provisions of the Zambian Companies Act 1994, including the articles of association (and/or any shareholder agreements) of a bank or financial institution, regarding the rights and duties of directors and shareholders. Closely related to such sources are relevant aspects of environmental law and criminal law. As a multi-faceted and interdisciplinary field, corporate governance is also informed by disciplines such as economics, business ethics and public policy.

In comparison to ‘corporate governance’, the concept of ‘good governance’ is examined elsewhere,\textsuperscript{963} where I have fleshed out shortcomings of the juristic interpretation of good governance. Following from that analysis, the term ‘governance’ can be understood as referring generally to the act or process of governing.\textsuperscript{964} Although many scholars and commentators have attempted to define the term ‘corporate governance’,\textsuperscript{965} there is no universally agreed sacrosanct definition of corporate governance. Citing the example of the Organisation of Economic Co-operation and Development (OECD), Tarinyeba observes that OECD defines corporate governance as a set of relationships between a company’s management, its board of directors, its shareholders and other stakeholders.\textsuperscript{966} She argues that corporate governance is defined by others as the means by which outside investors protect themselves from insiders, or the mechanisms for transmitting signals from products and input markets into corporate behaviour.\textsuperscript{967} According to

\begin{itemize}
\item \textsuperscript{962} See generally, eg, Davies (n 889 above); DD Prentice 'Some aspects of the corporate governance debate' in DD Prentice & PRI Holland (eds) Contemporary issues in corporate governance (1993); M Useem Investor capitalism (1996); M Blair Ownership and control (1995); G Stapledon Institutional investors and corporate governance (1996); P Davies 'Institutional investors in the United Kingdom' in Prentice & Holland (above); S Judge Company law (2008); DJ Bakibinga Company law in Uganda (2001); JE Parkinson Corporate power and responsibility: issues in the theory of company law (1995).
\item \textsuperscript{963} See generally KK Mwenda 'Can “corruption” and “good governance” be defined in legal terms? (2008) 2 Rutgers University Journal of Global Change and Governance.
\item \textsuperscript{964} See JL Colley Jr et al What is corporate governance? (2005) 2.
\item \textsuperscript{966} Tarinyeba (n 967 above) 6.
\item \textsuperscript{967} As above.
\end{itemize}
Legal framework for risk management and corporate governance

Tarinyeba, most definitions of corporate governance center on the manner in which a corporation is governed, directed and controlled, while the essence of corporate governance is to address conflicts of interest commonly referred to as ‘agency costs’ that arise out of the separation of ownership and control of companies. In stressing the issue of ‘agency costs’, she posits further:

Berle and Means first articulated the agency cost problem, in their book on the modern corporation and property, where they pointed out the problems that arise from the separation of ownership and control of a corporation. They state that the typical structure of the large American publicly traded corporations is the existence of several dispersed shareholders with small holdings and no substantial equity stake with which to exercise control. This in their opinion left too much power in the hands of the managers who would increasingly become unaccountable to the shareholders. Jensen and Meckling subsequently shed further light on the agency cost problem in their article on the theory of the firm. They state that the relationship between stockholders and managers in a corporation is a principal-agent relationship, and the problems that arise out of the separation of ownership and control are intimately associated with the general problems of such relationships. Such problems include divergent interests between the principal and agent, the costs of monitoring the agent and the costs of inducing the agent to maximise the principal’s welfare.

In concluding that corporate governance involves both external and internal mechanisms for reducing agency costs, Tarinyeba postulates that the internal mechanisms govern the relationships of participants in a corporation, such as controlling shareholders and the minority shareholders. The external mechanisms, on the other hand, govern relationships between insiders and outsiders, such as investors, creditors and society in general. The key aspects of corporate governance, according to Tarinyeba, ‘relate to mechanisms designed to ensure transparency and accountability of corporate managers and controllers, the independence of the board of directors from controlling shareholders, fairness and the equitable treatment of shareholders’. To that extent, the providers of capital, both debt and equity, who may not necessarily form part of the management of a corporation risk losing their investment in the absence of adequate measures to protect them. Such measures, Tarinyeba argues, ensure adequate and timely flow of information,

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968 As above.
969 As above.
970 As above.
971 Tarinyeba (n 967 above) 6-7.
972 As above.
973 As above.
974 As above.
975 As above.
especially financial information relating to the performance of the corporation. In addition, as she observes, mechanisms to prevent managers and controllers from extracting private benefits of control from the corporation through self-dealing and to prevent majority or controlling shareholders from oppressing minority shareholders must be put in place. And mechanisms to encourage managers to work in the best interests of stockholders must also be in place. These are usually referred to as 'bonding mechanisms', such as executive and board compensation schemes.

In Zambia, the Bank of Zambia defines corporate governance as the process and structure used to direct and manage the business and affairs of an institution with the objective of ensuring its safety and soundness and enhancing shareholder value. According to the Bank of Zambia:

For banks and financial institutions (persons other than a bank, conducting a financial service business which includes receiving deposits from the public but does not include chequeing accounts and current account deposits), the process and structure define the division of power and establish mechanisms for achieving accountability between the board of directors, management and shareholders, while protecting the interests of depositors and taking into account the effects of such processes on other stakeholders, such as creditors, employees, customers and the community.

Pointing to the nexus between corporate governance and risk management by banks and financial institutions, the Bank of Zambia argues that the increasing globalisation of financial markets, the emergence of conglomerate structures, the advances in technology and the innovations in financial products have added to the complexity or risk management in the financial sector. For these reasons, the Bank of Zambia argues, the quality of corporate governance expected of these banks and financial institutions is high. It is, therefore, necessary to achieve a balance and alignment among external and internal controls, risk management and competitive behaviour and at the same time operate within the principles of good corporate governance promulgated by the Bank of Zambia through the Banking and Financial Services (Corporate Governance) Guidelines 2006. These principles include discipline,

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976 As above.
977 As above.
978 As above.
979 As above.
980 See Bank of Zambia (n 915 above) 1.
981 As above.
982 As above.
983 As above.
984 As above.
transparency, independence, accountability, responsibility, fairness and social responsibility.\textsuperscript{985} Let us take a more reasoned look at each of the 15 principles set forth in the Banking and Financial Services (Corporate Governance) Guidelines 2006, and expanding on the respective principles are some guidelines.

\textbf{4.1 Principle I: Shareholders}

The first principle provides that shareholders of a bank or financial institution should jointly and severally protect, preserve and actively exercise their supreme authority over the institution in general meetings.\textsuperscript{986} And the board should foster constructive relationships with shareholders that encourage them to engage constructively with the respective entities.\textsuperscript{987} To assist banks and financial institutions in implementing this principle, the following five guidelines are spelt out in the Banking and Financial Services (Corporate Governance) Guidelines 2006:\textsuperscript{988}

\textbf{(i)} The board should have clear policies for shareholder relations and at least annually review practices, aimed at clearly communicating the goals, strategies and achievements of the bank or financial institution.

\textbf{(ii)} The board should facilitate, when deemed necessary by the shareholders, questioning of external auditors on the auditor's opinion during the annual general meeting or extraordinary meetings.

\textbf{(iii)} Shareholders should ensure that only competent and reliable persons who can enrich and add value to the bank or financial institution are elected or appointed to the board of directors.

\textbf{(iv)} Shareholders should ensure that the board is constantly held accountable and responsible for the efficient and effective governance of the bank or financial institution.

\textbf{(v)} Shareholders should change the composition of a board that does not perform to expectation or in accordance with the mandate of the bank or financial institution.

In chapter 3, we observed that this author's study of banking regulation and supervision during the Kaunda and Chiluba regimes in Zambia revealed that a major constraint that posed as a challenge to the efficacy of the legal, regulatory and institutional framework for banking supervision included the inability of the Bank of Zambia to extricate itself from political pressure and interference.\textsuperscript{989} We noted, for example, that, whilst it was the view of the Bank of Zambia that

\textsuperscript{985} As above.
\textsuperscript{986} Bank of Zambia (n 915 above) 4.
\textsuperscript{987} As above.
\textsuperscript{988} As above.
\textsuperscript{989} Interview with Mr Marshall Mwansompelo, Senior Inspector, Financial System Supervision, Bank of Zambia, Lusaka, 8 October 1999.
under the Banking and Financial Services Act 1994 a person who was
a director of a bank that had since collapsed could not be appointed
as a director of another bank or financial institution, without being
cleared by the Bank of Zambia, there were cases during the Chiluba
regime where the law was flagrantly disregarded. Indeed, some
ineligible individuals were 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.990 Weighed against dictates
of the Banking and Financial Services (Corporate Governance)
Guidelines 2006, how do such practices measure up to the third
guideline under the First Principle? To recapitulate, the third
guideline stipulates that shareholders should ensure that only
competent and reliable persons who can enrich and add value to the
bank or financial institution are elected or appointed to the board of
directors.

By parity of reasoning, and based on the fourth guideline
highlighted above, can we say that shareholders of banks and financial
institutions in Zambia have been vigilant enough in ensuring that the
board is constantly held accountable and responsible for the efficient
and effective governance of the bank or financial institution? We saw
in chapter 3 that Zambia has had many failed banks which have ended
up in liquidation. But how many directors of such banks and financial
institution have ended up being held accountable and responsible,
individually or severally, for the inefficient and ineffective
governance of the failed banks and financial institutions?

4.2 Principle II: Ethical Standards and Corporate Values

The second principle under the Banking and Financial Services
(Corporate Governance) Guidelines 2006 provides that the board of
directors, in keeping with their responsibilities to the shareholders
and other stakeholders, is committed to the achievement of business
success and the enhancement of long-term shareholder value with the
highest standards of integrity and ethics.991 Each director, as well as
each member of senior management, is therefore expected to lead by
example in a culture that emphasises trust, integrity, honesty,
judgment, respect, responsibility and accountability.992 Although the
principle talks about corporate culture, it hardly addresses the issue
of power politics in an organisation. It is not easy to maintain a culture
of trust, integrity, honesty, judgment, respect, responsibility and
accountability where the organisational politics do not favour such a
culture. Senior management, therefore, through various problem-

990 As above.
991 See Bank of Zambia (n 915 above) 4.
992 As above.
solving tools, such as total quality management, business process-re-
engineering, total systems intervention and systems thinking, must be pro-active enough to ensure that politics in the bank or financial institution do not get in the way of achieving the institution’s desired ethical standards and corporate values. Some guidelines have been advocated on how to implement Principle II. For example, the board should ensure that senior management implements policies that prohibit or appropriately limit activities and relationships that diminish the quality of corporate governance, such as:

(i) lending to directors and employees or officers from affiliated companies contrary to insider lending limits stipulated in Statutory Instrument No 97 of 1996, the Banking and Financial Services (Insider Lending) Regulations 1996;

(ii) providing preferential treatment to insiders, for example, lending contrary to market practices;

(iii) improper use of a bank’s property and/or information;

(iv) unfair dealing with customers/clients, employees, suppliers, competitors and other stakeholders, or

(v) allowing the delinquency of loans to board members.

Also, the board should ensure that a policy is place that encourages employees to communicate freely concerns about illegal, unethical or questionable practices to the board or an independent committee thereof, as well as to senior management, without fear of reprisal.994 This process should include an option for employees to make their concerns known anonymously.995 But what happens where employees begin to use this system to settle scores and vendettas against some managers by sending out anonymous defamatory memos? It would have been helpful if the guidelines under Principles II had pointed out that where anonymous but malicious and false allegations are made that would attract punitive measures from management. All in all, the board should, indeed, ensure that a policy to protect whistleblowers is in place. Where, for example, a report is made by a bank employee of a suspicious transaction or suspicious activity pertaining to money laundering, the identity of that whistleblower must be protected. Otherwise, there will be no incentive for the employee to report the case.

Further, the board of every bank and financial institution should adopt a written code of ethics that sets out explicit expectations for ethical decision-making and personal behaviour by all board members.


994 Bank of Zambia (n 915 above) 5.

995 As above.
and employees with respect to conflicts of interest, which include circumstances such as a director participating in a board discussion and voting on matters in which the director has a personal interest. The code of ethics should include measures to deal with breaches of the code by any employee. And it is proposed that such a code could also set out measures to prohibit sexual relationships between a superior and his or her direct subordinate as well as measures to prohibit extra-marital affairs between two married employees, on the one hand, and between an unmarried employee and a married employee, on the other.

4.3 Principle III: Board responsibilities and composition

The third principle postulates that the board of directors’ role is to oversee the proper functioning of the bank or financial institution. In order to achieve this, the board should have clear, well-defined and understood responsibilities. And there should be a balance of skills, knowledge, experience and perspectives among directors so that the board works effectively to ensure the long-term safety and soundness of the bank or financial institution.

Closely related to this principle are the guidelines which stipulate, inter alia, that the board should have a formal charter that sets out its responsibilities. The charter should, at a minimum, confirm the board’s responsibility for adoption of strategic plans, the monitoring of operational performance and management. And the charter should allow the board to determine appropriate policies and processes to ensure the integrity of the bank's or financial institution’s risk management practices and internal controls, communications policy, and director selection, orientation and evaluation. The guidelines also provide for executive and non-executive directors of a bank or financial institution, training of executive directors, performance evaluations of employees, as well as a chairperson who has to be an independent non-executive director.

996 As above.
997 As above.
998 Bank of Zambia (n 915 above) 7.
999 As above.
1000 As above.
1001 As above.
1002 As above.
1003 As above.
1004 Bank of Zambia (n 915 above) 7-10.
4.4 Principle IV: Board committees

The fourth principle states that the board should use committees where this would enhance its effectiveness in key areas while retaining its overall responsibility. Board committees, it is argued, are an aid to assist the board of directors in discharging its duties and responsibilities more effectively and efficiently. The principle postulates that committees should preferably be made-up of non-executive directors. The inclusion of management on these committees should be the exception rather than the rule, to reinforce the independence of the board. That said, management can, however, be invited to provide input on any matter that is of interest to the board.

The guidelines in support of Principle IV provide that, at a minimum, each board should ensure that the following committees are in place: (i) Board Audit Committee; (ii) Risk Management Committee; and (iii) Loans Review Committee. In addition, each board should endeavour to have a Nominations Committee and a Remuneration Committee, or a combination of the two.

The function of the Board Audit Committee includes providing oversight of a bank’s or financial institution’s internal and external auditors, approving the appointment, compensation and dismissal of the aforesaid auditors; reviewing and approving the audit scope and frequency; receiving audit reports and ensuring that management is taking appropriate corrective action in a timely manner to address control weaknesses as well as non-compliance with laws and policies identified by auditors; satisfying itself that accounting principles, policies and practices are adequate to ensure resources are safeguarded, laws are followed, reliable data is disclosed, and the internal control systems are adequate; and supervising the review and approval of public financial statements.

By contrast, the function of the Loans Review Committee includes reviewing and approving lending strategies and policies as well as reviewing and approving loan limits. Other functions are approving asset quality standards with respect to all lending areas and monitoring concentration of credit by product, industry and

1005 Bank of Zambia (n 915 above) 10.
1006 As above.
1007 As above.
1008 As above.
1009 As above.
1010 As above.
1011 As above.
1012 Bank of Zambia (n 915 above) Appendix, I.
1013 As above.
geographical area; approving appropriate general underwriting guidelines with respect to all lending areas and ensuring that banks and financial institutions adhere to such guidelines; reviewing the lending activities of banks and financial institutions and ensuring compliance with the approved internal policies and all applicable laws; reviewing and, if appropriate, approving all loans recommended by the management credit committee and, where appropriate, approving exceptions to defined policies; reviewing reports of examination by supervisory authorities as well as internal and external audit reports and management letters that pertain to the bank's or financial institution's loan portfolio; monitoring management's response to all supervisory examination and internal audit comments pertaining to the bank's or financial institution's loan portfolio; and reviewing the quality of loan portfolios, including but not limited to trends in loan quality, classified loans, charge-offs and delinquencies.\textsuperscript{1014}

Then, the functions of the Risk Management Committee are to provide oversight of activities of senior management in managing credit, market, liquidity, operational, legal, compliance, reputational and other risks of the bank or financial institution.\textsuperscript{1015} Also, the Risk Management Committee has the responsibility of receiving periodic information on risk management activities from senior management.\textsuperscript{1016}

Providing oversight of remuneration and compensation of directors, senior management and other key personnel, the Remunerations Committee ensures that compensation is consistent with the culture, objectives and strategy of the bank or financial institution.\textsuperscript{1017} The Remunerations Committee also makes recommendations to the board regarding the use of incentive compensation plans and equity-based remuneration plans.\textsuperscript{1018}

Then, the Nominations Committee identifies and assists with the recruitment of qualified candidates for board membership and for the positions of chairperson of the board and chairperson of the committees and committee members.\textsuperscript{1019} The Nominations Committee also establishes formal selection criteria for prospective directors, including the evaluation criteria for current directors.\textsuperscript{1020} Other tasks of the Nominations Committee include assessing the effectiveness of the board and directing the process of renewing and

\textsuperscript{1014} As above.
\textsuperscript{1015} Bank of Zambia (n 915 above) Appendix, II.
\textsuperscript{1016} As above.
\textsuperscript{1017} As above.
\textsuperscript{1018} As above.
\textsuperscript{1019} As above.
\textsuperscript{1020} As above.
replacing board members, recommending nominees for each board committee; recommending to the board to accept or decline any tendered resignation of a director; ensuring a review at least annually of incumbent directors’ performance and attendance at board and committee meetings; ensuring that the board members receive thorough orientation on board governance and key strategic issues facing the institution; and reviewing and reassessing the adequacy of the bank’s or financial institution’s corporate governance principles and practices for the board of directors, at least annually, and recommending proposed changes to the board.\textsuperscript{1021}

The Bank of Zambia expects that every board committee of a bank or financial institution should have a clear formal charter that sets out its role, schedule of meetings and delegated responsibilities whilst safeguarding the ultimate decision-making authority of the board as a whole.\textsuperscript{1022} And the proceedings of each committee’s meetings are to be reported back to the board to allow the other directors to be informed and to seek clarification from the committee members if so desired.\textsuperscript{1023} Further, all board committees should preferably be chaired by an independent non-executive director, who may be the board chairperson.\textsuperscript{1024} In essence, board committees can take independent, external professional advice as and when deemed necessary at the cost of the bank or financial institution itself.\textsuperscript{1025} And board committees should be subjected to regular evaluation by the board to ascertain their performance and effectiveness.\textsuperscript{1026}

4.5 Principle V: Evaluation of board performance

The fifth principle under the Banking and Financial Services (Corporate Governance) Guidelines 2006 deals with evaluation of board performance. This principle postulates that self-evaluation is a proactive, best practice by boards that intend to excel to higher levels of performance.\textsuperscript{1027}

The evaluation of board performance seeks to identify specific areas in need of improvement or strengthening and the results and any actions to be taken should be discussed by the full board.\textsuperscript{1028} As a guideline for implementation, the board, through its Nominations Committee, should review its required mix of skills and experience

\textsuperscript{1021} As above.
\textsuperscript{1022} Bank of Zambia (n 915 above) 10.
\textsuperscript{1023} As above.
\textsuperscript{1024} As above.
\textsuperscript{1025} As above.
\textsuperscript{1026} Bank of Zambia (n 915 above) 11.
\textsuperscript{1027} As above.
\textsuperscript{1028} As above.
and other qualities, such as diversity, in order to assess its effectiveness. The review should be by means of peer and self-evaluation of the board as a whole, its committees and the contribution of each and every director, including the chairperson. But, then, in reality, how many banks and financial institutions in Zambia adhere to this dictate of carrying out reviews and evaluations? Yet, the evaluations are required to be conducted annually. And the reviews and evaluations should include, among other things, an assessment of the board’s

(i) composition and independence;
(ii) performance against its objectives at the beginning of the year;
(iii) performance against the board charter;
(iv) effectiveness in the bank’s or financial institution’s strategic direction;
(v) response to problems and crises;
(vi) responsiveness to shareholders’ and stakeholders’ concerns;
(vii) maintenance and implementation of the board’s governance principles; and
(viii) access to and review of information from management and the quality of such information.

4.6 Principle VI: Roles of senior management

According to the Bank of Zambia, it is the responsibility of the management of a bank or financial institution, under the direction of that institution’s chief executive, to conduct the institution’s business and affairs in an effective, responsible and ethical manner, consistent with the principles and direction established by the board through a strategic plan. To achieve this, senior management should have the necessary skills to manage the business under their oversight and have appropriate control over the key individuals in these areas. Senior management should also implement strategies and policies approved by the board. In addition, senior management should ensure that strategies and policies are communicated to all relevant staff members of the bank or financial institution. And senior management should also ensure that there is segregation of duties in order to avoid and prevent conflicts of interests.

1029 As above.
1030 As above.
1031 As above.
1032 Bank of Zambia (n 915 above) 11-12.
1033 Bank of Zambia (n 915 above) 12.
1034 As above.
1035 As above.
1036 As above.
carrying out its functions, senior management should provide the board with timely, relevant, and complete reports on the implementation of the bank’s or financial institution’s business strategy.\(^{1037}\) The Sixth Principle requires also that senior management of a bank or financial institution be held liable for false or misleading statements to the board, staff members, and regulators.\(^{1038}\)

The Bank of Zambia postulates that the chief executive officer of a bank or financial institution should be a suitably-qualified person with appropriate and relevant experience, and should possess a proven track record at senior management level.\(^{1039}\) But, based on practice in Zambia, is this always the case? Do all past and present chief executives of banks and financial institutions regulated by the Bank of Zambia meet this requirement? The Bank of Zambia, however, argues that the chief executive officer of a bank or financial institution should be subject to a fit and proper test by the Bank of Zambia in the same manner as is recommended for all new director appointments.\(^{1040}\) While this view seems laudable, the Bank of Zambia has not promulgated publicly the specific criteria for its ‘fit and proper test’ could explain why in some instances the enforcement of this dictate appears weak. This lacuna is no form of regulatory forbearance. Some directors and chief executives of banks and financial institutions do not have strong professional and academic backgrounds in the relevant areas of the financial sector. Others have risen through ranks without much formal education. It could thus be argued that not every director or chief executive of a commercial bank or financial institution in Zambia can objectively satisfy the ‘fit and proper’ test. We saw in chapter 3, for example, that some directors of failed banks that have since gone under have now reincarnated themselves into new directors at other banks. So, how can we explain this ‘fit and proper’ test?

At common law, a decision to reject an application for approval for a controlled function, such as that of chief executive officer or director of a bank, must be based on material significance.\(^{1041}\) In the English case of Cox v the FSA,\(^{1042}\) an application for approval was refused on the basis of Ian Douglas Cox’s previous conduct of trying dishonestly to surrender a pension, which resulted in two insurance companies and the Inland Revenue being defrauded.\(^{1043}\)

\(^{1037}\) As above.
\(^{1038}\) As above.
\(^{1039}\) Bank of Zambia (n 915 above) 13.
\(^{1040}\) As above.
\(^{1042}\) Ian Douglas Cox v Financial Services Authority 12 May 2003, cited in Singh (n 1043 above) 103.
\(^{1043}\) As above.
Generally, in Zambia, the chief executive officer of a bank or financial institution will be responsible for the day-to-day operations of the bank or financial institution, and should, thus, be conversant with the operations of the institution, the state of its internal controls, the relevant legislative requirements, as well as any current issues and policies affecting the financial sector. That said, every bank or financial institution is forbidden by the Bank of Zambia from making any public pronouncement about any proposed appointment of its new chief executive officer or director before the bank or financial institution obtains the Bank of Zambia's written consent for the proposed change.

The Sixth Principle of the Banking and Financial Services (Corporate Governance) Guidelines 2006 provides further that the company secretary of a bank or financial institution should be a lawyer, or chartered accountant or chartered secretary or a firm or any person of similar capabilities that the Bank of Zambia deems fit, and the company secretary should preferably be an executive officer of the bank or financial institution. The board of the bank or financial institution should empower the company secretary to provide the board, as a whole, and directors, individually, with detailed guidance on how their responsibilities should be properly discharged in the best interest of the bank or financial institution and in compliance with laws, internal rules and corporate governance guidelines.

Where a lawyer is about to be appointed as a company secretary, the guidelines do not spell out whether the individual should have been called to the Bar in Zambia or not. And what would happen, if, unknown to the Bank of Zambia, the individual is a discredited lawyer who has been disbarred from legal practice in Zambia or elsewhere? Would such a person be capable of meeting the 'fit and proper test' requirement of the Bank of Zambia?

All in all, the company secretary should, in addition to the aforesaid roles, be responsible for the induction and continuing training of directors, and for assisting the chairperson and the chief executive officer in determining the annual board plan and the administration of other issues of a strategic nature at board levels. And copies of the induction and continuing training

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1044 Bank of Zambia (n 915 above) 13.
1045 As above.
1046 As above.
1047 As above.
1048 As above.
1049 Bank of Zambia (n 915 above) 14, on the requirement that a company secretary undergoes a 'fit and proper test' by the Bank of Zambia.
1050 Bank of Zambia (n 915 above) 14.
programme should be made available to the Bank of Zambia on the latter's request.\textsuperscript{1051} The company secretary should serve as a central source of guidance and advice to the board, and to the bank or financial institution in general, on matters of ethics and good governance.\textsuperscript{1052}

The Banking and Financial Services (Corporate Governance) Guidelines 2006 also promulgate the requirements pertaining to the appointment and functions of a chief financial officer of a bank or financial institution. The chief financial officer, in addition to the requisite academic and professional qualification, should be of good standing and a member of a professional association (ie the Zambia Institute of Chartered Accountants).\textsuperscript{1053} And like appointments of chief executive officer, director or company secretary of a bank or financial institution, the appointment of a chief financial officer should be subjected to a fit and proper test by the Bank of Zambia.\textsuperscript{1054}

4.7 Principle VII: Reporting and disclosure

Under Principle VII of the Banking and Financial Services (Corporate Governance) Guidelines 2006, the board of a bank or financial institution should demand integrity both in financial reporting and in timeliness and balance of disclosures on the bank's or financial institution's affairs.\textsuperscript{1055} It is responsibility of the board to ensure that the institution's financial statements fairly present the state of affairs of the institution as at the end of the financial year and the profit or loss and cash flows for the reporting period.\textsuperscript{1056} In this regard, the preparation of the financial statements of a bank or financial institution should be done in line with the Bank of Zambia Prudential Guidelines on the Application of International Financial Reporting Standards 2006. These guidelines provide in part:

Following the directive by the Zambia Institute of Chartered Accountants (ZICA) that all corporate entities, including commercial banks and non-bank financial institutions registered and operating in Zambia, adopt the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) for reporting periods beginning on or after 1 January 2005, the Bank of Zambia herewith provides supervisory guidance to ensure that the financial statements are prepared within the existing regulatory framework ... The purpose of this circular therefore is to enhance the

\textsuperscript{1051} As above.
\textsuperscript{1052} As above.
\textsuperscript{1053} As above.
\textsuperscript{1054} As above.
\textsuperscript{1055} As above.
\textsuperscript{1056} As above.
accounting framework such that financial statements produced by commercial banks and financial institutions incorporate the regulatory and prudential concerns of the Bank of Zambia. Given that the Zambia Accounting Standards were not significantly different from the IFRSs, the Bank of Zambia has disallowed the optional exemptions IFRS 1.13-25 that are available when an entity prepares its first IFRS financial statements. This approach will ensure that the comparability of a financial institution from year to year and with other financial institutions is not made unnecessarily intricate.\textsuperscript{1057}

The external auditor should indicate in the auditor’s report, in accordance with section 64 of the Banking and Financial Services Act 1994, whether the financial statements of the bank or financial institution present a true and fair view of the entity.\textsuperscript{1058} Section 64 of the Banking and Financial Services Act 1994, dealing with auditors’ reports, provides as follows:

(1) Every auditor of a bank or financial institution shall have the right of access at all times to all books, accounts and records of the bank or financial institution, and shall be entitled to require from its directors, chief executive officer, chief financial officer, managers and agents such information and explanations as the auditor requires to perform the auditor’s duties under this Act.

(2) In every report made for the purposes of this Act by an auditor, the auditor shall:

(a) express whether, in the auditor’s opinion, the bank or financial institution made available all necessary information to enable the auditor to comply with the requirements of this Act;

(b) state whether, in the auditor’s opinion, each of the statements included in the annual statement are fully, fairly and properly drawn up, whether they exhibit a true and fair statement of the bank’s or financial institution’s financial condition and, if the auditor has called for explanation or information from the directors, chief executive officer, chief financial officer, managers or agents of the bank or financial institution, whether a satisfactory response was received;

(c) state whether in the auditor’s opinion the bank or financial institution has complied with the provisions of this Act and the regulations, guidelines and prescriptions under this Act and any other written law; and

(d) report any transactions or conditions that have come to the attention of the auditor affecting the well-being of the bank or financial institution that in the opinion of the auditor, are not satisfactory and require rectification and, without limiting the generality of the foregoing shall, report on:


\textsuperscript{1058} Bank of Zambia (n 915 above) 14.
(i) any transaction of the bank or financial institution that has come to the attention of the auditor and which, in the opinion of the auditor, has not been within the powers of the bank or financial institution or which was contrary to this Act or any other law; and
(ii) any loan owing to the bank or financial institution by any person that is a non-performing loan, or that has been restructured or the terms of repayment of which have been extended, if the principal amount of the loan is five per centum or more of the regulatory capital of the bank or financial institution.

(3) The directors shall submit a copy of the report of the auditor, together with a copy of the annual financial statement to the Bank of Zambia and each shareholder of the bank or financial institution within a period of three months from the end of each financial year.

(as amended by Act 18 of 2000)

But does an external auditor owe a duty of care to the bank or financial institution whose books of account he or she is auditing? Similarly, does the external auditor owe a duty of care to third parties that ultimately rely on those audited accounts? The Banking and Financial Services (Corporate Governance) Guidelines 2006 are silent on these issues. Neither does the Banking and Financial Services Act 1994 provide any clues. We are thus left to look to the English common law. In Re Kingston Cotton Mill, Vaughan William J, examining the legal position of an auditor, ruled as follows: ‘[N]o doubt he is acting antagonistically to the directors in the sense that he is appointed by the shareholders to be a check upon them.’

Woolf observes that the House of Lords in the United Kingdom has issued rulings to eliminate the open-ended liability to third parties faced by auditors. The House of Lords, according to Woolf, has declared that auditors have a duty of care to a third party only if they have knowledge on the nature of the third party’s transactions, know

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1059 See Caparo Industries plc v Dickman & Others [1990] 1 All ER 568; and Al-Saudi Banque v Clark & Pixley [1990] 1 ch 313, showing that, in general, auditors only owe a duty of care to the company (as a legal entity) rather than to any individual shareholder or creditor. See JEB Fasteners Ltd v Marks & Bloom & Co [1983] 1 All ER 583; and Twomax Ltd v Dickson, McFarlane and Robinson [1983] SLT 98, which tended to show the possibility that under some highly restrictive circumstances auditors may be held liable to third parties. See also Candler v Crane Christmas & Co [1951] 1 All ER 426; McNaughton (James) Paper Group Limited v Hicks Anderson & Co [1991] 1 All ER 134 and [1990] BCC 891; Berg Sons & Co Limited & Others v Adams & Others [1992] BCC 661. Following the case of Barings plc & Another v Coopers & Lybrand [1997] BCLC 427, auditors of subsidiary companies could owe a duty of care to the parent company (as a legal person) but not to any human stakeholder.

1060 [1896] 1 ch 6, 11.

1061 As above.

that their reports will be disclosed to the third party, and are aware that the decisions of the third party will be based on these reports.\textsuperscript{1063} However, these rulings have also made UK auditors apprehensive that the less likelihood of being sued will render the generality of accounts useless, thus reducing their credibility.\textsuperscript{1064} The changing trend of auditor's liability, Woolf argues, is also evident in 'case rulings in the US and Australia. The 1992 \textit{Security Pacific Business Credit v Peat Marwick Main & Co} and the \textit{AWA v Deloitte} cases in the US and Australia, respectively ...'\textsuperscript{1065}

In the English case of \textit{Re Kingston Cotton Mill (No 2)},\textsuperscript{1066} it was noted that an auditor is not required to prepare the audit report with suspicion, but should prepare such report on the basis that, if suspicion does exist, then an obligation exists to 'probe it to the bottom'.\textsuperscript{1067} Accordingly, the standard of knowledge, skill and care required of an external auditor is that expected of a reasonably competent auditor,\textsuperscript{1068} and the court should consider whether the act or omission departs from 'general practice'.\textsuperscript{1069} Citing the case of \textit{Bolam v Friern Mgmt Comm},\textsuperscript{1070} Singh argues that, in such a case, 'general practice' is interpreted to mean the typical behaviour of a skilled person accepted by a 'responsible body' of opinion.\textsuperscript{1071}

Commenting on a recent 2008 court ruling in the United Kingdom, Curd and Hare observe as follows:

A recent case has considered the standard of care owed by auditors. The auditors were retained to prepare a report for the purposes of the 'whitewash' procedure under the Companies Act 1985, allowing a sale of shares by directors of the company to a new company incorporated for that purpose, with the purchase being funded by a loan from the company. The auditors prepared the report stating that they had enquired into the affairs of the company and that there was nothing to indicate that the opinion stated by the directors (i.e. that the company was presently solvent and would be able to pay its debts in full within the following 12 months, or within 12 months of being wound up if the winding up commenced within 12 months) was unreasonable. The company subsequently went into liquidation. It transpired that the company did not have sufficient distributable profits (as required by the statute) at the time the loan was provided. The directors had

\begin{footnotes}
\footnotetext[1063]{As above.}
\footnotetext[1064]{As above.}
\footnotetext[1065]{As above.}
\footnotetext[1066]{[1896] 2 ch 279.}
\footnotetext[1067]{[1896] 2 ch 279 288-289. See also Singh (n 1043 above) 163; \textit{Re London and General Bank} [1895] 2 ch 166; \textit{Re D'Jan of London Ltd Copp v D'Jan} [1994] BCLC 561.}
\footnotetext[1068]{Singh (n 1043 above) 163.}
\footnotetext[1069]{As above; \textit{Kraji v McGrath} [1986] 1 All ER 54 61.}
\footnotetext[1070]{[1957] 2 All ER 118 122.}
\footnotetext[1071]{Singh (n 1043 above) 163.}
\end{footnotes}
significantly overvalued the worth of the company shares. The company, in liquidation, claimed against the directors for reimbursement of the purchase price, damages for breach of fiduciary duty and damages for negligence. It also claimed against the auditors for breach of contract and negligence, on the grounds that they had failed to deliver a competent report. The court held:

- The directors were liable in respect of the claims against them they had allowed the company to provide unlawful financial assistance and had preferred their own interests over those of the company.

- The court assessed the standard of care owed by the auditors against the best practice publication 'Audit Quality' published by the ICAEW. The court did not accept that the techniques that the auditors should have adopted to apply the standard would vary because of the size of the transaction. A proper analysis of the company's assets and business would have revealed it was in no position to advance the loan. The court also rejected the argument that, by analogy to negligent valuation cases, the auditors' opinion was not so far outside the reasonable range that they should be held liable for the entirety of the company's loss. The auditors were in breach of duty in that they failed to enquire into the affairs of the company to the extent that an auditor of reasonable competence would have done. If they had, the certificate would not have been signed and the loan would not have been provided.

- On the same basis, the auditors were liable to the director shareholders for breach of duty. The measure of damages was the loss in the value of their shareholdings.

- Both the directors and auditors were liable to the company for the same damage, therefore the court was entitled to apportion liability between them. The directors had received the whole of the sum advanced to the company, which was a personal 'windfall' to them, to the extent that it exceeded the true value of the shares at the date of completion. The directors were ordered to pay this difference in value to the company, and the auditors were required to pay the balance.\textsuperscript{1072}

In Zambia, closely related to the issue of the external auditor's report is the requirement that the board should attest in a statement on the adequacy of the accounting records and the effectiveness of the system of internal controls and risk management, and that this statement should be included in the annual report.\textsuperscript{1073} The annual statement should include a statement confirming that appropriate

\textsuperscript{1072} R Curd & K Hare 'United Kingdom: Auditors' negligence: Liability to company and shareholders' 2 June 2008, available at http://www.mondaq.com/article.asp?articleid=61268 (accessed 3 May 2009). See Cook & Another v Green & Others Chancery Division District Registry (Manchester), 2 May 2008; and the English Companies Act 1985, secs 151, 155 & 156. Note that the restrictions on financial assistance in relation to most acquisitions of shares in private companies (including the whitewash procedure) were scheduled to be repealed on 1 October 2008.

\textsuperscript{1073} Bank of Zambia (n 915 above) 15.
accounting policies supported by reasonable and prudent judgments and estimates have been used consistently. The annual report should also state whether the International Financial Reporting Standards have been adhered to or if there has been any departure in the interest of fair presentation. Where there has been a departure, the departure will not only be disclosed and explained, but should also be quantified. And the annual report should state, additionally, whether the Banking and Financial Services (Corporate Governance) Guidelines 2006 have been adhered to or if not, where there has not been compliance the bank or financial institution should give reasons. Complementing these guidelines is Core Principle 22 of the Basel Core Principles for Effective Banking Supervision which stipulates that

> [s]upervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.

### 4.8 Principle VIII: Remuneration

Principle VIII of the Banking and Financial Services (Corporate Governance) Guidelines 2006 stipulates that the remuneration of directors and executives of a bank or financial institution should be transparent, fair and reasonable. The board should have a clear policy for setting remuneration of executives and non-executives at levels that are fair and reasonable in a competitive market for the skills, knowledge, experience, nature and size of the institution. And every bank and financial institution should disclose its remuneration policy in the annual report, making a clear distinction between remuneration of executive directors and that of non-executive directors. The remuneration of executive directors should include an element that is dependent on individual performance as well as the bank's or financial institution's performance.

The Bank of Zambia suggests that, preferably, every bank and financial institution should appoint a remuneration committee,

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1074 As above.
1075 As above.
1076 As above.
1077 As above.
1078 See Basel Committee (n 7 above).
1079 Bank of Zambia (n 915 above) 15.
1080 As above.
1081 As above.
1082 As above.
consisting entirely or mainly of non-executive directors and/or independent non-executive directors.\textsuperscript{1083} The remuneration committee would have the task of making recommendations to the board with agreed terms of reference on the institution’s framework for executive remuneration and to determine specific remuneration packages for each of the executive directors.\textsuperscript{1084} And the chief executive officer could, at the invitation of the committee, which committee should ideally be chaired by an independent non-executive director, attend meetings to provide input on the remuneration of the other executives.\textsuperscript{1085} Every bank and financial institution should provide full disclosure in the annual report of director remuneration on an individual basis, spelling out details of earnings, share options, restraint payments and any other benefits.\textsuperscript{1086}

4.9 Principle IX: Risk management

Principle IX of the Banking and Financial Services (Corporate Governance) Guidelines 2006, dealing with risk management, is today complemented and reinforced by the Banking and Financial Services Risk Management Guidelines 2008. When the Banking and Financial Services (Corporate Governance) Guidelines 2006 were issued by the Bank of Zambia in 2006, the Banking and Financial Services Risk Management Guidelines 2008 were not yet in existence. This feature helps to explain why the Banking and Financial Services (Corporate Governance) Guidelines 2006 has a provision on risk management. But, then, what happens where a provision of Principle IX of the Banking and Financial Services (Corporate Governance) Guidelines 2006 conflicts with or contradicts a provision of the Banking and Financial Services Risk Management Guidelines 2008? Which one of the two provisions will prevail or take precedence over the other? There is a lacuna in the law here. We are left to infer that, more likely than not, the Banking and Financial Services Risk Management Guidelines 2008 could take precedence since it was developed much later than the Banking and Financial Services (Corporate Governance) Guidelines 2006 and is, thus, likely to have been designed to provide for a fuller and more comprehensive framework for risk management.

Principle IX of the Banking and Financial Services (Corporate Governance) Guidelines 2006 postulates that the board of a bank or financial institution should include in its annual report information on risk identification, risk management and internal controls in

\textsuperscript{1083} As above.
\textsuperscript{1084} As above.
\textsuperscript{1085} Bank of Zambia (n 915 above) 16.
\textsuperscript{1086} Bank of Zambia (n 915 above) 15.
accordance with section 56 of the Banking and Financial Services Act 1994. The said statutory provision reads as follows:

(1) The directors of a bank or financial institution shall place before the shareholders at every annual meeting:

(a) annual financial statements for the financial year immediately preceding the meeting and the financial year, if any, immediately preceding that year showing separately:

(i) a balance sheet as at the end of each of each of those financial years;
(ii) a profit and loss account for each of those financial years;
(iii) a cash flow statement for the last financial year;
(iv) a statement of changes in the shareholders' equity for the last financial year;
(v) a capital adequacy computation as at the end of each of those financial years;

(b) a directors' report containing the following information:

(i) common enterprise and related party transactions;
(ii) risk management, processes and practices during the year;
(iii) directors' interests disclosed;
(iv) the existence of prohibited borrowings or lendings; and
(v) internal control; and

(c) any information that may be required by or under the law under which the bank or financial institution is established.

(2) The information and particulars referred to in subsection (1) shall contain what is necessary to present fairly, in accordance with generally accepted accounting principles consistently applied, the financial position of the bank or financial institution as at the end of the financial year to which it relates and the results of the operations and changes in the financial position of the bank or financial institution for that financial year.

(3) The directors shall also place before the shareholders at every annual meeting:

(a) the report of the auditor of the bank or financial institution; and

(b) any additional information concerning the financial position of the bank or financial institution and the results of its operations as may be prescribed by the Bank of Zambia.

(4) In subsection (1), a related party transaction means a transaction whereby two or more persons, by virtue of their relationship, will or are likely to benefit severally or jointly from funds or services arising from a transaction involving any one of them and a bank or financial institution.

(As amended by Act 18 of 2000)
4.10 Principle X: Internal audit

Under Principle X of the Banking and Financial Services (Corporate Governance) Guidelines 2006, the internal audit of a bank or financial institution should give assurance that (a) the internal controls in place are adequate to mitigate risks; (b) organisational goals and objectives are met; and (c) corporate governance processes are effective and efficient. The internal audit function should have its purpose, authority and responsibility defined in an internal audit charter. And the internal audit charter should include, among other issues, the following: (a) the internal audit’s role and responsibility for governance, risk management, consulting services, and fraud investigations, etc; (b) the right for the chief internal auditor to have unrestricted access to the audit committee chairperson, employees, facilities and records of the institution; (c) that the chief internal auditor reports directly to the board of directors or its audit committee in order to ensure his or her independence from management; (d) that the chief internal auditor has a right to attend audit committee meetings without management; and (e) that the chief internal auditor meets with the audit committee at least once a year.

The internal audit function of a bank or financial institution, the Bank of Zambia argues, should be performed by professionals with an in-depth understanding of the business culture, systems and processes of the institution. Internal auditors should not assume any operational responsibilities since that would impair their objectivity as internal auditors. And banks and financial institutions should put in place robust internal audit procedures, with appropriate reporting lines to the board of directors, and with oversight by the audit committee of the board.

4.11 Principle XI: Internal control compliance

The development and implementation of an adequate and sound system of internal controls are the responsibility of senior management. The board of directors is ultimately responsible for ensuring that such a system is established, implemented and maintained. This requirement is in line with Core Principle 18 of

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1087 Bank of Zambia (n 915 above) 17.
1088 Bank of Zambia (n 915 above) 18.
1089 As above.
1090 As above.
1091 Bank of Zambia (n 915 above) 19.
1092 Bank of Zambia (n 915 above) 18.
1093 Bank of Zambia (n 915 above) 19.
1094 As above.
the Basel Core Principles for Effective Banking Supervision which promulgates as follows:

Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.\(^\text{1095}\)

Under Zambia's Banking and Financial Services (Corporate Governance) Guidelines 2006, internal controls encompass the policies, processes, culture, tasks and other aspects of a bank or financial institution that support the achievement of the entity's objectives and mission.\(^\text{1096}\) Also, internal controls facilitate the efficiency of operations, contribute to effective risk management, assist compliance with applicable laws and strengthen the institution's capacity to respond appropriately to business opportunities.\(^\text{1097}\) While the board should review at least annually the system of internal controls to determine whether it works to expectation and to ensure it remains appropriate, the audit committee should ensure that the institution complies with regulatory requirements, including prudential requirements, taxation rules and various reporting obligations.\(^\text{1098}\) The corporate governance framework should therefore include systems for ensuring that all statutory and regulatory requirements are being complied with, and to highlight potential or actual braches as and when they occur.\(^\text{1099}\)

### 4.12 Principle XII: External auditors

Principle XII, emphasising that the board should ensure the quality and independence of the external audit process, is supported by guidelines that stipulate that the board, through its audit committee, should acquaint itself fully with the responsibilities of external auditors and be rigorous in its selection of auditors on professional merit.\(^\text{1100}\) And the board should satisfy itself that there is no relationship between the auditor and the bank (or financial institution) or any related person that could compromise the independence of the auditor, and should require confirmation of this

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1095 See Basel Committee (n 7 above).
1096 Bank of Zambia (n 915 above) 19.
1097 As above.
1098 As above.
1099 As above.
1100 Bank of Zambia (n 915 above) 20.
from the auditor.\textsuperscript{1101} The board should also facilitate full and frank dialogue among its audit committee, the external auditors and management.\textsuperscript{1102} That said, we have also examined above the issue of legal liability of external auditors during the performance of their audit functions.

An auditing firm that provides auditing services can be engaged to provide other non-audit work subject to prior approval by the audit committee to avoid possible conflicts of interest and to ensure independence and objectivity of audit work.\textsuperscript{1103} In the annual report, the board should explain what non-audit work was undertaken, if any, and why this did not compromise auditor independence.\textsuperscript{1104} The board should include in the annual report the amount of fees paid to the auditors by the bank or financial institution and any affiliates of these institutions, and clearly distinguish audit fees from non-audit fees.\textsuperscript{1105} That said, the external audit of a bank or financial institution should not be performed by the same audit engagement partner for more than five consecutive years in order to mitigate the threat of over-familiarity.\textsuperscript{1106} Furthermore, an individual external auditor cannot serve as an engagement partner with the same bank or financial institution until a period of two years has elapsed.\textsuperscript{1107} All in all, banks and financial institutions should strive for efficient audit processes using external auditors in combination with the internal audit function.\textsuperscript{1108} The external auditors should evaluate and make an opinion on the effectiveness of the internal controls of the bank or financial institution.

4.13 Principle XIII: Stakeholder interests

Under Principle XIII, the board of a bank or financial institution should respect the interests of stakeholders within the context of the institution's ownership and its fundamental purpose.\textsuperscript{1109} This principle is supported by the following guidelines:\textsuperscript{1110}

(a) The board should have clear written policies for the institution's relationships with significant stakeholders, bearing in mind distinctions between public, private and government ownership.

\textsuperscript{1101} As above.
\textsuperscript{1102} As above.
\textsuperscript{1103} As above.
\textsuperscript{1104} As above.
\textsuperscript{1105} As above.
\textsuperscript{1106} As above.
\textsuperscript{1107} As above.
\textsuperscript{1108} As above.
\textsuperscript{1109} Bank of Zambia (n 915 above) 21.
\textsuperscript{1110} As above.
(b) The board should regularly assess compliance with these policies to ensure that the conduct towards stakeholders complies with the code of ethics and the law, and that it is within broadly accepted social, environmental, and ethical norms, generally subject to the interests of shareholders.

(c) The institutions should include in their annual report information of their activities, performance and how they have served the interests of their stakeholders.

(d) The institutions should include in their annual report the nature and extent of their social transformation, ethical, safety, health and environmental management policies and practices. The board must determine what is relevant for disclosure, having regard to the institution's particular circumstances.

4.14 Principle XIV: Board relationships with supervisors

Under Principle XIV, the board of bank or financial institution should maintain an open relationship with the Bank of Zambia which promotes mutual trust and confidence.\textsuperscript{1111} To achieve this, the board should understand the regulatory environment within which it operates and be open to sharing with supervisors, information pertaining to the supervisors' oversight of the institution.\textsuperscript{1112}

4.15 Principle XV: Transparency

Under Principle XV, transparency is essential for sound and effective corporate governance.\textsuperscript{1113} Here, transparency will help to ensure that shareholders, other stakeholders and market participants monitor effectively and also hold properly accountable the board of directors and senior management.\textsuperscript{1114}

As a guideline, banks and financial institutions should make appropriate disclosures to facilitate market discipline as ownership transparency is central to the effectiveness of external governance.\textsuperscript{1115} This is particularly important for institutions that have complex shareholding structures which could foster opacity in a manner that impedes effective market and supervisory oversight.\textsuperscript{1116} And the same applies to banks and financial institutions that operate, say, through corporate trust providers, special purpose vehicles of any corporate structures that impair transparency, including those that operate in offshore financial centres as well as those that operate in

\textsuperscript{1111} As above.
\textsuperscript{1112} Bank of Zambia (n 915 above) 21-22.
\textsuperscript{1113} Bank of Zambia (n 915 above) 22.
\textsuperscript{1114} As above.
\textsuperscript{1115} As above.
\textsuperscript{1116} As above.
jurisdictions that have secrecy laws or weak enforcement mechanism or any other jurisdiction that impairs transparency.\footnote{As above.}

5 Conclusion

This chapter has examined the efficacy of the legal framework for risk management and corporate governance by banks and financial institutions in Zambia. The chapter highlighted some conceptual issues in the definition of ‘risk’ before turning to examine the Banking and Financial Services Risk Management Guidelines 2008 and the Banking and Financial Services (Corporate Governance) Guidelines 2006. A metaphor was used to demonstrate the practice meaning of the term ‘risk’. With that, the chapter proceeded to examine the Banking and Financial Services Risk Management Guidelines 2008. Some shortcomings relating to the Banking and Financial Services Risk Management Guidelines 2008 were highlighted, with proposals made to redress the shortcomings. Thereafter, the chapter proceeded to examine the efficacy of the Banking and Financial Services (Corporate Governance) Guidelines 2006. Likewise, shortcomings pertaining to the Banking and Financial Services (Corporate Governance) Guidelines 2006 were fleshed out, with proposals made to redress some of the weaknesses. Among the issues addressed was that of legal liability of external auditors during the course of their audit function. An argument was made that an auditor is not required to prepare the audit report with suspicion, but should prepare such report on the basis that if suspicion does exist then an obligation exists to ‘probe it to the bottom’. It was also noted that the standard of knowledge, skill and care required of an external auditor is that expected of a reasonably competent auditor, and that the court needs to consider whether the act or omission departs from ‘general practice’.

A further argument was made that, notwithstanding that the Banking and Financial Services Risk Management Guidelines 2008 and the Banking and Financial Services (Corporate Governance) Guidelines 2006 have been issued by the Bank of Zambia pursuant to a piece of legislation, these guidelines, unlike principal legislation (for instance an Act of Parliament) or subsidiary legislation (for instance a statutory instrument), are generally not legally binding since, strictly speaking, they do not have the same force of law as an Act of Parliament, a statutory instrument or a judicial precedent. The chapter posited, however, that the Banking and Financial Services Risk Management Guidelines 2008 and the Banking and Financial Services (Corporate Governance) Guidelines 2006 are a corollary to and form part of the tenets of the legal and regulatory framework for banking supervision.
in Zambia. To that extent, it was pointed out, banks and financial institutions are expected by the Bank of Zambia to comply with and adhere to the said guidelines. A submission was made that these two sets of guidelines, like principles or codes of conduct for financial regulation, when compared with the development of customary international law, can, through established practice and some form of *opinio juris*, crystallise into legally-binding norms of customary law at the national level.

However, where the regulatory guidelines do not crystallise into binding norms of customary law, and some banks and financial institutions decide not to comply with the guidelines, the Bank of Zambia can, arguably, impose some sanctions on the culpable banks and financial institutions for engaging in unsafe and unsound practice. It would be for the Bank of Zambia to demonstrate that non-compliance with the provisions of either the Banking and Financial Services Risk Management Guidelines 2008 or the Banking and Financial Services (Corporate Governance) Guidelines 2006 constitutes unsafe and unsound practice under the Banking and Financial Services Act 1994. And where there is lax compliance with, as well as weak enforcement of, laws and regulations, as in situations where there are poorly-designed systems of corporate governance and risk management, a higher likelihood exists of some banks and financial institutions failing to meet minimum capital requirements. This, in turn, could escalate into insolvencies of some banks and financial institutions. In the next chapter, we examine the legal aspects of bank insolvency in Zambia.
REGULATING THE INSOLVENCY OF BANKS AND FINANCIAL INSTITUTIONS

1 Introduction

This chapter examines the legal and institutional framework for bank insolvency in Zambia. Aspects of corporate finance law indirectly related to or somewhat impacting on bank insolvency, such as complex arrangements relating to debt subordination, factoring, subrogation and block discounting, as well as elaborate arrangements for insolvency set-off, guarantees, loan syndications, security interests (for instance floating and fixed charges), priorities (for instance priority of successive equitable assignees and the rule in Dearle v Hall) assignment of receivables and equities affecting assigned receivables, are not the concern of the chapter. They all fall outside the scope of this chapter. By contrast, the chapter, avoiding superfluity, concerns itself mainly with the efficacy of the legal and institutional framework for bank insolvency in Zambia.

In the chapter, some international efforts to harmonise insolvency systems around the world are highlighted. The chapter also points to a strong need for Zambia to introduce a legal framework for cross-border insolvency. And although somewhat related to the issue of bank insolvency, the issue of deposit insurance is not discussed in this.

The rule in Dearle v Hall (1828) 3 Russ 1 is an English common law rule to determine priority between competing equitable claims to the same asset. The rule broadly provides that where the equitable owner of an asset purports to dispose of his equitable interest on two or more occasions, and the equities are equal between claimants, the claimant who first notifies the trustee or legal owner of the asset shall have a first priority claim. The rule has been subject to some scathing criticism, and has been abrogated in a number of common law jurisdictions. See, eg, RM Goode Commercial law (1995) 704-706. See also generally RM Goode Legal problems of credit and security (1995); WJ Gough Company charges (1996); FOditah Legal aspects of receivables financing (1991); Ward v Duncombe [1893] AC 369; Re General Horticultural Company (1886) 32 ch D 512; Re Holmes (1885) 29 ch D 786; Foster v Cockerell (1835) 3 Q & Fin 456; Re Lake [1903] 1 KB 151; Re Dallas [1904] 2 ch 385; The UK Law Commission Consultation Paper No 164.

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chapter since it has already been explored in chapter 3.\footnote{See also KK Mwenda Banking supervision and systemic bank restructuring: An international and comparative legal perspective (2000) 34-38 101-126.} That said, Cranston observes:

As with mergers and acquisitions, some jurisdictions have a special regime for bank insolvencies. Thus from the nineteenth century the United States developed special rules for the liquidation of banks. Under them, shareholders might be required to inject extra funds in the event of bank failure, liquidations were to be handled speedily, and government was given a monopoly power to close banks. The justification was the special character of banks, in particular the problem of systematic risk. By reassuring depositors, the special rules were supposed to reduce systematic risk. In more recent times the rationale for special laws for bank insolvency has been to minimise calls on the deposit insurance fund. Since the American experience is that banks are particularly prone to insider abuse, this is the basis for some of the especially strict rules imposed on insiders in a bank insolvency.\footnote{RCranston Principles of banking law (1997) 19-20.}

The chapter argues that the Bank of Zambia does not have adequate mechanisms for the management of banks in liquidation and the activities of liquidation managers.\footnote{This view is confirmed by the Bank of Zambia in Bank of Zambia Financial Sector Development Plan (FSDP) (2004-2009) (2004) 64.} This shortcoming, as the Bank of Zambia concedes too, has allowed failed banks to languish without resolution, and liquidations drag on for years thereby sending perverse signals to the market.\footnote{As above.} According to the Bank of Zambia, because of the growing tradition of lack-lustre post-failure collection efforts, borrowers have incentives to push troubled banks toward failures by withholding repayment.\footnote{As above.} It should be noted that, generally, money deposited in a bank account by a depositor/bank customer is no longer deemed as belonging to the depositor but rather to the bank.\footnote{See Edward Thomas Foley v Thomas Hill [1848] II HLC 1002.} The depositor remains as an unsecured creditor and, as Singh observes, has very little redress to recover the debt if the bank is put into liquidation.\footnote{Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd and Others [1986] 1 WLR 1072.} In Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd and Others,\footnote{[1986] 1 WLR 1072.} Lord Templeman ruled:

If the bank becomes insolvent the customer can only prove in liquidation of the bank as unsecured creditor for the amount which was, or ought to
have been, credited to the account at the date when the bank went into liquidation.\footnote{1128}

Thus, in a banker-customer relationship, the bank is only contractually accountable for the sum of money paid in by the customer, in addition to any interest accrued on that amount.\footnote{1129} Accordingly, in \textit{Foley v Hill},\footnote{1130} Cottenham LC ruled as follows:

\begin{quote}
The money paid into the banker's is money known by the principal to be placed there for the purpose of being under the control of the banker; it is then the banker's money; he is known to deal with it as his own; he makes what profit of it he can, which profit he retains to himself ... The money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with it as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the principal if he puts it into jeopardy, if he engages in a hazardous speculation.\footnote{1131}
\end{quote}

However, the relationship between a depositor and the bank is not one of principal and agent. By contrast, it is one of unsecured creditor and debtor.\footnote{1132}

In Zambia, the legislative revisions made in 2000 to the Banking and Financial Services Act 1994 appear to have targeted, among other issues, the strengthening of the supervisory and regulatory functions of the Bank of Zambia. Although that goal was not achieved in totality, the legal and institutional framework for bank insolvency in Zambia is not just concerned with the protection of creditor rights at the expense of debtor interests, or with the protection of debtor interests at the expense of creditor rights. By contrast, and as will become clearer in the course of this chapter, under the Banking and Financial Services Act 1994, the Bank of Zambia has extensive regulatory and supervisory powers. These powers increased with the coming into force of the Banking and Financial Services (Amendment) Act 2000.

What the Banking and Financial Services (Amendment) Act 2000 does is that it takes away from the Minister of Finance some of his

\footnotetext{1128}{\textsuperscript{\textnormal{n\ 1129 ab ... 1005-1006.}}}
\footnotetext{1129}{\textsuperscript{\textnormal{Singh (n 1043 above) 83.}}}
\footnotetext{1130}{\textsuperscript{\textnormal{[1848] II HLC 1002.}}}
\footnotetext{1131}{\textsuperscript{\textnormal{n 1132 above, 1005-1006.}}}
\footnotetext{1132}{\textsuperscript{\textnormal{See Foley v Hill (1848) 2 HL Cas 28; and Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd & Others [1986] 1 WLR 1072. See also Oditah (n 1120 above) 23.}}
powers to pass banking and financial services regulations. This statute transfers these powers to the central bank. Further, the supervisory and regulatory powers of the central bank have been strengthened by the abolition of the statutory requirement in the Banking and Financial Services Act 1994 for the central bank to appoint a curator. The central bank can now move in directly and seize a troubled bank or financial institution. Previously, under the repealed section 81(2)(a) of the Banking and Financial Services Act 1994, and as part of its supervisory powers, the Bank of Zambia had powers to appoint a person (ie a curator) who in its opinion had proper training and experience, to advise the financially-distressed bank or financial institution on the implementation of such measures as would be specified by the Bank of Zambia to rectify the matter. Although the Bank of Zambia had the statutory power to fix the remuneration that had to be paid to a curator, it was the financially-distressed or troubled bank or financial institution that had to pay such remuneration.

Also, under statutory provisions such as section 87 of the Banking and Financial Services Act 1994, a clearer definition of when it can be said that a director, chief executive, chief financial officer, manager or employee of a bank or financial institution 'knew' that the bank or financial institution was insolvent should be spelt out. If this is not done, it will not be easy to prosecute culpable company officers, since the burden of proof in criminal law cases stands beyond reasonable doubt. Indeed, when can it be said, beyond reasonable doubt, that a concerned officer of a bank or financial institution 'knew' that the bank or financial institution was insolvent?

Further still, not much thought has been accorded to the issue of regulating cross-border insolvencies affecting banks, financial institutions and other companies. Neither does the Companies Act 1994 nor the Banking and Financial Services Act 1994 provide convincing answers. The issue of cross-border insolvency is particularly important when we consider, for example, the collapse of banks such as Meridien Bank (Z) Ltd, which was part of a group conglomerate with assets all over the world. How does the Bank of Zambia, as the lead supervisory and regulatory authority, trace some of the assets of such an institution if these assets have been laundered and placed abroad? It is the view of this author that the legislature in Zambia and the central bank should seriously look into the prospects for enacting legislation to deal with cross-border insolvency. And we do not need to go far to find a model law on cross-border insolvency. The United Nations Commission on International Trade Law (UNCITRAL) in Vienna, Austria, adopted, on 30 May 1997, a model law designed to assist countries to equip their insolvency laws with a modern, harmonised and fair framework to address more effectively
instances of cross-border insolvency.\textsuperscript{1133} Those instances include cases where the insolvent debtor has assets in more than one country or where some of the creditors of the debtor are not from the country where the insolvency proceeding is taking place.\textsuperscript{1134} The model law respects the differences among national procedural laws and does not attempt a substantive unification of insolvency law.\textsuperscript{1135} By contrast, it offers solutions that help in several significant ways, including: foreign assistance for an insolvency proceeding taking place in the enacting state, foreign representative's access to courts of the enacting state, recognition of foreign proceedings, cross-border cooperation and co-ordination of concurrent proceedings.\textsuperscript{1136} To that end, a country can, in adopting the model law, enjoin or adapt the said model law to its own country-specific conditions.

Goode argues, however, that countries differ in their approach to addressing problems of cross-border insolvency.\textsuperscript{1137} According to Goode:

Two opposing pairs of principles are of particular significance. They relate respectively to jurisdiction over a company and jurisdiction over assets ... The principle of unity ascribes exclusive jurisdiction over winding up to the courts of the state of the company's incorporation,\textsuperscript{1138} to which all other courts defer. If strictly applied such a principle would route winding up to a single forum and avoid the problems of concurrent liquidations, but would also expose local creditors in other states to risk of loss of the assets within their jurisdiction. The principle of unity is a theoretical model, not a reality, for in no jurisdiction are courts willing to give up all control over local assets where there are local creditors.\textsuperscript{1139}

Goode argues further that the principle that is adopted almost everywhere is that of plurality, which admits of concurrent proceedings in different jurisdictions.\textsuperscript{1140} According to Goode, in most states, the plurality arises through the adoption of the principle of territoriality, and that some states, however, recognise the concept of a main liquidation in one jurisdiction and one or more


\textsuperscript{1134} See UNCITRAL (n 1135 above).

\textsuperscript{1135} As above.

\textsuperscript{1136} As above.

\textsuperscript{1137} See Goode (n 693 above) 495.

\textsuperscript{1138} There are variants on this, such as the principal place of business or the centre of the debtor's main interests, but the underlying idea is the same, namely the state with which the company has its closest juridical connection.

\textsuperscript{1139} See Goode (n 693 above) 495.

\textsuperscript{1140} As above.
ancillary liquidations in other jurisdictions which are confined to local assets and, in some countries, to local creditors. Referring to the principle of territoriality and that of universality in cross-border insolvency, Goode observes:

Under the principle of universality, to which English law subscribes, a winding up proceeding covers not only the company's local assets but assets situated anywhere in the world, though it is recognised that the ability of the liquidator to have resort to those assets is dependent on local law and recognition by local courts. However, the majority of jurisdictions adopt the principle of territoriality, by which the winding-up process is confined to assets (and sometimes to creditors) within the jurisdiction. The principle of universality would, of course, be a necessary concomitant of the principle of unity, but can also apply in jurisdictions (of which England is one) which recognise plurality of jurisdiction. This creates potential conflict where there are concurrent liquidation proceedings in two different jurisdictions and both rights over the debtor company's assets on a world-wide basis claimed in both jurisdictions.

Closely related to the concepts of unity and universality is that of non-discrimination against foreign creditors. Indeed, 'if all the company's assets, in whatever part of the world, are to be subsumed within a single liquidation, then claims of foreign creditors must be admitted on the same basis as those of local creditors'. This principle was ably articulated in an opinion on US bankruptcy law for the assistance of the English court in Felixstowe Dock and Railway Co v US Lines Inc by Judge Howard C Buschman of the US District Court for the Southern District of New York. Judge Buschman observed:

The intended scope of bankruptcy and reorganisation jurisdiction extends beyond the border of the United States ... The nature of the jurisdiction is in rem. The res, the estate of the debtor created by the commencement of a bankruptcy or reorganisation case, is viewed as a single entity to be dealt with in a single proceeding. The broad scope of bankruptcy jurisdiction under United States law is intended to permit similarly situated creditors, regardless of where they are located, to be treated equally in a bankruptcy or reorganisation case. Discrimination of the basis of citizenship is not permitted. All creditors are given the

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1141 As above.
1143 Goode (n 693 above) 496.
1144 As above.
1145 Goode (n 693 above) 496-497.
1147 See Goode (n 693 above) 497.
opportunity to file claims against the state and their recovery is not limited to the assets in their own country.1148

According to Goode, the position is the same under English insolvency law.1149 Likewise, the position is no different under Zambia's insolvency law. The jurisdiction of the Zambian courts in insolvency proceedings is governed generally by the Zambian Companies Act 1994 and by the English common law rules pertaining to conflict of laws. In the case of banks and financial institutions, Zambia's Banking and Financial Services Act 1994 provides an additional legal regime for determining the jurisdiction of the Zambian courts.

Generally, it is a widely-accepted principle that the law of the place where the liquidation is opened (lex fori concursus) governs all matters relating to the winding up, whether substantive or procedural, including the assets comprising the estate, the proof and ranking of claims, the admissibility of set-off and the avoidance of preferences and other transactions.1150

2 International efforts to harmonise insolvency systems

The World Bank, in partnership with the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the International Association of Insolvency Practitioners, the International Bar Association, the International Finance Corporation, the International Monetary Fund, the Organisation for Economic Co-operation and Development, and the United Nations Commission on International Trade Law, has developed a report on Principles and Guidelines for Effective Insolvency Systems.1151 For a good introduction to principles of corporate insolvency law in common law jurisdictions, the reader is encouraged to read Goode's book, Principles of corporate insolvency law.1152 That work sets out ten main principles of corporate insolvency law,1153 namely that

1149 Goode (n 693 above) 497.
1150 As above. There is, however, some uncertainty regarding the relationship between lex fori concursus and the law governing the creation of security interests and other real rights in assets in the possession of the debtor company. See World Bank The World Bank Insolvency Initiative available at http://www4.worldbank.org/legal/insolvency_inl/overview.htm (accessed 6 May 2002).
1152 Goode (n 693 above) 54-63.
corporate insolvency law recognises rights accrued under the general law prior to liquidation, only the assets of the debtor company are available for its creditors, security interests and other real rights created prior to the insolvency proceedings are unaffected by the winding up, the liquidator takes the assets subject to all limitations and defences, the pursuit of personal rights against the company is converted into a right to prove for a dividend in the liquidation, on liquidation the company ceases to be the beneficial owner of its assets, no creditor has any interest in specie in the company's assets or realisations, liquidation accelerates creditors' rights to payment, unsecured creditors rank pari passu, and members of a company are not as such liable for its debts.\textsuperscript{1154}

2.1 World Bank Principles and Guidelines for Effective Insolvency Systems

Commenting on the Principles and Guidelines for Effective Insolvency Systems prepared by the World Bank and other financial institutions and partners, the World Bank observes:

Recognising the complexity of economies, and the diversity in legal systems and their unique cultural expressions, the initiative does not envision the creation of a one-size-fits-all model. Rather, it is contemplated that the report will aspire to provide a diagnostic tool for self-assessment, which takes into account all important and relevant variables that should be considered in designing an appropriate insolvency system, with a proper respect for global economics and current insolvency trends. An effective system will embrace specific policy choices that balance the strengths and weaknesses of different facets of the broader system.\textsuperscript{1155}

Against this backdrop, this chapter, as noted earlier, focuses on Zambia's legal and institutional framework for bank insolvency. But, before turning to that discussion, it would be helpful to provide a review of a notable seminal work published by the International Monetary Fund in 2001 on bank insolvency.\textsuperscript{1156}

3 Legal aspects of regulatory treatment of banks in distress

Asser provides an insightful examination of pertinent legal issues

\textsuperscript{1154} As above.

\textsuperscript{1155} See World Bank (n 1153 above).

\textsuperscript{1156} See generally TMC Asser \textit{Legal aspects of regulatory treatment of banks in distress} (2001).

Although primarily a comparative study of banking legislation in a select group of countries, Asser's work serves also as a standard text on the treatment of banks in distress. Over the last two decades, Asser observes, the deregulation of domestic and international banking transactions and the growth of national and international capital markets have had profound effects on the business of banking.1158 In many countries, according to Asser, domestic capital markets drew both borrowers and depositors away from banks, forcing banks to replace traditional forms of relationship banking with a broad array of financial services and to supplement their funding from traditional forms of deposit with funding from financial markets.1159 These developments require a reappraisal of bank regulation and supervision to protect domestic financial sectors from the new systemic risks that they pose. Asser notes further that banks have played a crucial international role in the unprecedented growth of cross-border capital flows, especially to emerging markets.1160 This development, Asser argues, has led to a continuing financial integration of national economies, which has brought many benefits, including dramatic increases in global investment and consumption that have stimulated global trade and prosperity.1161 The downside to this expansion of international banking activities, in Asser's view, is that it has facilitated the spread of domestic financial problems throughout the international monetary system, and that this development has made banks conduits for the transmission of domestic economic problems around the globe.1162

There are three major conclusions that can be drawn from Asser's work. The first of these is that building and maintaining the confidence of domestic and foreign investors requires a credible bank regulatory system that closely supervises banks, strictly enforces banking law, helps restore ailing banking institutions to financial health, and expeditiously expels insolvent banks from the financial system.1163 Secondly, there is the argument that creditor banks share

1158 See Asser (n 1158 above) 1.
1159 As above.
1160 As above.
1161 As above.
1162 As above.
1163 Asser (n 1158 above) 2.
in the blame for economic crises in foreign debtor countries when their irresponsible lending practices contribute to the build-up of excessive external debt.\textsuperscript{1164} Thirdly, Asser observes that effective prudential regulation of banks participating in an international monetary system of growing complexity requires internationally uniform prudential standards that are strictly enforced by qualified and autonomous bank regulators in close co-operation with their foreign counterparts.\textsuperscript{1165}

In making a case in support of these conclusions, Asser distinguishes between general insolvency law and bank insolvency law, noting that restructuring under banking law is a broader concept than rehabilitation under general insolvency law.\textsuperscript{1166} Enterprise rehabilitation under general insolvency law, according to Asser, typically commences only if the enterprise has been declared insolvent on the basis of strict statutory standards, whereas restructuring of a bank may begin at a much earlier stage with corrective measures ordered by the bank regulator as soon as the bank shows significant signs of non-compliance with prudential requirements.\textsuperscript{1167} Asser observes that, in many countries, bank restructuring is part of a continuum ranging from regulatory enforcement of prudential law to receivership. He examines also the issue of liquidity support provided by a central bank as 'lender of last resort'.\textsuperscript{1168} Principles of the administration procedure for dealing with insolvent banks are spelt out.\textsuperscript{1169} Further, Asser details some of the common issues pertaining to regulatory intervention of banks and some corrective actions that can be undertaken by bank regulators.\textsuperscript{1170} The issue of revoking banking licences, for example, is examined in detail,\textsuperscript{1171} analysing the common grounds upon which a banking licence can be revoked. The legal effects of revoking a banking licence are also examined, together with the authority to revoke a banking licence. A short chapter, which appears to have been written in a hurry, on the legal aspects of systemic bank restructuring, appears at the end of the book.

Although a major milestone in its contribution to the body of literature on bank insolvency law, and on general insolvency law as well, Asser's book fails to provide a valuable contribution on the implications of power politics and culture when dealing with banks in financial distress. The question of power politics is particularly rife in

\textsuperscript{1164} As above.
\textsuperscript{1165} As above.
\textsuperscript{1166} Asser (n 1158 above) 5-7.
\textsuperscript{1167} Asser (n 1158 above) 6.
\textsuperscript{1168} Asser (n 1158 above) 20-24.
\textsuperscript{1169} Asser (n 1158 above) 119-126.
\textsuperscript{1170} Asser (n 1158 above) 52-71.
\textsuperscript{1171} Asser (n 1158 above) 149-154.
countries that have state banks as well as in those countries where politicians have a large percentage of equity/debt interests or deposits in a financially-troubled bank. Politically powerful stakeholders do sometimes use all sorts of political pressure to circumvent the corporate governance structure of institutions. Thus, no matter how good the legal and institutional framework, the effectiveness and efficiency of the enforcement arm might be weakened where there is a politically coercive and powerful social class.

Generally, the experience of many countries shows that banking practice has evolved along three main lines: First, in some countries, banks have been set up by foreign multinational firms as conduits for channelling capital in and out of the host country for the multinational firm itself. Here, banks hardly engage in any serious financial intermediation but could be a vehicle for money laundering or tax avoidance and evasion. Secondly, some banks have been set up as parent or subsidiary companies under increasing levels of conglomeration. Thirdly, other banks are authorised to engage in universal banking, offering products such as insurance policies and securities, thus blurring the distinction between traditional banking practice and what could be deemed as innovation in the field of banking. Each of these cases requires a pragmatic approach when dealing with banks in financial distress. Also, the organisational structure of a bank and the span and layers of control in management all give indications as to what type of approach would be suitable when undertaking the restructuring of such institutions. Although making reference to a few of these issues, Asser’s work would have scored a further milestone by including a more insightful and detailed examination of the issues referred to above.

Furthermore, in countries with high levels of corruption, not only is compliance weak in the regulated institutions, but the enforcement arm of the regulator or supervisor is also weak. Asser has not fully addressed the impact of these cultural issues which include corruption. Indeed, the law does not operate in a vacuum. Its overall importance must be viewed in proper political, cultural, social and economic contexts. Clearly, an insightful and instructive analysis on such issues would have strengthened Asser’s work.

4 The Zambian legal and institutional framework for bank insolvency

The bulk of statute law governing the insolvency of banks in Zambia can be found in chapter VII of the Banking and Financial Services Act 1994, as amended by the Banking and Financial Services (Amendment) Act 2000. Other sources of the law on bank insolvency, as noted
above, include the Companies Act 1994 and some aspects of private
and public international law as well as the English common law.

Section 73 of the Banking and Financial Services Act 1994 provides
that where, in relation to banking business or financial service
business, any written law is inconsistent with the Banking and
Financial Services Act 1994, the relevant provision of the Banking and
Financial Services Act 1994, to the extent of the inconsistency, will
prevail. But, then, when can it be said that a bank or financial
institution governed by the Banking and Financial Services Act 1994 is
insolvent?

4.1 The concept of bank insolvency

In Zambia, a bank or financial institution is insolvent when:

(a) it ceases to be able to meet its obligations as they fall due; or
(b) its assets are insufficient to meet its liabilities; or
(c) the amount of its regulatory capital requirement prescribed by the
Bank of Zambia is nil or lower.1172

In essence, the law provides for three tests of insolvency for banks
and financial institutions:

(a) the cash flow test of insolvency;
(b) the balance sheet test of insolvency; and
(c) the capital requirement test of insolvency.

The cash flow test relates to a bank or financial institution being able
or unable to meet its debt obligations, as and when they fall due.1173
The balance sheet test deals with a situation where, although a bank
or financial institution may be able to meet the demands of the
creditors, the bank’s or financial institution’s liabilities, in the
balance sheet, exceed the assets.1174 Indeed, a bank or financial

1172 Banking and Financial Services Act 1994, sec 86.
1173 See Bank of Australia v Hall (1907) 4 CLR 154 1528, discussing the meaning of the
comparable phrase ‘as they become due’ under Australian legislation. See also
Expo International Ltd v Chant [1979] 2 NSWLR 820; Cooke v Taylor (1888) 5 QBD
565; per Cockburn LJ 575; O’Driscoll v Manchester Insurance Committee [1915] 3.
KB 499; Re Bryant Investment Co Ltd [1974] 2 All ER 683; Re Globe New Patent
Iron & Steel Co (1875) LR 20 Eq 337; Mann v Goldstein [1968] 2 All ER 769;
Cornhill Insurance plc v Improvement Services Ltd [1968] 1 WLR 114.
1174 See Re a Debtor (No 17 of 1966) [1967] Ch 590; Re European Life Assurance Co
(1889) LR 9 Eq 122; Tottenham Hotspur plc v Edendine plc [1995] 1 BCLC 65;
Winter v IRC [1961] 3 All ER 855; Re William Hockley Ltd [1962] 2 All ER 111;
Stonegate Securities Ltd v Gregory [1980] 1 Ch 578; Re British Equitable Bond and
Mortgage Corp Ltd [1910] 1 Ch 574; Re A Company (No 001573 of 1983) [1983] 1
BCC 96 937; Re Dollar Land Holdings Ltd [1994] BCLC 404; Re Primlaks (UK) Ltd
institution can be insolvent even when it is able to pay its debts. What matters is that the liabilities exceed the assets. The policy basis of such a rule is to provide the right incentives to management of a bank or a financial institution not to commit the bank or financial institution to further debt obligations when it is reasonably clear that the books of account are in the red.

The third test of insolvency, the capital requirement test, unlike the other two discussed above, is peculiarly limited to banks and financial institutions. Whereas at common law and under the Companies Act 1994, the concept of cash flow and balance sheet tests of insolvency can be applied to almost all companies and bodies corporate, the concept of capital requirement test cannot be applied to any company or body corporate existing and operating outside the framework of the Banking and Financial Services Act 1994. This distinction is an important departure from the framework for insolvency law under the Companies Act 1994.

As a general rule, banks and financial institutions, while insolvent, are prohibited from receiving deposits, or entering into any new, or continuing to conduct existing banking or financial services business. They can only do so if undertaking such an action would point to the orderly realisation, conservation and preservation of the bank’s or financial institution’s assets. Also, a transaction with a depositor or a creditor and a settlement in a netting or gross settlement arrangement under the system of settlement approved by the Bank of Zambia or provided for in or under any written law will not be treated as part of the prohibition only because of the insolvency of the bank or financial institution if the transaction or settlement took place prior to a resolution to liquidate the bank or financial institution or prior to the appointment of a receiver or the taking possession of the bank or financial institution by the Bank of Zambia. It is a criminal offence for any director, chief executive, chief financial officer, manager or employee of a bank or financial institution, who knows or, in the proper performance of his duties, could reasonably be expected to know of the insolvency of the bank or financial institution, to cause or permit an act in contravention of the rule prohibiting the receipt of deposits, or the entering into new, or the continued conduct of banking or financial services business. The question, then, is: when can it be said that the concerned officer of the bank or financial institution ‘knew’ that the bank or financial institution was insolvent? What constitutes ‘knowledge’? The Banking

1175 See generally Goode (n 693 above).
1176 Banking and Financial Services Act 1994, sec 87(1).
1177 As above.
1178 Banking and Financial Services Act 1994, sec 87(2).
1179 Banking and Financial Services Act 1994, sec 87(3).
and Financial Services Act 1994 is silent on this matter. There is need for some clarity here in order to avoid any misinterpretations of the law.

A recent ruling of the Supreme Court of Zambia, handed down as recently as 2008, in the appeal case of *Bank of Zambia v Chungu and Others*,\(^{1180}\) examined the issue of whether a solvent bank or financial institution can be placed under compulsory liquidation by the Bank of Zambia under the statutory provision relating to 'unsafe and sound practice' in the Banking and Financial Services Act 1994 even when the bank or financial institution is not insolvent. This case challenges the traditional view that insolvency has to precede a compulsory winding up.

The Supreme Court of Zambia observed that, after setting out and reviewing the provisions of section 81 of the Banking and Financial Services Act 1994, the trial judge in the lower court accepted that, where a bank or financial institution commits breaches under section 81(1) of the Banking and Financial Services Act 1994, the respondent bank — that is, the Bank of Zambia — can take any one of the supervisory actions under section 81(2). The Supreme Court then pointed out that section 81(1) of the Banking and Financial Services Act 1994 reads as follows:

Where:

(a) a bank or financial institution refuses to comply within an order or directive of the Bank of Zambia under this Act;

(b) a bank or financial institution refuses to permit an inspection to be made as provided under this Act or obstructs an inspection;

(c) in the opinion of the Bank of Zambia an inspection instituted under this Act shows:

(i) that the bank or financial institution concerned conducts its business in breach of any written laws or engages in a course of conduct that is unsafe and unsound;

(ii) that for any reason the bank or financial institution is under or is likely to become unable to continue its operations in the ordinary course of business;

(iii) the bank or financial institution's capital is less than the prescribed minimum; or

(iv) the bank or financial institution is insolvent; the Bank of Zambia shall take supervisory action against the bank or the financial institution.\(^{1181}\)

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The Supreme Court observed further that section 81(2) continues as follows:

The supervisory action the Bank of Zambia may take includes:

(a) taking possession of the bank or financial institution;
(b) suspending the bank's or financial institution licence for a period not exceeding six months;
(c) restricting the bank's or financial institutions' licence; and
(d) revoking the bank's or financial institution's licence.1182

In reflecting on the merits of the ruling by the trial judge, the Supreme Court went on to say the following:

The court, properly so in our view, refused to be drawn into inquiring into the merits of the decision the respondent bank arrived at and which was the subject of judicial review. The court accepted that if the respondent bank was satisfied that the applicant companies breached some laws and committed unsafe and unsound practices as outlined in the affidavit as contained in the documents attached thereto, then it was entitled to take possession of the applicant companies. The taking possession of the applicant companies was not therefore in dispute. The court analysed the further actions that follow taking possession. The court found that the respondent bank closed and placed the applicant companies under compulsory liquidation by virtue of powers under section 84B(b) as read with section 101(1) of the Act. The crux of the complaint in grounds one and two of appeal is against the passage, in the judgment, where the trial judge stated as follows:

The meaning of section 84B(b) and as read with section 101(1) of the Act is that if a bank or financial institution is found to be insolvent, the respondent may order it to be placed under compulsory liquidation. The prerequisite of placing the bank or financial institution under compulsory liquidation is that it is insolvent. Conversely, a bank or financial institution cannot be placed under compulsory liquidation if it is solvent. In that case the respondent will act under section 84B(a) of the Act.1183

Striking down the ruling of the trial judge and allowing the appeal of the Bank of Zambia, the Supreme Court produced the following argument and reasoning:

Section 84B of the Act reads as follows:

Upon taking possession of a bank or financial institution the Bank of Zambia shall prepare a statement of affairs of the assets and liabilities and shall within ninety days from the effective date of taking possession take any of the following actions:

1182 As above.
1183 As above.
(a) Where the statement of affairs of the assets and liabilities shows the bank or financial institution to be solvent:
(i) to restructure or reorganise the bank or financial institution;
(ii) to sell the bank or financial institution as a going concern;
(iii) to close the bank or financial institution;
(iv) to take any action which is necessary to enable the Bank of Zambia to carry out its functions under this Act: or
(b) where the bank or financial institution is insolvent, to take such action as it considered appropriate under part 4 of Chapter VII of the Act.

And section 101(1) reads as follows:

The Bank of Zambia may by resolution order the compulsory liquidation, winding up or dissolution of a bank or financial institution; and where the Bank of Zambia makes an order under this subsection, it shall record the date, hour and minute of the passing of the resolution.

On behalf of the respondent bank, it was submitted that the interpretation of sections 84B and 101(1) of the Act by the trial judge was wrong on three fronts; namely, that section 101 of the Act is a provision distinct from section 84B(b); that the trial judge failed to appreciate the whole spectrum of the law of liquidation; and that even if the respondent bank proceeded under section 84B(a) of the Act, in dealing with a solvent company, the section empowers the respondent bank to take 'any action', which umbrella authority enables the bank to place into compulsory liquidation a solvent company. The argument on behalf of the applicants is that section 84B(a) and 84B(b) must be construed disjunctively. We agree. It was, however, argued that the phrase 'any action' in section 84B(a) does not include compulsory liquidation which is covered under section 84B(b). We do not agree with this interpretation. In our view, 'any action' must include compulsory liquidation which can be taken even against a solvent company.\textsuperscript{1184}

In concluding its ruling, the Supreme Court noted further:

The trial judge, after interpreting section 84B(b), which he said must be read with section 101(1), proceeded to analyse when a bank or financial institution is 'insolvent' and set out section 86 of the Act, which states:

For the purposes of this Chapter (VII), a bank or financial institution is insolvent when it ceases to be able to meet its obligations as they fall due or when its assets are insufficient to meet its liabilities.

The Court found that the section was self-explanatory and then went on to consider when a company is insolvent. The Court concluded that the two applicant companies were not insolvent as the inspections conducted by the respondent bank only revealed 'disturbing evidence of

\textsuperscript{1184} As above.
wrong doing' at the two institutions, which included unsafe and unsound banking practices. According to the trial judge, this did not constitute insolvency and could not be the reason for having placed the two applicant companies under liquidation. The trial court stated as follows:

The respondent therefore erred in placing the two applicant companies under compulsory liquidation as it was not established that they were insolvent.

In our view, by this approach, the trial judge delved into the merits of the decision made by the respondent bank. Equally, the trial judge's insistence to have insolvency established beyond that which was in the report attached to the affidavit in opposition was a misdirection since these were judicial review proceedings which were limited in scope to addressing the decision-making process. The Court was not permitted to delve into the merits of the case neither was the Court permitted to substitute the decision made by a lawful authority, the respondent bank, with one of its own. We have anxiously considered the submissions on grounds one and two of the appeal. We agree that in terms of the provisions of the Banking and Financial Services Act, the trial judge was in error in suggesting or holding that a solvent company cannot be placed under compulsory liquidation. We agree that such a position is contrary to section 101 of the Act. Section 101 does not require the respondent bank to establish insolvency of a bank or financial institution. It gives the respondent bank a general power to place a financial institution under compulsory liquidation irrespective of its financial status. We agree that there is no requirement under the Act that section 101 be read only in conjunction with section 84B(b) nor is there any requirement in the Act that section 101 can only come into operation if a financial institution is insolvent. We agree that when section 101 is invoked the issue of insolvency does not come into play. The trial judge was thus in error in holding that a solvent company cannot be placed under compulsory liquidation. In our view, insolvency was not the only issue in the instant case. It is quite clear to us that apart from insolvency, the respondent bank has a number of options to take in dealing with a financial institution. The trial judge equally misdirected himself in holding that a financial institution can be placed under compulsory liquidation only pursuant to section 84B(b) as read with section 101(1) of the Act. We allow grounds one and two of appeal. On these grounds alone this appeal ought to succeed and we so order. 1185

4.2 Avoidance of transactions in bank insolvency

The general law on corporate insolvency, as reinforced by the Companies Act 1994, provides for the avoidance of certain transactions entered into by a debtor company. These transactions include the preferential treatment of creditors who do not have a preferential right of claim and, also, what is commonly known as

1185 As above.
transactions at an undervalue’. The pursuit of such activities by company directors can attract liability. Section 277 of the Companies Act 1994, pointing to situations where the avoidance of transaction can occur, spells out the following:

Any disposition of the property of the company, including things in action, and any transfer of shares or alteration in the status of the members of the company made after the commencement of winding up by the court shall be void unless the court otherwise orders.

This statutory provision applies to banks and financial institutions as well, as long as these institutions were incorporated under the Companies Act 1994 (or its predecessor, the Companies Act 1921). Closely related to section 277 of the Companies Act 1994 is section 278 of that same statute, which provides as follows:

Any attachment, sequestration, distress or execution put in force against the estate or effects of the company after the commencement of a winding-up by the court shall be void.

The Companies Act 1994 goes on to say that any conveyance, transfer, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company which, had it been made or done by or against an individual, would in his bankruptcy under the law of bankruptcy be void or voidable, will, if the company is wound up, be void or voidable in the same way. Also, any transfer or assignment by a company of all its property to trustees for the benefit of all its creditors would be void. The policy basis underlying such rules is the avoidance of transactions which can prejudice the interests of the general body of creditors at the expense of a few preferred creditors. Also, the need to avoid the dilution of the corpus of assets available for distribution to the general body of creditors is another reason behind these rules. Section 348 of the Companies Act 1994 adds:

A floating charge on the undertaking or property of the company created within twelve months before the commencement of the winding up shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid except to the amount of any cash paid to the company at the time, or subsequently, in consideration for the charge, together with interest on that amount at the rate fixed by the terms of the charge.

For a detailed discussion on ‘Avoidance of transactions’, see Goode (n 693 above) 343-442.

As above.

Companies Act 1994, sec 347(1). Sec 347(2) of the same statute adds: ‘For the purposes of this section, the date which corresponds with the date of presentation of the bankruptcy petition in the case of an individual shall be the date upon which the winding-up commenced.’

Companies Act 1994, sec 347(3).
On extortionate credit bargains, the Companies Act 1994 provides as follows:

(1) Where any property, business or undertaking has been acquired by a company within the period of two years before the commencement of the winding of the company:

(a) from a person who was at the time of the acquisition a director of the company; or

(b) from a second company of which, at the time of the acquisition, a person was a director who was also a director of the first company;

the liquidator may recover from the person or company from which the property, business or undertaking was acquired any amount by which the value of the consideration given exceeded the value of the property, business or undertaking at the time of its acquisition.

(2) Where any property, business or undertaking has been sold by a company within the period of two years before the commencement of the winding-up of the company:

(a) to a person who was at the time of the sale a director of the company; or

(b) to a second company of which at the time of the sale a person was a director who was also a director of the first company;

the liquidator may recover from the person or company to which the property, business or undertaking was sold any amount by which the value of the property, business or undertaking at the time of the sale exceeded the value of the consideration received.

(3) For the purposes of this section the value of the property, business or undertaking includes the value of any goodwill or profits which might have been made from the business or undertaking and any similar consideration.\(^{1190}\)

All these rules of corporate insolvency law apply to banks and financial institutions in Zambia, in so far as they (the rules) are consistent with provisions of the Banking and Financial Services Act 1994.

4.3 Disclaimer of onerous property in bank insolvency

As a general rule, and subject to the provisions of the Banking and Financial Services Act 1994, a liquidator of a bank or financial institution has a right to disclaim onerous property of the bank or financial institution. Such property could include any estate or interest in land which is burdened with onerous covenants, or shares in any body corporate that are subject to restrictions on transfer, or unprofitable contracts, or any other property that is unsaleable or not

\(^{1190}\) Companies Act 1994, sec 349.
readily saleable, by reason of its binding the possessor thereof to the performance of an onerous act or to the payment of a sum of money.\textsuperscript{1191}

Also, where a financial institution licensed under the Banking and Financial Services Act 1994 becomes insolvent, if it is a company incorporated under the Companies Act 1994 (or its predecessor, the Companies Act 1921), then the Bank of Zambia has the power to take possession of that institution in order to undertake supervisory functions.\textsuperscript{1192} If the insolvent financial institution is not a company incorporated under the Companies Act, but is subject to the supervision or control of another authority, then the Bank of Zambia will revoke the institution's licence and give directions to the appropriate authority to place that institution into liquidation or dissolution.\textsuperscript{1193} And, where the insolvent financial institution is a body established by a separate written law, the Bank of Zambia can only revoke its licence, while offering some recommendations to the relevant authority that the institution be placed into liquidation or dissolution.\textsuperscript{1194}

4.4 Voluntary winding up and liquidation

Both banks and financial institutions are prohibited from passing any kind of resolution to institute voluntary winding up or dissolution, pursuant to provisions of the Companies Act 1994, except with the approval of the Bank of Zambia, or under a specific written law.\textsuperscript{1195} And, where a bank or financial institution passes such a resolution, it is required to record the date, hour and minute of the passing of the resolution.\textsuperscript{1196}

The Bank of Zambia has the right to grant approvals for a voluntary winding up or dissolution on such terms and conditions as it determines and only if it appears to the Bank of Zambia that a bank or financial institution has sufficient liquid assets to repay its depositors and all other creditors in full and without delay.\textsuperscript{1197} When a bank or financial institution receives approval for a voluntary winding up or dissolution, it is required to surrender immediately its licence to the Registrar.\textsuperscript{1198} The bank or financial institution is also required to cease doing business.\textsuperscript{1199} It can only continue exercising

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{1191} Companies Act 1994, sec 350.
\item \textsuperscript{1192} Banking and Financial Services Act 1994, secs 87A(a) & 81(2)(a).
\item \textsuperscript{1193} Banking and Financial Services Act 1994, sec 87A(b).
\item \textsuperscript{1194} Banking and Financial Services Act 1994, sec 87A(c).
\item \textsuperscript{1195} Banking and Financial Services Act 1994, sec 88(1).
\item \textsuperscript{1196} As above.
\item \textsuperscript{1197} Banking and Financial Services Act 1994, sec 88(2).
\item \textsuperscript{1198} Banking and Financial Services Act 1994, sec 89(1)(a).
\item \textsuperscript{1199} As above.
\end{itemize}
\end{footnotesize}
its powers to the extent necessary to effect its orderly winding up or dissolution.\textsuperscript{1200}

Furthermore, upon receipt of the central bank's approval for a winding up or dissolution, a bank or financial institution is required to repay in full its depositors and other creditors,\textsuperscript{1201} and to wind up all operations undertaken prior to the receipt of such approval.\textsuperscript{1202} It is, indeed, a criminal offence for any director, chief executive, chief financial officer, manager or employee of a bank or financial institution, who knows or, in the proper performance of his duties, could reasonably be expected to know of the insolvency of the bank or financial institution, to cause or permit an act in contravention of the above rules.\textsuperscript{1203}

Within the 14-day period following the approval for a voluntary winding up or dissolution, a bank or financial institution should, by registered mail, notify:\textsuperscript{1204}

\begin{enumerate}
\item every depositor and other creditors of the bank; and
\item any person otherwise entitled to any funds or property held by the bank or financial institution as a trustee, fiduciary, lessor of safe-keeping facility or bailee, of its intention to wind up or dissolve.
\end{enumerate}

The Bank of Zambia can dictate to a bank or financial institution terms that it should include in the notice that will go out within the 14-day period.\textsuperscript{1205} And the Bank of Zambia's approval for a winding up or dissolution will not prejudice the rights of depositors or other creditors to payment in full of a claim nor the right of an owner of funds or other property held by a bank or financial institution to the return thereof.\textsuperscript{1206} All lawful claims are to be paid promptly and all funds and other property held by a bank or financial institution are to be returned to their rightful owners within such maximum period as the Bank of Zambia will in writing direct.\textsuperscript{1207}

Where, in the opinion of the Bank of Zambia, a bank or financial institution has discharged all obligations relating to the rights of depositors and creditors, as discussed above, the remainder of the property can be distributed to its rightful owners.\textsuperscript{1208} The Banking and Financial Services Act 1994 provides as follows:

\begin{enumerate}
\item As above.
\item Banking and Financial Services Act 1994, sec 89(1)(b).
\item Banking and Financial Services Act 1994, sec 89(1)(c).
\item Banking and Financial Services Act 1994, sec 89(2).
\item Banking and Financial Services Act 1994, sec 90(1).
\item Banking and Financial Services Act 1994, sec 90(2).
\item Banking and Financial Services Act 1994, sec 91(1).
\item Banking and Financial Services Act 1994, sec 91(2).
\item Banking and Financial Services Act 1994, sec 92(1).
\end{enumerate}
Distribution ... shall not be made before:

(a) all claims of depositors and other creditors have been paid in full or, in the case of a disputed claim, the bank or financial institution has turned over to the Bank of Zambia funds sufficient, in the opinion of the Bank of Zambia, to meet any liability that may be judicially determined; and

(b) any funds payable to a depositor or other creditors who has not claimed them have been turned over to the Bank of Zambia to be dealt with as unclaimed funds in accordance with this Act. 1209

If the Bank of Zambia finds that assets of a bank or financial institution whose voluntary winding up, liquidation or dissolution it has approved will not be sufficient for the full discharge of all its obligations or that completion of the winding up, liquidation or dissolution is unduly delayed, it can, if it considers it proper to do so, take possession of the bank or financial institution. 1210

4.5 Compulsory liquidation, winding up or dissolution

As a general rule, the Bank of Zambia can, by resolution, order the compulsory liquidation, winding up or dissolution of a bank or financial institution. 1211 Where such an order is made, the Bank of Zambia should record the date, hour and minute of passing the resolution for the order. 1212 The Banking and Financial Services Act 1994 points out that:

Upon making an order ... the Bank of Zambia shall notify each director, shareholder, other owner, depositor and other creditor of the bank or financial institution and every interested party of the order by written notice to such of those persons for whom the Bank of Zambia discovers a name and address, and by published or other form of public notice. 1213

Each person notified by the Bank of Zambia has 30 days to file an objection or an appeal to the High Court. 1214 Once an appeal is made to the High Court, the Court will render its decision within a period of 30 days after the end of the period during which objections to the liquidations were admissible and, in so doing, can make any order it considers just in the circumstances. However, it is not clear whether the Court, in reaching its decisions, focuses only on the procedural

1209 Banking and Financial Services Act 1994, sec 92(2).
1210 Banking and Financial Services Act 1994, sec 93. The lengthy statutory provisions that were contained in Part 3 of the Banking and Financial Services Act 1994, on the central bank's seizure of insolvent banks, have now been repealed by the Banking and Financial Services (Amendment) Act 2000.
1212 As above.
1214 Banking and Financial Services Act 1994, sec 101(3).
aspects of the law or it examines also the substantive issues in a particular case. There is need to amend the law here so as to provide some clarity.

What is clear, nonetheless, is that, in carrying out its functions on compulsory liquidation, winding up and dissolutions, the Bank of Zambia can appoint an agent to act on its behalf. Furthermore:

Upon taking possession of a bank or financial institution by the Bank of Zambia under this Act (that is, the Banking and Financial Services Act 1994), no proceedings may be instituted by any person, other than the Bank of Zambia, for the liquidation, winding up, dissolution or other action of a similar nature.

Whilst the policy basis of such moratorium can be appreciated, it is not easy to comprehend why there is no statutory provision for a private party to institute legal proceedings 'with leave of the court'. What happens, for example, where the Bank of Zambia acts in bad faith when taking possession of a bank or a financial institution? Should management of such a bank or financial institution stand by and wait for the Bank of Zambia to start proceedings for liquidation, winding up or dissolution? What about the business interests of the financially distressed bank or financial institution? Will these interests not suffer in the process? What is clear, however, is that, in line with the recent Zambia Supreme Court ruling in the case of Bank of Zambia v Chungu and Others, a bank or financial institution can be placed under compulsory winding up by the Bank of Zambia if the latter determines that the bank or financial institution has been engaging in unsafe and unsound practice even though the bank or financial institution is not insolvent.

Elsewhere, I have examined the law in Zambia regarding the legal liability of company directors for fraudulent trading and wrongful trading, including the salient and pertinent aspects of fraud by officers of companies that have gone into liquidation. The analysis there applies also to directors of banks and financial institutions. And as such, I will not repeat that discussion here. Suffice it to say, there are not many mechanisms to deal with the enforcement of directors' liability other than to rely on the judicial process. As an incentive to promote more efficient compliance with best practices in corporate governance, and to deter misfeasance and misconduct by bank and company directors, legal rules to disqualify persons convicted of such

1216 Banking and Financial Services Act 1994, sec 110A.
offences as wrongful trading and fraudulent trading should be introduced. Such a development, it is argued, could help to bolster and strengthen Zambia's legal and institutional framework for corporate and bank insolvency.

Closely related to the issue of strengthening the law on the liability of company and bank directors is a glaring absence of a legal framework to license and regulate Zambia's insolvency practitioners. Currently, insolvency practitioners in Zambia are not professionally regulated or licensed, in spite of the growing evidence suggesting that some of these individuals and firms purposely, and with wanton disregard of the law, enrich themselves from the estate of insolvent companies under their control.1219 There is a need in Zambia to introduce legal requirements for insolvency practitioners to be qualified and licensed as well as to set standards on some punitive measures against those insolvency practitioners who offend the law.

4.6 The effect of an order for compulsory winding up, liquidation or dissolution

While the Banking and Financial Services Act 1994 makes provision for schemes of arrangement by creditors, such as debt subordination agreements, reorganisation and restructuring,1220 the Bank of Zambia can, in addition to any other powers, exercise powers, whether express or implied, of the insolvent bank or financial institution when effecting a compulsory liquidation, winding up or dissolution.1221 But, then, what is the effect of an order for compulsory liquidation, winding up or dissolution?

Upon an order for compulsory liquidation, winding up or dissolution:
(a) every contract of employment of any person with the bank or financial institution shall terminate with effect from the date on which the order comes into effect;
(b) the Bank of Zambia may terminate:
(i) any contract for the provision of goods or services to which the bank or financial institution is a party; or
(ii) any obligation of the bank or financial institution as a lessee of real property; but a lessor to whom the Bank of Zambia gives not less than ninety days' notice of termination of lease shall have no claim for rent other than rent accrued and outstanding on the date of termination of the lease, nor any claim for damages by reason of such termination.1222

1219 As above.
1220 Banking and Financial Services Act 1994, sec 84.
1221 Banking and Financial Services Act 1994, sec 104(1).
1222 Banking and Financial Services Act 1994, sec 104(2).
After making the decision to liquidate, wind up or dissolve a bank or financial institution, the Bank of Zambia has to take any necessary steps to terminate all fiduciary functions performed by the bank or financial institution. Further, the Bank of Zambia has to return to each owner all assets and property held by the bank or financial institution as a fiduciary in relation to the owner, and settle its fiduciary account. In addition, the Bank of Zambia is under statutory obligation to:

cause to be made available at each branch for collection by each depositor, other creditor, safe-keeping services customer and bailor of property held by the bank or financial institution, a statement (in this part called ‘the customer’s statement’) of the nature and amount for which each one’s claim is shown in the bank’s or financial institution’s records, and cause to be published in a newspaper of general circulation in Zambia, a notice informing all such persons of the availability for collection of the statement at their respective branches.

The customer’s statement should provide that claims must be filed with the Bank of Zambia before a specified date not earlier than 60 days thereafter, and should call upon safe-keeping services customers and bailors to withdraw their property. Any property held in safe-keeping on the premises of a bank or financial institution that has not been withdrawn before the date specified in the customer’s statement will be taken into possession by the Bank of Zambia in a manner that will be prescribed by the Bank of Zambia itself. And any unclaimed funds and property held by a bank or financial institution as bailee, together with inventories pertaining thereto, will be deemed to be unclaimed funds and will be dealt with in accordance with provisions of the Banking and Financial Services Act 1994 on unclaimed funds.

Within six months after the last day specified in the customer’s statement for the filing of claims, the Bank of Zambia has to:

(a) defer payment of any claim that is out of time and reject any claim that appears to be of doubtful validity;
(b) determine the amount, if any, owing to each known depositor or other creditor and the priority class of his claim in accordance with the Banking and Financial Services Act 1994;
(c) prepare for filing with the High Court a schedule of the steps it proposes to take (that is, a ‘liquidation schedule’); and

1224 As above.
1225 Banking and Financial Services Act 1994, sec 104(3)(b).
1227 Banking and Financial Services Act 1994, sec 104(5).
1228 Banking and Financial Services Act 1994, sec 104(6).
(d) notify each person whose claim has not been allowed in full and publish once a week for three consecutive weeks, in a newspaper of general circulation in every place in Zambia where the bank or financial institution had a branch, a notice of the date and place where the liquidation schedule will be available for inspection, and the date, not earlier than thirty days after the date of the third publication of the notice, on which Bank of Zambia will file the schedule to the High Court.

Within 20 days after the filing of the liquidation schedule, any depositor, other creditor or owner of a bank or financial institution, and any other interested party, can file with the High Court an objection to the proposed steps. If the objection is upheld, the Court can order that an appropriate modification of the schedule be made. In spite of the foregoing, the Bank of Zambia can, from time to time and soon after filing the schedule, make partial distributions to holders of claims which are undisputed or which have been allowed by the High Court, on condition that a proper service is established for the payment of disputed claims. The final distributions, however, can only be made after all objections have been decided upon.

4.7 Priority of creditors in a compulsory winding up, dissolution or liquidation

As a general rule, section 346 of the Companies Act 1994, dealing with preferential debts, as amended by the Companies (Amendment) Act 6 of 1995, applies to banks and financial institutions only in as far as it is consistent with the statutory provisions of the Banking and Financial Services 1994 on the statutory priority order of insolvency claims. In the event of contradictory provisions between the two statutes, provisions of the Banking and Financial Services Act 1994 prevail. By parity of reasoning, the same analogy applies to the Preferential Claims in Bankruptcy Act 1995.

In a compulsory liquidation, winding up or dissolution of a bank or financial institution, the following is the statutory priority order of claims:

(a) necessary and reasonable expenses incurred by Bank of Zambia in carrying out its functions relating to liquidation, winding up or

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1230 Banking and Financial Services Act 1994, sec 106(1).
1231 Banking and Financial Services Act 1994, sec 106(3).
1233 Banking and Financial Services Act 1994, sec 106(5).
1234 Banking and Financial Services Act 1994, sec 107(1).
dissolution of the bank or financial institution;\footnote{1235} 
\begin{itemize}
  \item[(b)] taxes and rates due, whether payable to the government of Zambia or to a local authority;
  \item[(c)] wages and salaries of officers and employees of the bank or financial institution for the three-month period preceding the effective date seizure, within the limit of an amount not exceeding one hundred thousand kwacha per person or such higher amount as may be prescribed by regulation;
  \item[(d)] fees and assessments due to Bank of Zambia;
  \item[(e)] claims established under a deposit protection scheme;
  \item[(f)] other deposits; or
  \item[(g)] other claims against the bank or financial institution in such order of priority as the High Court may determine upon application by Bank of Zambia.
\end{itemize}

After payment of all claims submitted and accepted, the remaining claims which have not been submitted within time are to be paid, and thereafter interest, if any, in the order of priority of their submission and at a rate to be fixed by the Bank of Zambia. In short, late submissions are treated on a first-in-first-out basis.

If the amount available to pay a particular class of creditors—that is, either from the list of creditors noted above or from any late submissions—is insufficient to provide payment in full, then claims within that class of creditors will abate pari passu.\footnote{1236} And, as soon as all assets of a bank or financial institution have been distributed, the Bank of Zambia will render an account to the High Court and will be relieved of any liability in connection with the winding up, dissolution or liquidation.\footnote{1237}

5 Conclusion

This chapter has examined the efficacy of the legal and institutional framework for bank insolvency in Zambia. The chapter also looked at some of the international efforts to harmonise insolvency systems around the world. A major divergence among many Western countries has been whether to promote insolvency frameworks that provide more protection to creditors or those that offer more protection to debtors at the expense of creditors. These two competing agendas help to explain why the UK introduced the Administration Order

\footnote{1235}{As a reinforcement, sec 110B of the Banking and Financial Services Act 1994 provides as follows: 'All necessary and reasonable expenses incurred by the Bank of Zambia in the application of the provisions of this chapter shall be defrayed from the funds of the bank or financial institution concerned.'}
\footnote{1236}{Banking and Financial Services Act 1994, sec 107(3).}
\footnote{1237}{Banking and Financial Services Act 1994, sec 108.
regime of insolvency law in its Insolvency Act of 1986 (though, as far as bank insolvency is concerned, this has now been replaced by the Special Resolution Regime pursuant to the UK Banking Act 2009), and also why the US leans more towards chapter 11 of its bankruptcy law.

The chapter argued that the Bank of Zambia does not have adequate mechanisms for the management of banks in liquidation and the activities of liquidation managers. It was noted that this has allowed failed banks to languish without resolution, and that some liquidations have dragged on for years, thereby sending perverse signals to the market. Also, because of the growing tradition of lacklustre post-failure collection efforts, borrowers have incentives to push troubled banks toward failures by withholding repayment. In spite of these weaknesses, it was argued, the Zambian framework neither focuses on promoting and protecting mostly creditor rights at the expense of debtor interests, nor does it tilt towards protecting and promoting mostly debtor interests at the expense of creditor rights. By contrast, and as demonstrated above, the Zambian legal and institutional framework strengthens more the supervisory and regulatory functions of the central bank. Under the Banking and Financial Services Act 1994, the Bank of Zambia has extensive regulatory and supervisory powers. And these powers increased with the coming into force of the Banking and Financial Services (Amendment) Act 2000. What the Banking and Financial Services (Amendment) Act 2000 did was to take away from the Minister of Finance some of his powers to pass banking and financial services regulations. The Banking and Financial Services (Amendment) Act 2000 transferred these powers to the central bank. In addition, the supervisory and regulatory powers of the central bank were strengthened by the abolition of the statutory requirement in the Banking and Financial Services Act 1994 for the central bank to appoint a curator. The central bank can now move in directly and seize a troubled bank or financial institution. In spite of all these efforts to empower the central bank, it appears that there has not been much thought accorded to the issue of cross-border insolvency. Proposals were spelt out for the legislature in Zambia to consider introducing legislation on cross-border insolvency covering banks, financial institutions and all other companies.
1 Introduction

In the preceding chapters, we examined the efficacy of the legal and institutional framework for regulating banks and financial institutions in Zambia. As we conclude, it is time to stand back to take a more reasoned look at some policy considerations propagated by the Bank of Zambia to strengthen the robustness and soundness of the financial sector framework. Most of these pronouncements are contained in the Financial Sector Development Plan (FSDP) (2004-2009). As a strategy for implementing the FSDP (2004-2009), the Zambian government has issued the following policy statement:

The FSDP which was approved by Cabinet in June 2004 is both a vision statement and a master plan by the government of Zambia for the development of the entire financial system. It is aimed at achieving a financial system that is sound, stable, and market-based, that would support efficient resource mobilisation necessary for economic diversification and sustainable growth. In order to effectively and efficiently coordinate the implementation of the FSDP on a consultative basis, an implementation structure was established and this comprises the FSDP Steering Committee (FSDPSC) and the FSDP Implementation Committee (FSDPIC). The FSDPSC is domiciled at the Ministry of Finance and National Planning (MoFNP) and provides overall direction and advice on the implementation of the FSDP recommendations on a prioritised basis. The FSDPIC is domiciled at the Bank of Zambia (BoZ) and is responsible for reporting to the FSDPSC on the progress of the FSDP implementation. The FSDPIC is supported by the FSDP Secretariat and 11 FSDP Working Groups composed of experts who are charged with the responsibility of finding practical ways of implementing the recommendations of the FSDP.

The current FSDP covers a time period of five years, and its mandate comes to an end at the close of the year 2009. Also, the FSDP (2004-

2009) covers almost all areas of the financial sector, while our study is limited to the banking industry. Therefore, in examining the policy pronouncements of the government through the Bank of Zambia, we will limit our analysis to those financial sector policies that affect the banking industry. Elsewhere, I have examined major legal and policy issues that cross-over between, say, the banking industry and the securities industry, or between the banking industry and the insurance or pensions industry.1239 With that, we now turn to examine the relevant aspects of the FSDP (2004-2009).

2 FSDP (2004-2009) on the regulation of banks

The Bank of Zambia observes that commercial banks — mostly subsidiaries of foreign banks — are the most dominant and oldest financial institutions in Zambia.1240 According to the Bank of Zambia, the dominance of these banks is reflected in the size of their total assets relative to other types of financial institutions as well as in their relatively wider role in financial intermediation.1241 Commercial banks also have a wider outreach than any other financial institution and, as at 2002, had a total branch network of 140.1242 The Bank of Zambia postulates further:

Traditionally, the commercial banks are engaged in provision of short-term finance whilst specialised banks and other non-bank financial institutions provide long-term finance. Commercial banks offer traditional retail banking services, including current, savings and term deposit facilities, short-term and medium lending facilities, trade finance, money market trading activities, foreign exchange trading activities, safe deposit facilities and other banking facilities... As at 30 June 2003, there were a total of 14 commercial banks operating in Zambia. Of these, six were private foreign owned banks, whilst two were foreign state owned banks. One bank was state-owned and local entrepreneurs owned the rest... Subsidiaries of foreign banks continue to take the lead in controlling banking system assets, loans and deposits. As at 30 June 2003 they controlled 65% of the banking systems' total assets, 85% of total loans and 64% of total deposits compared to 64%, 82% and 66% respectively in December 2002. Government-owned banks, on the other hand, accounted for 26% of the industry's total assets, 7% of total loans and 28% of total deposits compared to 26%, 10% and 28% respectively in 2002. Local banks continued to lag behind and accounted for 9% of the industry's total assets, 8% of total loans and total deposits compared to the previous year's 9%, 8% and 6% in December 2002.1243

1239 See generally KK Mwenda The legal administration of financial services in common law jurisdictions: With special attention to the dual regulation system in Zambia (2006); and Mwenda (n 5 above).
1240 Bank of Zambia FSDP (n 1123 above) 59.
1241 As above.
1242 As above.
1243 As above.
In terms of the legal framework for the banking sector, the Bank of Zambia observes that the framework primarily consists of the Companies Act 1994, the Bank of Zambia Act 1996 and the Banking and Financial Services Act 1994. According to the Bank of Zambia, banks which operate as public companies are also required to comply with the provisions of the Securities Act 1993. Under the FSDP (2004-2009), it has been argued that:

The regulatory framework of the banking industry consists of the BoZ (Bank of Zambia) as the regulatory agency for both the banking and non-banking financial institutions sectors. The BoZ's power to regulate banks is derived from the BoZ Act and the BFSA (Banking and Financial Services act 1994). The BFSA gives the BoZ power to supervise banks and non-bank financial institutions. It also gives the BoZ power to prescribe, issue regulations and guidelines and to enforce them. The power to licence banks lies with the Registrar of Banks and Financial Institutions ... An assessment of BoZ's supervisory practices against best practice revealed that the framework for banking supervision was generally adequate and that supervisory skills were of a good standard. Further, most prudential guidelines including those for capital adequacy, single and related party exposures, and net open foreign currency exposure are in line with the Basel requirements.

Be that as it may, financial intermediation in Zambia is low. According to the Bank of Zambia, Zambian banks are holding a larger proportion of their assets in government securities and foreign assets, in contrast to what is obtaining in other sub-Saharan African countries. The central bank observes that Zambian banks hold a significant part of their foreign currency deposits outside the country. This practice, according to the central bank, reduces the resources available for lending in Zambia. Further, Zambia has one of the highest ratios of public sector credit to total commercial bank assets on the continent. The ratio of private sector credit to GDP in Zambia at 8% is said to be one of the lowest ratios in sub-Saharan Africa. The ever-increasing demand for credit to the government has pushed real lending rates very high and only major corporations can borrow at the prime rate. The Bank of Zambia observes that the high real interest rates not only discourage potential borrowers, but also make the banks wary of credit risk, since mainly undesirably risky businesses attempt to borrow at high

1244 Bank of Zambia FSDP (n 1123 above) 61.
1245 As above.
1246 Bank of Zambia FSDP (n 1123 above) 62.
1247 As above.
1248 As above.
1249 As above.
1250 As above.
1251 As above.
1252 As above.
1253 As above.
real rates. Almost all lending is short term, partially as a measure to control credit risk and partially because sources of finance (deposits) are largely of a short-term nature.

In Zambia, the earnings of Zambian banks are mostly dependent on foreign exchange trading and interest on government securities. This, as the central bank observes, reduces the incentives to expand intermediation for the private sector. Without income on foreign currency operations, most banks would have been unprofitable over the last four years. Other constraints and challenges facing the banking industry, as highlighted by the Bank of Zambia in the FSDP (2004-2009), are as follows:

Zambia has a weak credit culture. It is possible for borrowers to default on loans without affecting their credit ratings with other financial institutions. This discourages borrowers from repaying their outstanding loans in both failed and operating banks... Related to the above, there is a tendency among borrowers to have their assets (used as collateral) overvalued in relation to the amounts of the loans they obtain. This encourages borrowers to default on loan repayments... Zambian banks have extremely high operating costs. This cost structure makes it difficult to develop efficient low-cost services that the population can afford... The treatment of erring directors of failed and operating financial institutions by some regulatory authorities has been lenient, with appropriate action not taken in some cases of blatant violation of laws. In some cases, managers were/are even allowed to take jobs elsewhere in the financial sector.

With regard to the issue of erring directors of failed and operating financial institutions not being disciplined or penalised by some regulatory authorities where there is blatant violation of law, I have examined elsewhere the law on the legal liability of company directors for fraudulent trading and wrongful trading, including salient and pertinent aspects of fraud by officers of companies that have gone into liquidation. In that work, I have highlighted, inter alia, the glaring absence of a legal framework to license and regulate Zambia's insolvency practitioners, giving reasons why such practitioners should be regulated. Currently, insolvency practitioners in Zambia are not professionally regulated or licensed, in spite of the growing evidence suggesting that some of these individuals and firms purposefully, and with wanton disregard of the law, enrich themselves

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1254 As above.
1255 As above.
1256 Bank of Zambia FSDP (n 1123 above) 63.
1257 As above.
1258 As above.
1259 As above.
1260 See generally Mwenda (n 1220 above).
1261 As above.
from the estate of insolvent companies under their control. That work argues further that Zambia continues to experience a weak compliance culture in the area of corporate governance, and that there are not many mechanisms to deal with the enforcement of directors’ liability other than to rely on the judicial process.\textsuperscript{1262} As an incentive to promote more efficient compliance with best practices in corporate governance, and to deter misfeasance and misconduct by company directors, legal rules to disqualify persons convicted of such offences as wrongful trading and fraudulent trading should be introduced. Such a development, we contend, could help to bolster and strengthen Zambia’s legal and institutional framework for corporate insolvency.\textsuperscript{1263}

With regard to the issue of some managers of failed and operating financial institutions being allowed to take jobs elsewhere in the financial sector in spite of the fact that they have not been properly cleared by the regulator, we have already explored this issue at length in chapters 3 and 7, respectively. To some degree, Zambia has experienced some lax compliance with and weak enforcement of laws and regulations when it comes to the regulation of banks and financial institutions. According to the Bank of Zambia:

There is a widespread perception that financial crimes are not prosecuted, whether it is mismanagement and political lending in the public financial institutions, staff embezzlement, client fraud, willful default on loans, or mismanagement in banks that lead to failure and loss of depositors’ funds, or corruption, or money laundering. This adversely affects the development of the financial sector by reducing public confidence ... Notwithstanding the adequacy of the supervisory practices, the following deficiencies are noted:

(i) Enforcement of the banking laws is weak and the general recovery process through the legal mechanism is slow.

(ii) Interference in the execution of the supervisory function due to lack of central bank independence.

(iii) Minimum capital requirement has been eroded in real terms by inflation since it was last adjusted in 1996. The minimum capital requirement in real terms is one of the lowest in Africa.

(iv) The BoZ’s internal procedures for liquidating banks are cumbersome and lengthy.\textsuperscript{1264}

Following below is an examination of the policies of the Bank of Zambia on the regulation of non-bank financial institutions, as spelt out in the FSDP (2004-2009).

\textsuperscript{1262} As above.
\textsuperscript{1263} As above.
\textsuperscript{1264} Bank of Zambia \textit{FSDP} (n 1123 above) 64.
3 FSDP (2004-2009) on the regulation of non-bank financial institutions

As pointed out at the start, we are focusing only on those non-banking financial institutions that are regulated by the Bank of Zambia. Although the FSDP (2004-2008) covers, in addition to specialist lenders and bureaux de change, such contractual savings providers as insurance companies and pension funds, these types of contractual savings providers are not regulated by the Bank of Zambia. According to the Bank of Zambia:

The non-bank financial institutions (NBFIs) play a complementary role to banks in the financial system. The NBFIs present a window for transforming the financial sector in Zambia through their role in long-term lending and provision of financial services to the under-served rural consumers and small businesses often ignored by the traditional banking channels.1265

The Bank of Zambia observes that its focus is on key elements of a strategy for restructuring the development finance institutions, housing finance institutions and the rural banking institutions as well as developing a regulatory framework for the micro-finance institutions.1266 Included in this strategy is the regulation of leasing companies that engage in the provision of asset-based finance.1267

In Zambia, many commercial banks that had branches in peri-urban and rural areas closed down a number of their branches.1268 According to the Bank of Zambia, commercial banks still maintaining rural branches do not cater for the financial needs of most of the people in rural areas owing to high bank charges and minimum amounts required for opening savings accounts.1269 Further, the majority of Zambians are not able to meet the collateral requirements for the credit facilities. This has created a gap in the provision of financial services to low-income households, especially in the rural areas.1270 As such, micro finance institutions (MFIs) have risen to fill the gap in the provision of financial services. MFIs offer financial services, such as, small loans and savings facilities in the peri-urban and rural areas.1271 Although expansion is much slower in rural areas, growth, according to the Bank of Zambia, is evident along the line of rail and the peri-urban areas of the country.1272 The

1265 Bank of Zambia FSDP (n 1123 above) Executive Summary vii-viii.
1266 Bank of Zambia FSDP (n 1123 above) Executive Summary viii.
1267 As above.
1268 As above.
1269 As above.
1270 Bank of Zambia FSDP (n 1123 above) Executive Summary viii-ix.
1271 Bank of Zambia FSDP (n 1123 above) Executive Summary ix.
1272 As above.
provision of financial services in the rural areas has been slow due to unsatisfactory supportive infrastructure and absence of an appropriate regulatory and supervisory framework. The Bank of Zambia concludes that key recommendations for the specialist lenders and bureaux de change include:

(i) repealing the Development Bank of Zambia (DBZ) Act, the National Savings and Credit (NSCB) Act and the Building Societies (BSA) Act;
(ii) restructuring or closing insolvent non-bank financial institutions;
(iii) incorporating development finance institutions (DFIs), housing finance institutions (HFs) rural banks and micro-finance institutions (MFIs) under the Companies Act;
(iv) establishing a legislative framework to provide for effective regulation and supervision of DFIs, HFs, rural banks and MFIs;
(v) reviewing value added tax (VAT) on lease finance charges in order to stimulate growth of the leasing sector; and (vi) reviewing the 25% shareholding limit.

That said, in both cases of regulating banks and non-bank financial institutions, the FSDP (2004-2009) hardly talks about possibilities of decriminalising some regulatory offences while strengthening the regime of civil sanctions. In the case of the United Kingdom, Singh observes, however:

Succeeding in proving criminal wrongdoing is no simple task, and particularly difficult in the area of complex fraud. Another major concern is the infrequent use of criminal sanctions to punish severe regulatory wrongs. A crucial factor here is whether the culprit is a company or an individual, giving rise to problems associated with establishing the mental element necessary to satisfy a criminal conviction. The growth in the use of civil sanctions is based on a systematic process of decriminalising regulatory offences, which has curtailed the use of criminal sanctions for all but the most serious offences. Civil sanctions come in various forms: compensation, injunctions, restitution, asset forfeiture or civil fines.

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1273 As above.
1274 As above.
1275 See Singh (n 1043 above) 118-119.
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