AN EXAMINATION OF THE LAW ON DEPOSIT GUARANTEE AND RESOLUTION FUND IN THE BURUNDIAN BANKING SECTOR

A Thesis

Submitted to the College of Higher Degrees and Research of
Kampala International University
Kampala, Uganda

Partial fulfilment for the Award of Master Degree in Law of
Kampala International University

BY:

GAHIMBARE GRATIA

1153/01056/02148

OCTOBER 2018
DECLARATION

I declare that this thesis is the work of Gahimbare Gratia alone, except where due acknowledgement is made in the text. It does not include materials for which any other university degree has awarded

Name and signature of Candidate

1153/01056/02148

Date
APPROVAL

I certify that I have supervised and read this Thesis and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate in scope and quality as a Thesis in partial fulfilment for the award of Degree of Master of Laws of Kampala International University.

________________________________________
Name and Signature of Supervisor

Date
ACKNOWLEDGEMENT

I am honoured to express my special gratitude to my God for his unfailing support and guidance every day of my life. My complete worship is due to him.

My gratitude also goes to all the persons who made this work a success.

To the Dean of Faculty of Law, the Head of Department of Law and all the lecturers of the School of Law at Kampala International University who have imparted in me skills and knowledge and made my stay a pleasure.

Special thanks goes to my supervisor, Mr. Sewaya Muhamud for whom I feel deeply indebted for his tireless support and guidance through the research time. To my mother Marie Goretti Muhitira, who has always been pushing me to look for higher knowledge, I would not have gone so far without her support. To my husband Christophe Ndayiragije, who so trust in me for better and always reminded me that efforts pay. Thank you so much.
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Loi n° 1/17 du 22 août 2017 portant réglementation des banques et des établissements financiers (loosely translated as Financial Institutions Act 2017)

Loi n°1/09 du 30 Mai 2011 portant code des sociétés privées et à participation publique (loosely translated as code on private and semi-public companies 2011)

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Décrêt n°100/203 du 23 juillet 2016 portant réglementation des activités de microfinances au Burundi (loosely translated as Regulation on Microfinance activities in Burundi 2016)

Circulaire n°17/2013 relative à l’interdiction au bénéfice du crédit par les clients défaillants auprès du secteur bancaire (loosely translated as Circular n°17/2013 on credit prohibition to defaulting customers in the banking sector)

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Microfinance Institutions and Money Lenders Act 2016 (Uganda)

Deposit Insurance Act 2012 (Kenya)

Kenya Deposit Insurance (amendment) Act 2013

Malaysia Deposit Insurance Corporation Act 2011

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<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>BIF</td>
<td>Burundian International Franc</td>
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<tr>
<td>BRB</td>
<td>Bank of the Republic of Burundi</td>
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<tr>
<td>DIS</td>
<td>Deposit Insurance Scheme</td>
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<td>FDIC</td>
<td>Federal Deposit Insurance Corporation</td>
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<tr>
<td>FGDR</td>
<td><em>Fonds de Garantie des Dépôts et de Résolution</em> (French Deposit Insurance and Resolution Fund)</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<td>OECD</td>
<td>Organisations of Economic Cooperation and Development</td>
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<td>USA</td>
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ABSTRACT

Deposit Insurance schemes are currently recognised by the general consensus as being vital to financial system’s stability by protecting depositors from incurring large losses due to deposit taking institutions’ failures and preventing them from engaging simultaneous withdraws when these institutions’ solvency is questioned; provided that the scheme is well established by a clear legal framework. Burundi also took a significant step toward Deposit Insurance, when in August 2017 the Financial Institutions Act introduced a Deposit Guarantee and Resolution Fund through two provisions. However, in order to be credible for the stakeholder, a Deposit Guarantee or Deposit Insurance, as it is most commonly referred to, has to be well provided legally. There are even basic aspects of the Deposit Insurance that must be clearly set by law and that are recognised by international standards. Unfortunately, the provisions on the Burundian Deposit Guarantee and Resolution Fund in Burundi do not seem to meet these criteria. This research therefore highlights the deficiencies that should be adjusted in the banking sector toward depositors’ protection and the deficiencies of the law on Deposit Guarantee and Resolution Fund in Burundi and proposes enhancements based on Deposit Insurances Funds’ key provisions in selected countries which the Burundian law-makers and law enforcers can use as references in improving the law governing the Deposit Guarantee and Resolution Fund.
CHAPTER ONE

GENERAL INTRODUCTION

1.1. Background to the study

The banking sector is a key-component of the financial sector. However, in the process of its intermediating function, the provision of liquidity service that banks traditionally performed by using liquid, short-term liabilities to fund relatively long-term illiquid assets leaves them exposed to runs. Bank runs are situations where a large number of depositors, fearing that their bank will be unable to repay their deposits in full and on time, simultaneously try to withdraw their funds immediately. Consequently, the insolvency of one bank may trigger a contagion run on other banks when public concern about one bank regarding the safety of deposits leads to concerns about other banks. This situation can even culminate in a financial system failure. In fact, stress in the banking system can easily lead to massive banks collapses. In the United States of America (USA) between 1930 and 1934 only, more than 9000 banks failed in the midst of the banking crisis.

Such a situation does not only affect the bankers, but in its worst effects it can lead to a social crisis. Thus, because banking institutions failures have the potential to trigger a broad spectrum of harmful events, including economic recessions; policy makers have been conscious of the necessity to erect a financial safety net to make systemic banking breakdowns less likely to happen and to limit the disruption and fiscal costs generated when they occur. One special feature of this financial safety net is the Deposit Insurance. The Deposit Insurance, which is sometimes also referred to as Deposit Protection or Deposit Guarantee as it is the case for Burundi, refers to guarantees made by deposit insurers institutions to bank deposits. Thus, though the term ‘insurance’ can be misleading in nature, the nature of the guarantee does not meet the criteria of genuine insurance. Deposit Insurance was thus first put in place as a mean to comfort depositors that their money is not at risk in

the bank. In fact, depositors knowing that their money is covered by a Deposit Insurance Scheme (DIS), are unlikely to run to the Bank when its financial stability is questioned.

Deposit Insurances, however, have different forms but the one to be mainly considered in this study is the Deposit Insurance Fund and can be defined a Fund set aside to pay back the money lost due to the failure of a financial institution.\(^5\)

The first national Deposit Insurance system was created in the USA in response to a wave of turbulence in the banking system. Prior to its creation, the USA has had a hard banking crisis. In fact, an average of more than 600 banks per year failed between 1921 and 1928. Then after, a wave of bank failures during the last few months of 1930 triggered widespread attempts to convert deposits to cash. Many banks, seeking to accommodate cash demands or increase liquidity, contracted credit and, in some cases, liquidated assets. This reduced the quantity of cash available to the community which, in turn, placed additional cash demands on banks. Banks were forced to restrict credit and liquidate assets, further depressing asset prices and exacerbating liquidity problems. As more banks were unable to meet withdrawals and were closed, depositors became more sensitive to rumours. Confidence in the banking system began to erode and bank ‘runs’ became more common.

The crisis could not be hampered by the federal government, and banking conditions deteriorated so rapidly that in March 1932, all the states had to declare bank holidays which lasted almost a week. The federal government took different measures to calm the situations which resulted ultimately in the creation of the Federal Deposit Insurance Corporation in 1933.\(^6\)

For one to understand the rationale behind Deposit Insurance, it is important to know that the USA was not the only country hit by banking crisis. The 1980s and 1990s witnessed waves of systemic banking crises in many countries around the globe. The waves struck developed and developing countries alike, resulting in 112 episodes of systemic crises in 93 countries and 51 episodes of borderline crises in 46 countries.\(^7\)


\(^7\) Caprio and Klingebiel, 1999 (as cited in Asli Demirgüç-Kunt & Edward J Kane, ‘Deposit Insurance around the Globe: where does it work?’(2001)16(2), Journal of Economic Perspectives, 2).
These large-scale banking crises were costly and disruptive. For example, Thailand and Korean banking crises exceeded 30 percent of GDP, and in Indonesia budgetary costs for the banking crises approached 50 percent of GDP. Sadly, the full costs of these crisis go beyond direct fiscal costs; depositors lose access to their funds, even good borrowers can lose access to credit and be forced into bankruptcy, and some sound banks may be driven out of business. Turkey banking system’s weaknesses triggered a crisis of confidence in other domestic financial institutions and led to a large-scale flight of foreign capital and a severe currency crisis.

These worldwide crises have enlarged the audience for Deposit Insurances, mostly Deposit Insurance Funds, and their adoption have spread rapidly. In the African continent also Deposit Insurances have evolved. Since the 1990s, African countries have adopted Deposit Insurances, like the Nigeria Deposit Insurance Corporation (NDIC) which was established on 15 June 1988 to strengthen the safety net for the newly liberalized banking sector and the Ugandan Deposit Protection Fund created in 1994.

The growing use of Deposit Insurance Funds by governments as important components of a larger framework that is intended to protect depositors and promote the safety and stability of the financial systems has also extended to Burundi recently. The necessity of putting in place a system of Deposit Insurance was highlighted in a survey conducted in 2012 by the Central Bank on financial inclusion in Burundi. Among the conclusions of the survey it was recommended the conduct of a study on the feasibility of a Deposit Insurance system that would be self-financed by contributions from licensed financial institutions on the basis of a percentage of their volume of deposits. Following that recommendation, a Deposit Guarantee and Resolution Fund was introduced in the Financial Institutions Act 2017. This Act provides that all the financial institutions that receives fund from the public in Burundi must adhere to the mechanism of Deposit Guarantee and Resolution Fund for the compensation of customers of the affiliated institutions in case of unavailability of their deposits or other refundable funds or to rescue an institution in difficulty. The Act also provides that the Central Bank will fix the conditions of existence of that fund, with no further details on how the Fund will carry its activities.

8 World Bank, 2001( as cited in Asli Demirgüç-Kunt & Edward J. Kane (n 7)2).
9 Ibid.
That step forward concerning Deposit Insurance was positive for Burundi depositors but the legal provisions on the Deposit Guarantee and Resolution Fund are insufficient as they do not meet the basic characteristics internationally accepted for such an institution to be trustworthy for depositor of a given banking system.

1.2. Statement of the problem

Deposit Insurances were created with the primary objective of assuring the public’s confidence in the banking system so that banks could perform their mid and long-term lender function without being apprehensive of systemic runs. However, since they are currently part of the general public policy of financial sector stability, DISs, besides the intrinsic objective of bank run prevention, also follow the objective of small (unsophisticated) depositor protection.  

The objective of reimbursing depositors in the event of a financial institution’s failure is at the core of the Burundian Deposit Guarantee and Resolution Fund, as provided by the Financial Institutions Act 2017. Nevertheless, it is important that a DIS be properly designed, well implemented and understood by the public to be credible. Though it is early to delve in the implementation and publicity considerations, it is apparent that the provisions on the Burundian Deposit Guarantee and Resolution Fund do not meet the prior condition of proper design and this is not promising for the depositors in Burundi in the event of a deposit taking institution’s collapse. Having an explicit and well provided Deposit Insurance mechanism at their disposal would guarantee depositors that their money will not be completely lost if their institution becomes illiquid or insolvent.

This study, therefore, aimed to examine the adequacy of the provisions on the Deposit Guarantee and Resolution Fund, as laid down in the Burundian Financial Institutions Act 2017, in consideration of international standards on key aspects of Deposit Insurance Funds in general, and in selected countries in particular. The legal analysis will highlight key provisions which can be incorporated in the law on the Deposit Guarantee and Resolution Fund in Burundi to make it suitable in the Burundian banking sector.

13 Financial Institutions Act 2017, Art 86, para 1 (Burundi).
1.3. Research objectives

1.3.1 General objective

This study aimed mainly to investigate the adequacy of the provisions on Deposit Guarantee and Resolution Fund towards depositors’ protection in Burundi and to propose enhancements based on examples from selected countries.

1.3.2 Specific objectives

(a) To examine whether the nature of the Burundian banking sector fit the existence of the Deposit Guarantee and Resolution Fund.

(b) To analyse the deficiencies of the depositors’ protection in the Burundian banking sector.

(c) To investigate Deposit Insurance fund’s key provisions in some selected countries which can be considered in improving the adequacy of the provisions on the Burundian Deposit Guarantee and Resolution Fund.

1.4. Research questions

This study seeks to answer the following questions:

(a) Does the nature of the banking sector of Burundi fit the existence of the Deposit Guarantee and Resolution Fund?

(b) What are the deficiencies of the banks depositors’ protection in the Burundian banking sector?

(c) What are Deposit Insurance Funds’ key provisions in selected countries which can be considered in improving the law on the Burundian Deposit Guarantee and Resolution Fund?
1.5. Significance of the study

The study findings will be important for the Burundian legislators, who are invested with the power of legislation, as it gives guidance on how to improve the legal provisions on the Deposit Guarantee and Resolution Fund to adjust them to international standards.

This study will also benefit the Central Bank of Burundi because it raises the awareness of impediments that should be addressed so to enforce the banking sector’s stability and discusses how the Central Bank can enforce banks’ depositors protection. This study can as well be of value for academicians since it will draw out detailed informations concerning the state of Deposit Insurance in other countries and in Burundi. This research can, moreover, incite other researchers to study on the subject of Deposit Insurance in the Burundian context thus create other useful informations. This study will finally be of importance for the researcher because of the moral satisfaction of participating to the building of knowledge in the law field.

1.6. Scope of the study

This study examined the nature of the Burundian banking sector with a focus on banks and the implicit guarantee that the government have been exercising toward depositors in Burundi after collapse of banks. The study also explored the deficiencies that banks accuses toward depositors’ protection and the deficiencies of the provisions on the Deposit Guarantee and Resolution Fund. It also drew out and commented some key provisions on Deposit Insurance Funds, in selected countries, designed to make them efficient toward the depositors’ protection. This study do not aim to make a comparative study between Burundi and other countries on their respective deposit insurance schemes, but rather to take examples from other countries which can be useful in the Burundian context, whose DIS is at a nascent stage.

This study was thus carried out in relation to the Burundian context with references to other jurisdictions on Deposit Insurances aspects. The key institutions that were targeted in Burundi were the Central Bank and commercial banks. These institutions were targeted for their key role regarding the existence and efficiency of depositors’ interests protection in the Burundian banking sector and thus in the implementation of the Deposit Guarantee and Resolutions Fund.
1.7. Research methodology

This study used the legal desk research. The study thus involved primary and secondary sources. In fact, desk research also known as secondary research, involves the summary, collection and or synthesis of existing researches. It differs from primary research, in which data are collected from, for example, research subjects or experiments.\textsuperscript{15} Desk research is basically involved in collecting data from existing resources.

The primary sources that were employed included the Financial Institutions Act of Burundi 2003, the Financial Institutions Act of Burundi 2017; the Financial Institutions Act of Uganda 2014 as amended in 2016 and the Kenya Deposit Insurance Act2012, among others. The Burundian primary sources were reviewed for the provisions they have on the banking sector in regard to depositors’ protection. The other sources were used for the examination of the key provisions on Deposit Insurance funds in the selected model countries.

The research also relied on secondary sources, namely text-books, journal articles, newspapers, working papers and reports from physical and virtual libraries. These sources offered a selected literature on Deposit Insurance’s aspects. A particular attention was laid on key legal aspects of Deposit Insurance Funds and their efficiency in depositors interests’ protection.

1.8. Literature review

A DIS is an important tool in the legal arsenal of any banking system as have been said previously. However, it is hard to find a literature on the subject linked to Burundi. The subject of Deposit Insurance has not yet been earnestly discussed enough in the Burundian context. In other environments, nonetheless, an abundant literature has been developed.

\textit{Nibitegeka Advocates},\textsuperscript{16} a Burundian law firm, has published an article commenting the financial protection given by the Central Bank to depositors and third parties. That article highlights that the Central Bank of Burundi have established prudential standards by which banks and financial institutions have to comply with management standards designed to guarantee liquidity, solvency and the balance of their financial structures. This publication also cited the Financial Institutions Act2003, prevailing at the time, which provides that in the

event of financial difficulties, the Central Bank’s Governor may command the shareholders of an institution in difficulty, to provide to it all the required support. The Central Bank can also organize assistance from all banks and financial institutions in order to maintain the proper functioning and reliability of the banking system.\(^{17}\) This article discussed an aspect of financial institutions’ management which is, as many others, connected or oriented toward the methods of prevention of Banks and other financial institutions insolvency. However, despite the importance of the subject, authors did not yet significantly put attention onto the handling of the banks depositors’ protection through a Deposit Guarantee and Resolution Fund when a financial institution collapses in Burundi. This article was thus mentioned here to highlight the gap that exist in the literature on the subject under study.

_Ndayisenga and Kaburaburyo,\(^{18}\) two Burundian authors have also written on the financial sector, particularly on risk management of banking activities in Burundi. They analysed the potential risks a bank faces and they recommended that banks carefully comply with the Central bank’s regulations in order to lower the potentiality of crisis’ occurrence. These authors studied one aspect of the risk management of a bank as well, nonetheless, the insolvency of a financial institution is no longer a myth in modern economies and consequently it is important to have clear and efficient mechanisms of depositors’ reimbursement in order to protect the banking system’s balance.

In other countries, however, there have been developed a literature on Deposit Insurance, ranging from the origin, nature and even importance of DISs. Concerning the importance of DIS, Booysen,\(^{19}\) said that bank’s customers rank are ordinary creditors in the estate of an insolvent bank and as such, they are unlikely to recover much, if anything at all. This may have a devastating impact on depositors and for this reason, depositors have been identified by governments, parliaments and regulators, as deserving protection in the event of a bank’s collapse. Deposit Insurance is an overt example of such protection and is an important component of a larger framework that is intended to promote the safety and stability of the banking system. Booysen goes on to precise that the regulatory framework aims to minimise, but not eliminate, bank failures by striking a balance between necessary prudence and permissible risk-taking so as to promote a vibrant yet stable banking system. If despite these

\(^{17}\) Financial Institutions Act 2003, Art 50 (Burundi).


\(^{19}\) Sandra Booysen, ‘Deposit Insurance in Singapore: why have it, who gets it, how it works?’ (2013) Singapore Journal of Legal Studies 76, 76.
measures, a bank fails, the DIS and other measures are intended to soften the blow that is inevitable from the collapse. In fact, a regulatory system cannot pretend to totally protect against banks’ failures for they can be provoked by unpredictable causes; but given that the best regulated systems can fail, there must be measures to protect the stakeholders when it happens.

The International Association of Deposit Insurers (IADI) has as well emphasized that Deposit Insurance, whether explicit or implicit, is a political reality in effectively all jurisdictions that have got a banking system and the role of an explicit Deposit Insurance system in today's financial environment will continue to evolve and expand. It is important here to remember that the wakeup call of regulators took place after different banking distresses. They caused many governments to align to the fact that protecting people’s bank savings was an important part of the banking stability. Hence, the leaders figured out that the confidence of depositors was in their best interest because lack of confidence in the banking system could evolve in a systemic run which is likely to result in the instability of the whole national financial system.

In addition, those banks that are insolvent will not have to undertake a fire sale of their assets in order to quickly raise money. Fire sales are undesirable because they can lead to a crash in asset prices, which can also lead to the insolvency of others (including banks) that hold similar assets. In fact, banks constitute a system, being peculiarly sensitive to one another’s operations, and not a mere aggregate of free agents’. This interconnectedness explains the effect their problems may have on one another.

Kunt and Kane, also believe that the primary desired benefit of establishing a DIS is to reduce or eliminate the threat of a sudden financial panic. A number of secondary advantages are related to this primary goal. Authorities may hope that explicit Deposit Insurance can cover the government’s future commitments to depositors of insolvent institutions, rather than leaving an open-ended implicit possibility that the government might decide to bail out all

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20 Ibid 77.
24 Asli Demirgüç-Kunt, Edward Kane, and Luc Laeven, ‘Deposit Insurance Database’ (n4) 8.
depositors. Offering Deposit Insurance may allow a government to negotiate increased rights to intervene in a timely fashion into the affairs of insolvent institutions. Sometimes, however, a country might decide to keep an implicit scheme because without an explicit commitment to compensate in the event of failures, there is opportunity of reimbursing some of the depositors only.

It is thus better to have a different agency to manage the deposit fund, as have commented Mukubwa,\textsuperscript{25}because it restricts payments to depositors of failed banks.

An International Monetary Fund (IMF) working paper, on DIS funds\textsuperscript{26} also asserted the importance of DIS and commented that it fulfilled its foremost purpose of preventing open runs on bank deposits. As the paper reports, ‘in the face of large shocks to the global financial system, as well as concerted and protracted concerns about the solvency of practically every large financial institution in the world, we did not observe widespread bank runs. There were some notable exceptions (such as Northern Rock in the United Kingdom) and there were protracted withdrawals by uninsured depositors, but the world did not experience systemic bank runs by insured depositors. From this perspective, DIS delivered on its narrow objective. This working paper seems to induce that DIS only achieved its primary objective, but on a larger scale it can be said that DISs contributed to the stability of the banking system at least in part. In part because it takes other components of the financial sector to be efficient in order to achieve an effective stability.

Although the prevailing objective of a DIS is to protect depositors who are usually unsecured creditors, it should also be considered that having access to his money is the first right of any depositor. This right lies at the heart of every banker-customer contract and even though some risks are not dependent to the Banker, it should not have taken the collapse of banks, and the consequent social and economic stresses, to highlight the importance any depositor has as an individual. Fortunately, law has evolved to such an extent that it is recognised that the confidence of the public plays a great role in the overall stability of the banking system. As a result depositors have got greater consideration.


\textsuperscript{26} Ibid4.
Frolov, however argued that Deposit Insurance is not the only mean to cope with the problem of bank runs. Yet, it is a prevailing solution because banks dominate the credit channels in most economies over the world, and the modern payment systems are based on the convertibility of the bank deposits into cash.

Thus, today legislators have decided to entrust DIS and there is currently a wide range of DIS which can vary from a given country to another. Some countries have even adopted more than one system. Germany for example has nine DISs. Moreover, the design of DISs varies substantially across countries. The high degree of variation suggests that an ideal global design is not likely to be found.

Van Der Kamp, nevertheless, sees a danger in Deposit Insurance for he believes that it encourages moral hazard. He explains it by this scenario: ‘Under conditions in which you have no government guarantee that your bank deposits are safe you might think twice if Bank A offers you a 10 per cent deposit rate while Bank B, where you have your money, pays you only a 5 per cent rate. But what if the reason that Bank A offers such a high rate is that it is desperate for money because it is in financial trouble? What if it offers so much only because it plays high-risk games with your money? Until you hear more, perhaps you should be careful and just leave your money with Bank B.’ Van Der Kampsays that people no longer take precautions because they know that even if they put all their money with Bank A, when it fails their government will make up the difference to them. He goes on explaining that what is wrong with this thinking is that it encourages Bank A to take exactly those risks that used to worry depositors. The depositors no longer care for they will get their money back whatever happens.

However, one cannot forget that banks used to fail even before DISs, and DISs came as part of the solution against banking activities instability. It is fairer to say that insufficient regulation and inefficient supervision will always encourage risk-taking by banks. Thus, the DIS is not the problem in itself, but the way it is regulated, as well as the interconnectedness with the other players of the banking system in which the DIS operates will influence its success or failure.

27 Mikhail Frolov (n 12).
28 Asli Demirgüç-Kunt, Edward Kane and Luc Laeven (n 4) 4.
29 Ibid.
Lubano,\textsuperscript{31} also finds interesting the argument that Deposit Insurance undermines market discipline, the rationale being that as a result of having such an insurance scheme in place, financial institutions tend to take undue risks while customers take little or no interest in the way these institutions are run. She emphasises that in Kenya, despite the relatively low level of protection offered, unscrupulous financial institutions do not seem to shy away from taking very high risks with depositors’ funds. Such unrestrained risk-taking, coupled with depositors’ disinterest, ignorance or blind trust in financial institutions ultimately leads to their imminent failure or collapse. However, this author takes a more balanced opinion when she finally says that Deposit Insurance should ideally reduce the risk of a bank run based on the premise that depositors who are assured that the insurer will reimburse their deposits in the event of a bank failure, are less inclined to withdraw their deposits in the event of an institution’s insolvency. It was largely commented that this ideal has been achieved by DISs.

Ngalawa et al,\textsuperscript{32} took a further step for he investigated the connection between moral hazard caused by Deposit Insurance and banking instability, using an empirical framework that distinguishes banking instability triggered by bank runs from banking instability caused by insolvency of banks or credit crisis. The study found weak evidence that Deposit Insurance is associated with moral hazard, which has the consequence of causing bank insolvency or credit crunch that ultimately triggers a run on banks. The study also establishes that a country is more vulnerable to banking instability when it has a more generous DIS, when the Deposit Insurance agency has a legal mandate to cancel or revoke Deposit Insurance for any participating bank, when the Deposit Insurance has a permanent fund, and when the scheme is funded jointly by the government and the private sector or solely by the government. The investigation finally concluded that since there are many types of regulation in any given banking system, it may be difficult to study with complete confidence the effect of a given banking regulation alone, and he adds that perhaps it is the combination of many types of regulations which matters. This position reflects the previous assumption that the effect of Deposit Insurance cannot be evaluated out of a general financial context for it is not the only component of a national financial safety net.


Bhatta,\textsuperscript{33} has a mitigated view for he states that Deposit Insurance protects insured depositors against the consequences associated with the failure of a bank but it is not designed to protect banks from failing. Instead, it could increase the cases of moral hazard if specified rules and regulations could not be implemented effectively. Indeed, if the DIS is not backed by an efficient regulation it is left at risk as any other institution of such a sensitive role. That is to say, the risk is not inherent to Deposit Insurance itself but to non-compliance with the regulations and an insufficient supervision by the supervisory body.

From the above, it appears that Deposit Insurance is a much discussed concept around the world. Many researchers have studied the aspects of that important subject. However, there are only few researches to date on Deposit Insurance in Burundi. This might be the reason why the Burundian government decided to adopt it late in comparison to its peers. There are obviously not enough commentaries or researches on the importance and necessity of a DIS or even on how such institution can work and help in Burundi. Due to that lack of literature, this research intended to fill the gap by reviewing the adequacy of the recent legal provisions on Deposit Guarantee and Resolution Fund in Burundi in order to address their weaknesses or strength toward the protection of banks’ depositors.

1.9. Research structure

This study is built upon five chapters. The first chapter provides a general introduction of the study, the background of the study, the statement of the problem, the objectives of the study, the research questions, and the scope of the study, the significance of the study, the methodology, the literature review, and the research structure. The second chapter reviews the legal nature of the Burundian banking sector, the role of the Central Bank in the banking sector, and the circumstances that surrounded the collapses of banks in Burundi. The third chapter provides the legal analysis of the deficiencies of the banking sector in Burundi concerning depositors’ protection. The fourth chapter discusses some of the key provisions on Deposit Insurance funds from selected models. Lastly, the fifth chapter summarizes the key findings of the study, and draws conclusions and recommendations concerning the law governing the Deposit Guarantee and Resolution Fund in Burundi.

\textsuperscript{33} Kiran Prasad Bhatta, Core principles and global practices of Deposit Insurance scheme: A comparison of the trend with the Nepalese system (2014), Banking journal 2 (1) 59, 61.
CHAPTER TWO

THE LEGAL NATURE OF THE BANKING SECTOR OF BURUNDI

2.1. Introductory background

Burundi’s post-independence history has been marked by diverse waves of political violence which has disadvantaged the performances of the country’s financial sector in general. Besides the political instability and its consequences on the economy, political inferences in the financial sector has had disastrous effects through poor management. As a result, the need to control economic and political power determined or influenced the ownership of banks, undermined the independence and regulatory capacity of the Central Bank, and perpetuated inefficiencies in the allocation of resources, particularly of credit. Bank credit was often issued on the basis of political connections rather than projects’ expected returns. A large fraction of bank loans were never paid back and poor management led many banks to the brink of collapse, prompting the Central Bank to bail them out. This was indirect resource transfer from the public to the defaulting customers, bank managers, and employees. In many cases, banks that were bailed out kept their management team who continued to use these institutions to extract rents. In other cases, mismanagement led to the collapse of several financial institutions.34

Burundi, however, engaged many reforms to improve the efficiency of the financial system, under the Structural Adjustment Program (SAP). The government initiated the liberalization of its financial system in 1987 with the objective of correcting market distortions and creating a level playing field, to improve resources mobilization and achieve efficient allocation of resources across sectors.35

On the positive side, liberalization succeeded in opening up the sector to entry of new banks. In 1987, the financial system was comprised of only 3 commercial banks, 4 non-bank financial institutions and an emerging network of microfinance institutions. The sector was dominated by the State enterprises and they held the lion’s share of the assets. Following liberalization, new commercial banks were established, and some of the previously protected

35 World Bank, ‘Burundi First and Second Structural Adjustment Credits’ (ProgramPerformance Audit Reports, 1991) 14.
institutions succumbed to competition like *Caisse D’Epargne du Burund* (Saving Fund of Burundi), (CADEBU) and *Caisse de Mobilisation et de Financement*, Financing and mobilisation Fund (CAMOFI) Over time, commercial banks were partially privatized though the government kept a relatively strong influence in their management. The influence of the State in banks’ management had always played a significant role, having disastrous effects when the politic would mix in incorrectly, or contrary having positive effects when serious measures to fix the distortions were taken.

Nevertheless, to date, the Central Bank is actively looking for measures to foster the banking sector and the introduction of a Deposit Guarantee and Resolution Fund materialises the efforts undergoing. Among the other improvements that are taking place, there are studies ongoing on how to automatize the Burundian banking sector in order to increase the rapidity of monetary transactions. Yet, the influence of the State in the global governance of banks is still evident in the three major banks which control 45% of the credit to economy and who mostly give credits to public or mixed companies in which the State hold a big part of own funds. Future changes will maybe tackle this aspect as well.

Currently, banks dominates the financial sector which also includes some formal non-bank financial institutions, mainly development banks and a growing microfinance sector. These institutions are regulated by specific laws but they are primarily governed by the Financial Institutions Act 2017.

### 2.2. The Central Bank of Burundi

An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. In Burundi, the supervisory function is carried out by the Central Bank also named Bank of the Republic of Burundi (BRB), which is governed by the Central Bank of Burundi Act 1993. The BRB has the fundamental mission to ensure the maintenance of monetary stability and the continuation of a policy of credit and foreign exchange conducive to the harmonious development of the

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36 World Bank (n 35) 11-12.
38 Bank de la Republique du Burundi, ‘Welcome to BRB’<www.BRB.bi/en/content/> (accessed 2 March)
economy.\textsuperscript{40} It means that the BRB is in charge of prudential regulation and supervision. It ensures that Banks and Financial institutions do not engage in unnecessarily risky operations, that prudential financial ratios are maintained especially in regard to capitalization, liquidity, assets and reserves and that all stakeholders maximize value. It also make sure that the banking system is sound, stable and effective and that the development and growth of national economy is maintained. The BRB must as well ensure professionalism, transparency and high levels of integrity of the market such that practices like money laundering and market manipulation do not occur.\textsuperscript{41} The high standards expected from a Central Bank are comprehensible given the high mission it is given. In fact, supervising the whole financial system involve to be able to detect threats and prevent crisis when it is possible.

Further still, for carrying the financial supervision overview task, the Central Bank has to supervise banks and financial institutions’ compliance with the laws and regulations and it must penalize the breaches.\textsuperscript{42} As such, the BRB can grant or withdraw a banking licence. In particular, it can refuse the incorporation of a bank that does not have the required capital. It is also invested with the power to force bank in liquidation when the legal conditions are met.\textsuperscript{43}

The supervision and regulation roles of the Central Bank are of great importance since all the consumers of the financial institutions are not able to evaluate the performances of the system. For this reason the Central bank functions as an eye for the consumers. The regulatory has the responsibility of gathering all the needed informations for assessing the true financial state of all financial firms, so to protect the public against loss.

As bankers work to supply loans, accept deposits, and provide other financial services to their customers, they must do it within a climate of extensive rules designed primarily to protect the public interest. In fact, bank regulation encompasses the legislative framework and guidelines which govern bank activities. Supervision of banks is a process primarily aimed at promoting and maintaining a safe and sound banking system and preventing financial instability. It also aims to foster efficiency and competitiveness of banking institutions and to protect depositors’ funds. The BRB has been playing whistle-blowing on the malfunctioning banks though it was criticised that it carried this function when the situation was already

\textsuperscript{40}Central Bank of Burundi Act 1993 , Art 2.
\textsuperscript{41}Jembrace Paul Erongot,\textit{Banking in relation to financial and economic growth in Uganda} (Saint Christian Graphics Limited 2014) 82.
\textsuperscript{42}Financial Institutions Act 2017, Art 60 (Burundi).
\textsuperscript{43}Ibid, Art 71.
disastrous. It is the BRB that decided the closure of the CAMOFI, Meridian BIAO Bank (MBB) and the Banque Populaire du Burundi, Popular Bank of Burundi (BPB) after a verification of the malfunctioning they were going through. 44 As the general supervisor, the BRB also perform these functions:

The issue of currency: the BRB has the exclusive privilege of issuing banknotes and minting metal parts, which are denominated in francs, and it has the sole legal tender power in the territory of the Republic. 45 This function aims to protect the integrity of the Burundian francs through the control of its influx on the market. The BRB therefore has to be centralised in order to effectively control the currency’s circulation in the country.

The conduct of monetary and credit policy: after exercising direct control over the creation of money, the Bank determines the interest rates to be applied.46 The control of financial institutions’ allocation of credits is meant to avoid high interest rates which would hinder people from borrowing. On the other side, the credit policy is drafted in a way that normally discourages payment institutions from giving credit to defaulting customers. On this particular point, law provides that: ‘credit institutions are prohibited from granting credit to customers defaulting in another credit institution currently in operation or in bankruptcy with the exception of customers endorsed by the State…’47

To be a banker of Financial Institutions: the BRB is the bank of banks. It is the lender of last resort.48 When there is a crisis of liquidity, commercial banks would look to the BRB for support. The Central Bank normally has to deal with institutions that have liquidity problems, but with insolvent institutions, which are considered to be the responsibility of the State. But in practice, it is difficult to distinguish between liquidity and solvency problems, because a problem which, initially, relates to liquidity could, because of the impact on asset prices, evolve into an insolvency case.

46 Ibid, Art 45.
47 Circular n°17/2013 on Credit Prohibition to Defaulting Customers in the Banking Sector, Art 2 par1 (Burundi).
48 Ibid, Art 45 & 46.
To be the cashier, banker and adviser to the state: as cashier of the state, the BRB holds in its books Treasury accounts and execute cash transactions of the latter. 49

To regulate the rate exchange: BRB is the Government’s adviser to all the problems related to exchange rate and the economy in general.50 It is thus responsible for the custody and management of the country’s foreign exchange reserves and it can buy or sell gold. As such, the BRB is entitled to enact regulations on foreign currency transactions. 51

The legal and regulatory framework for banking supervision of the BRB has long lagged behind international standards52 and many improvements are necessary. Some significant reforms have nevertheless been undertaken, like the enforcement of credit’s regulation and an amendment to the Central Bank Act is in preparation.

2.3. The Financial Institutions Act 2017

The primary legal instrument that gives a common legal basis for banks and other financial institutions operating in Burundi is the Financial Institutions Act 2017, which will be referred to as ‘the Act’ in the following.

The Act regulates all the financial institutions having their offices registered or operating in Burundi53 save the BRB, the Treasury, the National Post Office and insurance companies are for they are under specific regulation. Nevertheless, this last three institutions are required to transmit to the BRB all informations and documents necessary for the exercise of its supervision mission.54

The Act primarily deals with the operations that financial institutions normally carry in their daily activities, their limits, the legal implications and the exceptions that exist in regard to some of the financial institutions. Nevertheless, some financial institutions are also regulated by particular statutes and the prescriptions of the Act are not to prevail against these particular statutes.55

49 Ibid, Art 33.
50 Ibid, Art 36.
51 Ibid, Art 41 & 43.
53 Financial Institutions Act2017, Art 41 (Burundi).
54 Ibid, Art 2.
55 Ibid, Art 1.
It is important to note that the Act reflects the amendments that have been done through the years in order to foster the banking sector in Burundi as it was set for strengthening the capital base, improve the quality of management and supervisory bodies.

The Act provides on the Deposit Guarantee and Resolution Fund as follow: "the affiliated institutions receiving funds from the public subscribe and contribute to a protection and resolution mechanism to compensate the customers in case of unavailability of their deposits or other reimbursable funds, or to help an institution in difficulties. The unavailability of funds is stated by the Central Bank when it turns out that an institution is no longer able to return, immediately or in the short term, funds that it has received from the public in accordance with the contractual terms and conditions. The deposits covered by the State guarantee are not concerned by this mechanism".56 The Act also provides that: "the Central Bank sets by law the conditions for setting up the guarantee mechanism, its operations and the management of the funds collected. It also sets the maximum amount of compensation per depositor and the compensation’s modalities and the time limit. It also sets the regulations on mandatory informations of the customers as well as the rules of intervention of the fund for the resolution of the establishments’ difficulties."57

The Act does not give further details concerning the Deposit Guarantee and Resolution Fund and there is currently no regulations on this aspect. These provisions on the fund are very narrow as they do not give the basic informations necessary concerning a Deposit Insurance mechanism like 'how exactly is the contribution of the affiliated institutions to be done or under which conditions the fund will compensate depositors. The provisions on the Deposit Guarantee and Resolution Fund are too narrow and need to be expanded in order to reflect the mandatory components of a Deposit Insurance system. Those provisions, though, echoes the absence of researches and commentaries on the Deposit Insurance in the Burundian context.

However, in the absence of an explicit instrument of protection of depositors, the financial institutions and the depositors have to rely only on the implicit guarantee of the Central Bank and the respect of prudential norms by banks. Unfortunately, banks can collapse despite the existence of prudential regulations, as it has already happened in Burundi and elsewhere. It is thus uneasy to escape the responsibility of setting a clear explicit mechanism of compensation.

56Financial Institutions Act2017, Art 86(Burundi).
57Ibid, Art 87.
2.4. The Commercial Banking environment

Burundi’s banking system, although relatively small, represents about 75 percent of total financial system assets. There are currently 9 commercial banks, Banque Commerciale du Burundi (commercial Bank of Burundi)(BANCOBU), Banque De Gestion Et De Financement (Bank of administration and finance)(BGF), Banque Burundaise Pour Le Commerce Et L’industrie (Burundi Bank of Commerce and Industry)(BBCI), Financial Bank (FINBANK), Interbank Burundi (IBB), ECOBANK, Banque De Credit De Bujumbura (Credit Bank of Bujumbura)(BCB), Diamond Trust Bank Burundi (DTB), Kenya Commercial Bank (KCB limited), Cooperative Rural Development Bank (CRDB) a Tanzanian bank having branches in Burundi and Interbank Burundi (IBB). The banking sector is highly concentrated with two mature banks BCB and BANCOBU accounting for a commanding share of the market; together with IBB they are the largest banks.

Direct State ownership in the banking sector is low, representing only 3.6 percent of total capital of commercial banks. However, the government still has substantial influence in the banking sector through its public entities that own up to 31.6 percent of the capital of all banks combined. The government is also a majority shareholder in two out of the three most important banks (BANCOBU and BCB). Hence, the government is still able to influence the management of banks through the nomination of its representatives to the board of directors. This threatens the transparency in the banks ‘management for there is still mean for the government to influence the allocation of credit, directly through borrowing by state entities and indirectly through political pressure on bank management.

With such a large importance of banks in the financial sector, the failure or instability of one bank can have great consequences and this assethe importance of strengthening banking supervision and backing the system with an efficient Deposit Guarantee and Resolution Fund.

59 Ibid.
61 Ibid.
2.5. Development banks and non-bank financial institutions

The Banque Nationale de Développement Economique (National Banque of Economic Development) (BNDE) is the only genuine development bank with a statutory mandate to finance economic development. In particular, the BNDE contributes to the financing of small and medium enterprises and microfinance operations.

The Fonds de Promotion de l’Habitat Urbain, Fund for the Promotion of Urban Housing (FPHU), is a mortgage bank specialised in urban housing which also participates in development financing. There is also The Institut National de Sécurité Sociale National Social Security Institute (INSS) which accounts for 5 percent of total financial assets, the Service National des Postes National Postal Services (RNP) the Mutuelle de la Fonction Publique mutual of the civil service (MFP), forex bureaus and credit reference bureaus (CRBs).\(^62\) These institutions, though not banks performs one or more banking operation, that is why they are also covered under the Financial Institutions Act 2017. As a consequence, they also fall under the scope of the provision on Deposit Guarantee and Resolution Fund. In fact, these institutions receive funds from the public and are consequently obliged to have those deposits protected.

Although the CRBs are mentioned among the financial institutions under the BRB’s supervision, they are not yet created; there is only a database of customers owing unpaid loans to bank is domiciled under the BRB’s auspices so that the banks can get access to the data.

2.6. Microfinance institutions

The Microfinances institutions (MFIs) are a relatively new phenomenon in the Burundian financial system. Apart from BNDE’s microfinance operations dating from the 1960s, genuine microfinance began with the creation of the savings and credit cooperatives (‘Coopératives d’Epargne et de Crédit, COOPECs’) in 1985. Currently there are 23 microfinances institutions in Burundi.\(^63\)

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\(^{62}\) Janvier D Nkurunziza, Léonce Ndikumana and Prime Nyamoya (n 60).

MFIs are different from banks in nature. They thus have a regulation, different from that of banks for they perform different activities. In Burundi the MFIs are governed by the Financial Institutions Act 2017 but their activities are specifically delimited under the Regulation on Microfinance activities in Burundi 2016.

The microfinances which are sometimes called ‘banks of the poor’ are a significant tool used to involve the middle class population in the banking activities. In Burundi, the microfinance sector has experienced a rapid growth over recent years. The increase in the cost of living and the decline of purchasing power due to political and economic crisis have made it difficult for people to survive on regular wage incomes. It explains the growing interest for MFIs.

In 2012, a national financial inclusion survey revealed that the number of depositors in MFIs was bigger in Burundi (170 persons out of 1000) than in Rwanda (127 out of 1000) and in Tanzania (30 out of 1000), though the situation is different in Banks. The survey also showed MFIs have experienced tremendous growth, serving more than 700,000 users in 2013, representing 65% of all users of financial services and products. This growing interest for Microfinances Institution has been at the origin of the adoption of new regulation in 2016, it was necessary to adapt the regulatory system to the changes in the sector.

The MFIs are under the supervisory scope of the BRB which is responsible for enforcing the laws and monitoring the sector. This role is meant to protect consumers (savers) in order to secure their deposits. These actions also have a significant impact on the professionalism of the sector.

It is worth noting MFIs like banks are to adhere to the deposit protection schemes, where these schemes are established, because they also receive funds from the public. As an example every microfinance in Uganda contributes to the deposit protection Fund like all other financial institutions.

The provision on Deposit Guarantee and Resolution Fund in Burundi obviously include MFIs for it provides that: ‘the affiliated institutions receiving funds from the public subscribe and contribute to a protection and resolution mechanism to compensate the clientele …’, and the

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65 Republic of Burundi, Ministry of Finance (n 63) ix.
66 Financial Institutions Amendments Act 2016 s111A (3) (Uganda).
67 Financial Institutions Act 2017, Art 86 (Burundi).
Act defines ‘affiliated institutions’ as ‘any institution authorized by the Central Bank to carry out one or more banking activities, such as credit institutions, payment institutions, microfinance institutions, financing and / or guarantee funds and the national postal system in respect of its banking and / or microfinance activities subject to the authorization and control of the Central Bank and pursuant to this Law’. 68

The supervision of the BRB over MFIs’ operations seems to be however lagging. In particular, it was brought to light during a conference on the state of financial inclusion in Burundi, that some MFIs’ managers deviate from the standards governing microfinance in the country when granting of credits.

MFIs indeed ask for guarantees to the applicants to credits whereas it does not fall within their competences. They also raise abnormally high interest rates for institutions supposed to support those with low revenues. It seems that some MFIs take advantage of the ignorance of the population by adopting strategies that disadvantage their customers. As some experts stressed, during the conference, the MFIs’ credit rate is exaggerated for it can vary between 6 and 48%. 69

2.7. An overview of the conditions surrounding banks’ failures in Burundi

Burundi’s banking troubles have been identified to be the result of various factors evolving around bad governance. In actual fact, the state has representatives on the boards of almost all major financial institutions. The problem is that the loyalty of state representatives therefore lies with their political backers and not with the firms they are supposed to manage. Even when the government became a minority shareholder in three of Burundi’s commercial banks, the government managed, through the Ministry of Finance, to choose the managers of these banks against the wishes of the majority of shareholders and, by so doing, put subtle pressure on their boards of directors. These appointments were conducted irregularly because decisions were not submitted to the general assembly of shareholders in accordance with bank statutes. 70

68Ibid, Art 4(Burundi).
Bad governance has had direct negative effects on the financial sector. Traditionally, the state in Burundi either fully owned or had controlling shares in most Burundian financial institutions. As was the case with other state-owned enterprises (SOEs), these institutions were used as sources of rents. Managers and employees were carefully selected to ensure that financial institutions remained in the hands of the ruling elite. This was a reality in the banking sector as well. Concerning this, authors have found that the nature of bank ownership, whether private or public, domestic or foreign, has a strong association with various aspects of bank performance. State ownership of banks, has revealed widespread evidence of political abuse and governance problems in state-owned Institutions. It is true that the government is an important player which can positively influence the banking sector, but when it influences a misallocation of resources it becomes necessary to open the field to other players. These new participants can for example be allowed to inject funds in the capital of banks therefore lower the influence of the state in the decisions making and operations of banks.

Still, due to government’s negative influence in management, banks’ credits were often issued on the basis of political connections rather than projects’ expected returns. A large fraction of bank loans were never paid back and poor management led many banks to the brink of collapse, prompting the Central bank to bail them out. This was indirect resource transfer from the public to the defaulting customers, bank managers, and employees. In many cases, banks that were bailed out kept their management team who continued to use these institutions to extract rents leading them to collapse. These insider dealing practices are fortunately dealt with in the Financial Institutions Act 2017 as will be seen in the following developments.

2.8. The collapsed banks’ profile

The traditional involvement of state and public sector entities in the creation and management of financial institutions being very strong, they had a controlling share in all the existing banks. The State thus had the power to nominate managers as political appointees, who often had little managerial experience and were accountable to their political backers as said previously. Since the 1990s, five banks have collapsed. They are: CADEBU, MBB,

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72 Janvier D Nkurunziza, Léonce Ndikumana and Prime Nyamoya (n 60) 6.
CAMOFI, BPB and Banque de commerce et de développement (Bank of Commerce and Development) (BCD). The number of failed banks may appear small but in a shallow financial system like Burundi, this has had a profound effect.

Below are observations on specific reasons to some of the collapsed banks:

CADEBU which was created in 1964 as a fully state-owned bank and whose main role was to mobilize financial resources and allocate them to the economy through low interest rate credit. CADEBU had the monopoly over the collection of mandatory savings from public sector workers. In turn, these funds were used to finance low-interest loans to businesses and the public which made securing credit from CADEBU a privilege. This provided substantial power to CADEBU managers. As a result of their own abuse of authority and political pressure, CADEBU managers extended credit to less deserving applicants while denying it to more credit-worthy projects. With the liberalization of the financial sector, CADEBU lost some of its traditional privileges. Competition and bad management led to its collapse in 1992. Its liquidation started in 1994 but with little success in recovering loans from CADEBU debtors, its receivers were quick to repossess other assets, particularly real estate, which was hastily sold in obscure circumstances. The Director of Administrative Recipes and the State Portfolio admitted in 2007 not knowing the capital of CADEBU and the number of savers, nor the amount already recovered and the number of savers already disinterested. The case of CADEBU reveals disastrous management and it encroaches the reputation of the supervisory body.

CAMOFI was created in 1977 as a fully state-controlled development bank providing funding for medium- and long-term projects. In 1997, for example, it lost almost three times its equity capital. Accumulated debt by CAMOFI resulted in its liquidation despite several attempts by the Central Bank to save it through injections of cash. The firm's poor management by a prominent politician led to its collapse in November 1998 with debts of 5 times its equity. Given that there are evidences on the responsibility of the former president of this bank it is abnormal that there has not been any judicial trial against him nor even investigations and it is easy to think that he had some protection on the government.

73 Ibid 31.
74 Jean Claude Bitsure, 'Le Compte Liquidation CADEBU est Vide' (‘The CADEBU liquidation account is empty’) (February 4 2010), Buja news<http://sites.google.com/site/bujanews/news-3569> accessed 20 February 2018.
75 Ibid.
The President Pierre Nkurunziza in his 2008 New Year speech promised that ‘the perpetrators of funds misappropriations which led to financial institutions’ bankruptcy will be seriously penalised’. Though this promise has not yet showed favourable response, there is hope that more light will be shed on these cases.

MBB Meridien BIAO is the result of a 1991 merger between the Meridien group’s banks started by Mr Andrew Sardanis, a Cypriot born Zambian, and a network of 11 banks he bought from the French liquidator of Banque Internationale pour L’Afrique Occidental (BIAO). In Burundi the subsidiary branch of Meridien- BIAO was created on the 1st of August 1988 as a limited liability company but with some public shareholders. The MBB network had also branches in Burkina Faso, Cameroon, Gabon, Gambia, Ghana, Kenya, Niger, Sierra Leone, Swaziland, Tanzania, and Togo. Insufficiency of liquidity seem to have dogged the group from its early days, compounded by the 1991 merger, and well informed sources have indicated funds were taken from the more profitable banks in English-speaking Africa to shore up less profitable operations in francophone countries the main cause of its collapse was a liquidity crisis following the failure of the parent company to pay back a large loan it had contracted from MBB. Meridien-BIAO had adopted a practice of financing its investments using large intra-group loans, with no clear repayment modalities. The pan-African bank eventually collapsed. It was thus evident that the poor management of the network played an important role in the failure of all its subsidiaries.  

76 This case also show evidence of weak banking regulation and supervision.

BCD, created on 14 January 1999, paradoxically had a CEO who was the same politician who had led CAMOFI to failure. His appointment was in flagrant violation of Article 17 of the Financial Institutions Act which stipulates that a person cannot be allowed to manage a bank if he (she) has played a key role in a company which, under his (her) leadership, was declared bankrupt. This unethical appointment was surely hiding politic involvement and it was again deplorable that the Central Bank was not independent enough to oppose such a nomination. As a result, BCD was badly managed and went bankrupt four years later.

BPB was established in 1992 largely with public funds including those of the national pension fund, and the state which contributed 15 percent of equity capital. Just three years after its creation, there were rumours of potential collapse of the bank due to

mismanagement. The government reacted by appointing a professional banker to be the new CEO. BPB then functioned normally but eventually collapsed in 2006 as it was extremely weakened by failure to recover 40 percent of the loans, representing BIF 4 billion. The Central Bank launched an inquiry to assess whether BPB’s failure was the result of mismanagement or corporate malpractices but the results of this inquiry were never made public.

One constant factor appearing in all five cases reviewed above was the failure of the Central bank to play its surveillance role and make prompt interventions whenever problems were detected. The absence of a Central Bank’s independence generally hampers the good functioning of a financial system, not only in Burundi but all over the world. There is actually a considerable literature on the subject and one of the way to monitor the performance of a Central bank is to evaluate its level of independence toward political pressures. In fact, the performances of such an important institution are impeded if it is not free from political intrusion.

2.9. The legal remedies to customers of failed Banks

This section reviews the legal options that depositors of the failed banks had access to in absence of a DIS. There were two options, namely an implicit guarantee by the government and the resolution of the failed institutions’ assets.

2.9.1. The government’s implicit guarantee

When a bank collapses in Burundi, and the insolvency have been formally declared, there is an implicit guarantee the government would exercise toward small depositors. A mention of this guarantee is even found in the Financial Institutions Act, 2017 which provides that the Deposit Guarantee and Resolution Fund does not include the deposits covered by the State guarantee. Such a provision was inexistent in the repealed Act of 2003, for the guarantee is ad hoc.

Experts in this sector disclosed that, as soon as the bank in difficulties was declared insolvent, the liquidation commission would, before it starts the liquidation of the bank’s assets, distribute money from the government to some of the small depositors. That amount of

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78 Financial Institutions Act 2017, Art 86 para 3 (Burundi).
money was not enough to cover all of them but normally compensated some of the small depositors only. The considerations used in deciding who to reimburse or not were subjective and left to personal judgement of the concerned official. For example, would be given priority a person who could evidence that he had many debts to cover or a mother who was raising her children alone. There was thus no regulation on to the criteria to follow and this normally gives opportunity for misuses to occur. Those who did not benefit the government’s guarantee had to wait for the liquidation of the banks’ assets.

2.9.2. The resolution of the failed institution

The provisions relating to dissolution and liquidation of companies in Burundi are found in the Financial Institutions Act 2017, from article 108 to 130 and the Bankruptcy Act 2018. When the BRB pronounce the beginning of a liquidation it also approves the appointment of the liquidator. The depositors hold the rank of unsecured creditors they thus have little chances to be reimbursed. This is due to the fact that the liquidations of banks in Burundi are surrounded by unclear circumstances which causes them to last long and to be unfruitful in many cases. The factors involved are different and some are inherent to the bank others are inherent to the customers of the Bank:

There are insufficient collaterals that banks can use to recover money lent to creditors. The agricultural sector for example, need to be covered by disaster insurance so that the bank can recover the credits it grants even when the sector was unproductive after a natural disaster. In actual fact, the existing law mainly provides for the mortgage as a bank guarantee, yet the vast majority of the population does not have a title of ownership which again handicaps loans recovery.

A clear example of how the absence of mortgages can be hindering is found in the case of Bank of the Republic of Burundi v Popular Bank of Burundi, 2015. In that case, the Ministry of Finance, via the BRB was requesting the closure of the BPB’s liquidation for its financial situation was no longer covering the charges of the liquidation process. The judgement was indicating that the debtor clients at 31/8/2014 (one year before the end of the liquidation),

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79 These informations were disclosed by a former president of the liquidation commission of one of the failed banks.
80 Financial Institutions Act 2017, Art 108 (Burundi).
totalled an amount of 3,609,173,651 Fbu (approximately $ 2,356,796 at the rate of that time). The same judgment highlighted that 'some of these customers are secured by mortgages of which the amounts inscribed amount to 58,500,000Fbu'. The amount of secured debt was thus far below the debt itself. The judgment goes on to state that: 'It is clear from the list of debtor clients that much of their credit is not covered by mortgages, while another part is covered by a simple deposition of title (unregistered) while others are mere mortgage warrants ...'.

Apart from the insufficiency of collateral it is evident that there have been irregularities in credit granting for there should have been verifications on the validity of the titles brought by the clients requesting loans.

A fact that appeared with the liquidation of banks in Burundi is that some banks accepted mortgages and forgot to require mortgage registrations from the registrar of land titles. The application for mortgage registration were then made after the bank went bankrupt. It was then up to the receivers to do the registration for the unhappy owner who was no longer interested in doing it. Even the liquidator cannot do that registration quickly for he first has to seek permission from the commercial court. When allowed to do so he has to pay a transfer fee of 3% which in most cases discourages the bankers from continuing the procedure.

Another factor that obstructed the liquidation processes was the insufficiency of informations on the borrowers. The receivers sometimes strived to find the debtors whose addresses were unknown as these debtors could be hiding themselves from the liquidator. The socio-economic crisis that the country has been through also contributed to frustration of debt recovery’s operations and the realization of collaterals. In fact, the properties of some businessmen, financed by banks, have been destroyed or stolen and many guaranties have suffered the same fate. Yet this situation reveals insufficient use of KYC requirements and this is to be corrected if the Burundian banking system is to be in harmony with the other countries of the East African Community.

84 Ibid ; personal observation when working on banks loans recovery.
85 Ibid 5.
The factors previously mentioned, coupled to a light application of the bankruptcy law, the
difficulty of ensuring an effective follow-up of the liquidation committees (by the
Commercial Court), the denial of the claims by the defaulting customers, thus creating
numerous recourses in justice, slow and irregular trials causes Banks in Burundi to last very
long as the experts in the sector denounces.\textsuperscript{86} Other problems, however, originated much
further upstream in the appointment of the receivers.

As liquidation lags behind, both the administrative costs and the salaries of the support staff
increase. In addition, a long-term liquidation entails the difficulty of realizing collateral at
their formerly estimated value (as a result of depreciation), and even reduces the chances of
substantial amounts for the bankrupt.\textsuperscript{87} Sometimes even the liquidation commissions changed
frequently during the liquidation of a single bank. This happened during the liquidation of the
BPB. It started on 16/3/2007 and closed on 17/6/2015. In the judgment closing the liquidation
of the BBP, it is stated that: ‘the liquidation commission has been renewed several times over
the 7 years of its existence’.\textsuperscript{88}

If at any time it is recognized that the assets are no longer sufficient to cover the alleged costs
of administration and liquidation of the bankruptcy, the court may, at the request of the
curators, the bankrupt duly summoned by judicial, declare the closing of the operations of
liquidation. In this case, the creditors enter into the exercise of their individual claims against
the person and the property of the bankrupt, unless the court has declared the bankrupt
excusable.\textsuperscript{89} Although the concerned authorities are reluctant to reveal how the cases ended, it
is well recognized by different observers that the applicants rarely succeed.\textsuperscript{90}

Whether these inefficiencies of the liquidation process have been caused by lack of genuine
efforts from the receivers or the insufficiency of the regulation, it is evident that change is
needed. An efficient insolvency process can considerably damage the confidence of investors
in the Burundian financial sector, and it surely disadvantaged the depositors. The Deposit
Guarantee and Resolution Fund was highly needed for the depositors, provided that is well
regulated.

\textsuperscript{86}See \textit{Rose Fidélité ndayishimiye} (n83); \textit{Association des Banques et Établissements Financiers du Burundi
(n 81)

\textsuperscript{87} The liquidation of \textit{CADEBU} which started in 1994 has never been formally closed and by 2008 the
account ‘CADEBU liquidation’ only amounted 102 fbu.

\textsuperscript{88} RCO 4994: BRB C/ BPB.

\textsuperscript{89} Burundi Bankruptcy Act2018, Art 204 (Burundi).

\textsuperscript{90} Ms DK, lawyer who worked on liquidation of a Bank in Burundi.
Apart from the provisions on the Deposit Guarantee and Resolution Fund which establish reimbursement of the depositors in case of failure of a deposit-taking institution, the Financial Institutions Act 2017 introduced other privileges for depositors.

It provides: ‘the Central Bank may, before any final approval of the statement of liabilities, and on the basis of the inventory and valuation provided for in Article 119, authorize the liquidator to make partial distributions to the applicants’.91 This provision is however difficult to evaluate for it is not clear unto the criteria to be used, especially unto who will benefit that partial distribution if the money is insufficient to cover the demand. There should be to be clarification unto the scope and conditions attached to this guarantee.

Nonetheless, even though this provision seem positive for depositors, there might be conflict of law because the employees of the bank are special creditors according to labour law: ‘The salaries must be paid in full, before the other creditors claim their share, as soon as the necessary funds are collected. In the event of bankruptcy or judicial liquidation of a company, the workers employed in it have rank of privileged creditors over all other creditors including the Treasury…’92

It is thus inconceivable that any other category of creditor can be disinterested before the employees. The following provision is more realistic concerning depositors: ‘in any compulsory liquidation of a credit institution or a microfinance institution the claims of the depositors shall be settled by preference to the other unsecured creditors. Where the assets of the establishment concerned are insufficient to interest all the depositors, they shall pay each of them an equal dividend, to be fixed by the Central Bank according to the value of that asset. The eventual balance is paid pro rata. The State is subrogated in the rights of the depositors for the advances granted by him to reimburse them.’93

91 Financial Institutions Act 2017, Art 120 (Burundi).
92 Labor code 1993, Art 93.
93 Financial Institutions Act 2017, Art 121 (Burundi).
2.10. Conclusion

The legal study of the Burundian banking Sector revealed that there are challenges mainly inherent to poor management and insufficient regulatory. The Central Bank which has the role to supervise the sector is given different prerogatives in order to well carry its functions but it seems that these prerogatives have sometimes been lightly or not at all exercised and it influenced the banks’ collapses.

Fortunately, the banking sector is in the development stage though it still has a way to go. Some of the recent developments were engaged latterly compared to other countries in the East African Community for example. Poor creditworthiness informations on borrowers, weak project preparation capacities and limited abilities to enforce guarantees also restricted the expansion of the banking system and those weaknesses have to be adjusted as the Deposit Guarantee and Resolution Fund is to be implemented efficiently in Burundi. As the presence of deposit-taking institutions is substantive in the Burundi, the banking system evidently needs a DIS. However, in order for this DIS to be given opportunity to function smoothly in the banking system and be credible for depositor, adjustment must as well be done in the banking regulatory system.
CHAPTER THREE

LEGAL ANALYSIS OF THE DEFICIENCIES OF THE DEPOSITORS’ PROTECTION IN THE BURUNDIAN’S BANKING SECTOR

3.1. Introduction

The Burundian government has engaged development-oriented changes in the banking sector, particularly in the governing legislature and operation tools. In 2015 (before the political crisis begun in Burundi), the country was even said to be going through the most important transformations of its banking industry. Due to the efforts made by the Burundian government to improve its business climate, the country was ranked among the 29 most reform-oriented countries in the World Bank’s 2015 Doing Business Report. Nevertheless, due to the political crisis Burundi has been through, many significant progress of the banking sector have been delayed. Thus behind the enhancements made, the banking sector accuses many impediments which call for solutions, particularly concerning the protection of depositors.

This chapter, therefore, highlights the advancements in the regulatory system before reviewing the weaknesses that the banking sector has to address concerning depositors’ protection.

3.2. The legislative developments

Well-designed banking laws are critical for regulating the market access and operations of banks, as well as their removal from the market in case of failure. That is why the Burundian government has engaged in improving the legislation.

(a) The evolution of banking regulation over time

A brief retrospective analysis of the changes that affected banking regulation through time, gives an insight on the significant steps taken and a better appraisal of the most recent transformations’ importance:

The first important modifications introduced in the banking system regulation were reflected in the Financial Institutions Act 1993. In fact, this Act was put in place as the replacement of the Financial Institutions Act 1976 which had become scanty in regard to the huge reforms undertaken in the financial sector. The government had previously introduced reforms under a Structural Adjustment Program (SAP) and the Act of 1976 had become obsolete as it was not reflecting the changes reached under the program.

The Act of 1976 was characterized by policies of an interventionist nature, contradicting, in particular, the liberalization of granting of loans and the determination of intervention conditions by financial institutions. Without mentioning the practical details of what these policies were, the main purpose of the structural adjustment program was to liberalize the financial market. This would include a lesser presence of the government in it and encourage greater competition.96

Yet, liberalization effectiveness was very limited due to institutional deficiencies (included a manifest antagonism from some political leaders who had personal interests in the situation remaining the same as will be expanded later), structural features of the economy, and inappropriate implementation of the reforms. One important shortcoming was that the reforms were implemented over a very short period (18 months) which did not allow for the development of the institutional capacity to manage the new system. It was impossible for the existing monetary institutions to absorb such wide ranging reforms in such a short period of time.97

In particular, the Act of 1993 intended to put in place a common legal framework for all stakeholders in transactions related to the trading of money, and to strengthen the protection of depositors and third parties. It also introduced the legal basis for penalties to banks and financial institutions.98 With regard to the protection of depositors and third parties, the Act provided for banks and other financial institutions to comply with management standards designed to guarantee liquidity, solvency and the balance of their financial structures. They were obliged to adopt and apply the risk coverage and division ratios. Under the Act of 1993, it became compulsory for banks and financial institutions to establish an internal control system and an external audit. These standards were inspired by the fundamental principles of the Basel Committee for effective banking supervision. Concerning the framework of the

97 Janvier D. Nkurunziza, Léonce Ndikumuna and Prime Nyamoya (n 60)13.
98 Banque de la Republique du Burundi (n 96).
legal basis for disciplinary measures it provided the procedure of sanctions for banks that do not comply with banking regulations or law in general.\textsuperscript{99} This provision came to fill a gap on the procedure to follow for applying disciplinary sanctions. Basically, under the Act of 1993, the protection of depositors was limited to the banks’ obligation to comply with prudential norms in order to avoid lack of liquidity.

Another great step was materialised with the adoption of the Financial Institutions Act 2003. In general, that Act and the regulations put in place aimed to strengthen again the financial base, improve the quality of management and supervisory bodies. The Act strengthened the requirements for directing and administering a bank or financial institution and for the control by the external auditor. At the executive level, the said law stipulates that the approval of an officer or a director by the Central Bank constitutes a prerequisite for the performance of their duties. These officers must also have management experience and competence.\textsuperscript{100} This provision obviously came to curb the culture of appointing directors according to subjective sympathies (political or otherwise).

Yet, in practice, subjective considerations are still at the core of appointment of CEOs or managing bodies of banks through the ministry of Finance in spite of the multiple protestations from other stakeholders (private investors among others).\textsuperscript{101}

Concerning auditing, the Act specified the qualifications of the auditor and the duration of his or her term of office. Thus, the auditing of financial institutions has been entrusted to audit firms instead of natural persons, so that this work can be carried out objectively. The same provision precludes an auditor from auditing the same company five consecutive years unless given a special permission by the Central Bank.\textsuperscript{102} Avoiding subjective affinities between the auditor and the directors is at the core of any ethical audit conduct and it is important that law protects this aspect.

The Act also set the obligation for banks and other financial institutions to inform the Central Bank of illegal activities in relation to customer funds.\textsuperscript{103} This supplement was meant to take

\begin{itemize}
\item \textsuperscript{99} Ibid.
\item \textsuperscript{100} Ibid.
\item \textsuperscript{101} International Crisis Group (n 70) 10.
\item \textsuperscript{102} Financial Institutions Act 2017, Art 59 (Burundi).
\item \textsuperscript{103} Ibid, Art 16.
\end{itemize}
action against capital laundering practices. The latter amendment reflects the fight initiated against that crime.

The Act also provided for a more inclusive liquidation procedure. It, hence, required the liquidator to disclose the liabilities of the bank or the company concerned in the gazette as well as the amount and nature of each claim.104 The spirit of the letter is to make public the circumstances surrounding the liquidation of enterprises so that the interested parties can assert their rights in due time. Moreover it protects the interest of different stakeholders against unlawful practices by certain creditors.

In addition, different regulations implementing the Financial Institutions Act were modified. They focused firstly on strengthening the financial base: the minimum capital has been raised from 300 to 10,000 million of Burundian Francs (MBIF) for commercial banks and from 200 to 6000 MBIF for other financial institutions. The increase in required minimum equity capital for banks has been a boost for the stability of the banking sector. High equity capital allows banks to credibly engage in long-term relationships with their clients and partners; this is critical given the central importance of reputation for financial institutions. Secondly, the period of time required for an unpaid contentious claim to be 100% provisioned, was reduced to 12 months instead of 24 months as before. Thirdly, there was a limitation on credit risks: credit institutions must comply with the tenfold rule, that is the total amount of credit granted by the bank or the financial institution must not exceed ten times its own funds.

The most recent improvements in the banking regulation are echoed in the Financial Institutions Act that have recently been adopted. They cannot all be recorded here but only some of the most relevant to the study. Some of the major aspects appearing in that Act are the prohibitions concerning international crimes like money laundering and terrorism. In fact, the Act has lengthened the list of offenses a bank’ officer can be liable for by including those offenses. It provides that: 'No one may administer, direct or manage an affiliated institution to any title whatsoever if he is prosecuted or has been sentenced in Burundi or abroad as author or accomplice and has not been rehabilitated for the offenses of ... money laundering, the financing of terrorism or any other economic and financial crime…’.105 This list of preclusions even included ‘a person who has been declared incompetent in regard to the

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104 Financial Institutions Act 2017, Art 87 (Burundi).
principles of the Central Bank.\textsuperscript{106} This provision shows a new ethical perspective in the conduct of banking activities.

The requirements prior to the granting of a license have also been reinforced positively: ‘Among the allocations of the net result each bank must constitute a mandatory reserve of not less than 30% for the investment, and after ten years each bank must justify the realization of a large infrastructure that contributes to the socio-economic development of the country. The area of intervention will be decided in agreement with the Central Bank’. It seems that the BRB intends to push banks to be not only financial institutions making profits but also investors in order to increase their backup resources.

The requirement concerning a large infrastructure goes beyond the sole interests of the Bank but introduces a notion of corporate social responsibility. Corporate social responsibility is defined as a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.\textsuperscript{107} The debate on corporate social responsibility is gaining ground in today’s economic debates for consumers expects the companies to give back to society. The steps taken by the Central Bank is important toward harmonisation of its operations to international standards.

The Act also widely provided on the qualification of directors, administrators and auditors of banks and the regular control that is to be done by the BRB to ensure compliance with the norms: ‘the Central Bank refuses the agreement of a credit institution, a microfinance institution, a payment institution in particular when it deems that… the qualified shareholders, the directors and the proposed managers do not fulfill the required criteria…’ and also ‘every credit institution must keep a duly documented and up-to-date record of qualified shareholders, directors, officers and auditors containing, in particular, the conditions relating to eligibility criteria provided for natural persons by this Act and its application instruments. For legal persons, who are qualified shareholders, the record must display their personal financial situations. Any modification in the required informations must be communicated to the Central Bank.’\textsuperscript{108} This is of great importance in an economy where the abusive management of public enterprises has been pointed out to be at the origin of bankruptcies. While the previous Act prohibited the granting of loans or assistance to a single

\textsuperscript{106}Ibid, Art 15 para 5.
\textsuperscript{108}Financial Institutions Act 2017, Art 30 (Burundi)
natural person in excess of 20% of the bank’s capital without prior authorization of the BRB; the present Act prohibits the granting, in deposit, credit or guarantee, conditions of favour to relatives in a manner contrary to the rules and procedures in force in the institution.

The same provision precludes affiliated institutions to waive claims in conditions contrary to the Regulation in effect. The restriction of activities on basis of subjective connection is obviously at the core of this provision and it was time to legislate on these practices since they played an important role in destabilizing the financial situation of banks. Under the new Act, the auditor is precluded from carrying on business for an institution in which he has a conflict of interest like a personal relationship with qualified shareholders, directors or managers. The management and supervisory standards have been extended well beyond those laid down in the previously repealed Act. Henceforth, financial institutions are even obliged to make their financial results public, no doubt, to encourage transparency in the management of their activities. In effect, all credit institutions must publish their annual and quarterly financial information in the Official Bulletin of Burundi, according to the conditions fixed by the Central Bank.

This has the objective of promoting a transparent management by making the public aware of the actions that the credit institutions are engaging in and the results thereof.

(b) Other related laws

The effective implementation of the banking law requires the issuance of a variety of secondary legal instruments. Moreover the Financial Institutions Act2017 as a primary law, is not the only one that plays a role in the evolution of the banking sector. Other laws also play a significant role in Burundi by their interconnection with the Financial Institutions Act.

The Code on private and semi-public companies2011 can be mentioned here. That code manifests the legislator’s will to safeguard the interests of the companies’ shareholders and all the stakeholders. It expands the obligations of those in charge of management, control and the liquidation of a society.

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109Ibid, Art 53 3o and 4o.
110Ibid, Art 75 4o.
111Ibid, Art 57,60,61,64,etc.
112Ibid, Art 97-100.
For example, the code provides for the right of each shareholder to participate in collective decisions, while limiting the possibility of abuse. For this purpose, the majority or minority shareholders may be liable respectively for undue use of their majority or minority position when the collective decisions taken cannot be justified by the interests of the company. This provision is an innovation intended to curb the abusive tendencies observed in the past whereby shareholders could slowly sink a society by hiding behind decisions taken at majority of votes without being worried. The shareholders are also forced to exercise governance of the company in full transparency.

The law governing insolvency has also been improved in 2018. Under the Bankruptcy Act 2018, the judgement pronouncing bankruptcy must be published in the gazette and for each bankruptcy, a file containing the bankruptcy’s judgement and all the details of the liquidation process must be kept at the registrar so that any interested person can access it. More interesting, in the two months following the beginning of the liquidation process, the receivers must inform the court on the state of the bankruptcy, namely, the causes and circumstances of that particular bankruptcy. All these requirements are meant to force the receivers to act in good faith. In fact, in the past they could do mistakes without being monitored by the public, but if they obey to the previous requirements, their actions will be mentioned and it is hoped that it is going to improve the liquidation process.

The improvements did not concern the legislative area only, but the banking system has also modernised its operations. The most visible devices introduced might be the Automated Machines (ATMs) launched in 2009. It is expected that opening the Burundian market to external banks will create opportunities for more innovations which in turn will increase financial deepening.

New payment instruments such as mobile banking and internet banking have also been introduced since 2012 and higher use of Information and Communication Technologies in

113 Code of private and semi-public companies 2011, Art 51 (Burundi).
114 Ibid, Art 60 and 61.
115 Ibid.
117 Ibid, Art 171.
118 Ibid, Art 172.
banking operations is expected as well as the emergence of new savings/investment instruments such as equity funds which are now missing.\textsuperscript{120}

Different reasons motivates the need for those communication technologies. In fact, not only for the expansion of business activities and the search for greater profitability, the combat against money laundering will also be advantaged. With majority of transactions in the country being made in cash; it is difficult to track and monitor informal financial transactions which don’t go through the formal banking systems, thus creating a gap that can be exploited by money launders.\textsuperscript{121}

Another worth mentioning achievement in the Burundian banking industry is its opening to competition from banks in the region. The country’s entry into the East African Community (EAC) has in fact greatly influenced developments. Competition from its peers for example has challenged Burundi’s businesses to improve the quality of their goods and services in order to attract more customers and expand market share.

The traditional banks in Burundi never faced real competition until 2007 when the country joined the EAC. In this regard, the entry of new banks such as Diamond Trust Bank and Bank of Africa, as well as the large number of other banks considering entry into the Burundian market, are expected to have a positive impact on the Burundian financial sector. Already, the introduction of ATMs could be considered a result of increasing competition and diversification. As part of this diversification process, telephone banking has already been introduced as a cheaper and more efficient form of banking.\textsuperscript{122}

There is also the expansion of microfinances to consider here. In terms of client base, microfinances have outperformed the traditional banking sector by a factor of three to one. This has opened up opportunities for entrepreneurship particularly in rural areas.\textsuperscript{123} As a consequence, given that poverty in Burundi is by large a rural phenomenon, microfinances institutions are responsive towards the objective of fighting poverty in the country.

\textsuperscript{120} Ibid.
\textsuperscript{121} Burundi direct Report on Observance of Standards and Codes—FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism, 2010, 25.
\textsuperscript{122} Bank of the Republic of Burundi, ‘Burundi National Financial Inclusion Survey’ (n 11) 40.
\textsuperscript{123} Ibid.
3.3 The deficiencies

Despite the previous highlights, the banking sector faces several challenges. These challenges impends the protection of depositors directly or indirectly. The deficiencies are observed in two segments. Firstly, are highlighted the deficiencies in the regulatory system prior to any institution’s failure and secondly are highlighted the deficiencies in the regulatory concerning the protection of depositors or the weaknesses in the provisions on the Deposit Guarantee and Resolution Fund.

3.3.1. The deficiencies in the protection of depositors before failures

Although there is need to have a well-defined Deposit Guarantee and Resolution Fund, it would be weakened if it is not part of a larger efficient legal framework protecting the banking system. In fact, the law on Deposit Guarantee is not the only one to protect the depositors. Protection is also provided upstream by respecting and protecting the banking system’s consumers rights. In a broader way, the provisions for prudential regulation can also be considered. Following are the aspects which should be given more consideration:

(a) Banks Credit misallocation and bad lending practices

Burundian banks allocate relatively more credit to the Central government than in the rest of Sub-Saharan Africa. On average, bank credit to the government represents about 38 percent of total credit, compared to 25 percent in the rest of Africa.\(^{124}\) Although governments are not necessarily wasteful, cross-country evidence has shown that higher state ownership of the economy, as is the case in Burundi, is positively associated with high capital misallocation.\(^{125}\) Hence when, in consequence to the low productivity, government delay to pay back the credit the bank look for compensation in other means not favouring its other clients.

Moreover, regardless of its importance for the national economy, agriculture attracts an insignificant amount of credit which do not reflect the economic importance of the sector. Yet, there is an excessively high concentration of credit on one sector, trade, and this


increases bank vulnerability. Negative shocks to the trade, particularly its import-export segment, can severely undermine the stability of the banking sector.\textsuperscript{126}

In addition, due to undercapitalization of the financial system in Burundi, banks' lending capacity is limited, particularly credit to large clients is impeded. Indeed, Central bank requires that one client should not be granted a credit exceeding 20 percent of a bank's capital.\textsuperscript{127}

It has been mentioned earlier that credit allocation is influenced by subjective considerations; the cost of credit is highly differentiated according to the identity of applicants. Learned economists have observed that the small group of credit recipients is divided into two categories: ‘outsiders’ who pay high interest rates and ‘insiders’ who pay no or very low interest rates. The distribution of interest rates is bi-modal, with the upper part of the distribution, which have the highest mode, showing interest rates paid by ‘outsiders’ who are the regular bank clients. This group pays interest rates between 18 and 23.5 percent. The lower tail of the distribution corresponds with the low interest rates paid by ‘insiders’, who are bank executives and employees and a small group of special ‘clients’ who have interest-free credit. They pay interest rates between zero and 7.5 percent, with a mode of 4 percent. Other indicators also confirm that the credit market excessively favours insiders at the expense of the majority of borrowers.\textsuperscript{128} Bad lending practices result from lack of ethic in banks’ administration, especially in corporations under state bodies influence. This have greatly harmed the financial results of banks over the years. These facts raises a concern on ethic in the governance of banks in Burundi.

(b) The gaps in the regulatory system

The straining factors are also inherent to the weaknesses of the policies and those in charge of their enforcement. Certain factors need to be considered urgently as have generally recommended the Basel committee in its minimum standards of banking laws. Timely and accurate informations on borrowers’ debt profile is absent from the banking regulatory, yet it is of importance. In fact, in Burundi, the non-repayment of loans is commonly cited among the factors that hinder the good functioning of the banking industry.

\textsuperscript{126} Janvier D Nkurunziza, Léonce Ndikumana and Prime Nyamoya (n 60) 30-31.
\textsuperscript{127}Financial institutions Act 2003, Art 20 (Burundi).
\textsuperscript{128} Ibid.
Many customers have been given credits without proper investigation on their repaying capacity and it has happened in many cases that when the concerned bank seeks to recover the credit it can no longer find the creditor’s address, being thus disadvantaged in the judicial procedures to get reimbursed. In absence of necessary informations to assess the borrowers’ profiles the loans issued by banks to particulars are in many cases risky. The Association of Banks and Financial Institutions of Burundi says that this lack of informations is one of the major deficiencies of banks because it causes them to be less willing to grant credits.

The kind of informations on borrowers that are compulsory are incorporated in a system called ‘the credit reference bureau’. An example of the Credit Reference Bureau (CRB) can be considered from Uganda; it is a legal entity established as a company that allows financial institutions and Microfinance Deposit Institutes (MFI) to exchange informations on their clients’ repayment history and current debt profiles and which compiles a database that collects, stores, consolidates and processes informations related to persons, companies and enterprises.

The informations given by CRBs are of a great importance not only for banks and MFIs but for debt trade in general as one of the largest areas that businesses are involved in. Credit being of such an importance in an economy, it is paramount for financial institutions to be able to evaluate the creditworthiness of their customers. Even more, for banks, whose operations rely enormously on the credit-business, the credit evaluation must be, as much as possible built on a complete and reliable picture of the customer and his financial condition.

As has observed Sam Omukoko, the use of CRBs even helps providing credit managers with independent third party support for evaluating the creditworthiness of their customers. In fact, Credit Bureaus collect various types of informations, including applicants credit behaviour and loan history (number and types of previous loans, historical arrears and even enterprises profile if applicable (business type, size, projected profits …)). Some credit Bureaus even include data on clients such as informations, history guarantees and legal

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129 Based on personal experience while working with two great banks in recovery of funds.
130 Association of Banks and Financial Institutions of Burundi (n 81)
131 Preliminary of the Financial Institutions (Credit Reference Bureaus) Regulations 2005 (Uganda).
suits. In fact, CRBs are not put in place with the objective of restricting the issue of credits, but they help credit providers to make informed decision.

The Basel committee too states that well developed public infrastructure is one of the preconditions for an effective banking supervision. Efficient and effective CRBs make available credit informations on borrowers. For this reason, they are cited among the components of that infrastructure which, if not adequately provided, can contribute to the weakening of financial systems and markets or frustrate their improvements.

Though the absence of CRBs has been mentioned as an impediment to the Burundian banking system, the government has recently given attention to it. In line with the efforts of the Burundian government to render financial services and products accessible to all categories of the population, a National Financial Inclusion Strategy (NFIS) has been carried out with different objectives to achieve. Among the activities to be carried out for improving financial inclusion’s climate, the NFIS has targeted the need to create CRBs. Following this objective, a draft law governing the Credit Information Offices has been prepared and sent to the Burundian Parliament for analysis.

The absence of specific consumer protection laws is also a deficiency. The financial crisis highlighted the importance of financial consumer protection for the long-term stability of the global financial system. At the same time, rapid increase in the use of financial services have highlighted the need for strengthened financial regulation and consumer education to protect and empower consumers. In the absence of a strong financial consumer protection, the growth-enhancing benefits of expanded financial inclusion may be lost or severely undermined. Lack of recognized guidelines has often led policymakers to focus on only a few of the many consumer protection issues while failing to close gaps in other areas.

There is presently no comprehensive multi-sectorial consumer protection legislation or mandated authority in Burundi. The existence of such a legislation or body in Burundi

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134 Basel Committee (n 39), 14-15.
135 Republic of Burundi, ‘National Financial Inclusion Survey’ (n11) 79.
138 Lorraine Manishatse, ‘Eac Competition Policy :Adopted but not Implemented in Burundi’ *Iwacu*
would influence a concrete discussion on consumer needs in many areas. Consumer protection laws, and their reinforcement, would certainly correct many deficiencies in the quality of services offered by banks as have commented the Burundian association of consumers\textsuperscript{139} but it would as well encourage positive steps onto considering the customer as more than a client in the banking sector but also as an important player whose rights must evolve according to the standards encouraged by international bodies. In banking, the presence of specific customer protection regulations would undoubtedly play a positive role regarding effective depositors’ protection not only before a banking crisis but also downstream of a consumed crisis.

The absence of corporate governance specific guidelines like the King Codegovernance for South Africa 2009 or the Financial Institutions (Corporate Governance) Regulations, 2005 for Uganda, is also an impediment. The many onslaught of corporate scandals has compelled the world to acknowledge the profound impact of good corporate governance practices on the global economy. The Asian financial crisis, which caused so much damage to the global economy, was triggered by poor corporate governance practices just as the Enron scandal in the US has shown poor practice undermines investor confidence and affects overall market stability.\textsuperscript{140} The existence of corporate governance specific guidelines would help improve ethic in the banking sector services providing. In fact, it is easier to feel accountable when standards to follow are stated than when one expected to rely on his own personal ethic only.

An IMF working paper has, also, revealed that most banking failures are caused by weaknesses in their governance.\textsuperscript{141} In response to the challenges of corporate governance in banks, the Basel committee has recognized consistently enforced corporate laws as part of sound business law systems tantamount to an effective banking supervision.\textsuperscript{142}

Nevertheless, bad corporate governance is among the weaknesses commonly shared by banks on the international scale and Burundian banks have as well been largely affected by it. Corporate governance shortcomings in banks, examples of which were observed during the global financial crisis, do not harm the concerned banks only but they can have potentially

\textsuperscript{139}Association des Banques et Etablissements Financiers du Burundi (n 81).


\textsuperscript{141}Wouter Bossu and Dawn Chew (n 95) 23.

\textsuperscript{142}Basel Committee on Banking Supervision (n 39).
serious consequences for the financial system as a whole. For this reason, the Baseline committee principles (BCP) of 2012, focused on effective corporate governance as one of the essential elements in the safe and sound functioning of banks. The BCP gives greater emphasis to sound corporate governance practices.  

In previous developments the review of banks’ failures has brought to light how the country has been led by groups seeking to advance and preserve their own interests by using the financial sector and the economy in general to extract rents. Banks and other financial institutions were put in the hands of managers who used them to offer employment to their relatives and political associates and misbehaved up to the point of appropriating the banks’ assets.  

This calls for a serious reflexion on the need to initiate and train on best practices concerning corporate governing and many authors have observed poor corporate governance lies at the heart of the reduced performance of enterprises, multiple and conflicting objectives, excessive political interference, corruption and a lack of transparency.  

Given the central importance of governance in corporations, the framing of corporate governance guidelines to be followed by companies should be prior to any other developing action. In fact, despite the size of any institution its success lies greatly on the way it is managed or governed. As have observed Ross Levine, When banks efficiently mobilize and allocate funds, this lowers the cost of capital to firms, boosts capital formation, and stimulates productivity growth. In contrast, if banks managers enjoy enormous discretion to act in their own interests rather than in the interests of shareholders and debt holders, then banks will be less likely to allocate society’s savings efficiently and exert sound governance over firms.  

One cannot say enough about the importance of corporate governance. Nonetheless it is surprising that bad governance it is still pointed to be at the origin of so many financial institutions in Africa and around the world.  

Concerning Africa, Alain Niyubahwe has attempted an answer. He says that the promotion of corporate governance in Africa has not been effectively adapted to the context and needs of the continent. He says that, in general, corporate governance has been preached to Africa  

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143 Ibid 7.  
144 These cases were more evident during liquidation process.  
almost exclusively as a way to attract foreign investment, especially through privatization. This has led Africans to view corporate governance as part of the privatization process of ‘throwing away the ownership and control’ of Africa’s rich natural heritage in exchange of foreign investment; not as something that leads to enhanced productivity by more efficient enterprises for sustainable growth and development.146

At last, it would be impossible to cover here all the issues related to corporate governance in the banking sector without trespassing the scope of the current study for they are numerous and a brief review on how bad corporate governance have affected the Burundian banking sector have been given in the second chapter of this study.

The problems of corporate governance, however, raise question on how the BRB exercises its overall supervisory role under article 2 of the Central Bank of Burundi Act 1993 and article 60 of the Financial Institutions Act 2017. The BRB has many times been accused of being unwilling to enforce appropriate regulation and supervision of banking sector, thus giving way for irregularities to impend the sector.

In relation to bankruptcies of the CAMOFI, the CADEBU and even BPB, the BRB is pointed to have failed to regulate and ensure compliance in the banking sector mostly due to political pressure, limited instruments for intervention, and the limited technical capacity to deal with the challenges of financial sector supervision in a changing international environment. In addition, persistent political and economic instability created high uncertainty that discouraged long-term credits and investments which are so needed to address the country’s structural challenges. The current banks are fragile, in spite of their apparent high profitability.147

In fact, the BRB has faced severe constraints, due the political instability and its repercussions on the economy in general plus the political interferences and corruption. These factors have limited its ability to effectively regulate and supervise the banking industry. First, effective regulation requires independence of the Central Bank from political interferences. As the case of BCD illustrates, the BRB failed to intervene due to political pressures. Another constraint to effective regulation is inadequate capacity, especially in the

147 Janvier D. Nkurunziza, Léonce Ndikumana and Prime Nyamoya (n 60) 45.
area of information technology. In particular, the fact that bank operations are not managed by a fully digitized system precludes speedy and timely examination. Lack of adequate training for the staff in banking supervision and regulation is a critical barrier to effective regulation as well. This constraint is exacerbated by the fast-changing nature of the regulatory framework, especially in the wake of the recent financial crisis which has placed a premium on modernization and harmonization of national banking regulations in line with global standards.\textsuperscript{148}

Lastly, if a bank has the legal right to use the money deposited with him, the depositor as well should be assured by law to get his money back even when banks falls in difficulty. The customer’s reliance on banks was highlighted in \textit{Woods vs Martin’s Bank Ltd}\textsuperscript{149} as a consequence of the banker-customer relationship; depositing funds in a bank with the confidence of withdrawing it when needed can be seen as an extension of the customer’s reliance. Laws has therefore to protect this aspect of the banking contract as well. Law can give this assurance only if that protection is clearly provided for, but it is not yet the case concerning the Deposit Guarantee and Resolution Fund which is to be created in Burundi.

### 3.3.2. The deficiencies of the provisions on the Deposit Guarantee and Resolution Fund

The previous observations concern the protection that should be given to the depositors in the banking sector in particular. However given that failures are not always predictable there must be provisions protecting the depositors in case of a deposit-taking institution failure. The legal framework of the Deposit Guarantee and Resolution Fund thus have to be well established. In fact the Financial Institutions Act 2017 has only two provisions on the Deposit Guarantee and Resolution Fund, articles 86 and 87. This is insufficient to lay down all the aspects that concern such an institution. Those provisions are originally in French language.

Article 86 provides:

\textit{les établissements assujettis recevant des fonds du public adhèrent et contribuent a un mécanisme de garantie des dépots et de résolution destine à indemniser la clientèle en cas d’indisponibilité de leurs dépots ou autres fonds remboursables ou à secourir un établissement en difficultés. L’indisponibilité des fonds est constatée par la Banque Centrale,}

\textsuperscript{148}Ibid
\textsuperscript{149}[1954] 1 QB 55.
lorsqu’il s’avère qu’une institution n’est plus en mesure de restituer, immédiatement, ou à court terme, les fonds qu’elle a reçu du public, conformément aux conditions contractuelles.

Ne sont concernés par ce mécanisme, les dépots couverts par la garantie de l’Etat. La garantie est formalisée par écrit.

This provision is loosely translated as ‘the affiliated institutions, receiving public funds subscribe and contribute to a deposit guarantee and resolution mechanism designed to compensate the customers in the event of unavailability of their deposits or other repayable funds or to assist an institution in difficulty. The unavailability of funds is ascertained by the Central Bank when it turns out that an institution is no longer able to return immediately or in the short term the funds it has received from the public in accordance with the contractual conditions. The deposits covered by the government guarantee are not concerned by this mechanism. The guarantee is formalised on writing.’

Article 87 provides:

la Banque Centrale fixe par voie réglementaire les conditions de mise en place du mécanisme de garantie, de son fonctionnement et de la gestion des fonds. Elle arrête également le montant maximum d’indemnisation par déposant, les modalités et les délais d’indemnisation, les règles relative à l’information obligatoire de la clientèle ainsi que les règles d’intervention du fond pour la résolution des difficultés des établissements.

This provision is loosely translated as ‘the Central Bank establishes the regulation on the conditions for setting up the guarantee mechanism, its operations and the management of the funds collected. It also sets the maximum amount of compensation per depositor, the modalities and the time limits for compensation. The rules relating to the mandatory informations for the customers and the regulation of the fund’ intervention in resolution of institutions’ difficulties.’ It is too early to evaluate the performances of the Central Bank towards this objective, because the informations on the advancements of putting in place the Deposit insurance fund in place are not disclosed. But, it is hoped that the project of putting in place the Deposit Guarantee mechanism will not delay.

These provisions on the Deposit Guarantee mechanism are however too narrow for they do not give clear informations as to the following important aspects:
(a) The legal regime governing the fund. Will this fund be an independent entity or will it be dependent on the Central Bank or another institution?

(b) The composition of the fund’s management;

(c) The conditions of affiliation to the fund and the amounts to be collected from the concerned institutions;

(d) The date of commencement of operations;

(e) The level of insolvency that opens up the intervention of the fund, for it is provided that ‘the unavailability of funds is ascertained by the Central Bank when it turns out that an institution is no longer able to return immediately or in the short term the funds…’;

(f) The beneficiaries of the fund’s operations;

(g) The pronouncement of unavailability of funds, which opens the reimbursement process, is left to the sole discretion of the Central Bank or the court may as well pronounce it?;

(h) The distinction between the persons to benefit the government’s guarantee and those to benefit the fund’s guarantee.

These are aspects which can help identify how the Deposit Guarantee and Resolution is to work and how exactly it will benefit the depositors and the Burundian banking system. In absence of this aspects, the Fund cannot yet inspire confidence in the beneficiaries.

3.4. Conclusion

The informations gathered in this chapter show how the Burundian banking sector has been striving to rise and develop. In fact, the banking sector is still now recovering from the disastrous consequences of political and social instability on the financial sector. Banking as other spheres has long lagged behind the international standards and is still accusing of major gaps.

The developments undertaken have proved an enthusiasm of the government to foster its banking sector as many reforms have been undertaken. However, efforts still have to be made to reach the best of a healthy and stable banking system which effectively protects depositors
and other stakeholders. In tracing the way to that ideal, some issues like bad corporate governance and negative political intrusion in the banking operations need to be addressed with priority.

Furthermore, the effective operability of the announced Deposit Guarantee and Resolution Fund must be better provided for if the Fund is to be credible for the depositors it intends to protect. The other deficiencies concerning the depositors’ protection must as well be adjusted for easing the operations of the Deposit Guarantee and Resolution Fund, when it is put in place, and for it to be an added value to the Burundian banking sector and the depositors.
CHAPTER FOUR

PERSPECTIVE ON DEPOSIT INSURANCE FUND IN SELECTED COUNTRIES

4.1. Introduction

More than two-thirds of member countries of the International Monetary Fund (IMF) have experienced one or more banking crises in recent years. The inherent fragility of banks has motivated many countries in the world to establish DISs. Nevertheless, the purpose of many Deposit Insurance Funds is simply to reimburse insured depositors in the event of bank insolvency whereas other funds have additional responsibilities, varying from licensing of banks, supervisory authority, and ability to collect information from banks. Visiting different Deposit Insurance funds gives insight on what the Burundian Deposit Guarantee and Resolution Fund needs and can incorporate on its framework in order to be proficient.

In this chapter attention will thus be put to the general considerations concerning Deposit Insurance, thereafter the study will focus in particular on the Ugandan protection fund, the Kenya Deposit Insurance Corporation and the Malaysian DIS. This study does not intend to advocate any particular “one size fits all” scheme, nor does it intend to be comparative; but the Deposit Insurance models are merely selected for reference purposes and have been chosen for the availability of informations. The review does neither pretend to depict a complete picture of the models but attention will be put on some specific aspects because analysing the complete legal framework of these DISs would entail details that go beyond the scope of this study.

4.2. Generalities on Deposit Insurance

As have been ruled in *Folley v Hill*, when a customer deposited monies into an account with a bank, the transaction is a loan by the customer the bank. Yet bank customers’ rank as ordinary creditors in the estate of an insolvent bank gives them little chances to recover much, if anything at all thus creating potentiality for disruption of payment systems and spill over in domino fashion to other banks and even macro economy. It is for this reason that at its

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151 Asli Demirgüç-Kunt, Edward Kane, and Luc Laeven (n 4) 7.
152 (1848), 2 H.L. Cas. 28. 9 E.R. 10002.
most basic level, Deposit Insurance serves the goal of banking stability in these following three ways:

It protects retail depositors and small businesses: Deposit Insurance within prescribed limits protects a significant proportion of retail depositors and small business owners, who are generally unprepared to assess the condition of the bank that they rely on for payments.\textsuperscript{153} In fact Deposit Insurance will not only protect the small depositors but all the depositors, as long as their deposits fall under the protected category. The idea here is that the small depositors who do not have the necessary technical skill to assess the performance of their bank and take action when it is not acting toward their interests, will at least have their deposits covered by the deposit protection scheme.

It minimizes the risk of runs. A bank run, characterized by the rushed withdrawals of deposits by depositors, puts a significant strain upon the deposit-taking institution due to the asset-liability maturity mismatch. Because Deposit Insurance provides protection for insured deposits, even in the event of a bank failure, it reduces the incentive for retail depositors to run. Deposit Insurance has an added advantage of reducing the chance of liquidity problems causing an otherwise healthy and well-capitalized institution to fail.\textsuperscript{154}

It mitigates risks of contagion. Because Deposit Insurance mitigates depositor uncertainty, it also mitigates contagion risk. When a banking industry that lacks robust Deposit Insurance encounters asset problems, small depositors are unable to know which banks are safe. Without Deposit Insurance, depositors of all banks may fear financial losses and feel compelled to withdraw funds to safeguard them. This fear is as likely to cause a run on a healthy and well-capitalized institution as on a failing institution. Insurance reduces a customer’s compulsion to withdraw funds in a panic, and, in doing so, promotes financial stability.\textsuperscript{155} This objective will however be attained only if these depositors are fully aware or well informed on how the institution covering their funds functions. For this reason a good DIS must also be disclosing its means of operations through banks notices and other public informations made available to the public in the environment it operates in.

\textsuperscript{154} Ibid.
\textsuperscript{155} Ibid.
In the USA, for example, Deposit Insurance has been a fundamental component of public confidence and financial stability for over 80 years and through three banking crises. Even the latest post-2008-crisis tools achieved were built upon that foundation of confidence.\textsuperscript{156} The confidence provided by Deposit Insurance in USA extends beyond depositors alone. It is believed that banking system supported by a strong core of federally insured deposits can withstand considerable stresses and strains. Uninsured creditors and other financial market participants can also remain confident in overall American banking and payment systems.\textsuperscript{157}

4.2.1. The main subdivisions of Deposit Insurance schemes

Traditionally, the protection of deposits is divided in two different forms, the explicit deposit protection schemes and the implicit deposit protection:

(a) Implicit protection schemes: Demirgüç-Kunt, Kane and Leaven point out that every country has a de facto IDIS in place since governments get pressed for relief at the breakout of a large systemic banking distress. Those authors assume that if an explicit DIS does not exist, then the country has an implicit Deposit Insurance.\textsuperscript{158} In fact in most countries, governments and citizens have an implicit agreement that depositors will be protected against loss in case of bank failure. Implicit protection is, by definition, never formally specified. In an implicit system there are no statutory rules regarding the eligibility of bank liabilities, the level of protection provided or the form which reimbursement will take. By its nature, implicit protection creates uncertainty about how depositors, creditors and others will be treated when bank failures occur. Funding is discretionary and often depends on the government’s ability to access public funds.\textsuperscript{159} Yet if the government does not limit its exposure through Deposit Insurance, it may end up bailing out all depositors which would probably cause a significant disturbance in the public funds. It is at this point that explicit DIS becomes important.

Attempts to limit Deposit Insurance must be explicit and transparent, and must reliably precommit the government not to bail out depositors in total. For Jonathan R. Macey and Geoffrey P. Miller this would ideally involve a promise not to insure deposits at all. In light of contemporary realities, however, Deposit Insurance enables the government as insurer to

\textsuperscript{156} Ibid 4-5. 
\textsuperscript{157} Ibid. 
\textsuperscript{158} Asli Demirgüç-Kunt, Edward Kane & Luc Laeven (n 4) 2. 
\textsuperscript{159} Ibid.
make a credible commitment to cap its losses in cases of bank failure to the amounts specified in the regulations.\textsuperscript{160}

The implicit protection format is the one that existed in Burundi under the Financial Institutions Act 2003, because it was silent about any explicit protection scheme, but every time a bank become insolvent and failed the government reimbursed some of the small depositors. This was evidently meant to avoid a social unrest, but when this intervention has no legal basis it is seated upon, it will not produce equitable results. Depositors with the same amount of money held in the Bank might not all get reimbursed when the funds are not enough to cover the deficit.

This implicit guarantee is however found in the Financial Institutions Act 2017, which provides that the Deposit Guarantee and Resolution Fund will not concern the deposits already covered by the government.\textsuperscript{161} It seems that the provision on the fund implies two deposit protection: an explicit guarantee by the Fund and an implicit guarantee by the government, without explaining however how the explicit one will be carried on.

China has had an implicit guarantee until recent years. Large bank failures are mostly unheard of in China, as the government generally steps in to assist banks and investors and implicitly guarantees deposits, especially at bigger banks. Politically, Chinese decision-makers feel that they cannot allow banks to fail, as such a move would further undermine confidence in the leadership and China’s economic system as a whole. Nevertheless, the Chinese government recognized that by implicitly making guarantees, they are also failing to discourage banks and investors from making risky choices. China’s decision to introduce Deposit Insurance, therefore, was designed in part to highlight that there is a limit to government assistance and to encourage better investment decisions. Concern over internal stability also played a role in China’s decision to introduce Deposit Insurance for the country’s banking system in May 2015.\textsuperscript{162} This example show how the implicit guarantee has limited effect when it comes to ensuring public confidence.


\textsuperscript{161}Financial Institutions Act 2017, Art 86 (Burundi).

(b) Explicit insurance schemes: until 1990, the explicit DIS mostly prevailed and kept building in high income countries but since 1995 it has been observed a surge to explicit DIS, especially in lower and middle income countries.\textsuperscript{163} Today most countries have an explicit DIS and the Basel committee on banking supervision has even recalled the need for a Deposit Insurance system.\textsuperscript{164}

The majority of explicit schemes are legally separated from the Central Banks, banking supervisory agency, or Ministry of finance, even though they may be “housed” within such institutions.\textsuperscript{165}

Explicit DISs are various and relevant laws explain the main ingredients that compose them and differentiate them one from another. They thus range from simple deposit protection structures to insurance or even co-insurance. Explicit DISs vary in their extents and amount of coverage. They also differ in the types of deposits and institutions they apply to. For example countries which would like to protect their payments systems only limit the guarantee of explicit DISs to deposits with commercial banks and to other depository institutions providing payment transactions. Some countries have adopted different sets of explicit DIS that apply to different institutions. Usually, there exists one explicit DIS for commercial banks and another one for deposit-taking institutions. On the other hands explicit DISs may extend guarantees to other types of institutions such as saving banks.\textsuperscript{166}

Depending on the objectives of the explicit DIS, the coverage differ as well from one type of scheme to another of even from one type of deposit to another. In most cases foreign deposits of domestic banks, domestic deposits of foreign banks, inter-bank deposits and deposits denominated in foreign currencies are not covered under the explicit DIS. \textsuperscript{167}

The previous subdivisions of deposit protections schemes are the most generally used and agreed for but one should note that some authors have preferred to consider guarantee schemes as existing under six forms that can sometimes be combined. There are an explicit denial of protection, a legal priority for the claims of depositors in the insolvency, a

\textsuperscript{163} Asli Demirgüç-Kunt, Edward Kane & Luc Laeven (n 4) 3.
\textsuperscript{164} Basel Committee on Banking Supervision (n 39) 6.
\textsuperscript{165} Ibid 13.
\textsuperscript{166} Asli Demirgüç-Kunt, Edward Kane & Luc Laeven (n 4) 5.
\textsuperscript{167} Ibid.
deliberate ambiguity regarding coverage, an implicit guarantee, an explicit limited coverage and a full explicit guarantee.\textsuperscript{168}

\section*{4.2.2. Some arrangements’ models of explicit DIS}

The arrangements are diverse if we consider the coverage, the mechanism, the coverage amount, the financing method or the legal status. The differences being so extensive, let us consider some explicit DIS’ model arrangements based on the coverage scope. There are:

a) Foreign currency deposits coverage: That nomination is explicit unto the kind of deposits covered in this case and some countries with systems covering foreign currency are restrictive to the set of foreign currencies they cover. Hungary for instance extends coverage to deposits denominated in European Union currency and currencies of other countries of the Organisations of Economic Cooperation and Development (OECD).\textsuperscript{169} 

b) Inter-bank deposits coverage: the explicit DIS mostly do not cover inter-bank deposits. In fact, unlike small depositors, banks are perceived to have enough resources to monitor other banks. Thus extending coverage to inter-bank deposits could reduce incentives to supervise other banks and undermine the market discipline.\textsuperscript{170} By 2012 the only countries with these scheme were Canada, USA, Indonesia and Australia. \textsuperscript{171} 

c) Co-insurance: Co-insurance mechanisms require depositors to bear part of the loss in case of bank failures. It is aimed to get depositors make more prudent bank choices in their deposit decisions. Co-insurance, while relatively common prior to the recent financial crisis, has almost disappeared as a feature of DISs, despite its loss-sharing appeal. The reason is that co-insurance rules were not enforced during the crisis to avoid imposing any losses on small depositors. It was feared that such losses might jeopardize depositor confidence and financial stability generally. Once the crisis abated, these co-insurance rules – having lost credibility – have not been reintroduced. While in 2003 a total of 16 DISs had co-insurance, this number dwindled to 3 by the end of 2013.\textsuperscript{172}


\textsuperscript{169}Asli Demirgüç-Kunt, Edward Kane & Luc Laeven (n 4) 5.

\textsuperscript{170}Ibid 6.


\textsuperscript{172}Asli Demirgüç-Kunt, Edward Kane & Luc Laeven (n 4) 14.
The choice of a deposit protection scheme will not only depend on the aspects cited above but also the performances of the concerned banking sector. A stable and wealthy banking system will have more choices than a relatively unstable system. For this reason, all the countries do not need to have the same schemes and there is no scheme which is better than others but each one of them ought to be evaluated in a given context.

4.2.3. The Financial safety net

The recent financial crisis emphasized that Deposit Insurance does not obviate the need for an overall safety net, particularly regarding banks with systemic importance. The interconnectedness between the banking system and the markets indicates that funding crises in the capital markets can easily spill over to the banks, and funding crises in the banks can rapidly spill over into the capital markets and even into the real economy. The systemic risk from such a spill over emphasizes how important it is to expand the safety net to nonbank entities as well.\textsuperscript{173}

The Nigerian Deposit Insurance Corporation, recognised that financial safety net is usually made up of three components: prudential regulation and supervision, a lender of last resort and deposit protection scheme. The distribution of powers and responsibilities between the financial safety-net participants is a matter of public-policy choice and individual country circumstances.\textsuperscript{174} For example, some countries incorporate all financial safety-net functions within the Central Bank, while others assign responsibility for certain functions to separate entities.

A Deposit Insurance system hence needs to be part of a well-designed financial safety net, supported by strong prudential regulation and supervision, effective laws that are enforced, and sound accounting and disclosure regimes. A large variety of conditions and factors that can have a bearing on the design of the DIS system need to be assessed. This include: the state of the economy, current monetary and fiscal policies, the state and structure of the

\textsuperscript{173} Ibid.

banking system, public attitudes and expectations, the strength of prudential regulation and supervision, the legal framework, and the soundness of accounting and disclosure regimes.\textsuperscript{175}

A Deposit Insurance system therefore refers to the set of specific functions inherent in providing protection to bank depositors, and their relationship with other financial system safety net participants to support financial stability. As such, an effective DIS is an important pillar of the financial safety net and plays a key role in contributing to the stability of the financial system and the success of a Deposit Insurance has to be evaluated in a broader institutional context. The insurance is prone to failure if its adoption is not preceded by remedies to observable weaknesses in the institutional environment.

In moving to a system of explicit Deposit Insurance guarantees, conscientious government officials must adopt coverage, funding, and managerial structures that mitigate the particular weaknesses in transparency, deterrence, and accountability that left their country vulnerable to financial crises in the past. Controlling bank risk-taking requires three characteristics: transparency deterrence, and accountability.\textsuperscript{176}

Complete transparency is obtained when institutions disclose informations that perfectly and costlessly informs either bank creditors or supervisors about changes in a bank’s financial condition and risk-taking.

Perfect deterrence describes a situation where individual creditors or supervisors can immediately understand the implications of information flows and can protect themselves completely and costlessly from any adverse consequences. Perfect accountability occurs when taxpayers can identify the actions of government officials and hold them fully responsible for the outcomes their actions produce.\textsuperscript{177}

The government of Burundi, is therefore, surely compelled to adopt a clear DIS by drawing more complete legal provisions in a bid to better embrace the protection of banks’ depositors complying with the principles listed above. As said by Ricky Tigert, a Deposit Insurance System can contribute to financial stability, but only if it is adequately funded and if other

\textsuperscript{175} Aslı Demirgüç-Kunt, Edward Kane & Luc Laeven (n 4) 14.
\textsuperscript{176} Ibid.
\textsuperscript{177} Aslı Demirgüç-Kunt and Edward J. Kane (n 7) 24
safeguards, such as a strong bank supervision program, are also in place. The law makers have to stay aware that the Deposit Insurance is part of the overall financial safety net.

4.3. The International Association of Deposit Insurance (IADI)

The IADI was founded in 2002 as a non-profit organisation constituted under Swiss law and domiciled at the Bank for International Settlements (BIS) in Basel, Switzerland. The IADI is a forum for deposit insurers from around the world to gather and share knowledge and expertise. It provides training and educational programs and produces research and guidance on matters related to Deposit Insurance. It is hence the global standard-setting body for Deposit Insurance systems and deserve an overview here.

The IADI contributes to the stability of financial systems by enhancing the effectiveness of Deposit Insurance and promoting international cooperation on Deposit Insurance and bank resolution arrangements in active partnership with other international organisations.

At the end of March 2016, 103 organisations are affiliated with IADI, including 80 Members, 10 Associates (primarily Central Banks and bank supervisors) and 13 Partners (other interested domestic and international organisations). IADI draws upon its membership to provide guidance on the establishment or enhancement of effective Deposit Insurance systems as well as training, outreach, educational programmes and research. Along with the other standard setters and committees hosted and supported by the BIS, IADI is part of the Basel Process, sharing with its host and peers the common goal of global financial stability and ensuring the jurisdictions’ financial systems operate effectively, support economic growth, and interact in a global environment increasingly characterised by cross-border interests. Being grouped with similar organisations enables IADI to engage in partnerships and collaborations to achieve its objectives and increase its value to its Members.

In the furtherance of its Objectives, IADI, in particular develops principles, standards and guidance to enhance the effectiveness of Deposit Insurance systems - taking into account difference circumstances, settings and structures; encourages consideration and voluntary application of its principles, standards and guidelines; develops methodologies for the

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assessment of compliance with its principles, standards, and guidelines, and facilitates assessment processes; enhances the understanding of common interests and issues related to Deposit Insurance, facilitates the sharing and exchange of expertise and information on Deposit Insurance issues through training, development and educational programs and provides advice on the establishment or enhancement of effective Deposit Insurance systems; undertakes research on issues relating to Deposit Insurance; co-operates with other international organisations, particularly those involved in issues related to financial markets and promotion of financial growth, stability and integrity; creates awareness among supervisors and regulators of financial institutions concerning the key role of Deposit Insurance systems in maintaining financial stability; and takes such other action as may be necessary or useful for its Objectives and activities.\textsuperscript{181}

Under influence of globalisation, there is an increasing need for international cooperation in different areas; countries which adopt Deposit Insurance benefit from international trends to use them in enhancing and strengthening their own Deposit Insurance systems through exchanges with other relevant organisations. Such an organisation as IADI profits to its members and even non-members which can refer to the core principles agreed upon. Moreover, the cooperation that member countries develop in the organisation fosters the efficiency of their practices toward Deposit Insurance and financial stability.

The core principles for Deposit Insurance systems set by the IADI applied by IADI were first developed in 2009 together with the Basel Committee on banking supervision, then revised in 2013 and in 2016 was issued a Handbook for the Assessment of compliance with the Core principles. That Handbook is designed to provide additional guidance for assessing the quality of their Deposit Insurance systems and for identifying gaps in their Deposit Insurance practices and measures to address them.\textsuperscript{182} The Core principles of IADI are not binding but the member countries are expected to comply with them as members or part of a cooperation.

\textsuperscript{181}International Association of Deposit Insurers (n 176).
4.4. Deposit Insurance Funds Models

The following discussion will consider the main features of the DIF:

(a) The mandates of the considered institutions. That is the set of official instructions describing its roles and responsibilities within the safety-net; the mandates are thus a statement of purpose.

(b) The funding or financing method, which is the mean through which they receive the funds to be used for compensating the covered deposits when necessary;

(c) The coverage level or the maximum amount of money which is protected by the fund and

(d) The reimbursement time which is the time that elapses between the collapse of the protected institutions and the effective payment of the protected depositors.

4.4.1. The Ugandan Deposit Protection Fund

(a) Mandates

At its creation, The Ugandan Deposit Protection Fund was controlled and managed by the Central Bank of Uganda. The Fund later on became a separate legal entity from the Central Bank with even its own board in order to ensure its autonomy and to protect its independence. External influences, however, threatens the Fund as two of its seven board members are members of the Central Bank board. In fact, the Financial Institutions Amendment Act, 2016 provides that: ‘The Fund shall be governed by a board compromising (sic):

(a) a chairperson who shall be appointed by the Minister;

(b) the Governor or his or her representative;

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185 International Association of Deposit Insurers (n 180) 81.
186 Ibid 82.
188 Financial Institutions Amendment Act 2016, s 108 (3) (Uganda).
(c) the Secretary to the Treasury or his or her representative;

(d) two representatives of contributing institutions;

(e) two persons appointed by the Minister, with experience in the business of banking or other financial services to represent the public.\(^\text{189}\)

The Governor and the Secretary of the Treasury are members of the Central Bank board, which is the regulatory agency. It should be noted that this might lead to conflict of interests because the Central Bank’s governor who participates in ruling the fund’s operation might not easily claim that the fund was mismanaged. It is noteworthy that Uganda is a member of the IADI and as such the institutional structure of the deposit insurer is expected to minimise the potential for real or perceived conflicts of interest.\(^\text{190}\)

Moreover, three of the board members are appointed by the Minister. This may cause an unbalanced influence of the executive power in the management of the Fund. The Executive Director supervision of the Central Bank of Uganda has however acknowledged in May 2016, during an IADI meeting, that plans were underway to update the crisis management framework to take into account the independent status of the Ugandan Deposit Protection Fund in order to minimise the interference of the executive bodies and to easily separate them from the deposit insurer.\(^\text{191}\)

The Ugandan Deposit Protection Fund is assigned different mandates: firstly, it is mandated to be a Deposit Insurance for customers of contributing institutions which are all the financial institutions existing in Uganda.\(^\text{192}\) According to the definition given in the Financial Institutions Act 2014, the financial institutions designated here are: companies licensed to carry on or conduct financial institutions business in Uganda and includes commercial banks, merchant banks, mortgage banks, post office savings banks, credit institutions, building society, acceptance houses, discount houses, finance houses or any institution which by regulations is classified as a financial institutions by the Central Bank.

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\(^{189}\)Ibid, s 110(1).

\(^{190}\)International Association of Deposit Insurers, ‘IADI Core Principles For Effective Deposit Insurance Systems’ (2014), Principle 3 (4).


\(^{192}\)Financial Institutions amendment Act 2016, s 111(Uganda).
The scope of the Fund can be considered to be automatically expanded to include the financial institutions regulated under The Tier 4 Microfinance Institutions and Money Lenders Act 2016 also. This include SACCOs, non-deposit taking microfinance institutions, self-help groups; and community based microfinance institutions.193 These institutions have remained unregulated since 2016 and due to this freedom of action many of these institutions have been using predatory practices and bad governance which led many SACCOs to collapse with members’ savings.194 It is hoped that the Uganda Microfinance Regulatory Authority, in charge of licensing and managing the Tier 4 institutions, will take action over similarly undisciplined institutions.

Regulation and supervision ought to be sound in order to discipline this branch of the financial institutions. In effect, it is very important that the Tiers 4 institutions be well disciplined so that they will not drain resources from the Fund and weaken it by multiple collapses. The deposit protection fund would not remain strong if it has to support too many depositors in a relatively short period of time.

It can be said that the Ugandan Deposit Protection Fund also play an important role in indirectly reinforcing the market discipline. In fact, the supervisor of the financial sector who cannot desire to have a weakened Deposit Protection Fund will have to enhance the regulation of the sector in order to keep the harmony and thus stability.

Secondly, the Ugandan Deposit Protection Fund can be assigned to be receiver or liquidator of a financial institution, if appointed for that purpose by the Central Bank;195

Thirdly the Ugandan Deposit Protection Fund may perform other functions when conferred upon it by law.196 The Financial Institutions Act does not clarify what are those other functions the fund may perform, though the success of a DIS also depend on the clarity of its mandates prior to the caring out of its duties.

(b)The funding method

The funding arrangements play a critical role in the success of any Deposit Insurance system. A well-designed system will ensure that adequate funds are readily available to respond to

193 Tier 4 Microfinance Institutions and Money Lenders Act 2016, s 4 (Uganda).
195 Financial Institutions amendment Act 2016, s 11 (Uganda).
196 Ibid, s 109.
problems as they arise and avoid delays in closing failed banks. The general experience has been that delays in closing failing banks increase the ultimate cost of failure.\textsuperscript{197}

In fact, prefunding for future losses is a fairer method to cover depositor losses when they occur. This prefunding arrangement is commonly described as an \textit{ex ante} scheme, and contrasts with an \textit{ex post} scheme. \textit{Ex ante} schemes maintain a fund that typically receives and accumulates contributions from covered banks. \textit{Ex post} schemes, on the other hand, collect premiums from surviving banks only if payouts from the scheme occur, that is, if a bank is declared insolvent and depositors need to be reimbursed.\textsuperscript{198} With an \textit{ex post} system, survivors pay the costs generated by those that fail. The \textit{ex ante} scheme allows the deposit insurer to smooth the cost of Deposit Insurance over time. Most bankers indicate they prefer steady, predictable premiums rather than rates that fluctuate and increase sharply in times of economic stress when banks can least afford it.

Finally, an \textit{ex ante} fund assures in advance depositors and taxpayers, thereby promoting confidence and enhancing banking stability.\textsuperscript{199} The Ugandan Deposit Protection Fund is an \textit{ex ante} scheme. It accumulates funds, through premiums charged to every licensed deposit-accepting financial institutions in the country.\textsuperscript{200} The financial institutions must contribute to the fund a minimum annual amount which is not less than 0.2 per cent of the average weighted deposit liabilities of the financial institution in its previous financial year. The board nevertheless may from time to time vary the percentage by regulations.\textsuperscript{201} As a matter of fact, a financial institution whose overall financial performance is unsatisfactory quarterly, shall be made to contribute up to 0.2\% extra or double the minimum contribution to the Fund.\textsuperscript{202} These prudential provisions are set because a financial institutions with unsatisfactory performances is potentially insolvent. It might therefore be compelled to contribute significantly beyond the required amount because it a threat to the banking stability. This provision might as well be set to discourage bad performances due to moral hazard. The premiums received from

\textsuperscript{197}Diane Ellis, ‘Deposit Insurance Funding: Assuring Confidence’ (2013), 2-3< www.fdic.gov/ deposit/ insurance/assuringconfidence > accessed 10 February.
\textsuperscript{198}Ibid 7.
\textsuperscript{199}Asli Demirgüç-Kunt, Edward Kane, and Luc Laeven (n 4) 3.
\textsuperscript{200}Financial Institutions Act 2004, s 108.5(a) (Uganda).
\textsuperscript{201}Financial Institutions Amendments Act 2016, s 111(4)(Uganda).
\textsuperscript{202}Ibid, s 111t(8)(Uganda).
financial Institutions are not the only funds that the Ugandan Deposit Protection Fund relies on, the Fund shall invest its funds to generate further incomes.\textsuperscript{203}

\textbf{(c)The Coverage level}

The most common form of DIS coverage is coverage ‘per depositor per institution’ level. However some countries cover deposits per depositor or per depositor account.\textsuperscript{204} Coverage per depositor account is more generous than coverage per depositor per institution because it allows depositors to increase their effective coverage by opening multiple accounts within the same institution.

The Ugandan Deposit Protection Fund has a ‘per depositor per institution’ coverage of UGX 5 million ($1400).\textsuperscript{205} This practically means that a multiple account holder in the same bank will only be covered up to 5 million for the total amount of deposits from his accounts. This solution is unsatisfactory for the medium and big depositors since the coverage level is relatively low but law may evolve on this aspect as it previously did from the coverage of UGX 3 million.

\textbf{(d) The reimbursement time}

After verification of legitimacy of claims lodged by customers of the Ugandan Deposit Protection Fund, those who are entitled to fund payments can get their funds only within ninety days after closure of the financial institution.\textsuperscript{206} The timing of reimbursement by UPDF is very promising for depositors and it reflects the current general agreement that DISs should be relatively quick in paying out if they have to be trusted by the customers of failed banks.

\textbf{4.4.2. The Kenyan Deposit Insurance}

The Kenyan DIS is established under The Kenya Deposit Insurance Act 2012 and is a corporation to be known as the Kenya Deposit Insurance Corporation (KDIC).\textsuperscript{207}

\textsuperscript{203} Financial Institutions Amendments Act 2016, s111 d (Uganda)
\textsuperscript{204} Aslı Demirgüç-Kunt, Edward Kane, and Luc Laeven (n 4) 8.
\textsuperscript{205} Financial Institutions Amendments Act 2016 (Uganda).
\textsuperscript{206} Ibid, s 111 c (5).
\textsuperscript{207} Kenya Deposit Insurance Act 2012, s 4 (1).
(a) The Mandates

The object and purpose for which the Corporation is established are to provide a DIS for customers of member institutions and to receive, liquidate and wind up any institution in respect of which the Corporation is appointed receiver or liquidator in accordance with this Act.\(^{208}\)

As the ‘liquidator’ of the failed bank, KDIC pays insured deposits up to the insured limit. After paying the insured limit, KDIC assumes the task of recoveries, realizing viable assets of the failed bank and settling its debts, including claims for excess of the insured limit.\(^{209}\)

When appointed receiver of Imperial Bank Limited (IBL), a bank that collapsed over mismanagement, IBL former depositors were paid by KDIC up to a maximum of Kenyan shillings 1 million each. On this basis, payment totalling Kenyan shillings 6.8 billion have been made, with 39.860 depositors (equivalent to 80 percent of depositors) in full or have not claimed their balance of less than Kenyan shillings 10,000.\(^{210}\)

The KDIC, in fact, is entrusted for recovering the debts of a failed bank. It is one of the tasks that deposit insurers are given. The KDIC assumed this function as it appears in The Deposit Protection Fund Board as Liquidator of Trust Bank Limited (in liquidation) V Ajah Shah & another.\(^{211}\) In this case, the Kenyan Deposit Insurance, then called Deposit Protection Fund Board (DPFB), sued two former executive directors of Trust Bank Limited (the bank in liquidation), who, in breach of their fiduciary duties to the said bank allowed and/or caused Trust Capital Services Limited in which they had personal interest to overdraw its accounts without proper security thereby causing Trust Bank Limited to lose large sums of money. The DPFB was thus seeking to recover Kshs 1,549,591,424.41 due in the account of Trust Capital Services Limited together with interest. It was eventually held that the directors were liable for misfeasance and that Trust Capital Services Limited owed Kshs 246.4 million to Trust Bank Limited (in liquidation).

\(^{208}\) Ibid, s5(1).
\(^{211}\) [2013]e KLR.
The previous cases gives a view on how the Deposit insurer can perform different tasks, given that they are of the same nature. In fact, here it paid money to the depositors of the failed bank and sought to recover debts of the same failed company.

The Act provides even wider on the objects of the corporation: ‘The Corporation shall levy contributions for the Fund from institutions in accordance with this Act; hold, manage and apply the Fund in accordance with the provisions of this Act and administer the DIS set up under this Act; provide incentives for sound risk management and generally promote the stability of the financial system; and perform such other functions as may be conferred on it by this Act or any other written law.’

The Act even further provides on the powers given to the Corporation: ‘the Corporation shall have all such powers as are necessary or expedient for the furtherance of its objects, the performance of its functions or the discharge of its duties and in particular, the Corporation shall have power to make investments and enter into any transactions necessary or desirable for the financial management of the Fund, to acquire assets of an institution under liquidation, to settle or compromise any claim by or against the Corporation; to enter into strategic agreements with the Central Bank of Kenya or any other financial sector regulators or deposit insurers within or outside Kenya.

The fund can also formulate such rules and guidelines as may be required for the purpose of carrying out its objectives, establish such subsidiaries as it may consider necessary for the performance of its functions; and request any information from any monetary authority, financial regulatory authority, fiscal or tax agency, or fraud investigations agency within or outside Kenya or a credit reference bureau licensed by the Central Bank where such information is reasonably required for the proper discharge of the functions of the Corporation.

Following the recommendations of the IADI, the Kenyan Deposit Insurance Fund has been given much more mandates and powers than a pay-out box function. This gives also to the Fund access to various informations pertaining to constituents of the financial stability, hence allows it to better assess the riskiness of the banking sector.

212 Central Bank of Kenya Press Release on Imperial Bank Limited (in Receivership) (n 207)
213 Kenya Deposit Insurance (amendment) Act 2013,s 3 (b) .
214 Kenya Deposit Insurance Act 2012, s 6s.
(b) The Funding method

Any institution licensed by the Central Bank of Kenya shall contribute to the Fund such annual amount, and at such times, as the Corporation may determine. The Corporation shall serve on every institution a notice specifying the amount and the period, which shall not be later than twenty-one days after the date of service of the notice, within which the amount shall be paid into the Fund.215

The amount of contribution to the Fund shall not be less than three hundred thousand shillings nor exceed 0.4 per cent of the average of the institution's total deposit liabilities during the period of twelve months prior to the date of the notice served and where it appears to the Corporation that the affairs of an institution are being conducted in a manner detrimental to its own interests or to the interests of its depositors, the Corporation may increase the contributions of that institution beyond the prevailing rate prescribed by the Cabinet Secretary.216

The affiliation to the Deposit Insurance is thus compulsory for all financial institutions operating in Kenya and an institution with unsatisfactory results will bear a greater burden for contributions. To set a risk-based contribution is a legal measure that protects all the institutions in the pool for it is difficult to predict the losses that the deposit insurer will have to absorb over the years. Moreover, from a public policy perspective it is extremely dangerous for an insurer to become illiquid.

(c) The Coverage level

The Corporation shall insure each deposit placed with an institution, provided that the maximum amount payable to a customer in respect of the aggregate credit balance of any deposit accounts maintained by the customer with the institution shall not exceed one hundred thousand shillings or such higher amount as the Corporation may from time to time determine.217

It means that where a depositor owns more than one deposit account with an institution, the accounts are consolidated for settlement as one claim subject to the maximum protected limit

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215Ibid, s 27(1)-(2).
216Ibid, s 27(3)-(4).
217Ibid, s 28(1).
of one hundred thousand Kenyan shillings (equivalent to 1000 US$). The protected amount is relatively small and needs to be reconsidered.

Mr Munyaka, an independent banking analyst, who claimed to have authored the concept paper that led to the creation of the deposit insurer said that the tune of Kenyan shilling 100,000 is far below the cost of living index adjustment given that it did not change since the establishment of KDIC in 1985. He said that in 1985, the exchange rate was approximately Kenyan shillings 12 per US dollar and today the exchange rate is Kenyan shillings 103 per US Dollar. 218

For Mr Munyaka, this implies that the amount insured should, to date, be amounting to Kenyan shillings 858,333 which can be rounded up to Kenyan shillings 1 million.219 A study, was however commissioned by the Office of the Technical assistance of the United States Treasury, to establish an adequate cover, an optimal target Fund and a risk-based contribution for KDIC. The coverage level was also set for upwards review.220

Nevertheless, at the relief of the depositors, the Act provides for the protection of account held in a fiduciary capacity given that trusteeship is disclosed in the records of the institution, for where an institution is under a lawful obligation to repay monies to a depositor who is acting as a trustee for another or as joint owner with another, and the trusteeship or joint ownership is disclosed on the records of the institution, the deposit of the depositor as trustee or as a joint owner, shall be deemed to be a deposit separate from any deposit of that depositor acting on his own behalf or acting in another trust or joint capacity with the institution.221

This option is very helpful in countries were the coverage level is low. Instead of having only a small portion of their money covered, they have an extended coverage possibility if they have joint accounts different from other personal accounts. It is also positive for a DIS to keep a relatively low coverage level than to set unrealistic high coverage that the Deposit Insurance will not be able to honour. Yet, the coverage level must be reviewed in

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219 Ibid.
221 Kenya Deposit Insurance Act 2012, s29(1).
consideration of the variances in the currency used. That is it must take into account the living cost. If it is high, the coverage must as well be adjusted.

(d) The reimbursement time

The Kenya Deposit Insurance Act does not provide on the period it takes for reimbursement of depositors. A reference can be took from the case of Chase Bank, a failed bank which was placed under receivership of KDIC on April 7, 2016 following a run on deposits after reports of liquidity hitches spread online. On January 12 2018, The Kenya Central Bank governor and KDIC chief executive officer in a joint briefing announced that Chase Bank customers will access 75 per cent of the Sh76 billion deposits locked in the troubled lender in staggered phases over a period of three years. The remaining 25 percent will remain as part of other “assets and liabilities” with Chase Bank until the Central Bank successfully seeks prosecution of the bank’s managers and owners who are implicated in the bank’s woes to attach their assets and borrowers who stopped paying after it was put under receivership.

4.4.3. The Malaysia Deposit Insurance Corporation

The Malaysian Deposit Insurance does not strictly correspond to the definition of a fund, however it has found its place in the current study for its special features as an overseer upon different deposits insurance funds. This DIS is administered by the Perbadanan Insurans Deposit Malaysia (PIDM), a statutory body established in 2005. PIDM is a government body entrusted with administering the system efficiently and effectively in the interests of depositors and other key stakeholders. PIDM is also known as the Malaysia Deposit Insurance Corporation (MDIC).

(a) Mandates

PIDM’s mandate is set out in the Malaysia Deposit Insurance Corporation Act, 2011. Its objects are to administer a Deposit Insurance system, takaful and insurance benefits protection system, provide insurance against the loss of deposits in member banks, provide protection against the loss of takaful or insurance benefits in respect of insurer members,

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223Perbadan Insurans Deposit Malaysia, Deposit Insurance Handbook (PDIM 2011), 3
224As provided by Takaful Act 1984, ‘takaful’ means a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose.
provide incentives for sound risk management in the financial system; and promote or contribute to the stability of the financial system.\textsuperscript{225} This inclusiveness of various element in the PIDM is an example of how mandates of the explicit DIS can be so various and this is not harmful for this institution unless some functions overlap or causes the Fund to not operate efficiently toward the stakeholders it is supposed to protect.

PDIM complements the existing regulatory and supervisory framework by providing incentives for member banks to implement sound risk management practices. PIDM is empowered with a wide range of legislative tools to intervene early to reduce or avert losses to the financial system.\textsuperscript{226} For example, under the PIDM Act, PIDM’s intervention and resolution powers are wide and include powers to acquire assets from member banks, make loans or advances to member banks, acquire the shares of member banks, and take all other necessary actions to reduce the cost of failures to the financial system. Once the Malaysian Central Bank notifies PIDM that a member bank is no longer viable, PIDM has as well the ability to assume control over the member bank, set up a bridge institution and restructure or liquidate the member bank to implement a least-cost resolution.\textsuperscript{227} The PDIM visibly assumes functions which are sometime conferred upon Central Banks.

\textbf{(b) The Funding method}

According to the IADI, in determining the most appropriate funding mechanism for a given country its policymakers need to take into account a number of features of its economy and financial system in addition to the considerations already mentioned. Public policy objectives, the general state of the economy, the profile of depositors, various aspects of the financial industry and other factors influence the soundness of a Deposit Insurance system. The objectives of the various financial safety net players are relevant and differ among countries. For example, if the objective is to protect small depositors against a failure of an individual bank, rather than contribute to the stability of the financial system, ex post funding may be sufficient. If the financial system is strong and there is a long history of effective bank supervision an ex ante fund may not be as necessary as in other systems.\textsuperscript{228} The PDIM is an interesting case for it collect funds from different funds. In fact, the PDIM Act provides that the Corporation shall maintain and administer six separate funds:

\textsuperscript{225}Malaysia Deposit Insurance Corporation Act 2011, s 4 (1).
\textsuperscript{226} Perbadan Insurans Deposit Malaysia (n 218)
\textsuperscript{227} Ibid 3.
\textsuperscript{228} International Association of Deposit Insurers (n 175) 10.
An Islamic Deposit Insurance fund which shall comprise all premiums received by the Corporation under the PDIM Act; and all other monies or assets which may in any manner become lawfully payable to, received by or vested in the Corporation relating to any matter incidental to its powers, duties and functions, in respect of Islamic deposits;\textsuperscript{229}

A conventional Deposit Insurance fund which shall comprise all premiums received by the Corporation under the PDIM Act; and all other monies or assets which may in any manner become lawfully payable to, received by or vested in the Corporation relating to any matter incidental to its powers, duties and functions, in respect of conventional deposits;\textsuperscript{230}

A family solidarity \textit{takaful} protection encompassing all premiums received by the corporation under the PDIM Act and all other monies or assets which may in any manner become lawfully payable to, received by or vested in the Corporation relating to any matter incidental to its powers, duties and functions, in respect of family solidarity \textit{takaful} certificates;\textsuperscript{231}

A general \textit{takaful} protection fund which comprises all premiums it receives under the PDIM Act; and all other monies or assets which may in any manner become lawfully payable to, received by or vested in the Corporation relating to any matter incidental to its powers, duties and functions, in respect of general \textit{takaful} certificates;\textsuperscript{232}

A life insurance protection fund which shall comprise all premiums received by the Corporation under the Act; and all other monies or assets which may in any manner become lawfully payable to, received by or vested in the Corporation relating to any matter incidental to its powers, duties and functions, in respect of life policies; and

A general insurance protection fund which shall comprise all premiums received by the Corporation under the Act; and all other monies or assets which may in any manner become lawfully payable to, received by or vested in the Corporation relating to any matter incidental to its powers, duties and functions, in respect of general policies.

The PDIM, like UPDF, is allowed to invest its funds but in the areas strictly provided for by the governing Act.\textsuperscript{233}

\textsuperscript{229}Malaysia Deposit Insurance Corporation Act 2011, s 28 (a).
\textsuperscript{230}Ibid, s 28(b).
\textsuperscript{231}Ibid, s 28(c).
\textsuperscript{232}Ibid, s 28(d).
\textsuperscript{233}Ibid, s 30.
(c) The Coverage level

The PDIM covers all depositors, individuals and business entities, if they hold eligible deposit accounts with a member bank. Here is another particularity of Deposit Insurances, a scheme my cover all depositors in the institution members whereas another covers a specific category of deposits.

Hence, PDIM Deposits which are eligible for protection include savings deposits, current or demand deposits; fixed deposits; foreign currency deposits; principal-guaranteed conventional structured products; Islamic deposit accounts such as wadiah234 savings accounts and Mudharabah235 investment deposits; and Bank drafts, cheques, other payment instructions or instruments made against a deposit account. Deposits not payable in Malaysia, Unit trusts, stocks and shares and Gold-related investment products or accounts are not covered by the Deposit Insurance.236

Concerning the coverage level, deposits placed with a member bank will be protected up to Malaysian Ringgit 250,000 per depositor per member bank, including both the principal amount of a deposit and the interest/return.237 That amount equals to $ 61370. The system is quite generous and surprisingly, the limit was set based on a study conducted showing that, with that limit, 99% of all depositors will be protected in full by PIDM.238

The arrangements made to coverage levels within Deposit Insurance are depending on different factors. For example Coinsurance is the feature where depositors have to bear part of the losses themselves or make a co-payment. Thus if they can receive up to €100.000 back, and have €50.000, they will not get €50.000 back but €45.000, under a system where they have to take 10% of the losses themselves. Although this can apply in regular insurance as

234Wadiah corresponds to safekeeping, custody, deposit and trust. In Islamic finance, Wadiah refers to the deposit of funds or assets by person with an Islamic bank. In this arrangement, the depositor deposit his funds or assets with the bank safekeeping and in the most of the agreement of the bank charges a fee for the safe custody of the depositor’s fund (<https://islamicbanker.com/education/wadiah> accessed 8 February 2018).
235Mudarabah, the most-widely known Islamic contract, is a profit sharing contract in which one party (the Rab al Maal) provides funds and the other (the managing trustee, the Mudarib or Ameel) management expertise (<https://islamicbanker.com#education/mudharabah>, accessed on 8 February 2018).
236Perbadan Insurans Deposit Malaysia (n 218)12-13.
237Ibid, 11.
238Ibid, 12.
well, the difference in Deposit Insurance is that the one who pays the coinsurance (depositor) is not the one who creates the risk (bank), while in other insurances this is mostly the case. 239

(d) The reimbursement time

The performances of a Deposit Insurance can be measured by the speed at which reimbursements of depositors becomes effective, and by its ability to make the procedure easy and understandable for the claimers. When an insured institution fails, the deposit insurer must provide the public with ready access to insured funds so that stability and confidence in the banking system are maintained; and the timely resolution of failed institutions reinforces systemic stability, promotes public confidence in the system. 240

Where a winding-up order has been made in respect of a member bank, PIDM reimburses insured deposits as soon as possible and no longer than three months from the date of the winding-up order. 241

Concerning the clarity of the procedure, PDIM offers a wide range of informations concerning activities and purposes of the PDIM to the public. PDIM has even set a regulation on information in order to promote transparency among member banks and enhance financial consumer protection. Depositors can thus make informed financial decisions based on the disclosures made by member banks. 242

The system broadly displays informations on the benefits and the scope of Deposit Insurance so that depositors can make informed financial decisions on deposit products offered by member banks. For this purposes, any bank has the following obligations: to inform the depositor whether a deposit product is eligible or not eligible for Deposit Insurance protection by PIDM. 243 This obligation allows the depositor to make an informed decision. One can, right from the beginning of his relation with his Bank, place his deposit in a way that will advantage him toward the protection by PDIM.

All member banks must display the PIDM membership sign at their offices, on their websites and the screensaver or homepage of their (ATM). 244 Thus the depositors still can decide

239 PA MCCOY, ‘Theory and Evidence’ (cited as in Arthur Barbé (n 165) 51).
240 International Association of Deposit insurers (n 21).
241 Perbadan Insurans Deposit Malaysia (n 218), 3
242 Ibid 29.
243 Ibid 30.
244 Ibid.
whether or not to keep his deposits with a financial institution knowing that his deposits are insured or not in that institution. Member banks are required to display a register of insured deposit products prominently at their branches where deposit-taking activities are carried out or on their websites and depositors can request for a free copy of the register. They are also required to provide depositors with a PDIM brochure before they place their funds in any deposit product and they must notify the depositor when his accounts is no longer protected. Such a clear procedure deepens the confidence of the public in the DPIM, for they have all necessary informations. This helps the banking system to build a trust in the customers who will in turn be more willing to keep their money in the bank than outside.

4.4.4. The Lessons Burundi should learn from Kenya, Malaysia and Uganda

The previous developments are explicit on the basic legal elements considered in order to have an overview of the considered deposit insurance scheme. From these elements Burundi can learn that its own law on the Deposit Guarantee and Resolution Fund must clearly and further provide on the following:

- The mandates of the Fund: The importance of this has been stressed enough through this research. If it is dangerous for a Deposit Insurance to have an unclear mandate it is more unsafe to have no explicit objects and powers. This has to be set by law even before commencement of operations of the Deposit Guarantee and Resolution Fund in Burundi. Some countries give limited mandates to the Deposit insurer while other give more powers to the institution, this will depend on many considerations but what is common is that the mandates or powers of the Deposit insurer must be explicit and clear. Burundi will have to put focus on this, otherwise the mission of the Deposit Guarantee and Resolution Fund might not be correctly fulfilled or even lap with that of the Central Bank which already has to intervene toward some depositors, at least, when a bank goes down.

- The funding method: It is as well important that the law on the Deposit Guarantee and Resolution Fund in Burundi provides on the procedure that will be followed for the Fund to collect the money that will be used to reimburse. This allows the Fund to work in transparency towards the stakeholders, as the proportions of money collection are also clearly provided for. The funds previously considered are given power to

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245 Ibid 33.
246 Ibid.
collect money from insured institutions but also to reinvest that money. The PDIM even goes further by limiting strictly the areas of investments to those provided for by the governing Act. This is a good example to consider in order to prevent the Fund misplacing the insured institutions money.

- Moreover, Burundi’s law on the Deposit Guarantee Fund should precise the coverage level of the depositors’ money and even attach conditions to the effective coverage. Otherwise, the Fund might end up paying much money in unrealistic proportions and to people who should not be entitled to payment. In fact, the example countries considered give an insight on how the relevant provisions can be directed to avoid such situations. It is obvious that the experience accumulated by these institutions compelled them to limit their coverage level in regard of other concerns than just the money that the depositor held with his financial institution. For example it was highlighted that some deposit insurers do not reimburse the depositor who played a role in the insolvency of the insured institution.

- The time period that will be required for reimbursement. It was previously emphasized that the more reimbursement is reasonable, the more the Deposit insurer gains the depositors’ trust.

4.5. Conclusion

Deposit insurance do not only exist to pay back the depositors. Furthermore, the Deposit insurance’ law provides a number of elements important for the success of the guarantee’s operations. One must also note that the introduction of a Deposit Insurance system can be more successful when a country’s financial system, and not the banking sector only, is healthy. A Deposit Insurance system can contribute effectively to the stability of a country’s financial system if it is part of a well-designed safety net. However, to be credible, a Deposit Insurance system needs to be properly designed, well implemented and understood by the public. It also needs to be supported by strong prudential regulation and supervision, sound accounting and disclosure regimes, and the enforcement of effective laws.

All those aspects surrounding a DIS have not been examined but in this chapter were highlighted the key aspects that must be well established for all DIS. The different countries considered differ in the type of insurance, the amount of coverage, and the institutional

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247Here we shall remember that in some Deposit insurance schemes, the depositor who played a role in the insolvency of an insured institution can be dismissed from reimbursement by the deposit insurer.

248Financial Stability Forum (n 14) 16.
mechanism, among other things. However, in order to be efficient all the schemes should, for example, be designed to reimburse the entitled depositors up to the insured amount within the legal time frame. In fact, while depositor’s confidence in the guarantee is based on the certainty of repayment, it is equally based on the speed of repayment. Unless depositors are confident that their funds will be available quickly, the risk of deposit runs on even solvent banks remains.

The models of Deposit Insurance funds studied and the references to other systems gives basic informations that can be useful for the Burundian policy makers for strengthening the provisions on the Deposit Guarantee and Resolution Fund. The informations contained in this chapter would certainly not be complete but can serve as a base for broader reflexion on the subject.

Besides the models considered, the International Association of Deposit Insurers is an important source of informations that can be considered because for the data it keeps on Deposit Insurances around the world. Moreover, the Association has published in 2014 an update to the core principles of an efficient Deposit Insurance system. The publication contains 16 principles which pertain, among other things, to the clarity of the objectives of the Deposit Insurance mechanism, the powers of the insurer, the insurer’s independence, the insurer’s connections to the other parties participating in the financial safety net, the level of insurance coverage, supervision and monitoring, the program’s participants (the requirement that all the banks participate in it), the sources and uses of financing, and more. These principles can be used as a reference for Burundi in providing further on the Deposit Guarantee and Resolution Fund.
CHAPTER FIVE

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1. Study findings

This study showed how failure of banks instability can affect financial sectors, and when the failure takes place, the stakeholders might suffer great loss if not adequately protected by laws and pertinent mechanisms. In Burundi, the depositors of the failed bank like CADEBU and BPB had the rank of unsecured creditors and were thereof exposed to huge loss when there was no explicit mechanism of reimbursement in place. Moreover, it was found that the Deposit Guarantee and Resolution Fund is not the only mechanism that ensure protection of the depositor; the following aspects also play a role in the banking sector functioning and needs consideration:

5.1.1. The Central Bank’s supervision and regulation functions

The research highlighted that many reforms have been undertaken to reinforce supervision and regulation roles of the Central Bank, but these roles are still lagging behind due partly to an inefficient exchange of accurate informations in the financial sector. Consequently, some activities are not yet well controlled by the Central Bank like mobile banking activities and the credit rate used by some MFIs.

The public has interest in the manner in which banking business is conducted. If the deposits that are collected are squandered by the bank and not paid back, the public will lose their savings. If the deposits are lent to unviable businesses and lost, the performance of the economy would be adversely affected. However, it is not the purpose of banking regulation to keep banks from failing. So long as the depositors are protected and adequate banking services are maintained, avoiding failures of banks is not the focus of banks regulation.\(^{249}\)

The Central Bank thus must exercise a strong supervision, to ensure the sector’s discipline and strict compliance with law.

\(^{249}\) GP Tumwine Mukubwa (n 25) 6.
5.1.2. The borrowers’ profile informations

The researcher noted that there is no credit reference bureaus in Burundi that could give key informations on the borrowers’ profile in order to minimise lender’s risk, leading to healthier portfolio like it is in Uganda under section 78 of the Financial Institutions Act 2004 and under the Financial Institutions (Credit Reference Bureaus) Regulations 2005.

5.1.3. The laws governing insolvency

The research revealed that in absence of an explicit DIS, Burundian depositors have long relied on an implicit guarantee of the Government and the liquidation of failed banks in order to recover their funds. Unfortunately, it was highlighted the guarantee of the Government could only help some of the small depositors and that the laws governing insolvency are not yet well enforced to ensure a smooth and timely liquidation. It hence affected transparency in managing liquidation procedures and for this reason all depositors were not ensured an efficient recovery of their funds from the proceeds of liquidation either.

5.1.4. Corporate governance literacy

The research revealed that there are no specific policies on good corporate governance in the Burundian banking sector which can be used as reference in the daily management of institutions. Provisions on corporate governance are of course found in different laws and regulations but there is no unique reference instrument as a code of corporate governance or code of ethics. Yet, this is important because well - governed firms perform better and good corporate governance is of essence to banks as well. In fact, as once said a President of the World Bank ‘The proper governance of companies will become as crucial to the world economy as the proper governance of countries’.

There is, hence, need for clear literacy on corporate governance good practices that encompass the whole banking services and corporate governance rules that are addressing particular institutions as banks for example so that each part of the financial sector has a reference to guide the staff members.

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5.1.5. Consumer protection literacy

The absence of sufficient consideration of depositors in the conduct of liquidation also raised the awareness that there are no consumer protection guidelines in Burundi to orientate the financial services providers on how to equitably protect the depositors and other stakeholders of the financial sector. Consumer protection guidelines help the financial services providers not overstep the rights of the consumers. This would help these providers to identify the need of the consumers and be more responsive to them. This would certainly boost the performances of the banking sector, while the banks’ depositors and other consumers are efficiently protected.

5.1.6. The provisions on the Deposit Guarantee and Resolution Fund

It was found that having a well-established framework was a prerequisite for the Deposit Insurances Fund functioning, and the countries considered have relevant provisions that can serve as reference for the Burundian legislators in operationalizing and regulating the Deposit Guarantee and Resolution Fund.

5.2. Recommendations

In consideration of the study objectives and findings, the following recommendations should be considered in order to ensure an efficient protection to the banks’ depositors through the Burundian Deposit Guarantee and Resolution Fund:

5.2.1. To enhance the efficiency of the laws governing the banking sector toward depositors’ protection in order to enhance this protection and to lay solid foundation for the introduction of the Deposit Guarantee and Resolution Fund in the Burundian banking sector

The research examined the Financial Institutions Act 2017 which is the primary law governing the banking sector, though it was highlighted that there are other laws and regulations which as well affects the banking sector as the law of insolvency. The research also reviewed the nature of the Burundian banking sector and it actually fits the existence of the Deposit Guarantee and Resolution Fund. Nevertheless, for the Deposit Guarantee and Resolution Fund to be efficiently implemented, there is also need to strengthen the efficiency of the laws governing the banking sector toward depositors’ protection. In particular, the law
governing insolvency should include more collaterals so to facilitate the work of the liquidator in resolving the failed bank’s assets. In fact, if the Burundian Deposit Guarantee and Resolution Fund is also given liquidator’s mandates, following the Kenyan DIS, it can refund depositors within the legal time frame and then repay itself from the proceeds of liquidation. This is a prudential measure to keep the fund’s liquidity available.

It was furthermore made clear that the DIS cannot be efficient alone in case of a systemic financial crisis. A strong DIS protects depositors and contributes to building confidence in the banking system. Its implementation must thus be backed by a broad set of rules to prevent and manage bank failures, in accordance with the international standards on bank recovery and resolution directive.

The statutes governing the Central Bank should also be enforced to ensure it undertakes an independent supervision of the Banking sector’s activities so to promote best practices in the sector. The Central Bank should for example ensure the quarterly disclosure requirements are met by all banks and microfinances. The quarterly disclosure of banks’ financial situation that is provided for by the Financial Institutions Act 2017 should, in fact, be effectively put in place for the public to be aware and appraise the performance of their banks and be able to hold them accountable. It should even set other disclosure policies, as posting the financial reports informations in banking halls and the banks’ websites. The Central Bank should also diligently seek for the Credit Bureaus that are still in plan to be established. The Central Bank would also have to facilitate capacity-building and training for members of the judiciary as well, law enforcement agencies and other relevant civil servants.

5.2.2. To provide further and better on the Deposit Guarantee and Resolution Fund

The research considered the provisions on Deposit Insurance Funds in selected countries and even in the literature provided by international organisations as the IADI, and it was found that Deposit Insurance Funds are organised differently from one country to another or from one legislation to another depending on the nature of the banking sector. Nevertheless, there is convergence on the minimum respect of a certain number of characteristics in order to preserve the efficiency of the DIS:

(a) It must be explicit and known to the public and its mandates must be set out clearly. The mandate is the most important aspect that should be completed for it establishes the exact roles of the fund, set the limits for its liabilities towards the beneficiaries and the modalities
of collaboration with the other actors of the safety net. The mandates of the Deposit Guarantee and Resolution Fund can be, as for the Kenyan Deposit Insurance, to provide Deposit Insurance for customers of member banks and to receive, liquidate and wind up in accordance with the governing Act. The mandates can even be more extended, as for the Malaysian example, to include the provision of incentives for sound risk management in the financial system.

(b) The level of intervention of the Deposit Guarantee and Resolution Fund in reimbursing the depositors when a member institution fails must be clearly set. This is the scope and amount of coverage. The amount should be substantial and reasonable and a risk-based coverage is more reasonable. The provisions must be clear enough for all interested person to know the exact kind of deposits that are covered and under which conditions. When providing further on the fund, legislators must answer key questions concerning for example the number of deposits that will be covered per depositor and per institution.

(c) The reimbursement procedure must also be clarified for the claimers and should be accomplished in an acceptable time which is known. There should also be added provision which sets how the deposit insurer will promote public awareness of how it works and how the Deposit Guarantee and Resolution Fund will cooperate with the member institutions and other safety-net participants to ensure consistency in the information provided to the consumers. The Malaysian model offers a very interesting example on this aspect. It displays enough informations so that every interested person can take an informed decision on the Deposit Guarantee and Resolution Fund before opening an account in any deposit-taking institution.

(d) As for the Kenyan model, it must be clearly provided on the sources of revenues of the Deposit Guarantee and Resolution Fund. This means that it is better that the kind of investments that the fund is allowed to make should be provided for without being neither too restrictive to discourage positive initiatives or too large to encourage unrealistic risks taking by the fund which would undermine financial discipline.

The models of Deposit Insurance Fund that have been reviewed offer more insights on how the important aspects can be provided for in order for the proposed Deposit Guarantee and Resolution Fund to work its mandate skilfully.
A well-designed Deposit Insurance system can make an important contribution to the integrity of a country’s banking sector, thereby promoting financial and economic stability. In order to meet its objectives of protecting depositors and maintaining public confidence in the ability of the Deposit Insurance system to meet its commitments adequate funding arrangements must be in place.

Moreover, the deposit insurer will have to honour his engagements for if it does not or cannot fulfil the promise of payment within an acceptable time the short-term liability problem inherent in deposit-based banking will create recurring crises as depositor confidence ebbs and flows. Ultimately, the breach of this promise of payment will drain liquidity and resources from the financial system and reduce economic activity. Once again, the reduction of uncertainty is as important to deposit based institutions as it is to market-based institutions.\(^\text{251}\)

In addition, to the previous it was highlighted earlier in this research that the IADI advises deposit insurers to cooperate in order to adjust their DIS toward best practices. Burundi will thus surely need to cooperate with other countries for an instructive share of informations before and after effective implementation of the Deposit Guarantee and Resolution Fund. Burundi will gain much from being member of relevant international institutions such as the IADI for a regular enforcement of good practices of its own DIS. In the East Africa as well Burundi can find important informations from its peers which have already instituted Deposit Insurances schemes and have substantive experience.

5.3. Conclusion

The banking sector in Burundi has gone far since the liberalisation of the financial sector in the 1980s and it has even moved further since recent years. The government has taken many actions to adjust the sector to an internationally accepted standards. The reforms undertaken in the regulatory system in particular are important, but it has been observed that the bank depositors has not yet been subject to a particular attention and theirs rights are not handled properly when banks face crisis.

The absence of a proper handling of the issues faced by the depositors when a bank goes down was found to be caused by many factors largely related to a weak regulation,

\(^{251}\) Financial Stability Forum (n 14) 15.
insufficient legal provisions and insufficient supervisory by the Central Bank. It is thus hoped that this research will raise awareness to the concerned authorities so that significant steps can be taken toward enforcement of existing laws and their adjustment toward protection of depositors not only in banks but in other deposit-taking institutions as well. In fact, the Deposit Guarantee and Resolution Fund can be more easily successful if Burundi’s banking sector is healthy and its institutional environment is sound.

In consideration to all the findings, the objectives of the research were achieved as all the research questions had an answer. This study concludes that articles 86 and 87 of the Financial Institutions Act 2017, which provided the Deposit Guarantee and Resolution Fund, are deficient hence not yet credible for the Burundian banking sector and depositors. Enough data has been gathered in this research and they can be a source of reference on how to adjust them to provide for a strong and credible protection fund of depositors in Burundi and for the national development.
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