

ELECTRONIC BANKING IN UGANDA

A REVIEW OF THE LEGAL AND REGULATORY FRAMEWORK

BY

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DECLARATION


I, MUSASIZI DENIS.....hereby declare that the work presented in this book is my original research and has never been presented to any other university or institution for the award of the degree or any other award. Where material from other books and reports is used, it is clearly indicated and acknowledged.

Signed.....

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Date.....22/07/2015

Submitted with my approval.

Signed.....

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DEDICATION

This piece of work is dedicated to my loving and caring daddy and mum, Mr Mufumbiro Paul and Melida Twafuna respectively, the family of my uncle Mr Wegulo Mephy and his wife Mrs Namwase Agnes, my brothers Mukisa Deogratius, Kyefuga Leo, and sisters (Kwagala Sharon, Mwesigwa Betty, and Kisakye Gorret); without whose effort i would be lost in this world. Thanks all of you for the support, encouragement and above all, being there for me whenever i needed you most.

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LIST OF STATUTES

The 1995 constitution of the republic of Uganda.

The Bank of Uganda Act chapter 51, laws of Uganda

The Electronic Signatures Act 2004

The Financial Institutions Act 2004, laws of Uganda

The Electronic Fund Transfer Act 1978

The Bank of Uganda Statute 1993, laws of Uganda

LIST OF CASES

Agip (Africa) V Jackson (1989) 3 WLR 1367

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Tayeb V HCSBC Bank (2004) 2 ALLER Comm. 880, 31, 151

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at 69

LIST OF ACRONYMS

ATM	Automated Teller Machine
APACS	Association of Payment and Clearing Services
BACS	Bankers Automated Clearing Services
BOU	Bank Of Uganda
CHAPS	Clearing House Automated Payment System
EA	East Africa
EAPSHC	East African Payment System Harmonization Committee
EFT	Electronic Fund Transfer
FIA	Financial Institutions Act
ICT	Information and Communication Technology.
ISO	International Standards Organisation
MAC	Monetary Affairs Committee
NPS	National Payment System
NPSS	National Payment System Secretariat
PSPC	Payment System Policy Committee
RTGS	Real Time Gross Settlement
UK	United Kingdom

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ABSTRACT

This research has reported the findings of the study issues concerning the legal and regulatory framework of electronic banking in selected commercial banks in Uganda. This study has investigated the use of e-technologies services as far as electronic banking is concerned in the selected commercial banks in Uganda. This research has surveyed the data on the regulation of electronic banking in Uganda. Using a well designed methodology, the researcher has found that much as most E-technologies are in place in these banks, there is still low level of supervision due to low levels of technological regulation.

The researcher found out that E-Banking, is becoming increasingly popular among retail banking customers. The Stanbic bank customers who were the researcher's classmates and at the same time his respondents, provided that E-Banking helps in cutting costs by providing cheaper and faster ways of transferring funds to their business partners through their accounts. It also helps the customer to choose the time, place and method by which one wants to use the services and gives effect to multichannel delivery of service by the bank. This E-Banking is driven by twin engine of "customer-pull and Bank-push. Electronic banking has been one of the most important factors for the development of quick banking transactions to customer in terms of access, process, storage and dissemination of information electronically. Banking industry is fast growing with the use of technology in the form of ATMs, on-line banking, Telephone banking, Mobile banking; and plastic card is one of the banking products that cater to the needs of retail segment has seen its number grow in geometric progression in recent years. This growth has been strongly supported by the development of the field of technology, without which this could not have been possible of course it will change our lifestyle in coming years. Under article 162 (c) and (d), the central bank (bank of Uganda) is mandated to regulate, supervise, and promote economic development

and the efficient utilization of the resources of Uganda through effective and efficient operation of a banking and credit system; and do all such other things not inconsistent with this article as may be prescribed by law.

In order to maintain their safety. In all its provisions, (the Bank of Uganda Act Cap 51), regulation of electronic banking is not provided anywhere, giving a researcher a ground for its review. In Uganda, obtaining property by false pretence and cheating, bank frauds, forgeries, money laundering, and insider dealing of public confidence; constituted critical issues in the modern Ugandan banking system, and this system in particular is electronic banking. It is because of this, that the legal and the regulatory framework of electronic banking system review in Uganda became paramount. This research examined the legal and regulatory framework of electronic banking in Uganda and the efforts of the central bank of Uganda to ensure success in transformation from traditional banking and improved institutional frame work and access to information.

CHAPTER ONE

GENERAL INTRODUCTION

1.0 Back ground of the study

Electronic banking can be defined as a means through which banking business is transacted using automated process and electronic devices, like personal computers, telephones, fax machines, internet, ATM cards, and other electronic channels. In 1998, Bank of Uganda created the National payment system secretariat (NPSS) and embarked on systematic and planned process of modernizing payment system. The advancement in information and Communication Technology has impacted positively on service delivery in the financial sectors of the Uganda economy. In a bid to provide a variety of advanced payment systems to the number of corporation and corresponding in increase in transaction, Bank of Uganda implemented the EFT for both credits and debits in 2003. These included the introduction of Electronic Fund Transfer (EFT) (both credits and debits), development of a Real Time Gross Settlement (RTGS) system. In August 2003, the Electronic Fund Transfer system was implemented. The EFT system supports both credits and debits, and the EFT transaction volumes and values have steadily increased since its introduction. The EFT system has proved popular for corporate salary payments and public servants. The electronic funds transfer (EFT) is expected to enhance efficiency and strengthen risk management in the national payment system.

Bank of Uganda has continued to work with commercial banks to expand electronic cheque clearing to cover the whole country. Electronic cheque clearing was introduced in Kampala city and its environs in May 2002, according to the monthly report of Development Trust Bank News Letter. After stabilizing and basing on a centralized electronic clearing system model, electronic cheque clearing is planned to be rolled out to upcountry areas, which would to a three day uniform clearing cycle for virtual entire country. This is expected to promote the

use of non-cash instruments, as customers would be able to receive money in the shortest time possible.

There is also a limit Directive to commercial Banks 2007 from the Bank of Uganda, limiting them from transferring twenty million shillings from one bank to another, or to a clients account. All this has been introduced to reduce on the rampant bank fraud, especially risk associated with cheques of large amounts of money and expected to enhance efficiency and strengthen the legal and regulatory framework in the country Uganda.

1.1 Statement of the problem

The payment mechanisms used by banks to effect payment in the traditional banking practices like physical delivery of money from one person to another in bags or brief cases or via bullion vans proved to be very risky and expensive during transit, and the insurance costs were also very high. This necessitated the transformation into a safer mode and hence introduction of cheques system. This mode was very safe and reliable initially, that's why it has persisted up to date.

However, as time went on, and with advancement in technology, a lot of risks associated with the cheque system has been exposed, including forgery, fraud, money laundering. This has occurred in the process when bank customers use ATM cards, using automated process and electronic devices, internet, and fax machines. This accompanied by its regulations, for example, the Electronic transactions Act 2014, the Bank of Uganda Act Cap 61, the Electronic Signature Act, and the Financial Institutions Act 2004 for its legal and regulatory framework

However, there are still some loopholes in the legal and the regulatory frame work in the country. For example, laws above regulating the ATM cards, and other mechanisms needed to be revisited. This is because there is still much fraud, money laundering associated with electronic banking. And in the supreme laws as far as banking is concerned, there is no section mentioning any offence relating to electronic banking. These are, the Bank of Uganda Act Cap 51 section 50 does

not include any bylaw governing electronic banking and section 51 of the same Act, does not include any offence relating to electronic banking. So this made it relevant to review the legal and the regulatory frame work of electronic banking in Uganda.

Under the electronic fund transfer Act (EFT), there is no limited stop payment privilege. when you use an electronic fund transfer, the EFT Act does not give the bank customer a right to stop payment. For example, if your purchase is defective, or your order is not delivered, it is up to you to resolve the problem with the seller and get your money back. Here the bank is not responsible. So this research took an initiative to review the legislation, and then suggested solutions to such dilemma which may be absorbed by the law reformers so that the Uganda electronic banking law is reformed. For example, if you arrange for recurring payment out of your account, to third parties like insurance companies, you can be in position to stop payment if you happen to notify your institution at least within a prescribed number of days before the scheduled transfer. This is because the payer might have lacked vivid knowledge of the transaction.

In addition, the EFT Act does not provide for refund in case the transfer was defective. There is no section in this Act that provides for such, and thus, the researcher reviewed this law in that line suggesred that a commission to deal in such management be established. For example, in America there is a commission called Federal Trade Commission which protects America's consumers, by making arrangements with insurance companies as third parties, who compensate in case a loss occurs. In this way, banks in Uganda that have electronic banking transacting service can borrow a leaf from America for their customers' enjoyment.

In Uganda, the law of electronic banking involves several jurisdictions, which is insufficiently regulated because it is just using internet from one's bedroom. According to the quarterly magazine of the international monetary fund (IMF) September 2002 vol 39, No 3, by Saleh M Nsouli and Andrea Schaecheter, on the challenges of E-Banking, sets out that there is a challenge of regulatory risk. He

states that because the internet allows services to be provided from anywhere in the world, there is a danger that banks will try to avoid regulation and supervision. Therefore, there is need to formulate strong holds in the law of electronic banking so that every transaction, whether from bedroom or in the open, is regulated.

The issue is whether the review of the existing legal frame work and its regulation together with advancement in technology will sufficiently lead to the development of Electronic banking system in Uganda.

1.2.0 Objectives of the study

1.2.1 Main objective of the study

To assess and examine the effectiveness of the existing legal frame work and the regulatory challenges in the electronic banking practice in Uganda.

1.2.2 Specific objectives

- To examine the regulatory, technological and challenges of electronic banking.
- To assess the operation of electronic banking and associated risks in Uganda.
- To come up with appropriate recommendations and conclusions for the betterment of electronic banking system in the country

1.3 significance of the study

The research was intended to lay down the weaknesses of the laws regulating electronic banking so that the legislators and the legal practitioners can suggest grounds for the amendments of the laws and if possible, also legislate other related laws for its regulation.

1.4 Scope of the study

The study was carried out on the examination of the legal and regulatory framework of electronic banking practice, with regard to payment system in some Kampala commercial banks. These are, UBA Bank, Equity Bank, Stanbic Bank and Barclays Bank Ltd; to represent other banks that carry on electronic banking, like Bank of Baroda and Crane Bank. The research was in Kampala because there are several commercial banks, which are owned by different investors, and the number of branches of some foreign owned commercial banks selected, that is Barclays Bank Ltd, Stanbic Bank Ltd and Equity Bank has increased enormously in recent times, the increase has occurred mainly in Kampala and also are easily accessible by the researcher because that is where the researcher was currently residing. Therefore these banks acted as good samples for the research.

The scope was in commercial banks because it is where electronic banking transaction is mostly done and easily accessible.

1.5 Hypothesis

The weakness in the legal and institutional framework and regulatory policies governing electronic banking has hindered the effective development of electronic banking in Uganda.

1.5.0 Research questions

1.Does the weakness in the legal and institutional framework and regulatory policies governing electronic banking hinder the effective development of electronic banking in Uganda?

2.Does the review of the legal and the regulatory framework of electronic banking lead to the development of electronic banking in Uganda?

Due to such existing weaknesses, there is still existing frauds, money laundering, forgery; which has slowed the development of electronic banking in the country.

This created a necessity to review the legal and the regulatory frame work of electronic banking

1.5.1 Limitations of the study

The customers of all banks selected, that is, Stanbic Bank, UBA Bank, and Equity Bank; were so busy with their work that were rear to find, which made the data so limited, and when some were found found, they were rushing to attend to their businesses, which led to scanty data.

The bank administrators mostly in Stanbic Bank, were fixed in their daily schedules, which did not create ample time to the researcher to collect data from them.

There was lack of enough funds that was needed for transport by the researcher to visit the selected banks for the purposes of collecting data.

1.5.2 Solutions to the limitations

The researcher in the first limitation above arranged with the customers in view of finding out on which days they were free, so that the researcher could have more time with them in the process of collecting data. This helped the researcher collect reliable information as far as the research subject matter was concerned.

The researcher still arranged with the bank administrators and informed them of his intention to meet them for the purpose of collecting data for the research purposes. As this facilitated the acquisition of relevant data which was required in the research

With lack of enough funds for transport, the researcher chose to carry out research in nearby commercial banks, so that the transport costs could be reduced.

1.6.0 Methodology

1.6.1 Introduction

According to the Oxford Advanced Learner's Dictionary seventh Edition, methodology is a set of methods and principles used to perform a particular activity. It is a group of methods used to carry out a task. For example, in carrying out research and teaching. It involves a systematic study of a fact, which can be legal, social, economic, or in any other form as the case may be. The following are the different methods employed in the study.

1.6.2 Interview method.

Interviewing, as a research method, typically involves a researcher asking questions and receiving answers from the people he/she is interviewing called interviewees. So the researcher used it to get bank customers' opinion, attitudes, and motivations about electronic banking, as well as the banks administrators' opinions about the regulation and management of the transfer of money electronically from one account to another, that is electronic banking. This method offered a flexible basis of finding out facts that a researcher desired to achieve. In this case, the information was first hand, and it was the researcher who recorded what was necessary for the research carried out. Still, it offered the possibility of modifying the researcher's line of inquiry, following up responses and investigating underlying motives in a way that postal questionnaires could not. Non verbal cues also gave messages which helped in understanding the verbal response, which possibly changed and reversed its meaning. This happened with face-to face interview method, where the interviewer and the interviewee came into contact during the interview. Although interviewing was in no sense soft opinion as a data gathering technique, it had the potential of providing rich and highly clear material, since the interviewer recorded the data by himself.

However much the interview method had all the above advantages, it also got its weaknesses as far as data gathering was concerned. First, interview method was time consuming, and it had the effect of reducing the number of persons willing to

participate, since they had their businesses to attend to. Also, all interviews required careful preparation arrangements to visit, securing necessary permissions which took time.

1.6.3 Interview methods used.

Both face-to-face interview method and group interview method were used to gather data from banks administrators and customers of the bank respectively; by going to them while in the field (visited banks on working days, after informing them two days before).

Face-to-face interview. This involved a researcher coming into contact with the respondents in the process of interviewing. Coming into contact, as far as research is concerned, means a direct interface between the interviewer and the interviewee, where the interviewer asks direct questions and the answers are given there and then, of which the interviewer records. Therefore the researcher came into contact with the respondents, who were bank managers and administrators, and the customers of the banks; during research. This method was used because it tends to give first hand information, since it is the researcher who recorded what was necessary for the research carried out. According to *CP Kothari, Research Methodology 2001*, Face-to Face interview gives the researcher the real expression of the interviewee, as far as the reliability of the information given is concerned. The researcher, in this case, realised that the information gathered from the Stanbic bank customer, who was his respondent found at the ATM machine, was genuine. The respondent stated that they are only eligible to report for the loss of ATM cards on working days, that is, Monday to Friday and yet electronic transactions can even take place on weekends. The respondent added that this means that one can lose money, if the ATM card gets lost during the weekend, if that card is to be used to hack into the account. So when the researcher got inside into Stanbic bank, Kabalagala Stanbic bank, on forth of June, the manager stated that under section 15 the Electronic Transactions Act 2004, the reporting for the loss of the ATM card is done only during working days, literally meaning from Monday to Friday, excluding public holidays. So

during such period in which a bank customer is limited to report such happening, his or her bank account may be hacked into, leading to the loss of money and trust in the electronic banking system. This calls for the need to review such regulation, so that a bank customer is at liberty to report for the loss of the ATM card or any debit card at any time the loss has occurred.

Group interview method. This refers to the type of interview where the researcher gets a gathering of respondents and then starts interviewing them as he/she is collecting data. Therefore the researcher gathered the bank customers, who were his classmates and his neighbours in the hostel as respondents and then got information about electronic banking practice.

In order to carry out the research, the researcher made an arrangement two days before with the branch manager of Equity Bank, Kabalagala branch so that the researcher would conduct face-to-face interview. It was on first of June 2015, when the researcher approached the said branch manager for the collection of data. The researcher asked a question relating to the validity of the electronic signature. In response, the branch manager, Equity bank Kabalagala stated that however much the electronic signature in electronic banking is acceptable, it is not automatic that it is acceptable all the time, hence it is discretionary accepted by the party one is dealing with.

In addition, he cited *section 101 of the Electronic Signatures in Global and National Commerce Act 2000*. It states that notwithstanding any statute, regulation or other rule of law, with respect to any transaction in or affecting interstate or domestic banking, a signature, or other record relating to electronic banking may not be denied legal effect, validity, or enforceability solely because it is in electronic form.

“This implies that there is no standard measure that can make the electronic signature be accepted, whenever it is presented” he added.

The researcher suggested that the discretionary acceptance of the electronic signature is what making the Equity bank customers lose interest in transferring

money electronically into their business partners' bank accounts simply because what be accepted might have been forged, since there is no standard appearance such signature, of which the branch manager agreed to.

During a face-to-face interview with the UBA administrator, Kansanga branch, the researcher wanted to know how the Bank of Uganda through its tool "*Bank Of Uganda Act chapter 51*", regulates the legal and the regulatory framework of electronic banking in Uganda.

While giving the information, in relation to the Act in question, he laments that the Act, does not give any penalty relating to offences under electronic banking. For example, fraud, and forgery. Under section 51 of the Bank of Uganda Act chapter 51, several penalties are mentioned therein, but there so penalty for offences under electronic banking in commercial banks and yet it is , (Bank Of Uganda) the controller of all commercial banks in Uganda.

Documentary method. Is a technique of gathering data from written documents either private or public. These included personal papers, commercial records, communication and legislations. For this case, public documents, like Newspapers, text books; were used mostly because they were easily accessed by the researcher, unlike the private, documents , like bank performance records, which consisted of confidential information, and hence were not accessed.

This involved analyzing such documents and the researcher considered them in his opinion of their reliability as far as electronic banking was concerned.

The researcher employed the documentary method to investigate the level of trust worthy the customers of Barclays bank ltd have in electronic fund transfer through their bank. While in one of the Barclays bank offices, administrator, in the statistics office, offered a file for the year 2013-2014 year of income, and it showed that only 40% of the percentage customers in the bank trust the electronic banking for electronic transactions. The reason was that under the EFT Act, 1978, The Electronic Transaction Act 2014, there is no provision which provides for refund of money in case where the transaction is resulting from fraudulent

dealing. Once the bank customer has transferred money electronically, the bank is does not stop payment in case of any fraudulent transaction. It is the transferee who to battle with the customer to get back the money.

Sampling method. This is a method which involves selecting elements from the population in such a way that the sample elements represent the population. With this method, the researcher extracted a portion of the banks, their customers, and administrators from which generalization to banks and customers was to be made. The researcher used this method for proper analysis of electronic banking practice, since a small number of banks and their customers was used for the data gathering.

This method was used because it enabled the researcher to study a relatively small number of units in place of the whole targeted unit (commercial banking sector), which was so big that getting the data needed would be difficult. In addition, sampling cut costs in terms of money and time compared to when all the commercial banking sector was used for research. If the data were collected for the entire commercial banking sector, as far as electronic banking is concerned, the costs would have been very high for the researcher. It became economical when the data was collected from the commercial banks the researcher sampled, as given bellow.

The portion of the research was in Kampala commercial banks, which are;- Stanbic bank Kabalagala branch, Equity bank Kabalagala branch, UBA of Kansanga branch, and Barclays Bank ltd. The researcher selected Kampala region because is where several branches of the main foreign commercial banks are mostly situated, especially the above which were sampled.

1.6.4 Literature review

Section 3 of the Financial Institution Act of 2004, defines a bank as any company licensed to carry on banking business as its principal business, as specified in the second schedule to the Act and include all branches and offices of that company in Uganda.

A bank includes a body of persons, whether incorporated or not, which carries on banking business. This is provided for under S.2 of the Bill of exchange Act Cap 68, laws of Uganda.

Lord Denning MR defined a bank by referring to the essential characteristics which constitute banking business. Such characteristics include, stability; and he suggested that one should look at the reputation of the firm amongst intelligent commercial men other words the banking community should lesson a banker when they see one. This is in reference to *Charley and smart*, one of the leading cases in banking.

According to the Federal Trade Commission, a commission based in America, electronic banking is explained also as electronic fund transfer (EFT), which involves the use of computers and electronic technology in place of cheques and other paper transactions. EFTs is initiated through devices like cards or cords that let you or those you authorize, access your account. For example Automated Teller Machine (ATM).

In defining payment, Sealy and Hooley, Commercial law text cases and materials 3rd edition, define it as gift or loan of money or an act offered, accepted in performance of a money obligation payment by physical delivery of the money. He further argues that the payment by physical delivery of the money can be both risky and expensive and these difficulties have led to the development of various forms of payment systems.

Benjamin Geva in his book, the law of Electronic Fund Transfer, defines the concept of payment as any machinery facilitating the transfer of money, which bypasses the transportation of money and its physical delivery from the payer to the payee, in payment mechanism. A payment mechanism facilitating a standard method of payment through a banking system is frequently referred to as a payment system. Whereas Geva deals with the nature of funds transfer only, it nonetheless provides prominent episodes on the overall electronic banking scene.

In the US, The US EFT Act 1978, defines EFT as any transfer of fund other than a transaction originated by cheque, draft, or similar paper instrument which is initiated through electronic terminal telephonic instrument or computer or magnetic tape so as to order, instruct a financial institution to debit or credit an account. According to Paget, cash dispenser CDS, ATMs, Electronic funds transfer at point of sale, teleshopping, are some of the electronic fund transfers. However, his analysis mostly dwells in the UK, does not discuss the challenges of EFT.

In reference to the Blacks law dictionary, review infers the consideration, inspection or reexamination of the subject matter or thing. And per this matter, the subject matter is the legal and regulatory framework of banking in Uganda.

G. Philip Ruteledge and Jason Haines (2007) *Electronic markets*, Haywards Heath UK: Tottel publishing ltd, defines electronic banking as a means of wide spreading of banking products and services to potential customers worldwide without physical presence somewhere. His practice focuses on corporate and securities law, regulation of financial intermediaries and regulatory representation.

Akampurira, in his Article, *The Bank of Uganda Magazine 40 years of service 2003*, on the evolution of payment systems in Uganda discusses a detailed assessment of the evolution of payment systems in Uganda and the payment systems reform from 1988 to date. He argues that in order to provide a variety of adequate payment instrument to growing number of corporations and corresponding increase in transactions. Bank of Uganda implemented both credit and debits in 2003. He further analyses the challenges ahead of banking for example there is no legal and regulatory framework for monitoring the efficiency of safety and security of the cashless payments that are introduced in the market by commercial banks, lack of hardware or software malfunction, communication, infrastructure failure, human error, omission or commission of any other type of risk.

The writer attempts to discuss payment systems at a wider a scope though he omits to make a concrete analysis of the electronic banking, its legal and institutional framework, he doesn't also contrast electronic banking in Uganda with other jurisdictions like Kenya and Tanzania where at least Electronic Banking is developed. His article is not so broad whether the payment systems and institutional framework have the capacity to adopt Electronic Banking in Uganda. Notwithstanding this article is of considerable help in my research because it lays a foundation for me to start looking at the challenges of Electronic Banking in a wider context.

Anthony C.K Kakooza, Embracing, on Advocates and lecturer in law 2005, a paper presented at the annual lawyers day, Kampala International University Law Society, on the theme legal directions in E-Commerce and human rights visa vies development in the region. The paper attempts to discuss E-commerce. It highlights on the likely constraints that stand in the way of an effective conversion from the traditional ways of doing business to taking on a touch of modern technology in commercial transactions. He discusses the challenges of E-Commerce but he does not elucidate on Electronic Banking, the relationship between the two. However, the work is useful because it tries to give a detailed discussion of E-Commerce; the arguments propounded therein may be relevant to an analytical discussion of E-banking.

Other sources of relevant information worth consideration in this research are the Newspapers(likely the Daily Monitor, Weekly Observer and the New Vision).these have been useful save for the fact that some articles are not researched, misconceived and are never exhaustive in handling critical points such the legal implications of Electronic Banking. Even then the author's opinion is generally conceived after a personal understanding of the issues raised in the articles.

The Electronic Fund Transfer Act (EFT) 1978, of the United States, defines electronic fund transfer as any transfer of funds, other than a transaction

originated by cheque, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tapes so as to order, instruct, or authorize a financial institution to debit or credit an account. This definition focuses on the way in which the payment instruction is initiated.

Henry R. Cheeseman, contemporary Business and E-Commerce Law 2004, 4th Edition, explains electronic fund transfer (EFT), in a way that computers and electronic technology have made it possible for banks to offer electronic payment and collection system to bank customers. And is supported by contracts among and between customers, banks, private clearing houses and third parties. On addition, he gives the common forms of EFT, which include Automated Teller Machine (ATM), which uses personal identification number (PIN) to access the bank accounts through ATM, and pay by internet.

Clarkson Miller Jentz Cross, West's Business Law 2003, Tenth Edition, talks about electronic fund transfer (EFT) as a transfer of funds made by the use of an electronic terminal, a telephone, a computer or a magnetic tape. He goes ahead to state that the law governing EFT depends on the type of the transfer involved. For example, consumer fund transfers are governed by the Electronic Fund Transfer Act (EFTA) of 1978; commercial fund transfers are governed by Article 4A of the Uniform Commercial Code. (UCC).

Under the Electronic Fund Transfer Act, electronic banking means a 24-hour access to make withdrawals or deposits. Again the same Act states that when your electronic card like the ATM card has been lost or stolen, you must file a claim within two business days to ensure protection from unauthorized transactions made on the account. This law needs examination because electronic banking is 24-hours done and if the ATM card is lost or stolen on non business days, this means that unauthorized transactions will be done on that person's account. On this basis therefore, there is need to examine this law.

Under the Electronic Banking Act, there is no provision for over drafts, in terms of order of payments, transfers, and other withdrawals. If your account has

insufficient funds, your account will be subject to bounce. This again requires one to go over the counter to conclude the issue of getting the over draft. This moves the researcher to examine the laws governing electronic banking so that such provisions of getting overdrafts via electronic banking transaction are considered in the law.

In conclusion, this chapter has attempted to provide a foundation for this dissertation. Therefore the views and arguments of the authors were of great value and formed strong considerations and a basis for some of the arguments in this research.

1.6.5 Synopsis

The dissertation is divided into five chapters. The first chapter gives the general introduction to the subject discussion. It provides a background to the dissertation and shows what the dissertation is set to achieve, the statement of the problem, the methods to be employed, and the literature review.

Chapter two discusses the history of banking law and practice in Uganda.

Chapter three will discuss the institution legal framework and regulation of Banks in Uganda.

Chapter four will discuss electronic banking and the impact of electronic banking on the financial institutions, the banking risks and on the regulators, ad the challenges of electronic banking in Uganda. Chapter five critically examines the legal and the regulatory frame work of electronic banking in Uganda

CHAPTER TWO

HISTORY OF BANKING LA W AND PRACTICE IN UGANDA

2.0 Introduction

The establishment of banking business in Uganda can be traced back in the first decade of the 20th century. The crystallization of banking in legislation in the form it is known today, does not appear to have been achieved until during the late sixties when a decision was taken to establish the Bank of Uganda which is Uganda's Central Bank. The chapter therefore, traces the historical development of banking law and practice in Uganda.

2.1 History of banking in Uganda

Banking as a social practice never arose in the abstract. It has its origins deeply enmeshed in the metamorphosis of the capitalist mode of production as Marx stated that,

"The banking system so far as its formal organization and centralization is concerned, was the most artificial and most developed product turned out by capitalist mode of production dealing on immense power over commerce industry .it possesses indeed the form of universal book keeping and distribution of means of production on social scale but solely form"¹

On the eve of colonialism, Uganda was taking an autonomous course until the forces of capitalism interfered with the social economic conditions prevailing with the social economic conditions prevailing in the pre-colonial Uganda. The British imperialists officially declared Uganda a protectorate in 1894.

British finance capital and imperialism had a strategy for Uganda and how it could contribute to the world capitalist system. The whole social, political and economic setup was disrupted reorganized in line with the interests of finance capital.

However a sound operation of banking was not possible without money which is central to the capitalist system of production. The economy was already monetized and commodities were brought with money. The appearance of money in the colonial economy and the money transactions between labour finance capital provided the foundation on which the early commercial banks were built.

¹ Karl Marx Capital Vol.III 1959,p.606

It is on this point that Uganda formed part of the currency area served by the East African Currency, established in London towards the end of 1919 to issue and redeem East African Currency in exchange for United Kingdom pound sterling². And prior to the establishment of the East African Board the Currency circulating in Kenya and Uganda was the Indian rupee, notes silver coins hence the origin of local word "rupiya" for money.

Therefore, the purpose of Uganda for capitalism was identified as production of agricultural raw materials and tropical food products. So Uganda became part of the international capitalist system through commercial unions like the British cotton growing association. It was extension of capitalist relation into colonial Uganda which necessitated the establishment and importation of banks more so, commercial banks and other credit institutions in Uganda.

On 24th may 1966 an act of parliament was passed that created bank of Uganda³. The Bank of Uganda was established in 1966 to succeed the African currency board that was established in 1919. With its headquarters in London, the board had since 1920 served the whole of East African including at one time or another, Uganda, Kenya, Tanganyika, Zanzibar, Somali land, Eritrea, Ethiopia and Eden⁴.

2.2 Banking practice in Uganda

In practice, effective regulation and supervision of banks and financial institutions has the potential to make a major contribution to the stability and robustness of financial system. However, there are distinct limits to what regulation and supervision can achieve in practice. It must be recognized that, in practice, there is no viable alternative to placing the main responsibility for risk management on the shoulders of management of financial institutions. Management can ever be allowed to hide behind the cloak of regulation or pretend that, if regulation and supervisory arrangements are in place, this absolves them from responsibility.

² Banking in Uganda 6th March 1970 P.3

³ Bank of Uganda Act No.5 Statute 1996

⁴ .22 Bank of Uganda Act No.5 Statute 1996

Nothing should ever be seen as taking away the responsibility of internal supervision within banks and share holders and managers themselves. External regulation and supervision by official agencies must never be viewed as an alternative to robust and effective internal supervision process and responsibility. In other words regulation must be both internal and external. The role external regulation needs to be kept in proportion, above all, the optimum degree of regulation falls far short of removing all possibility of bank failure. Such a degree of regulation intensity would certainly seriously impair the efficiency of the financial system in performing its basic functions. If banks and their customers had a strong expectation that regulation removed the possibility of bank failure, or that banks would always be rescued if they were to fail, banks would be tempted to take excessive risk and depositors would not exercise due caution in the selection of banks. Thus depositors must be able to distinguish

2.3 Payment Systems in Uganda

A payment system is set of instructions and procedure used for the transfer of value and settlement of obligations arising from the exchange of goods and services within a defined market. The ultimate goal of any payments system is to ensure that exchange of monetary value is achieved with the least risk, inconvenience and cost. For a payments system to be described as efficient therefore, it must be reliable, prompt, accessible, secure and cost effective.

In 1998, the Bank of Uganda adopted a strategic and collaborative approach to develop the country's payment system. The basic tenets of the approach include:

- A holistic approach to the analysis of the existing system, determination of the present strengths, weaknesses and challenges
- Development of an appropriate strategy to enhance the efficiency and strengthen risk management in the country's payment system.
- A collaborative approach with the different stakeholders in the payment system process.

2.4 The strategic Approach to Electronic Banking

It broadens the ownership and promotes the legitimacy of the payment system development process. It expedites the implementation of payment projects as unnecessary misunderstandings are minimized.

It weeds out unrealistic and unviable ideas at an early stage, thereby freeing scarce intellectual and financial resources to focus on potentially more useful work

2.5 Institutional Framework for payment System Development.

There is institutional framework within which the National Payment System (NPS) project is executed. The institutions include:

- *National Payment System Council (NPSC)*

Drawn from different payment system stakeholders, this is the highest policy making body on all matters pertaining to Uganda's payment system reform and development. The NPSC is chaired by the Governor, with the Deputy Governor as the alternate Chairman.

Payment System Policy Committee (PSPC). The PSPC is a Bank of Uganda internal committee that is charged with overseeing and tendering advice on matters related to payment system activities. Like the NPSC, the PSPC is chaired by the Governor, with the Deputy Governor as Vice Chairman.

- *National Payment System Secretariat (NPSS)*

The NPSS is responsible for the administration of the National Payment System project activities. It also served as Secretary during the NPSC, PSPC and NST deliberations. The NPSS also works closely with Uganda Banks' Association (UBA) on matters related to payment system development.

- *Regional and International Institutions*

With a view to developing a payment system that is in consonance with international standards and a facilitator of regional economic integration, the NPSS has liaised and coordinated with a number of regional and international bodies on payment system development issues.

Among them are the East African Payment System Harmonization Committee (EAPSHC), which is a subcommittee of the monetary Affairs Committee (MAC) of the East African Community (EAC), International Standards Organization (ISO), Bank for International Settlements (BIS) Germany technical and Development Agencies (GTZ& KFW), and Association of payment and Clearing services (APACS) of the United Kingdom. The Ugandan Payment System (NPS) has not grown beyond the traditional reliance on cash.

The limited electronic payments techniques in Ugandan financial system have resulted in limited acceptance, and at times, total rejection from end users and other players in the payments process⁵. However, because the Ugandan payments system is an integral part of the global payments system especially in this era of globalization, commerce, and technological advancements, the Ugandan payments system must be reformed to meet global standards as well as the needs of local consumers.

2.6 Payment instruments in Uganda

These are the media through which value is exchanged or transferred between different Parties. There are 3 categories of payment instruments in use today.

- Cash
- Cheque
- Electronic Funds transfer (EFT)

2.7 Challenges of the existing payment systems in Uganda

These include poor Information and Communication Technology (ICT), infrastructure, low income, lack of awareness of alternative e-payment techniques, inadequate legal and regulatory framework, and absence of trust and fear of insecurity in financial transactions.

2.7.1 Carrying physical Cash

The system is predominantly cash-based, with about billions of cash in circulation.⁶

⁵ Uganda Tourist Board NEWS LETTER, a monthly publication No I February 2006

⁶ Sour. Bank of Uganda Annual Report 2005

Though cash enjoys about 90% acceptance among Ugandans because of its immediacy, this mode of payment still faces some major challenges⁷.

- Security - cash transaction In Uganda are hindered by fear of theft and loss to hoodlums. But if it is through the electronic fund transfer system which is well regulated legally, it could offer a safe mode of banking. For example, when the loss of a debit card like the ATM card can be reported at any time it has occurred, there could be no loss of any money.
- Mutilation- Much of the cash in circulation are mishandled, mutilated and exposed to wear and tear. But if the electronic banking regulation is reviewed and bank customers gain concrete confidence in the system by assuring them that there will be no total loss of the money through electronic banking, they may be encouraged to transfer their money electronically, other than carrying it physically in their hands or bags.

2.8 Recent developments in the banking industry in Uganda.

Advancements in Information and Communication Technology have impacted positively on service delivery in the financial sector of the Uganda economy. In the bid to provide a variety of advanced payment systems to the number of corporations and corresponding increase in transaction, bank of Uganda implemented the EFT for both credits and debits in 2003. These included the introduction of Electronic fund Transfers (EFT) (both credits and debits), development of a Real Time Gross Settlement (RTGS) system in August 2003, the Electronic Transfer system was Implemented⁸, supports both credits and direct debits, and the EFT transaction volumes and values have steadily increased. Since its introduction, EFT system has proved popular for corporate salary payments.

According to the UBA branch manager, Kansanga branch, the EFT is expected to enhance efficiently and strengthen risk management in the national payment system, by filling in the loopholes in the law governing electronic banking, through the reviewing the legal and the regulatory frame work of electronic

⁷ Speech by Mutebile Emmanuel, governor bank of Uganda at the launch of the national Payment

⁸ Bank of Uganda Annual Report 2003/2004

banking in Uganda. Given an example of getting a refund of the money in case the transaction is proved to be defective.

Banks have continued to invest in payment technologies, including the Automated teller Machines (ATMs) whose numbers have shot up to over 450. Furthermore, the ATM functionality continued to expand, and besides cash withdrawals and deposits, statement ordering and account balance inquiry, some ATMs now provide for payment for utilities, loading of airtime on mobile phones and intra - bank transfer of funds. The ATM penetration levels to the upcountry areas also increased, with ATMs currently installed in more than 50 upcountry towns. Bank of Uganda has also continued to work with the commercial banks to expand electronic Cheque clearing to cover the whole country. This is expected to further promote the use of non- cash instruments, as customers would be able to receive money in a relatively short time. To further improve efficiency in retail electronic clearing. By and large, the banking sector since its inception in Uganda has categorically underwent a series of developments including but not limited to functional management of the monetary policy by the Bank of Uganda, modes of payments, industrialization of the sector, participation of the masses and product efficiency.

CHAPTER THREE
INSTITUTIONAL AND LEGAL FRAMEWORK FOR BANKING
PRACTICE IN UGANDA

3.0 Introduction.

"It is admitted that there is no perfect law, law is always subject to change as conditions in society change. But if at any time any law is so much out of step with the conditions and needs of society in which it is meant to serve, then it is law only in theory and book and if it is to in practice, it has to be reviewed ⁹."

One may wonder why it is important for the Government to legislate banks, more so commercial banks which re-allocate and mobilize resources or why they should be closely supervised and regulated, for it would appear like state interference in some of those which are privately owned. But experience has shown that it is necessary for the state to interfere in order to not only protect these commercial banks but also their depositors as well. The phenomena of the control of these commercial banks is such a vital issue that the state which is the custodian of public interest cannot ignore it or leave it to chance¹⁰. Furthermore, a lot has been said about the inadequacy of most laws. Bruck, one such proponent, says that,

"The legal systems of most developing countries cannot adequately support modern financial processes¹¹"

He is in similar terms supported by Ssemogerere who asserts that,

"Since independence, most underdeveloped countries over looked the importance of cultivating a supervisory and regulatory framework which is favourable to the financial sector hence economic growth,¹²"

⁹ Joseph. M Kakooza "Uganda perspective of copy rights, Neighbouring right" Seminar paper 1991 Pg.10

¹⁰ Lecture paper "Is Uganda ready for a Stock exchange?". Presented by Johnson so Kwesigabo on 28th April 1993-PgA.

¹¹ Financial systems and development. An overview. Article 1 Photostat copy of a larger edition. P.3

¹² Ssemogerere G. Problems and Prospects for financing rural development in Uganda. Hypothesis for brain storming in a search for modalities and policies (paper presented for the periodical lecture sen'er for bankers organized by Uganda Commercial Bank first draft. 28th Sept 1993.

Uganda is no exception to the above criticism and consequently it is necessary to review the past law governing these banks in order to realize the need for a new and prudential supervisory and regulatory instrument governing the financial sector, as reported by Ssemwogerere in his report *"Problems and prospects for financing Rural Development in Uganda 1993"* above.

3.1 Pre-1993 legal frame work relating to supervision and regulation of Commercial banks.

From 1902, case law and statutes of general application were mainly the law applicable to banks and credit institutions. Later they were regulated and controlled by the Banking ordinance 1955. The business of banking was to be carried out by a company with paid up capital of at least shillings one million and had to be licensed by the Registrar of companies to carry out such business. The post office, Credit and savings banks and registered cooperative were excluded from the ordinance. Insurance companies were regulated by insurance companies Act (cap 91) under the Ministry of cooperative and marketing.

After independence, the Banking Act 1966 was passed in similar terms. This reflected a slight deficiency since circumstances had changed over the years. It was an act to establish the Bank of Uganda which shall issue legal tender currency and maintain external reserves in order to safeguard the International value of that currency, promote stability and a sound financial structure conducive to a balanced and sustained rate of growth of the economy and other purposes connected there with.¹³ The crisis of accumulation which manifested itself in the Uganda economy at this time, necessitated efforts by the neo-colonial state to reduce borrowing from overseas, which problem as we have seen is chronic to the economies of the developing countries even to date. In light to this, the then President stated that,

¹³ Preamble to the Bank of Uganda Act of 1993.

"Much as -we appreciate the need to attract foreign investment, we are fully convinced that the economic future of this country depends on local capital formation and local savings and investment.¹⁴"

It was thus throughout that this strategy would be realized if the state controlled investment by control over monetary institutions. Hence there was a need to increase reserves in the financial Institutions to achieve these objectives.

To this end the Banking Act, 1969¹⁵ was enacted in March which Act amended and consolidated the law relating to the supervision and regulation of financial Institutions. The significant aspect of this Act was that mere formation of a Company to carry out the business of Banking was no permission for its operations.

"No person or no body incorporate should transact banking on credit business in Uganda without a valid license granted by the Minister of finance"¹⁶

However, in granting this license several factors were taken into account by the Minister. But if the Minister purported to reject any application on grounds other than those specified in the Act, his decision could be challenged as an improper exercise of discretionary powers.¹⁷

Factors such as the history of the applicant, his competence as well as his financial status had to be looked into since there was a minimum capital requirement for running a bank.¹⁸ Granting or refusing to grant a license by the Minister was a means of restricting entry existing banks protected from new competition by various regulations that limit entry into the banking industry or that limit entry into specific banking markets by restricting branching. The alleged reason for such restriction was to prevent excessive competition from bringing about an unstable banking system or one characterized by frequent bankruptcies. In analyzing the effect of entry restrictions or entry in banking, Sam Pettzman states.

¹⁴ President Obote Milton. Common mans charter. Government Printer Entebbe 1970. P. 10

¹⁵ Act No. 16/1969

¹⁶ S.I Ibid

¹⁷ H. W. R Wade. Administrative Law 5th Edition oxford Unit Press London Pg 361

¹⁸ S. 21 Ibid.

"The prime justification for bank entry restriction becomes clear by noting its date of adoption 1935. Bank entry restriction was designed to insure against a high rate of failure, Entry restriction is supposed to accomplish this in two ways. First, it weeds out those applicants who value their own chances more highly than do the regulators. Secondly it reduces interbank competition generally. In this way..... the whole distribution of profit rates in banking will be greater than it would be under free entry and fewer banks will incur losses that cause them to fail"¹⁹

Existing banks were protected from entry by two kinds of regulation. Restriction on the formation of new banks and restriction on branching. The effect of the first of these, was to limit the number of new banks allowed to have banking markets²⁰ According to S.20 of the Banking Act 1969, it was provided for that a conditional license could be given by the Minister for the opening up of a bank branch. However, although the Minister had these powers to locate, he did not use them and where they were used they were not properly used. Much of the confusion in the financial sector caused by this was due to the Minister- Bank of Uganda separation of notes. This authority to open or close banking offices was given on the advice of Bank of Uganda. The latter was required to satisfy itself that these new branches would not weaken the financial situation of the Banks which would wish to operate them and hence affect the depositors. However, some banks continued to open branches without this study.²¹

The same Act also provided that banks incorporated in Uganda were required to have a paid up capital in cash of at least two million shillings, while those incorporated outside were to have a minimum often million shillings in cash and to maintain in Uganda out of their own funds assets amounting to five percent of total deposits liabilities in Uganda.²²

¹⁹ Sam pettzman. "Banking entry Regulation. Its impact and purpose" There National Banks, Banking Review No.2 172 Dec 1965

²⁰ Edwards and Edwards. Measuring the effectiveness of Regulation, case of Bank entry Regulation Pg.

²¹ Leo Kifairango. The financial sector in Uganda. Problems and views on the restructuring process. Seminars on Uganda's economy by Ministry of finance at Uganda Institute of bankers. lee 12 - 16 Dec 1989 No. II compiled vol. June 1990.P. 117.

²² S.2 Ibid

In addition to this, each bank was required to maintain a reserve fund equal to its paid up capital by transferring at least 20% of its profits to the fund before any dividends are declared.²³ By its preamble, the Banking Act 1969 amended and consolidated the law relating to the supervision and regulation of the business of banking. However although this is what the Act was meant to do, it didn't quite achieve this. For instance it was criticized for this provision relating to banking business which are Commercial in nature. This tended to exclude post office savings banks and building societies²⁴ which institutions are involved in the mobilization of savings.

On October 13th 1969 an amendment to the 1969 banking Act was passed²⁵ to enable local incorporation of expatriate banks and credit institutions. Initially expatriate banks which were majority had no permanent capital in Uganda and relied mainly on local depositors' funds to finance their operations and partly on temporally inflow of funds from their head offices to cope with peak demand for credit. This lack of permanent capital in Uganda was unsatisfactory as banking practice later alone the need for localization of Commercial banking and the opportunity this would afford the Central Bank to exercise a farmer grip on the system. It was therefore decided in October 1969 amendment that,

" Every bank whether expatriate or indigenous should have locally a fixed paid up capital of not less than twenty million and credit institutions should have capital of not less than two million."²⁶

The Banking Act was accordingly amended to require each bank and credit institution to incorporate locally. Much later on, though with the invasion and subsequent take over in the liberation was 1979, the Banking Act (Amendment) statute 1980 was passed. The main feature of this was that it froze all the accounts of monies usurped by Arnin's fleeing soldiers²⁷. These monies were later

²³ S. 6 Ibid

²⁴ S. 39 Ibid

²⁵ The Banking (Amendment) Act No. 16 of 1969

²⁶ 57 S.21 Ibid

²⁷ Amending S.26 Previous Law Banking Ad (Amendment Statute) 19&0.

transferred to the consolidated fund under S.26B inserted by S.I of the Banking Act (Amendment) Act 1981.

These amendments fortunately were directed towards adapting to and meeting the needs and aspirations of the people through these financial institutions. However, there is nothing to date which shows that these changes have had any profound effect on the operation of Commercial banks.

As viewed above the power to control financial institutions up to 1993 was vested in the Minister of Finance with Bank of Uganda being an intermediary. The latter supervisory and regulatory powers were limited-complete and total controlling powers were given to Bank of Uganda following the enactment of the financial institutions statute in 1993.

3.2 Post 1993 Legal Frame Work relating to Supervision and Regulation of electronic banking in commercial banks.

3.2.1 The 1995 Constitution of the Republic of Uganda.

Under the constitution, Bank of Uganda shall be the Central Bank of Uganda and it shall be the only authority to issue the currency of Uganda.²⁸

It shall promote and maintain the stability of the value of the currency 'of Uganda, regulate the currency system in the interest of the economic progress of Uganda, encourage and promote economic development, and the efficient utilization of the resources of Uganda through effective and efficient operation of banking and credit system and do all such other things not inconsistent with this article, as may be prescribed by law.²⁹

Therefore with regard to the above provisions, the constitution clearly gives the Central Bank's powers over other banks, where by every person or persons proposing to carry out the business of banking must get the approval of the Central bank since it has the authority to do so. So after reviewing its electronic regulations, the commercial banks involved in offering such services may effectively regulate electronic banking on the guidelines of the central bank, through its legal regulatory tools, including the Bank of Uganda Act Cap 51.

²⁸ Article 161 (1) 1995 Constitution of Republic of Uganda,

²⁹ S 162 0) Ibid

3.2.2 The Bank of Uganda Statute 1993³⁰

It is a statute to amend and consolidate the Bank of Uganda Act for regulating the issuing of legal tender, maintaining external reserves and for promoting the stability of the currency and a sound financial structure conducive to a balanced and sustained rate of growth-of the economy and for other purposes related to the above.

The Bank of Uganda statute repealed the Bank of Uganda Act of 1966 and has rectified many weaknesses in the prior Act, Operations of the central Bank that were established directly affected the activities of commercial banks for the currency issued by the bank.

Bank of Uganda statute No.5 of 1993 found its way to commercial banks via customers who deposited it. Furthermore, the Central Bank acts as a banker to and supervisor of banks through accepting commercial bank deposits and assisting all failing banks. It further required commercial banks to maintain specified levels to variable funds (reservoir), which objective was to prevent a run on the banks and to ensure that the customer's demands were meant.

The major functions of the Bank are spelt out in the statute and include implementation and formulation of monetary policy directed to economic objectives of achieving and maintaining monetary stability, maintaining external assets and reserves, issuing currency notes and coins as well as acting as a banker to Government.³¹ Moreover the bank has got the important duty of acting as a financial adviser to the government as well as managing the Public debt. The important duty of advising the government is spelt out in PART VI of the statute where it's stated that,

"The government shall seek advice from the Bank on monetary policy, and it shall be the duty of the Bank to formulate such monetary policy and advise government accordingly."³²

However, although the bank has various functions this paper is going to focus on,

³⁰ Bank of Uganda Statute No.5 of 1993

³¹ S.5 Ibid

³² S.33 (3) Ibid

*Supervising, regulating, controlling and disciplining all financial Institutions*³³

This it does in order to maintain monetary policy and economic stability. The central Bank thus has powers to license all financial institutions after they have fulfilled certain conditions such as tendering in an application form. Therefore, the regulation and supervision of these Commercial banks where our concern is most specialized is a matter of considerable concern.

The nature of their business necessitates prudential supervision because confidence has to be maintained in the minds of investors for when confidence deserts a financial Institution, disaster is almost inevitable and the effect can be highly contagious throughout a financial system. The imposition of a regime of prudential supervision aims to foster an environment of safety and soundness and thus to dispel those arrant fears that may overcome depositors.

This is done by the establishing procedures to ensure that risk is properly recognized and measured and that the institutions concerned have adequate capital in place to support the level of business and risks which they run.

Therefore in discharge of its functions, Bank of Uganda in cooperation with banks is required to promote and maintain adequate and reasonable banking services for the public, to ensure high standards of conduct and management throughout the banking system, to provide facilities for the clearing of financial instruments for banks generally and on terms determined by it and to vet directors of banks and other financial institutions.³⁴

It's also authorized, in consultation with the Minister by statutory instrument to prescribe Inter alia the maximum amounts of investments, loans and advances, the purpose for, which loans and advances may be granted and the class of business underlying investments, maximum and minimum rates of interest and other charges which the banks may pay on any type of deposit or other liability and on credit extended in any form.³⁵ It becomes an offense to knowingly make an incorrect statement in a document submitted by any person to the Central Bank or

³³ S.5.(2) (J) Ibid

³⁴ S.38 and S40 (1) Ibid

³⁵ S 40 (I) Ibid

to knowingly make a false reply to a question asked of him for purposes of Bank of Uganda statute³⁶.

When such an offense is committed by a body of persons, every person who at the time of its commission was a director, manager or partner of that body is deemed to have committed the offense unless he proves that the offense was committed without his knowledge and that he took reasonable steps to ensure compliance with the provisions of the Bank of Uganda statute. Therefore many changes are taking place in the Uganda financial system. It is clearly heading away from the rather passive and controlled financial system that existed prior to the passing of this statute to a more liberalized market approach with a greater role for the Bank of Uganda in monetary policy.

3.2.3 The Financial Institutions Statute 1993³⁷

It has become quite clear that the previous laws governing Financial Institutions was grossly inadequate to handle the financial sector and hence, there was inevitably need for reform in the legal framework.

According to its preamble, it is a statute to amend and consolidate the law relating to the regulation and control of financial institutions and to provide for related matters. The statute repealed the 1969 Banking Act and has rectified many weaknesses in the Act including increasing the Bank of Uganda's supervisory role with the powers to license new banks. Since the powers of Bank of Uganda cannot operate in isolation, financial institutions are a necessary part of the financial sector and consequently monetary policies cannot be framed in isolation of these financial Institutions. Inevitably then the central Bank had to have more powers in the regulation of these institutions of which these powers are adequately portrayed in the financial institutions statute S993.

This authority had hitherto been vested in the Minister with consequences disastrous to say the least. Among its provisions,

"A person shall not transact banking business without a valid license granted for that purpose under this statute and the person

³⁶ S.52(1) (b) Ibid

³⁷ FIS No.4 of 1993

shall be granted this license if is a company within the meaning of this statute.³⁸

In addition to this, the statute endows the Central Bank with the legal authority to open or close a financial institution under part II of the statute,

"A Company proposing to transact business in banking shall apply in writing to the Central Bank for a license under this statute",³⁹

In doing so, the Central Bank becomes over all instead of the Minister contrary to the situation that existed under the Banking Act of 1969. More so, the provision as to licensing by the Central Bank instead of the Minister helps to curb political interference which greatly undermines the performance of the financial sector.

Coupled with the above, the provision for appeal is not worthy. Under 5.7 (4) (b),

"In the event of refusal to grant a license, the aggrieved applicant may appeal to the Minister who shall deal with the appeal in consultation with the Central Bank."

This ensures fairness in the operation of the powers of the Central Bank and supports the saying that Justice must not only be done but must also be seen to be done. The appeal to the Minister thus serves a just way through which a party can see that justice is done whichever way his appeal goes. Previously this was not readily so since the license was granted by the Minister and thus left an aggrieved applicant with almost no alternative to have recourse to save for court.

3.2.4 Financial institutions Act 2004

As a legislation that regulates the activities of the financial institutions where electronic banking is done, none of its provisions regulates electronic banking, as a system in the financial institutions, specifically in the commercial banks. So according to this fact, there is need to visit this law so that the regulation of electronic banking in Uganda is explored in the law' as indicated in the *Journal of Internet Banking and Commerce*, December 2005 Vol 1 No.3.

3.3 Conclusion

³⁸ S4 Ibid

³⁹ S.5 (I)Ibid

The banking sector is not legally regulated enough to remain effective because the regulatory framework governing financial institutions is a bit wanting according to the research carried out on electronic banking. This has been coupled with the loose electronic banking Supervision, which has not helped the commercial banking sector in capacity building and winning bank customers trust in the electronic banking practice, hence the banking laws should be amended by virtue of their inadequacies like those of the Electronic Transactions Act 2014. It will always be urged that the law should be enacted to fit in the context of the problem existing in the electronic banking system.

CHAPTER FOUR

ELECTRONIC BANKING PRACTICE, LEGAL AND REGULATORY CHALLENGES IN UGANDA

4.0 Introduction

In 1998 Bank of Uganda created the national Payment system Secretarial (NPSS) AND embarked on systematic and planned process of modernizing its payment role in the economy by gathering its payment role in the economy, by gathering deposits, repackaging them into a variety of financial products and services for their customers and the public. Of important consideration here, is the use of information and Communication Technology to provide the financial products and services for improved efficiency and effectiveness. These continuously affect the risk management, infrastructure provision, monetary policy development and regulatory frame work of the financial system. Advancements in the financial sector of the Uganda economy. These developments have however not been matched with appropriate legislation /regulations to address the resultant changes in the relationships, responsibilities, liabilities and right of the parties engaged in electronic banking. Having recognized the potential for the abuse and mismanagement inherent in the financial system, and the negative effect a weak system will have on the economy, the Ugandan Government and its agencies must be actively engaged in creating an extensive set of laws and regulations to dress the inadequacies of the current system.

Another concern is the potential of digital money to replace fiduciary currency as the predominant payment medium and its ability to flow freely across national borders, raising questions about the effect of e-money on monetary policy.

The central bank's oversight of the financial sector of any economy derives from the fact that it is the sole issuer of currency, and it is through control of money supply that the overall objective of monetary policy can be realized. Therefore monetary policy objectives should not be constrained by the replacement of fiduciary money with the digital equivalent.

4.1 Legal frame work of electronic banking

4.1.1 Electronic payment systems

The phrase 'electronic funds transfer' (EFT) is often used to describe the systems of electronic payment but it is a misnomer as no funds are transferred. The systems comprise the transfer by electronic means of payment messages consequent adjustment, also by electronic means, of various debtor-creditor relationships. The legal basis of the relationship and the legal rights and obligations of the parties to those relationships will then be discussed.

4.1.2 The paying bank

The paying bank is considered to owe a general duty to its customers to comply with their (legitimate) instructions and in carrying out those instructions it must exercise reasonable care and skill.⁴⁰ In making a payment for its customer, the paying bank acts as its agent and is liable for the negligence of any correspondent bank it employs⁴¹. It should only act on genuine instructions from its customer. If it excludes liability for acting on forged instructions or for the negligence of itself or its correspondent bank, this exclusion is subject to the limits imposed by unfair contract legislation. It is not necessarily liable for losses caused by failures in the payment system itself unless it should have been aware of defects in the system.

The paying bank's relationship with the receiving bank will be determined by the rules of the payment system being used. A payment made by mistake may be recoverable. The paying bank's relationship with the payee is not based on any contract and therefore any liability of the paying bank to the payee would have to be in the tort of negligence. If the paying bank fails to make a payment which its customer instructed it to make, the payee would look to that customer for payment. It is arguable that if the payee cannot enforce the payment because the customer has become insolvent or has died or decided not to make a payment

⁴⁰ Section 13 of the supply of goods and services Act 1982

⁴¹ Royal prozhiicts ltd -v- midland bank[1981J com LR 93

which was to have been a gift, the payee may have a claim against the paying bank on the basis that a duty was owed to him as beneficiary of the payment.⁴²

There is no case law relating to countermand of electronic payments between banks⁴³ but it is generally accepted that a paying bank must act on its customer's Notice of countermand of payment in a similar fashion as applies in the payment of cheque. In an electronic payment, countermand can be made at any time up to the point when the paying bank becomes committed to make the payment to the receiving bank. Under the BACS payment system this will be at the beginning of Day 2 when the receiving bank is told about the credit. Under the CHAPS system it will be when the Bank of England makes its adjustment of the accounts of the paying and receiving banks.

In *Momm v Barclays Bank International*⁴⁴ a customer of the defendant bank ordered it to transfer funds to the plaintiff who was also a customer of the defendant. The bank made the transfer but shortly after completing it, and before the plaintiff was informed of it, the bank reversed it, the bank by now having heard of the paying customer's insolvency. The plaintiff denied the bank had the right to reverse the transfer and the court agreed with him, holding that payment was irreversible once the bank had decided to credit the plaintiffs account and had initiated the payment process. It was irrelevant that the plaintiff had not yet been told of the credit.⁴⁵ Although this case concerns reversal of payment which the bank wanted to perform, it is reasonable to assume that the same rules would apply to determine up to what point a customer could countermand an intrabank transfer.

Once it has become too late for the customer to countermand payment or for the paying bank to reverse payment, the payment is considered complete and irreversible. This does not of course prevent the paying bank (or the payer) from

⁴² By analogy to *White v Carter (Councils) Ltd v McGregor* [1962] AC 413 HL.

⁴³ See the discussion in R. Goode, *Commercial Law*, 3rd edition at page 469-470

⁴⁴ [1977] QB 790, 150

⁴⁵ The plaintiffs bank statements did not show the payment or the reversal of it. The fact of the statement only emerged after litigation began.

claiming recovery of the payment as one made by mistake. The objection to recovery of payments made by electronic means stated in

*Agip (Africa) Ltd- v-Jackson*⁴⁶ are of particular relevance. Equitable tracing is not limited in this way but it is limited in other significant ways, primarily the requirement of a breach of some fiduciary relationship. The recovery of a simple mistaken electronic payment as was permitted in *Chase Manhattan Bank v Israel-British Bank*⁴⁷ has been placed in doubt by the decision in *Westdeutsche Landesbank Girozentrale v Islington LBC*⁴⁸.

Interestingly, the court in *Momm* stated that the absolutely final time when payment had become irreversible (if it was difficult to determine an earlier decision to credit the payee's account) was close of business on the value day, at any rate if the payee's account was credited intentionally and in good faith and not by error or fraud. This suggests that payment could be reversed after this time if it had been made in error.⁴⁹

When a payment is made in error, besides recovering a payment as one made under a mistake of fact, the paying bank could also be subrogated to the rights of the pay against the payer. In this case, the Bank of Uganda, as the regulator of commercial banks in Uganda, may borrow a leaf from the above so that when the bank, clients electronically transfer funds to their destined payees, are able to recover the money in case there was some fraud on the part of the payee, which could not have come to the intention of the account holder. This may enhance the confidence of the bank customers in the electronic banking system, thus the need to review the legal and the regulatory frame work of electronic banking in Uganda.

⁴⁶ [1989] 3 WLR 1367, Affirmed [1991] 3 WLR 116

⁴⁷ *Manhattan Bank v Israel-British Bank*

⁴⁸ [1996] 2 WLR 802 HL 1140, 150

⁴⁹ 100 Note that, recovery of a payment made under a mistake of the fact necessitates a court action to seek repayment and would not justify unilateral decision to reverse the payments

4.1.3 The receiving bank

The receiving bank has a banker-customer relationship with the payee and accordingly owes him a duty to act with reasonable care and skill. Thus it will be liable for any negligence in its processing of the transaction and for the negligence of its agents. Any attempt to exclude such liability will be subject to the unfair contract terms legislation.

In *Tayeb v HSBC Bank*⁵⁰, the receiving bank became concerned about a large deposit that it had credited to the claimant's account following a CHAPS transfer in. At 1403 hours on the day of the transfer, the bank credited the customer's account. At 1614 hours on the same day the bank (having become concerned about the source of the funds) placed an inhibit marker on the account. This prevented the customer from drawing against the funds. At 1444 hours on the following day, the receiving bank returned the funds to the paying bank. It was held that once an account was opened which was available for receiving incoming CHAPS transfers, HSBC engaged that it would accept into that account all CHAPS transfers which complied with the CHAPS rules and which were otherwise in accordance with the terms of the account. Once the claimant's account had been credited at 1403 hours, following authentication and the transmission of the LAK, HSBC became indebted to the customer in respect of the transfer. The imposition of the inhibit marker did not cancel the debt due to the customer. Nor did it reverse the account entries on the bank's computer. It simply had the effect of postponing the time when the bank would respond to an instruction from the customer for payment out of the account. The credit balance and the debt owed by the bank to the customer remained intact. Effectively therefore, when HSBC sent the money back to the paying bank, they were not sending back the customer's money but their own money.

Although the receiving bank has credited the customer's account, it does not necessarily follow that the customer is deemed to have received the money from

⁵⁰ [2004] 2 ALL ER comm. 880,31,151

the payer. It has been decided that the receiving bank receives the payment as agent for its customer, the payee.⁵¹

In the normal case, the receiving bank has its customer's authority to receive payments to his account but in some circumstances it may only have limited authority to receive payments, such as that from a ship charterer who would otherwise have established that payment had been accepted on the ship owner's behalf by its bank and thus the ship owner's right of forfeiture of the charter would have been waived.⁵² However, where the payee was aware of the payment and retained the funds for three weeks before returning them without paying interest, payment is considered to have been accepted.⁵³

4.2 Electronic banking in Uganda

Electronic banking may be defined as means whereby banking business is transacted using automated process and electronic devices such as personal computers, telephones, fax machines, internet, card payments and other electronic channels⁵⁴. Some banks practice electronic banking for informational purpose, some for simple transactions such as checking account balance as well as transmission of information, while others facilitate funds transfer and other financial transactions,. Many systems involve a combination of these capabilities. The bank of Uganda has facilitated notable improvements in the payment system including: installation of electronic banking with the national electronic switch; Automatic Teller Machines (ATMs) spread country wide; and the introduction of credit cards and debit cards. Some financial institutions are already considering introducing Internet banking. Mobile Banking Services are expected to reach an estimated 20,000 clients over a period of five years⁵⁵. These developments should facilitate smooth flow of remittances and attract remittances into the formal

⁵¹ Mordorf peach & co. ltd -y- Alltica Sea Carries Corpn of Liberia [1977] AC 850 HL

⁵² the fact of the mardorf peach case

⁵³ TBS bank of Scotland and -v- Welwyn Hatfield district council [1993]2 bank LR 267.

⁵⁴ R Bhala' the Inverted Pyramid of wire Transfer Law' ch7 J Norton, cReed "& I Walden (eds) cross boarder electronic banking challenging and opportunities (151 ed 1995 LLP).

⁵⁵ Speeches by Mr. Emmanuel Tumusiime Mutebile, Governor Bank of Uganda at the Second International Conference on Migrant Remittances: Remittances and Access to Finance County Hall 'London. United Kingdom November 13-14.2006

system. Some of the banks that offer Internet banking include Stanbic bank, Barclays bank, Orient bank, Crane bank, Eco bank and most of the banks have their websites hoisted in Uganda.

4.2.1 Personal computer (pc) banking

PC banking refers to the use of computer hardware, software and telecommunications to enable retail customers' access to both specific account and general information on bank products and services through a personal computer.

4.2.2 Telephone banking

Telephone links are used in electronic banking for direct connection either as private networks such as direct dial-in using leased or dedicated telephone lines or public networks. People can now use SMS banking by the in pull mode, one can find out their Account balance, check the last turnover, mini statements and by the push mode the bank can inform one when they earn their salary⁵⁶.

4.2.3 Automated Teller Machine (A TM)

ATMs enable cardholders to withdraw cash, make deposits or transfer funds between accounts. To use the ATM, Smart cards is inserted and a PIN (personal Identification number) is entered to give the customer access to cash all day long.

4.2.4 Electronic cards

Cards are a key tool for electronic banking, providing authentication and access to banking services. The most common card in Uganda are visa electronic cards containing one or more integrated circuit chips supporting multiple applications, thereby facilitating Access to funds in the cardholders account on the basis of information communicated electronically.

⁵⁶ Sunday Vision June 29, 2008 'your mobile phone can be the banking hall'

4.2.5 Electronic money

Another facility of e-banking is electronic money. Electronic money is an electronic store of monetary value on a technical device (smart cards) that may be widely used for making payments to undertaking other than the issuer without necessarily involving bank accounts in the transaction, but acting as a prepaid instrument. Risks that are also associated with electronic money are broadly divided into two⁵⁷.

- a) Quantifiable Risks comprising of credit, liquidity, interest rate, foreign exchange and equity prices.
- b) Non-quantifiable Risks comprising of strategic, operational, compliance, reputational and legal risks, which have already been explained under electronic banking.

4.3 Electronic payments

These were a number of significant payment system developments that took place during

2003. These included the introduction of Electronic Fund Transfers (EFT) (both credits and debits), development of a Real Time Gross Settlement (RTGS) system that was still in process by the close of the year; implementation of the payment system oversight; the drafting of a legal framework for the regulation of the payment system and the development and adoption of a payment switching regulatory framework by the central Bank and commercial banks.⁵⁸

In August 2003, the Electronic Fund Transfer system was implemented. The EFT system supports both credits and direct debits and the EFT transaction volumes and value have steadily increased. Since its introduction, the EFT system has proved popular for corporate salary payments.

The EFT is expected to enhance efficiency and strengthen risk management in the national payment system.

⁵⁷ sawyer: Electronic Transactions B,U FOR New Zealand (pan I) (2000) J.I.B,L issue 10

⁵⁸ 109 Bank of Uganda Annual Report 2003/2004

In order to further improve efficiency and strengthen risk management in the national payment system, the bank embarked on the acquisition and implementation of the Real

Time Gross Settlement (RTGS) System in June 2004, the Bank signed a contract for the supply, implementation and maintenance of the RTGS system in Uganda (now called the Uganda National Inter-bank Settlement (UNIS) system. Implementation of the system started on the 21st of February 2005⁵⁹.

Banks have continued to invest in payment technologies, including the Automated Machines (ATMs) whose number has shot up to over 150. Furthermore, the ATM functionality continued to expand and besides cash withdrawals and deposits, statement ordering and account balance inquiry, some ATMs now provide for payment for utilities, Loading of airtime on mobile phones and inter - bank transfer of funds. The ATM penetration levels to the up country areas also increased, with ATMs currently installed in more than 30 upcountry towns.

The Bank of Uganda has also continued to work with the commercial banks to expand electronic cheque clearing was initially implemented in the capital city Kampala and its nearby areas in May 2002. After stabilizing and basing on a centralized electronic clearing system model, electronic cheques clearing is planned to be rolled out to upcountry area, which would lead to a 3-day uniform clearing cycle virtually the entire country. This is expected to further promote the use of non-cash instruments, as customers would be able to receive money in a relatively short time. To further improve efficiency in retail electronic clearing, Bank of Uganda has continued to work with commercial banks to introduce electronic transmission of clearing data to the clearing house

On the regulatory front, in October 2003, the bank formally implemented a payment system oversight regime to monitor and evaluate strategic trends in the national payment system, and invoke corrective measures whenever deemed necessary. Among others, payment system oversight facilitates the expeditious identification of operational and other risks in payment systems, and the development and implementation of a safety and efficiency remedial measures.

⁵⁹ibid

Furthermore, between November 2003 and January 2004, the Bank developed a framework of regulating and guiding the management and operations of payment switching in Uganda. The Uganda Bankers' Association reviewed the regulatory framework and has since been adopted the same. Payment switching is expected to stimulate the use of payment cards, facilitate Electronic Fund transfer at point of Sale (EFTPOS), enable prepayments of consumption of utilities, and facilitate convenient loading of airtime on mobile (cell) phones.

Earlier on August 2002, the Bank engaged a team of consultants to develop legal and regulatory framework that could support the operations of a modern payment system. The

III Bank of Uganda Annual Report 2003/2004 consultants submitted their report in September 2003. An enabling National Payment System law has been drafted and when enacted, it will among others confer payment system oversight powers on the bank, and also vest it with powers to make legally binding regulations that are intended to strengthen and enhance the safety and efficiency of the national payment system. A policy paper to justify proposed amendments to existing laws and the rationale for the proposed new laws were scheduled.

4.4 Electronic banking risks and controls

Electronic banking systems primarily expose banks to transactional, strategic; reputation and compliance risks, for example, Electronic-banking systems may present credit risk if a bank offers lending services over the Internet. Requirements such as "Know your customer" may require the use of different identification, authentication, and transaction. Verification methods than those used with traditional delivery channels. Liquidity, interest rate, market, price and foreign exchange risks may also result from poor data integrity or unreliable systems. The regulatory/supervisory authorities expect banks to carefully consider the full range of these and other issues and the potential risks that they may pose in deciding whether to adopt an electronic banking product or to renovate an existing one. Electronic banking risks should be managed as part of a bank's

overall risk management process. Banks should use a rigorous analytic process to identify measure, monitor and control risks.

The quantity of risk assumed should be consistent with the bank's overall risk tolerance and must not exceed the bank's ability to manage and control its risks⁶⁰

Therefore management and bank staff are expected to have the knowledge and skills necessary to understand and effectively manage their electronic banking-related risks. The regulatory must evaluate system performance and the effectiveness of specific controls. Regardless of how a system is developed or operated, the regulator's expectation is for banks to effectively manage their electronic banking risks. Controls should take into account the level of risk posed to the institution and should be adopted by the party in the best position to control the risks. In some instances, that party may be an outside vendor or service provider. In practice, the controls necessary to effectively manage risk will differ depending on the degree of risk posed and how the electronic banking system is designed and operated.

4.5 Nature and types of risks associated with Electronic banking.

The risks associated with e-banking and e-money activities as per Basel Committee's categorization of risks include: Strategic Risk, Operational Risk, Security Risk, Reputational Risk, Legal Risk, Money Laundering Risk, cross Border Risks and other Risks. These risks are briefly discussed below.⁶¹

4.5.1 Operational risk

Operational risks take the form of inaccurate processing of transactions, no enforceability of contracts, and compromises in data integrity, data privacy and confidentiality. Also inadequacies in technology, human factors such as negligence by customers and employees, fraudulent activity of employees and crackers/ hackers can become potential source of operational risk.

4.5.2 Security risk

Security risk refers to the unauthorized access or intrusion to a bank's information systems and transactions. Attackers could be hackers, unscrupulous vendors,

⁶⁰ journal of internet banking and commerce, December 2005, vol. 10 no.3

⁶¹ Basel committee

disgruntled employees or even pure thrill seekers. Also, in a networked environment the security intrusion is often limited to the weakest link.

4.5.3 Non-compatibility of the Legal regulation with the bank customers' desires.

Legal risk results from the legal rights and obligation of parties to a transaction which are not well established in the course of delivery of electronic banking services and products via electronic channels.⁶² According to the respondent found at the ATM machine, Equity Bank in Kabalagala, stated that there is a maximum amount of money that is supposed to be withdrawn from the ATM machine, not that any amount you can withdraw

4.5.4 Money laundering risk

This is a risk that financial institutions are exposed to when their systems are used in the moving criminal funds. This involves the concealment of illegally acquired wealth in order to obscure its true nature or source.

4.5.5 Cross-border risks

Cross border risks are risks that banks are exposed to in the course of their international transactions from differences in legal/regulatory and jurisdictional ambiguities with respect to the responsibilities of different national authorities. These risks are associated with non-compliance of different national laws and regulations, including consumer protection laws, record-keeping and reporting requirements, privacy rules and money laundering laws.

By the nature of cross border risk apart from the legal risk, a bank could also be exposed to other risks like the operational, credit risk and market risk as a result of geographical and market expansion beyond the national borders which make monitoring more difficult.

4.6 Impact of Electronic banking risks.

While the basic types of risks generated by electronic banking and electronic money are not new, the magnitude of their impact on banks and merchants may

⁶² Fresh fields: Don't get caught in the internet: Know your liabilities - July 2000 publication

be new for them and regulators/supervisors. The impacts of the risks these banks/merchants face are embedded

In the types of risks associated with electronic banking and e-money. Some of them are discussed and examined below⁶³

4.6.1 Impact on financial institutions

Financial institutions are often faced with system redundancy due to rapid technological changes resulting to excessive costs particularly if an institution wants to be a technological pioneer just as in the case of an overly cautious technology follower which may find it unable to adequately position itself in a saturated market or a market that is consolidating rapidly.⁶⁴

Operational/Security Risks

These could lead to financial and capital losses due to inaccurate processing of transactions, non-enforceability of contracts, compromises in data integrity, data privacy and confidentiality, unauthorized access intrusion of Financial Institutions systems and transactions. Others include technological inadequacies or problems of integration, outsourcing, and Internet and third party services. Apart from financial losses, financial institutions also face the problems of loss of data, theft or tampering with customer information, disabling of a significant portion of Financial Institution's internal computer systems due to the activities of hackers.

Reputational Risks

Financial Institutions could face or experience problems of negative public opinion which result in critical loss of fund or customers arising from Financial Institutions or third party actions which could result to loss of public confidence in the Financial Institutions ability to perform critical functions or impair Financial Institution customer relationship.

In the same vein, it may have a bandwagon effect Financial Institutions that are providing similar services.

⁶³ R Bhala 'the Inverted Pyramid of Wire Transfer Law' ch 7 J Norton, CReed & I Walden (eds) cross boarder electronic banking challenges and opportunities (151 ed 1995 LLP)

⁶⁴ R Bhala 'the Inverted Pyramid of Wire Transfer Law' ch 7 J Norton, CReed & I Walden (eds) cross boarder electronic banking challenges and opportunities (1st ed 1995 LLP)

Legal Risks

Legal risks only arise where the bank is in a fiduciary relationship and therefore Financial institutions could face transactional disputes, unwanted suits or other regulatory sanctions due to inadequate information to customer about his rights and obligations to enable him take proper precautions in using Internet banking products or services. Also e-banking cuts across national boundaries bringing uncertainties and ambiguity about legal requirements. Financial Institutions are exposed to legal risks associated with non-compliance of different national laws and regulations, including consumer protection laws, record -keeping and reporting requirements, privacy rules and money laundering laws.

As Internet banking transactions are conducted remotely, banks could also be faced with legal sanctions for non-compliance with "know your customer" laws due to difficulties in applying traditional methods in detecting and preventing undesirable criminal activities⁶⁵.

4.6.2 Impact on regulators/supervisors

As the preceding discussion indicates, the basic types of risks associated- with E.banking are not new. However, the specific ways in which these risks arise, as well as, the potential magnitude and speed of impact on banks, may be new for bank management and supervisors alike. In addition, while assessing risk should be dynamic, the rapid pace of technological innovation supporting e-banking, the increased degree of systems out sourcing and reliance of some products/services on the use of open networks such as the Internet, intensifies the need for a rigorous and ongoing risk management process.

It is therefore essential for bank supervisors to recognize their own critical need for appropriate technology knowledge and skills to ensure that they understand the risks and challenges arising from the development of the e-banking delivery channels.

⁶⁵ Electronic Commerce part One: A Guide for the legal & Business Community (Oct. 1998) available at [Http://sss.lawcoll1.nziECOMM/RSOCon .htm](http://sss.lawcoll1.nziECOMM/RSOCon.htm).

Towards achieving this, enhanced technical training is essential for the supervisory staff and if necessary, to be complemented by appropriate attachment programs with other overseas regulatory/supervisory bodies.

In conclusion, though the electronic banking in Uganda is steadily developing, one has to remember that this is a new system that needs a progressive approach to be realized to attain its effectiveness. It is also worth noting that given the margin of illiteracy in Uganda coupled with a fact that we have very few banks that basically centralized in urban places creates gap for the effective implementation and realization of electronic Banking in Uganda.

4.7 LEGAL AND REGULATORY CHALLENGES FACING ELECTRONIC BANKING IN UGANDA

4.7.1 Legal Challenges

Despite the phenomenal increase in e-banking activities in Uganda today, it is unfortunate that this trend has not been matched with commensurate development in the legal framework for the practice of e-banking. In Uganda, reliance is being placed on existing legislations, rules and codes of professional ethics evolved in the relation to paper-based transactions to deal with electronic banking issues. It is therefore necessary to critically examine the legal issues involved in e-banking against the existing legal framework with a view to making necessary recommendations.

4.7.2 Ineffectiveness of the relevant regulations

The law is the starting point because it confers rights and remedies. The existing Legislation is BOU Act, Financial Institutions Act, Bill of Exchange Act, penal Code Act and Trial on Indictment Act, The Electronic Fund Transfer Act, The Electronic Signatures Act, and Evidence Act and the challenges is existing Legislations most of the provisions are unsuitable for the electronic age and experience elsewhere has shown that the starting point of protection is through enacting appropriate laws which declare what is legal and illegal through laws. The challenges that come to light in this regard is to how regulation is to be applied. The US law professor, Lawrence Lessing, in his book, code and other

laws of cyberspace (1999) distinguishes four categories of regulations these are; laws, norms, the market place and technology architecture.

4.7.3 Electronically generated evidence.

The electronic transactions, have the propensity to generate or lead to dispute. The resolution of such dispute may take the form of one of the following medium of dispute resolution: negotiation or litigation. To resolve any dispute utilizing any of the identified mediums requires the indispensable use of evidence.

Evidence in electronic banking transactions are essentially electronically generated documents, from either the hard disk or the floppy disk. Such electronically generated evidence qualifies to be classified as secondary evidence to be admissible certain conditions set out in section 64 of the evidence Act must be satisfied i.e., when the regional is immovable, lost or cannot be produced.

It has further been argued that the Computer print-out cannot be regarded as a c9PY of the original since the original is in code in Uganda however no legislation exists yet to regulate EFT. The Clearing House Rules clearly do not have the capacity to deal with EFT and cheque transaction.⁶⁶

Section 61 of the Evidence Act should be amended to admit computer generated documents as primary evidence. Therefore appropriate legislation be enacted to regulate the EFT and related transactions.

4.7.4 Contract laws

Electronic banking legislations must take cognizance of issues relating to encryption and digital signature to ensure that the legality and admissibility of such documents in the law Courts are not taken for granted. The Evidence Act must be amended to allow for the admissibility of electronically executed document as primary evidence. E-banking documents must guarantee the following: Authentication, Integrity, Non- repudiation and Confidentiality.

Encryption takes place of confidentiality while digital signature ensures authentication, integrity and non-repudiation. However there are proposed legislations and these include; Electronic Transactions Bill, the Computer Misuse

⁶⁶ Status of cyber laws and legal provisions in Uganda.

Bill, Electronic Signature Bill. These cover computer misuse, facilitation of electronic transactions, consumer protection and limitation of service providers' liability, privacy protection, intellectual property rights and security. Current efforts are the main activity towards cyber security issues is the formulation of the relevant laws, which will result in the setting up of the necessary authorities to address such issues.

Unfortunately cyber threats will not wait for one to be prepared to strike, so it is important to start moving, within the existing legal boundaries. The Uganda Communications Commission, as a big stakeholder, with security concern of public communication networks, IS taking some steps in addressing the challenges of cyber security UCC:

- Requires, though licenses issued, service providers to set up adequate protection of their networks. There is provision to review these regularly, to determine their suitability. Cyber threats are considered to be among the threats operators need to protect themselves against.
- Has joined both Kenya and Tanzania, as members of EARPTO, to among other things, raise awareness of the importance of the issues of security at regional levels. This is aimed at setting up a voluntary coordination body to deal with early warning and sharing of information. This, for the moment will only cover telecommunication networks but it is hoped that other bodies can join in.⁶⁷ however the proposed laws, certain provisions lack codification with the existing legislation, strict liability in nature i.e. unduly harsh, not comprehensive enough.

4.7.5 Criminal liability

In paper-based transactions involving cheques, persons who alter or forge a document may be charged for forgery. However in electronic banking there are no papers or written 120 Paper on the state of cyber security in Uganda by Uganda communications commission signatures that can fit into the definition of documents or writing under sections 342 or 347, of the penal Code especially as computer information does not exist in writing and the customer's PIN is not a written document.

⁶⁷ Paper on the state of cyber security in Uganda by Uganda Communications Commission

It is obvious that a person who engages in an unauthorized transaction in electronic banking may not be successfully tried and convicted for forgery especially as the provisions of the penal Code were not designed to deal with electronic banking. It is therefore suggested that the proposed legislation should identify offences that are peculiar to electronic banking and provide for punishment accordingly.

The regulatory authorities should be empowered by the legislation to enforce relevant provisions of the Act and issue appropriate guidelines on electronic banking. As a Stopgap measures and for purposes of setting parameters for electronic banking, a robust guideline must be put in place immediately.

The common feature of electronic banking environment in Uganda is the absence of statutory or regulatory provisions to protect the consumer of the products/services. By the large, the bank's customer is made to sign or execute standard forms of contract or agreements prepared by the bank, or non-bank financial institutions. The magnitude of risks as well as benefits to consumers using e-money products vary across products but those risks may be classified into some general categories as those facing existing payment mechanisms. These may include risk of financial loss, malfunction of cards/terminals or merchant acceptance and unauthorized disclosure of information without customers consent.

However, banks generally should have clear responsibility to provide their customers with a level of comfort regarding information disclosures, protection of customer data and business availability that approaches the level they would have if transacting business through traditional banking channels. The banks providing e-banking services and customers availing of the same are currently entering into agreements defining respective "Rights and liabilities in respect of electronic banking transactions. A standard format/minimum consent requirement to be adopted by banks may be designed which should capture all essential conditions to be fulfilled by the banks, customers and relative rights and liabilities arising

there from. This will help in standardizing documentation as also develop standard practice among bankers offering e-banking facility.

4.7.6 Jurisdictional impediment

Electronic banking transaction transcends the national borders. The issue of the applicable law becomes rife in electronic banking transaction involving money transfers from jurisdictions outside Uganda. The question is, in the event of any dispute, which law will apply? Over the years, the courts have adopted certain guiding principles where the issue of jurisdiction arises in a dispute. In such a situation, the courts have had recourse to the following to statutory provision and contractual provision. The law of the jurisdiction closely connected with the contract either in terms of where the contract was made or where it is expected to be executed or where the parties are domiciled.

4.7.7 Money laundering

Money laundering is the concealment, conversion, transfer or disguise of any property that represents proceeds from criminal activity. It can also be defined as legitimizing funds used in or resulting from criminal activity. Put differently it is cleaning dirty money. Another serious concern in e-banking is the high exposure of the system to fraudsters, hackers and other criminally minded persons who could access, retrieve and utilize confidential information from the system if appropriate security measures are not put in place to checkmate unauthorized intrusion into the system. In the case of *Re v Levin* a graduate of chemistry of St. Petersburg Institute of Technology Russia who was alleged to have transferred well over \$11 million from Citibank's Computer database in New York to accounts in Israel, San Francisco and Finland. This incident, among others, has brought to the risk of fraud prevalent in e-banking money laundering is a fact developing phenomenon in Uganda and its activities account for a significant measure of transnational organized crime in East Africa. Though the Anti-money-laundering bill was drafted, it is yet to be passed into law.

4.7.8 Credit and Debit Cards (plastic) Frauds

The most common plastic cards in Uganda today is the card e.g. ATM and point of sale cards. ATM and credit fraud occurs when criminals to withdraw cash from a customers' account use a stolen or cloned card. The fraud takes various forms. A close friend or even relative may accompany a bonafide customer to an ATM point to withdraw cash. In the process the relative or friend may learn the PIN number of the card and subsequently steals the card and withdraws the money from the bank without the knowledge of the customer. In more sophisticated cases, fraudsters mount cameras and other gadgets on ATMs and steal or capture the details of using the obtained details. These gadgets are cleverly disguised to look like normal ATM equipment or leaflet brochure holders.

In other instances criminal gangs or employees obtain the particulars of a credit card through imaging techniques when being used to pay for goods and services and use the Information to clone a fraudulent card which is then used to defraud the holder of the card.

To protect against such frauds, customers are advised to memorize their PINs and never to write it down or share it with any other person. They should desist from the habit of giving cards and PIN to other people to withdraw money on their behalf.

Cardholders should never use a card in an A TM where they see suspicious equipment or people. Always insist that cashier's swipe customer's cards in a machine that should be well located at the counters in the site of the cardholder and not under the counters or back officers. In *Re V. Levin*⁶⁸.The applicant in St Petersburg accessed Citibank's computer system in New Jersey and transferred money. He was arrested in the UK and US sought extradition, the applicant a graduate of chemistry of. Petersburg Institute of Technology Russia, who was alleged to have transferred well over \$11 million from Citibank 's Computer database in New York to accounts in Israel, San Francisco and Finland, This incident, among others, has brought to the fore the risk of fraud prevalent in e-banking. And bank frauds account for a large measure of laundered proceeds

⁶⁸ 121 [1997] QB 65

through hackers' credit/debit cards. The loss of funds as results of well organized bank fraud through theS financial sector has been enormous.⁶⁹

4.7.9 Privacy

Article 27 of the 1995 constitution provided for the right to privacy. It is recommended however, that in the penal provision of the proposed e-transaction legislation, stiff Penalties should be imposed on hackers and unauthorized intruders into the system to act as deterrent to others.

The banking regulatory authorities should be able to immediately make regulations or formulate code of conduct for the providers of electronic banking services, so as to ensure the privacy of customers and encourage the patronage of electronic banking⁷⁰.

Customer's privacy policies and standards should take account of and comply with all privacy regulations and laws applicable not only in Uganda but also any other jurisdiction to which the bank is providing e-banking products and services. In view of the level of development of e-banking in Uganda and because it will be difficult for Ugandan banks to be conversant with the privacy regulations of all countries (Internet banking by its nature being no respecter of international boundaries), it will be advisable to draw from the Indian experience and require banks at this point in time to restrict the provision of their e-banking services to customers in Uganda and Ugandans abroad who might want to use such service to remit money/execute projects at home.

The Ugandan Consumer protection Agency may have to take steps to protect the Ugandan consumer enjoying e-banking services. This may include the enactment of specific laws, as is the case in the US (the EFT A and Regulation E) or the establishment of self-regulation approach, as is the case in the U.K. (the UK Code of Banking practice Good Banking) and Australia (Supervisory Commission) or the enactment of consumer protection laws. In protecting the consumer, certain

⁶⁹ 122 Bank of Uganda, Bank Fraud - A challenge to Uganda's Banking Industry". BOU policy paper, pp. J-4

⁷⁰ 123 16 Jason Chuah: The New EU Directives to regulate electronic Money Institutions (2000) JIBL-Issue 8

information must be provided by both the bank and consumer in conducting electronic transactions.

The mandatory things that should be provided by the bank include:

- a) Properly authenticated documents.-Documents must be executed by both parties.
- b) Integrity - Document is not tampered with between being sent and received.
- c) Non repudiation parties' cannot deny document.
- d) Confidentiality - Document can only be assessed by sender or receiver.

Some of the additional information to be supplied to the customer includes:

- a) Condition and procedures for exercising right of withdrawal
- b) Geographical address of the banks place of business consumer may address complaints.
- c) Conditions for canceling contract if contract duration is unspecified or exceeds one year.
- d) Consumer has a right to withdraw without penalty or need to provide reasons within a week or three (3) months if supplier did not comply with its obligations to provide aforementioned information.

All these details to be sent in written and durable form (could be e mailed) to the consumer and must be received before or at the conclusion of contract.

CHAPTER FIVE

5.0 Conclusion and Recommendation

5.1 Conclusions

In the late 1990s and early 2000s, conventional wisdom was that internet banking was the way forward and eventually there would be little risks and queries in the commercial banking sector in Uganda. Pure internet-based banks with interesting aiding instruments like ATM cards, electronic transfer of funds, were viewed as the wave of the future. All were backed by established commercial banking institutions so these were no neophytes to banking. None of these pure-play internet banking instruments and regulation tools now exist. Is internet banking legal and the regulatory framework still viable and in what form has it evolved and how it may help develop the electronic banking system

The researcher recognized that there are many issues relating to e-banking and that they assume critical urgency. Drawing the weakness in the legal and the regulatory frame work of the electronic banking system in the field of study, this research proceeds to review the legal and the regulatory framework of electronic banking in Uganda, and at the same time, suggesting the way forward to achieve the development and confidence in the electronic banking system in the mentioned commercial banks above, by their customers. The weaknesses are as with modern payment system of electronic banking system, certainty of the requirements of a valid electronic signature, as it relates to when e-payment is considered to be complete, whether e-payment operates to discharge payment obligation under the underlying commercial transactions, whether the electronic payment system is fully trusted by the bank as far as its regulation is concerned. The above issues were similarly raised in the article "*Electronic Credit Transfer in China (2007)*", under the topic "*Electronic and Technological banking* 335-345, 338, under paragraph 2.2.

The study thus recommends that the bank needs to do more than installing such technologies and offer training sessions for their customers; either on their mobile phones or at physical sites. The researchers thus recommend that: i) Regular security updates be provided to bank customers on their mobile phones and e-mails; and ii) Provide regular training to bank staff on IT related security cautions.

Foreign banks are generally perceived by the business community and other clients to be well managed in legal terms and unlikely to fail. However, there is a general concern that these banks do not meet electronic fund transfer needs for the proportion of the population who use the innovation. Restrictive requirements by foreign banks for transferring funds electronically across bank account, reporting

of lost credit cards, high transaction risks, and the high level of uncertainty of the requirements of the electronic signatures, are some of the limiting factors that make it difficult for the majority of people to seek financial services from foreign banks. Box 1 (see below p. 37) gives an overview of the operations and activities of Stanbic Bank Uganda Ltd, one of the several foreign owned banks operating in Uganda

The researcher through the face-to-face interview, with the branch manager of Stanbic Bank, Kabalagala, and the bank customers can only report for the loss of the ATM cards on working days only, that is, Monday to Friday. In addition, through the *documentary method*, in the Barclays Bank Ltd, it was confirmed that there is no refund of money transferred through the electronic banking system. There is no third party that can facilitate the refund in case the transaction was fraudulent.

These results further affirm the contradiction; to the effect that all it takes to ensure security during transaction is available and in use, but one still wonders why the crime is on increase. Such security orientation seem to suggest that these risks and threats may not be caused by technology itself but other factors like behavioural orientations of staff, personal responsibility of customers among others, may be considered.

5.2 Recommendations

5.2.1 Weaknesses in the legal and the regulatory frame work of

Electronic Banking in Uganda.

Banks should establish effective management oversight over the weaknesses associated with e-banking system, including the establishment of the specific reforms in the legal and the regulation electronic banking frame work. These are *the Bank of Uganda Act Cap 51*, the *Electronic Signatures Act 2004*, *The Electronic Fund Transfer Act 1978*, and *The Electronic Transactions Act 2014*.

Banks should ensure that their legal boards review the legal and the regulatory system, and suggest solutions to the legislature in order to mend the weaknesses in the system. For example, suggesting third parties in the system, which can refund money transmitted through the electronic banking system. These can be insurance companies. The banks still should establish a comprehensive and ongoing due diligence and oversight process for managing the bank's outsourcing relationships and other third party dependencies supporting e-banking.

Banks should take appropriate measures to authenticate the specific features of an electronic signature, so that whenever it is presented, it is accepted instead of “may be accepted”

Banks should ensure that customers’ data are not lost in case there is any transformation in the technological system, by issuing electronic bank statement as a mandatory obligation, unlike currently as it is just an additional service in banks. For example, in Stanbic Bank, Kabalagala branch, there is a poster inside, stating that open up an account with Stanbic Bank and enjoy a complement of free account statement. Therefore, the banks should ensure that the electronic bank statement is a mandatory service, but not an additional service. It should be part of the full package when opening up any account with any bank.

To protect banks against legal, regulatory and reputation risk, e-banking services must be delivered on a consistent and timely basis in accordance with high customer expectations for constant and high transaction confidence maintenance demand. The bank must have the ability to deliver e-banking services to all end-users and be able to maintain such confidentiality in bank customers. Effective incident response mechanisms are also critical to minimise operational, legal and reputational risks arising from unexpected events, including internal and external attacks that may affect the provision of e-banking systems and services. To meet customers’ expectations, banks should therefore have effective capacity, continuity and contingency examining of the legal and the regulatory frame work of electronic banking. Banks should also develop appropriate refund plans, including transactions that have been proved fraudulent.

Banks should take appropriate measures to ensure adherence to customer privacy requirements applicable to the jurisdictions to which the bank is providing e-banking products and services.

Banks should have effective capacity, business continuity and contingency planning processes to help ensure the availability of e-banking systems and services. Banks should develop appropriate incident response plans to manage, contain and minimize problems arising from unexpected events, including internal and external attacks, which may hamper the provision of e-banking systems and services.

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