Analysis of Ham Enterprises Limited & 2 Others v Diamond Trust Bank (U) Limited & Another

By:

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Facts of the Case

The case concerns a loan Diamond Trust Bank (DTB) Kenya Ltd granted to a Kampala-based firm with interests traversing real estate to agriculture, using its Ugandan subsidiary as the agent. The DTB Kenya Ltd granted the Plaintiffs, (Ugandan companies), loans in Kenya. DTB Kenya Ltd instructed DTB Uganda to collect repayments of the loans from the Plaintiffs' Ugandan accounts. The court stated that to do this, however, DTB Kenya required a license from the Central Bank of Uganda authorising it to use DTB Uganda as agent, but it did not get one. As such the court held that the collection by DTB Uganda was a violation of Uganda's Financial Institutions Act 2004 (as amended) and ruled that the syndicated loan was illegal. The court ordered the recovery of more than $23 million from the bank by the Plaintiffs, for monies withdrawn from their loan accounts. The court also ordered the discharge of mortgages created over the Plaintiffs’ properties with respect to the loans. Suffice to mention that on October 13, 2020, the High Court Commercial Division suspended the execution of the orders issued by the judge, pending the appeal of DTB Uganda and Kenya. The court order, if executed, can have far-reaching effects.

Analysis of the Case

This case raises significant issues around the regulation of cross-border financial services in Africa and has vital implications. I attempt to address some of these in this analysis.

Implications for Uganda in raising finance in the domestic financial market and implications on the wider Ugandan economy

The court ruling that the recovery of the loan is unenforceable has not only been unsettling for the banking industry, it could also disrupt the financing of strategic projects in Uganda, such as in the long-desired oil industry. The reason for this is that it will put at risk of default at least $1.5 billion of syndicated loans provided by commercial banks, according to the Bankers Association Uganda. The ruling could also potentially trigger default by other borrowers seeking to avoid loan repayment on the basis of the judgment. This judgement, as such, is likely to dampen the already illiquid domestic market for loans. When the court attempted to contextualise the rationale for the decision as being the protection of the Ugandan economy from ‘uncontrolled flows of financial resources’, one wonders the extent to which the broader impact on domestic financing and the resulting implication of this on the wider economy, was considered. The court also mandated the Central Bank to ensure that the law is implemented in accordance with the intention of the law. However, on October 14, 2020, the Bank of Uganda stated that it had no jurisdiction to supervise foreign banks’ lending to local companies; this was the responsibility of their home country regulator.

Implications for Uganda in raising finance in the international financial market

This judgement can also send the wrong message to international lenders/investors who, through this judgement, may perceive lending to Uganda or Ugandan corporation as excessively risky and, thus, make loans costlier through higher interest rates. The Ministry of Finance's response to the judgement in a statement, that it is committed to its financial partners in respect of all procured and future syndicated loansis, as such, no surprise. It is particularly important that the Ministry of Finance put this statement out there given the context of the current dire economic situation resulting from the Covid-19 pandemic currently engulfing African economies and for which access to external financing (international finance) is likely to play a huge role in the economic recovery process.

Implications for financial integration in Africa and the AfCFTA, more broadly

Perhaps, one of the most significant issues highlighted by this case is the benefit that financial integration would have on the continent. One of the ways this can be achieved is through the integration of banking services among Member States of Regional Economic Communities (RECs) such as the East African Community (EAC) - of which Kenya and Uganda are both Member States. A key characteristic of an integrated banking market is a 'banking passport' which would grant banks that are licenced in one Member State the freedom to conduct services across other Member States. This would cut out unnecessary duplication of licensing requirements from banks wishing to offer services in other Member States – as is the bone of contention in the case under review. This subject is extensively covered in my 2012 book, *Financial Regulation in Africa: An Assessment of the Financial Integration Arrangements in Emerging and Frontier Markets*.

The EAC have already made significant strides in the field of economic integration and are among the most advanced RECs in Africa. Nonetheless, more still needs to be done to achieve significant progress with the EAC common market objective – of which the free movement of financial services is a critical part.

Of course, going by the European experience of the global financial crisis of 2007, the centralisation of the banking regulatory and supervisory framework is vital to any successful banking integration arrangement. The European dimensions of that crisis revealed the devastating consequences of gaps that can exist in an integrated banking market which fails to embrace maximum harmonisation (absolute centralisation of regulation and supervision at the regional level). Maximum harmonisation, as seen in the aftermath of the European financial crisis in the establishment of a Banking Union, was based on three pillars: a single supervisory mechanism; a single resolutions mechanism and a single deposit guarantee scheme. This banking union, among other things, saw the European Central Bank (ECB) take on full responsibility for the regulation of all banks operating within the eurozone. Were this same framework to be adopted in the East African Community (EAC), it would require the creation of some sort of EAC regional body, such as an EAC Central Bank or Monetary Authority to provide the oversight of such a banking union. Of course, the EAC countries are not close to achieving an integrated banking market, let alone a banking union. If they were, this case would not have existed. In fact, it was only on 7 October 2020 that the EAC, in collaboration with the EU, launched a joint programme to strengthen the implementation of the customs union and common market rules. An integral part of the programme focuses on facilitating the free movement of financial services through the mutual recognition of professions, as well as enabling the delivery of cross-border services by firms. For the legal and institutional infrastructure needed to set up such a regional financial integration agenda my book, Financial Regulation in Africa: An Assessment of the Financial Integration Arrangements in Emerging and Frontier Markets (2012, Routledge, UK) is a good reference point. In this article, 'Banking Union Framework in the Economic Community of West African States (ECOWAS): A European Comparison' *West African Journal of Economic and Monetary Integration*, (2015) Volume 17, No. 2, *pp1-30*, I discussed these principles in the context of ECOWAS that can now be applied to the EAC.

In summary, it is vital to place this case in the broader context of the African Continental Free Trade Area (AfCFTA). Regional financial integration of the sort discussed above, (such as an integrated banking market or a banking union), would significantly benefit the AfCFTA in the light of the bigger regional markets in trade that is now in operation. Outcomes of cases like the one under review, are likely be a stumbling block to the financing of trade within the AfCFTA. As such, such outcomes should, as far as is possible, be avoided. Avoiding such outcomes can occur through regional financial integration and this would require placing regional financial integration at the forefront of the immediate African economic integration agenda. This would also be particularly useful in the context of any robust African-wide post Covid-19 economic recovery plan.

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