

RUAHA UNIVERSITY COLLEGE
FACULTY OF LAW
DEPARTMENT OF ECONOMIC LAW
RLW 700: LAW OF BANKING
LECTURE NOTES

- A one semester course
- CW 40% UE 60%
- Basic Readings

: Books

1. M. Megrah: Pagets Law of Banking
2. C.B. Drover & R.W. Bosley: Sheldon's Practice and Law of Banking
3. Lord Chorley: Law of Banking
4. J.M. Holden: Jones & Holdens Studies in Practical Banking
5. M. Rogers: Outline of Commercial Law in East Africa
6. L.C. Goyle: Law of Banking & Bankers, Eastern Law House, 1995

: Statutes

1. The Bank of Tanzania Act 2006, No. 4/2006 as amended from time to time.
2. The Banking and Financial Institutions Act 2006 No. 5/2006 as amended from time to time
3. The Foreign Exchange Act, 1992 No. 1/92
4. The Investment Act 1997

: Landmark cases

: Journal articles

CHAPTER ONE

HISTORY OF BANKING, BANKING LAW AND BANKING PRACTICE

Historical origins, development & functions of banks

- How did banking come about? Have banks always been there, i.e., has the institution of banking been there from the first day the world was created?
- The rise & development of banking is closely linked with private ownership of property
- How did private property come about?
 - There were days when
 - : ownership of means a production was communal – property was communal
 - : membership in a community was very important
 - : in order to get a share of communal property one had to be a member of the community
 - : a member of a community was entitled to amenities of life – shelter, food and clothing
 - : a community took care of the sick, old, pregnant women etc.
 - : there was no family – children belonged to the community – trace mothers only not fathers
- What we have described above was the mode of life of the people. Such mode of life was dictated by the following factors:
 - very low level of development of productive forces
 - people in a community could produce the barest minimum – for survival – social **necessary product** only
- So people were forced to live together and cooperate. That was the only way to fight against natural hazards – bad weather, ferocious beasts, invalidity, sickness etc.
 - these were days when reciprocal dependence and cooperation was the order of the day.
 - this was the Era of Primitive Communalism (Middle & Upper Barbarism)
- **Note:**

- what members of a community produced was social **necessary product**
- No one was assured of survival if he/she decided to pull out of membership of a community
- members depended upon and assisted each other with expectation to receive assistance when a need arose – reciprocal dependence -
- reciprocal dependence was reflected in the mutual aid system – assist a member with a problem with an expectation that he would assist others in need
- After some years there were improvements in the productive forces based mainly on.
 - inventions
 - experience
 - skill
- These improvements led to production of not only social **necessary product** but also social **surplus product** for a community
- The surplus product was termed **social surplus product** because it was produced by the community at large
- What to do with the **surplus product**
 - Exchange it with a product from another community – barter exchange (c – c)
 - Consume it in a feast
 - store/keep it for use in future
- With production of social surplus product there developed relationships between communities
 - Barter system: Communities with surplus products entered into the barter exchange system.
 - Mutual aid system: A community with surplus product (i.e., with a “budget surplus”) assisted that community which was in need (with “budget deficit”)
 - Consideration : reciprocity or
 - : promise to reimburse no more than the amount “lent” and “borrowed”

Note: What a community with surplus product did was more or less giving a loan to the needy community but without interest being charged. No interest was charged because although surplus product was produced the communities were still not very sure of their survival without reciprocal dependence & cooperation.

Genesis of private property, family and the state

- Seen inventions, experience and skill led to production of not only necessary product but also **social surplus product**
- With more inventions, more experience, skill and knowledge especially in the areas of
 - : domestication of animals
 - : agriculture
 - : irrigation

it was found that more and more could be produced not only by the community but also by individuals in the community.

- When man the individual found that he could produce not only for his immediate needs but also a surplus product [i.e. not only an individual necessary product but also an individual surplus product] he became assured that he could survive without depending on the other members of the community. His surplus could be exchanged for products he did not produce.
- This assurance of survival outside the communal link made man develop acquisitiveness and greed.
 - : man began to claim for himself and his immediate relatives the wealth/the property he had acquired with his own hands – his property
 - : It became necessary for man to identify his immediate relatives. Man wanted a woman for himself alone to bear him children
 - : Man wanted his own children to inherit his property – hence monogamy to ensure that the children born of the woman were those of the man – legitimate children
- From the above we have
 - the product which man acquired for himself & immediate relatives – his property – private property
 - identification of immediate relatives – family.
- Private property and the family had the following effects -
 - led to decay of communal ties
 - a race by each family to accumulate and hoard wealth for itself
 - in the process of accumulating wealth, more and more work fell on each family necessitating using other people to accumulate wealth – Division of society into free men and slaves – thus creation of a great social division of

labour –Masters & Slaves – formation of classes in a society with conflicting interests & likelihood of having open conflicts

- establishment of the state to suppress open conflicts.

Pre-money banking institutions

- We have seen reasons for production of
 - social necessary product
 - social surplus product
 - individual necessary product
 - individual surplus product
- Use of the surplus product
 - exchange to get other products - barter
 - alms giving to the needy
 - consume in a feast or religious rite
 - store/keep for use in future – security for community/individual
- Surplus products were stored/kept in places like temples, shrines, palaces etc
 - for reasons of safety. They were either respected (and) or well guarded
 - priestly and or royal families took care of the social surplus products
- Limit of storing – perishability - so it became necessary to exchange perishable products for precious metals which could be hoarded.
- Effects of storing surplus products in temples, shrines or palaces
 - (i) Priestly and/or royal families began to live on the social surplus product i.e, they stopped participating in production directly. They asserted a right to the surplus as leaders of the community.
 - (ii) Having asserted a right to the surplus they came up with methods of accumulating more and more surplus product especially from individuals
 - Encouraged individuals to give surplus products voluntarily for storage or for religious purposes
 - when people began to hesitate they demanded **tithes**, presents, tributes levy and also mobilized labour to work for them
 - they engaged in wars to plunder and secure booty.
 - They engaged in trade with foreign countries

- Later they began giving loans and charged interest.
- (iii) Some rich people decided to keep their surplus products with the temples, shrines and/or palaces for safe custody.
- (iv) There were people who went to the temples, shrines and/or palaces to borrow e.g. wheat
- temples, shrines & palaces were in fact performing the following functions
 - accepting deposits (social and individual surplus product from communities and individuals) – became depositories
 - opening and maintaining accounts in respect of each community or individual depositor
 - lending out products to those in need
- Later the functions of these depositories became complicated. An individual depositor would give a loan to a needy person (borrower) and instruct the institution where he had deposited his surplus product to give the borrower the amount borrowed. When repaying the borrowed amount plus something extra the borrower gave the amount to the institution which accepted it on behalf of the lender. This required the institution to maintain some sort of ledger books in which credit and debit entries would be entered.
- The functions of temples, shrines & palaces were akin to those of bankers; only that they did not deal in money. We may call/term those institutions pre-money banking institutions.

Let us again go over the functions of pre-money banking institutions

- Acted as depositories of wealth and possessions of communities and individuals
- Made payments on behalf of depositors
- Accepted payments on behalf of depositors
- Opened and maintained books of account
- Extended loans – first from own deposits later from part of deposits entrusted with/to them by depositors. In Babylon, e.g. such loans were initially of seed grain to be repaid after harvest. A receipt was made out and a rate of interest was fixed (See Orsingher: Banks of the World p. 1)

Note: Lending and borrowing in kind was practiced long before adoption of money as a means of payment. In Greece, temples like Olympia and Delphi discharged functions of pre-money banking institutions. In Greece even private individuals established pre-money banks.

The rise and development of modern banking

(a) Commodity production

- Seen pre-money banking institutions and how they operated. These were established because of surplus product – social & individual – Certain institutions – temples, shrines, palaces - depositories
- Initially surplus product not produced with the aim of exchanging with other products.
- When acquisitiveness and greed got entrenched in individuals they began to produce surplus with the specific aim of exchanging such surplus with other products.
- With time such production of surplus for exchange became regularized. So production was production for exchange – came to be known as commodity production.
- Commodity production led to development of trade. Some people took it as their occupation to exchange surplus products (commodities) of other people.
- In order to do their business/trade these people needed a medium of exchange – a universal equivalent – measure of value and acceptable by stakeholders.
- People began searching for a medium of exchange. Various items were tried and tested – cowry shells, beads, cows, rice, etc were used as a universal equivalent. These items were used just as money is used today.

(b) Emergence of money as a medium of exchange and early banking institutions

- We have seen that regularized production of surplus products gave rise to commodity production that presupposes **exchange**.
- Initial mode of exchanging commodities – barter – exchange product for another product. Barter system convenient only under certain circumstances – e.g. articles for exchange are **few** and **in small quantities**.
- With regularization of production for exchange barter system proved inconvenient – look for a medium of exchange – to be a universal equivalent.
- As pointed out earlier, early universal equivalents included cattle, cowry shells, rice, salt, beads, precious metals – Writer – Einzing in “**Primitive Money**” terms them primitive money.
- These early universal equivalents could not adequately serve commodity production esp. circulation of commodities.
- In further search for a universal equivalent **coins were minted** out of precious metals. These were tried and tested. They were found to be very convenient and hence became the first money.

- Between 8th and 6th centuries B.C. Aegean and Asia Minor minting began
- Greece – 7th century B.C. – minting began.
- Problems associated with early money
 - (i) So precious that even the smallest coin was too valuable for small payments – hence money used for inter city or international trade.
 - (ii) Since money was very precious people **hoarded** it. People believed the money itself was wealth and not merely representing wealth. (See later).
 - (iii) Each State (city-state) minted its own money (coins). Money in one city-state was not recognized in another city-state.

The third problem gave rise to money–changers whose initial role was to exchange money of the various city-states. The moneychangers

- Kept money of different city states.
- Exchanged money. Traders and merchants went to exchange money there and got the money they wanted
- Later traders and merchants developed a habit of leaving/depositing their money with the moneychangers. So they became **depositories**.
- Made payments to the depositors on demand or according to their instructions.
- In order to know how much each depositor put in and assure each depositor that he would get his money when he wanted it the moneychangers:
 - (a) Began to keep books – ledgers – fill in amount deposited and withdrawn by each depositor
 - (b) Issued “notes” to the depositors promising to pay when the depositors demanded.
 For these services – charged commission.
- Later the money changers discovered that they could do business with the money they had. Initially they lent out their own money; later experience taught them that they could lend out money deposited with them at an interest before the owner came to demand it. They traded in money.

The above functions of the money-changers constituted them early banks.

From what we have seen above we find the prerequisites of banking namely:

- ❖ commodity production
 - ❖ money
 - ❖ wide—spread use of money
 - ❖ trade in money
- (See again later).

These moneychangers thus became the early banking institutions, composed of individual persons.

Growth of banking institutions

- As commodity production became more and more regularized and consolidated there arose more and more need for institutions where to deposit money and from where to borrow. The individual banker could not meet the demands of banking facilities. Banking institutions by individual persons, therefore, had to give way to commercial banking companies.
- During the capitalist mode of production – economy characterized by competition – In order to compete effectively the capitalist needed to borrow money. There therefore grew many commercial banks that competed against each other.
- The competing commercial banks were doing business blindly especially by lending out money without any controls. Uncontrolled lending was detrimental to the economy as the banks collapsed one after another. The state had to intervene to remedy the situation.
- States established central banks which were required to regulate and control the activities of commercial banks. It was uncontrolled commercial banking operations that necessitated establishment of central banks. England established its central bank called the Bank of England in 1694.

Development of banking in Africa

Conditions for emergence of banks

- Commodity production – money – wide spread use of money – trade in money..

Did banks emerge in Africa? Were the conditions for emergency of banks met in the African economies?

Conditions not satisfied: -

- African economies were subsistence economies until time of colonization.
- Colonialism – a result of imperialism – capitalism could not contain itself within its national boundaries – had to outflow to other countries through exportation of capital.

It became imperative to export capital because:

- In capitalist countries – use of machines in production – markets flooded with goods – people with little or no purchasing power
- Price of labour high, cost of raw materials high, price of land high – rate of returns/profits on investments very low
- Capitalism had to outflow its boundaries - companies looking for new lands – colonies – support of their governments – Treaties – colonies – colonial government – army - police - prisons – judiciary. In addition to the colonial government other strategic institutions to service it included banks, insurance and assurance companies, laws, etc. Why all these institutions?

To protect and service capital exported to backward countries

- Banks, insurance companies, laws etc imported/imposed on the backward countries to service capital
 - Banking in Africa linked with colonialism -

Points to note

- (i) Establishment of banks in Africa was a result of export of capital
- (ii) Export of capital to Africa had the effect of transforming the hitherto predominantly natural economy into a commodity producing economy.
- (iii) Commodity producing economy did not emerge/arise from the existing economy rather it was imposed, and with it were also imposed capitalist production relations.
- (iv) The nature of the economy so imposed necessitated imposition of institutions to service such economy.
 - Colonial govt., army, police, judiciary, prisons
 - Financial institutions – banks, insurance companies, etc.
 - Laws relating to various fields including banking.

- (v) Laws relating to banking applicable in Africa were laws that were applicable in the mother countries

: Regulatory laws: formation, regulation/control of banking – Co. law, Bankruptcy, Stamp Duty law etc.

: Substantive laws

- ❖ substance of the common law, principles of equity and statutes of general application (reception dates) Tanganyika. 22/7/1920, Kenya 12/8/1897, Uganda 11/8/1902, Zanzibar. 7/7/1897, Malawi 11/8/02, Zambia 17/8/1911.
- ❖ Local statutes
- ❖ Statutes in pari materia
- ❖ Relevant body of commercial law – usages, customs etc.

Development of commercial banking in East Africa

History

- Pre-requisites for emergence of commercial bank
 - commodity production
 - money
 - widespread use of money
 - trade in money
- Economies of E.A. before advent of colonialism
 - mostly natural economy - subsistence
 - here and there- petty commodity production
 - in some areas (esp. coastal) there was trade due to Arab influence
 - In some towns one could find money – Sultan of Kilwa minted money (copper coins) in 13th C.
 - Use of money was not wide spread
 - Due to trade connections with India – Indian rupee was in use in Tanganyika, Kenya and Uganda

Therefore commercial banks could not emerge from the E.A. economies.

- As pointed out earlier, colonization of the East African countries brought with it not only importation of capital but also strategic institutions to service it including financial institutions.
- Financial institutions that were imposed were:
 - 🚩 For Kenya and Uganda which were under the British colonial masters

- The Nat Bank of India - 1896
(later National & Grindlays Bank)
- The Standard Bank of South Africa - 1910
- The National Bank of South Africa - 1911

(later Barclays Bank Dominion Colonies and Overseas {DCO}.)

Currency in use: Pound sterling & the Indian rupee

The 3 were British banks in both **origin** and **ownership** (the names are misleading). Had branches all over the world.

✚ For Deutsch Ostafrika (Tanganyika)

- Deutsch – Ostafrikanische Bank of Berlin -
branch in Dar 1905- initially did commercial banking and also
issued currency (a function dropped 1906)
- Handelsbank für Ostafrika
branch at Tanga - Sisal
- Banque du Congo Belge
Belgian bank in Rwanda – opened 2 branches 1 in DSM another at
Kigoma

Currency in use

- The German rupee (same value as Indian rupee hitherto in use)
- Heller – was a fraction of German rupee (1/100 of a rupee)
- German Crowns

After defeat of Germany in WWI Deutsche Ostafrika was given to the British and was renamed Tanganyika. So Kenya, Uganda & Tanganyika were under the British.

WWI had devastating effects on the economies of the countries that were effectively at war. Even the economies of their colonies were badly affected.

When the British became masters of the E.A. countries the economies of these countries had been devastated by war. In order to revamp the East African economies the British had to strengthen the financial institutions. The first step taken was to set up the East African Currency Board

CHAPTER II

CENTRAL BANKING LAW AND PRACTICE

❖ The Currency Board System

- ❖ **The East African Currency Board**
- ❖ **Multilateral Financial Institutions [IBRD & IMF]**
- ❖ **Central Banking Functions, Principles, Laws and Practices**

A. The Currency Board System

- We have seen that banks were imposed on the African colonized communities, including East African communities. These banks were imposed to service capital that was exported to the African communities. But the conditions for operation of a bank had to be there. [What are the conditions/prerequisites?] So what happened? Export of capital to hitherto subsistence economies had the following consequences -
 - (i) changing the prevailing natural/subsistence economy into money economy
 - produce for sale – commodity production
 - (ii) with commodity production money was used as a medium of exchange
 - (iii) with regularized commodity production – widespread use of money
 - (iv) widespread use of money called for establishment/imposition of financial institutions
 - (v) imposition of bank branches of mother commercial banks abroad. These branches could not issue currency nor control the supply of currency.
- It therefore became necessary, in order to meet monetary demands which could not be satisfied by commercial bank branches, to establish currency boards.

The Boards were established to cater for regional groups

- ❖ The West African Currency Board - 1912
- ❖ Currency Board for Kenya & Uganda - 1903
- ❖ E.A.C.B. - 1919

- Basic functions of Currency Boards

- (a) Issue currency – notes & coins

Amount issued had to be fully backed by an equal amount of currency of the metropolitan country the colonies had in their deposits in the colonizing/metropolitan country.
- (b) Money changers – to convert local currencies to currencies of the Metropolitan countries - free convertibility – charged commission
- (c) Fix exchange rate – after consultation with Secretary of State for the Colonies

In practice any change in the exchange rate in the mother country automatically affected the exchange rate in the colonies.

- Aim of establishing currency boards – link economies of colonies with those of the mother imperialist countries. The Boards like the commercial banks, were thus extensions of the monetary system of the mother countries.

B. The East African Currency Board

- **Establishment of the E.A.C. Board**

There was a financial crisis in E.A. from 1919 to 1920 caused by W.W.I. This crisis called for a new financial structure and monetary arrangement in E.A. The establishment of the E.A.C.B. which took over from the then existing Currency Board for Kenya and Uganda (est. 1903) was geared towards rectifying the 1919 – 20 financial crisis. The Board was generally charged with supervising the monetary system in E.A.

Functions of the E.A. C. Board

- To organize the change from rupee based currency to the shilling based currency in E.A. by “buying up” all the rupees in circulation.
- To issue E.A. notes and coins against sterling (backing) at the rate of 20 E.A. Shs. to £ 1 sterling.
- To obtain British and colonial govt. securities for the sterling it collected from the exchange.

Summary: fundamental functions – (1) Stabilize currency in E.A. (2) thus put colonial economy in a healthy condition for exploitation of its resources (3) Link E.A. economy to Britain

Hdqts: London until 1960 – in E.A. there were currency offices. From 1960 Nairobi became the headquarters.

Obligations of the Board relating to funds

- (1) To stabilize the monetary arrangements and financial structure of E.A.
- (2) To see to it that the cash base of East African banking system was the British sterling. That the London money market determined the circulation of money in E.A.
- (3) To see to it that the determining factor of the amount of currency issued in E.A. depended on the balance of payments of Britain. If Britain had a favourable balance of payments, to the extent of the surplus the Board could issue more currency
- (4) To see to it that it made money
 - (i) by charging commission when exchanging currencies.
 - (ii) by investing money in British and Dominion government securities

References:

- (1) Zwanenberg & Anne King: **An Economic History of Kenya and Uganda 1800 -1970**
- (2) Newlyn **Money in an African Context**
- (3) Livingstone & Ord **An Introduction to Economics for E.A.**

CONSTITUTION, DUTIES AND POWERS OF THE E.A.C. BOARD.

- Were defined in the E.A.C. Board Regulations 1920 – 1955
- In these Regulations the functions of the board were defined
 - ❖ Provide for and control the supply of currency to the E.A. Protectorate

(Kenya) the Uganda Protectorate and any other Dependencies in E.A. which may be added by the Secretary of State.

- ❖ to ensure that currency was maintained in a satisfactory condition
- ❖ watch over the interests of the Dependencies so far as currency was concerned.
- These Regulations were amended from time to time
- In 1955 the Regulations were amended to incorporate
 - ❖ Regulation 7 which provided for **fiduciary issue**. **By fiduciary issue was meant that the Board could issue notes or coins in exchange for securities of or guaranteed by the governments of the constituent territories or of any other authority established to administer services common to two or more of constituent territories. . . .**
 - ❖ R.14 which empowered the Board to subscribe for, or buy or sell, and hold publicly issued securities of or guaranteed by governments of constituent Territories or colonies. **Limit of holding such securities – at the par rate of exchange on London, up to £10 million sterling.**
- In 1960 the Board was allowed **discretionary fiduciary issue** over and above the fiduciary issue for the purpose of lending to the banking system to finance crop marketing.

- **Devolution of the EACB from a moneychanger to a quasi central bank**

The Place of the E.A.C. Board vis-a-vis Commercial Banks

- The E.A.C. Board established in 1919 and Comm. Banks formed the E.A. banking system.
- Comm. Banks – branches of metropolitan banks.
- Commercial banks that were operating in E.A. before 1953:

Kenya

- Barclays Bank (D.C.O): 8 branches
- Standard Bank of South Africa Ltd: 11 branches
- National Bank of India (later National and Grindlays): 6 branches

Uganda

- National Bank of India (National and Grindlays): 5 branches: Entebbe, Port Portal, Jinja, K'la, Mbale
- Barclays Bank (D.C.O.): 5 branches: Fort Portal, Jinja, K'la, Mbale, Tororo
- Std Bank of S.A. : 2 branches: Jinja & K'la

Tanganyika

- Barclays Bank Ltd (DCO)
8 branches: Arusha, Moshi, Mwanza, Dar es Salaam, Lindi, Bukoba, Iringa and Dodoma.
- Std Bank of S.A.
5 branches
- National Bank of India (N & G)
3 branches
- The Congo Bank

1 branch

Governing Law of Board - EACB Regulations 1920

The relationship between E.A.C. Board and commercial banks before 1955

- Board used Comm. Banks as agents in distribution of currency.
- Comm. Banks had no accounts with E.A.C.B; they had direct links with mother banks
- Board had no control over commercial banks.

There was no reason for controlling the commercial banks because

- They operated according to the E.A.C. Board system i.e. all money belonging to commercial banks was backed by sterling.
- There was no fiduciary issue; as such the control of money supply in E.A. was automatic.
- E.A.C.B did not need any power to influence supply of money in the economy.

The relationship between E.A.C. Board and commercial banks after 1955

- ❖ The 1955 revised and approved regulations of the Board [1920], gave the Board through regulation 7 power to issue currency which was not backed by sterling. The Board was allowed fiduciary issue i.e. it was authorized to issue local currency backed not by sterling but by local securities offered or guaranteed by E.A. colonial governments.
 - Limit to fiduciary issue fixed at £10 million [Reg.14]
 - Limit increased to £20 million in 1957
 - £25 million in 1963
 - £35 million in 1964

- In 1960 a discretionary fiduciary issue was allowed over and above the £20 million for the purpose of lending to the banking system at the seasonal peak to finance crop marketing
- The limit of discretionary fiduciary issue was £5 mill.
- The £5 mill. limit was increased to £10 mill in 1962

- ❖ The total element of fiduciary issue:

1960 – 20 + 5 - £ 25 mill.
1962 – 20 + 10 - £ 30 mill.
1963 – 25 + 10 - £ 35 mill.
1964 – 35 + 10 - £ 45 mill

- ❖ **The ability to issue currency against local securities gradually changed the character of the E.A.C Board from that of a passive moneychanger to an institution with discretion to affect the volume of money in the E.A. economy. This role is a quasi central bank role.**

- Since the E.A.C. Board could affect the volume of money in the economy – esp. through lending to commercial banks – it began to acquire some of central bank roles
- ❖ The Board which had the function of issuing currency now acquired additional functions. It became
 - **Banker to commercial banks:** The Board began to call upon commercial banks to open accounts with it. Commercial Banks that refused to open accounts with the Board were refused credit facilities by the Board.
 - **Controller of the bank rate:** The Board also acquired the power to fix and control the domestic interest rate. Normally the bank rate here was to be the same as the bank rate applicable in Britain. However, while in December 1964 the bank rate in London went up from 4% to 7% the Board maintained the bank rate here at the ruling 4%.
- ❖ The E.A.C. Board was not a Central bank but had some elements of central banking. It did not become a central bank because it lacked some of the essential powers, for example power to compel commercial banks to maintain specified minimum reserve requirements, namely, cash ratio and liquid ratio
- ❖ The E.A.C.B. operated until the East African countries established central Banks for their respective countries by Acts of Parliament:

Tanzania: The Bank of Tanzania Act, 1965, No.12 of 1966

Uganda: Bank of Uganda Act 1966, No. 5 of 1966

Kenya: The Central Bank of Kenya Act 1966, No. 15 of 1966.

C. The Multilateral Financial Institutions [IBRD/WB & IMF]

Reasons for establishment of the IBRD and IMF (from a critical angle)

Two reasons can be given for establishment of the WB and IMF, namely (i) the effects of the two world wars and (ii) the position of the USA.

ad i. Effects of the two World Wars

- Each world war led to devastation of economies of those involved in the war.
- Those defeated in WW I lost their colonies to those who won the war
- Those who lost the WWI and consequently, colonies wished to regain the lost colonies and hence WWII.
- By end of 2nd WW in USSR Communism had been fully established. WEAKNESS of the W. European countries made them fear to be absorbed by communism. This called for:

- Fast reconstruction of the capitalist economies
- **Reliance** on big brother capitalist U.S.A. that was very strong economically and militarily

Ad ii. The position of USA

- The weak capitalist countries had to rely on USA for protection and revamping their economies
- USA used its economic and military strength to further strengthen itself. USA called on all capitalist countries
 - ❖ to rally behind it in order to regain their economic strength and avoid being absorbed by communism.
 - ❖ to eliminate restrictions in exchange and trade. It advocated for an open-door policy in trade and self-determination of colonies – motive – open them to international exploitation
 - ❖ to ensure there was international currency stability by establishing institutions to enforce rules governing international financial relations.
 - ❖ To consider putting in place a mechanism of multilateral system which would ensure
 - world production
 - world trade
 - world monetary policy
- To ensure that institutions to enforce rules governing international financial relations were established, U.S.A. convened 2 meetings of all capitalist countries, one in Havana (Cuba) and the other in New Hampshire USA (Brettonwoods Conference)
 - ❖ The Havana meeting proposed formation of an International Trade Organization (ITO). USA vetoed the proposal on the ground that the I.T.O did not ensure freedom of trade. Instead of ITO temporary arrangements were agreed and GATT was formed. The successor to GATT is the World Trade Organization (WTO) that was created in 1994 as a result of the Uruguay Rounds of Multilateral Trade Negotiations.
 - ❖ The NewHampshire Meeting (Brettonwoods Conference) discussed economic and financial arrangements. The result was creation of the IMF and the IBRD in December 1945. IBRD and IMF are known as the Brettonwoods Institutions. These institutions were created by agreements, known as the Brettonwoods Agreements, amongst the capitalist nations
- **Headquarters of WB & IMF: Washington:** Hdgt of state capitalism – oriented toward the financing of economic development on a world plane. Also hdgt of gigantic banking institutions – owners of finance capital.
- **W.B. affiliates**
 - (1) In 1957 the **International Finance Corporation (IFC)** was established.

Aim: Help to **finance private enterprises** either with direct investment or through low interest loans particularly in the less developed countries – (nurser capitalism)
 - (2) In 1959 the **International Development Association (IDA)** was created.

Aim: Grant loans at lower interest rates – or in certain cases interest free – raise standard of living in the more backward countries.

- **E.A. countries and IMF & IBRD**

- When IMF & IBRD created TKU were colonies – not in contemplation of the initiators of WB & IMF
- But note USA's appeal for self – determination of colonies. Many became independent
- After attaining independence KUT joined the Brettonwoods institutions, i.e the WB & IMF.

Procedure of joining the Brettonwoods institutions

Each nation that becomes a member of the WB and/or the Fund has to accept the WB and/or Fund Agreement by

- signing it
- depositing an instrument of Acceptance with the Govt. of USA
- passing a law to make provision for acceptance by the Govt. of the Fund and/or IBRD Agreement
- passing a law to make provision for acceptance by the Govt. of Amendments to the IMF and/or IBRD Agreement.

Laws by E.A. governments to make provision for acceptance of WB and Fund Agreements

- ❖ Brettonwoods Agreement Act, Cap. 469 (1962) as amended from time to time till 1969 [T]
- ❖ Brettonwoods Agreement Act, Cap. 464 [K]
- ❖ Brettonwoods Agreement Act, Cap. 161 [U]

Laws by Tanzania government to make provision for acceptance of Amendments to the Fund Agreement

- ❖ The Brettonwoods Agreements Act 1962 Cap 469 as amended by Acts 3 of 1968 and 7 of 1969 [T]
 - S. 3 A amendment to establish SDRs accepted
 - S. 3 B approval in participation in SDR's
- ❖ The International Monetary Fund Act 1969 No. 16 of 1969 [K]
- ❖ Act, No. 25 of 1969 [U].

The central banks and the IMF and the WB

It is the central bank of each country that transacts and deals with the IMF and WB.

Quotas & Subscription: Article II

Brettonwoods Agr. Act S. 4A – BoT to pay – Article V transactions with the Fund

S.1 Agencies dealing with the Fund

- Central bank s. 4A(3)

D. CENTRAL BANKING FUNCTIONS, PRINCIPLES, LAWS AND PRACTICES

In a blanket form the function of a central bank can be said to be central banking which consists essentially in the exercise of the public duty to influence the behaviour of banks and other financial intermediaries in a country by regulation, persuasion or open market operations – maintain the stability of the value of money and hence keep economy healthy -

The traditional functions of Ce Ba are the following

1. Responsibility for issue of currency
2. Act as bankers` Bank i.e. banker for banks and financial institutions
 - (a) By opening accounts for and accepting deposits from comm. banks & fin. Inst.
 - (b) By being lender of last resort for comm. banks & fin. institutions
3. Act as banker to the govt
4. Responsibility for controlling
 - (a) The domestic **monetary system**
 - (b) The external value of the currency or the foreign exchange rate – control/regulate and stock foreign assets and reserves; control import and export trade.

From 1945 with establishment of central banks in emerging countries, i.e., former colonies in Africa, India etc the main business of central banks became one of controlling the monetary system in a way which was conducive to the broad economic policies of the govt. (e.g. employment, economic development stability in prices, foreign exchange, smooth payments mechanism etc).

To control the monetary system the central banks are vested with the following powers:

- (1) to act as lender of last resort at an announced rate (bank rate)
- (2) to engage in open market operations
- (3) to fix reserve requirements for commercial banks
- (4) to supervise commercial banks
- (5) to act as banker to the govt. (generally involving important functions in relation to govt. debt).
- (6) to act as adviser to the govt. on foreign exchange policy
- (7) to act as a custodian of the country's international reserves
- (8) to act as an administrator of foreign exchange restrictions
- (9) to deal in foreign currencies and gold.

General principles of central banking relate to the powers enumerated supra.

CENTRAL BANKS & CONTROL OVER DOMESTIC MONETARY SYSTEM

A country's monetary system consists of three main parts, namely, the general public, the commercial banks and the central bank.

1. **The general public:** The general public does have a lot of money in their hands (cash in hand) and in the form of demand deposits [chequing/current accounts].
2. **Commercial banks:** Banks trade in money. To enable them do sound business commercial banks create deposits against assets. The deposits are liabilities to commercial banks because they are obliged to repay them.

Liabilities	Assets
5,270 demand deposits (chequing)	Currency held by banks as till money 506
4,730 other deposits (time) [savings/time deposits]	Bankers' deposits with Ce Ba <u>278</u>
	Total Cash Reserves 784
	[See s. 44(1) BoT Act]
	Loans at call and short notice, bills Discounted <u>2,166</u>
	<u>Total liquid assets 2,950</u>
	Investments 1,288
	Advances 5,670
	Special deposits with Ce Ba <u>92</u>
10,000 Total Deposits (Liabilities)	Total Assets 10,000

3. **CE BA: The central bank too does create deposits against assets.**

<u>Liabilities</u>	<u>Assets</u>
Govt. Deposits 13	Currency 61
Bankers' Deposits 278	Govt. Securities 357
Special Deposits 92	Discount and Advances 44

Other accounts	84	Other Securities	5
Total Deposits	467	Total Assets	467

Source: **An Introduction to Economics for E.A.** by Livingstone and Ord p. 270

Explanatory notes:

- Demand deposits are subject to withdrawals by cheque = money
- Till money is kept by banks to meet cash requirements of customers (note till money does not constitute money supply in circulation)
- Total cash reserves - liquid assets are made up of till money and money kept with Ce Ba as Bankers' Deposit (convertible into till money at will).
- Liquid assets are made up of loans at call and short notice that can quickly be recovered on the discount market and Treasury bills and trade/commercial bills that can be cashed at par (at face value) generally within 30 days
- Total liquid assets consist of total cash reserves plus loans at call and short notice and bills discounted

Commercial banks are required to maintain a specified cash ratio and liquid ratio.

The conventional ratios may be worked out according to the following formulae

Cash ratio means the ratio of cash reserves against total deposit liabilities

$$\text{Cash ratio} = \frac{\text{Total Cash Reserves} \times 100}{\text{Total deposit liabilities}} = \frac{\text{T.C.R} \times 100}{\text{T.D.L.}}$$

$$= \frac{784 \times 100}{10,000} = 7.84 = 8\%$$

$$\text{Liquid Ratio} = \frac{\text{Total Liquid assets} \times 100}{\text{Total Deposit liabilities}} = \frac{\text{T.L.A.} \times 100}{\text{T.D.L.}}$$

$$= \frac{2950 \times 100}{10000} = 29.5 = 30\%$$

The British conventional cash ratio used to be 8%

The British conventional liquid ratio used to be 29%

TOOLS USED TO CONTROL DOMESTIC MONETARY SYSTEM

- Main duty of Ce Ba – maintain stability of the value of money
- Done by controlling the volume of money in the economy
- Volume of money may be controlled by
 - (1) Controlling credit given by financial institutions
 - (2) Controlling government spending
- aim to keep the economy healthy – neither too much money - inflation nor too little money - deflation

Tools used to control the domestic monetary system

- A. The Bank rate
- B. Open market operations
- C. Variable reserve requirements: cash ratio and liquidity ratio requirement
- D. Selective and direct credit control
- E. Moral suasion

A. The Bank Rate [cf. s. 42(2) BOT Act]

- An officially announced rate charged by the Ce Ba on discounts or advances to banks and financial institutions [See s. 42(2) BOT Act]

- It measures the cost of obtaining funds from the Ce Ba by the other banks. When rate increased – cost of obtaining funds – higher. When reduced the cost of obtaining funds is lower. When rate changed – cost of borrowing is affected thereby influencing the volume of credit.

The higher the cost of borrowing the smaller the amount borrowed.

Preconditions for success of this tool

- (1) - Must be a well organized **money market** which is sensitive to the changes in the official rate
- (2) - Well developed securities markets – e.g. bills

[Money market:

Is not a particular place or building where money is bought and sold – it is merely a term embracing the central bank, commercial banks and other financial intermediaries that deal in money and credit. The term also covers those persons who wish to borrow.]

B. Open Market operations [cf. s. 43 BOT Act]

- ❖ Refers to purchase/sale in the market by the Ce Ba of any paper in which it is authorized to deal [See s. 43 BOT Act]
- ❖ Objective: influence reserve position of banks
- ❖ How does it operate:

Too much money in the economy (inflation). Ce. Ba – decides to sell govt. securities it holds to the general public. Buyers pay by writing cheques on their a/c with comm. banks in favour of Ce. Ba. This causes cash drain from the former to the latter hence causing fall in the Bankers' Deposit at the Ce Ba. Since the Bankers' Deposit forms the comm. ba effective reserves, a fall in such reserves means a fall in the cash belonging to the comm. banks. Since comm. banks are required to maintain a specified cash ratio, the loss of cash by the banks will bring about a multiple contraction of bank loans and deposits.

- ❖ Open market operations have a direct impact and indeed a positive impact on the volume of bank reserves.
- ❖ Efficacy of open market operations

- must be a suitable institutional framework
- must be a broad and active money and capital market
- reduction in reserve positions of comm. bas should be of such a manner as not to be readily offset by borrowing from the Ce Ba through discounts and advances as to leave the availability of credit from the comm. bas largely unaffected. At such time – Ce Ba discount rates are maintained at “penalty rates” – reduce incentive to borrow from Ce Ba [See s. 41 BOT Act]
- Ce Ba must have a sufficient volume of securities suitable for open market operations and the market holdings of securities eligible for central bank purchase should not be very small.

❖ Open Market operations and bank rate – usually – used together.

The capital market and stock market

stock = money lent to a govt. in return for interest:

= shares in the capital of a business company

- ***Stocks [and bonds] represent long – term finance from the point of view of the firm selling the stocks [and bonds] and receiving the funds from individual members of the public.***
- ***On the part of the members of the public who have bought them, they do not necessarily mean long-term investment because stocks [and bonds] can be freely traded among members of the public after issue by the firm***
- ***The market in which existing stocks [and bonds] are exchanged is referred to as the stock market.***
 - ***A shareholder [similarly] can sell his shares to some one else.***
 - ***the price of the [Bond or] shares will be the market price prevailing – Hence buy when cheap, sell when dear***
- ***Stock market must be contrasted with capital market in which new capital is raised, i.e. new stocks [and bonds] are sold.***

C. Variable Reserve Requirements: Cash/liquid

Comm. Banks are required by law to maintain a fixed amount/ratio of reserves (cash/liquid)

- By changing the ratio – influence amount of credit

(i) Cash Reserve Requirements (Cash ratio) [cf. s. 44 BOT Act]

- ❖ A bank is required to maintain a cash reserve consisting of bank notes, coins and balances available on demand with the central bank in order to meet demands of its customers for ready cash. [See s.41(1) BOT Act]
- ❖ The ratio between the total of cash reserves and the bank’s liabilities to the public on current, deposit and other accounts is known as the cash ratio.

$$\text{C. R.} = \frac{\text{Total cash reserves} \times 100}{\text{Total liabilities}} = \frac{784 \times 100\%}{10,000} = 7.84$$

- ❖ The ratio shows the percentage of the total amount of money lodged with the bank by its customers that is held in the form of cash in the till or as balances at the central bank convertible at will into cash.
- ❖ Since cash so held is a non-earning asset, banks endeavour to keep this amount to a minimum. This is however determined by the banks' experience of their daily cash requirements in the ordinary course of business
- ❖ Originally for making sure comm. banks could meet their obligations –pay customers instantly – at sight – safeguard the public's right to exchange its bank deposits for cash.
- ❖ Today Cash reserve ratio serves as a link between Ce Ba's operations and the ability of comm. bas to lend. When the ratio is altered this influences the availability of funds for bank loans and investment.
- ❖ Where banks – maintain ratio – yet have a great deal of cash to lend – raise ratio
- ❖ Ratio fixed by Law – why – comm. banks in time of heavy credit demands by the public are tempted to operate with reserve deficiencies. In such times bank rate is raised and open market operations are also stepped up.

(ii) Liquidity ratio requirement [cf. s. 45 BOT Act]

- ❖ Commercial banks are required by law to hold a minimum proportion of total deposits in the form of liquid assets. In addition to cash, these liquid assets comprise money at call and short notice, Treasury Bills and commercial bills discounted. [See s.45 BOT Act]
- ❖ The formula for liquidity ratio is:

$$\text{L. R.} = \frac{\text{Total Liquid Assets} \times 100\%}{\text{Total Deposit Liabilities}} = \frac{2,950 \times 100}{10,000} = 29.5$$
- ❖ Introduced during WWI
- ❖ Originally safeguard bank liquidity – protect bank depositors
- ❖ Later introduced for monetary policy purposes
- ❖ Liquidity ratios ensure that the commercial banks holding of treasury bills or of other govt. securities shall be maintained at a fixed prescribed minimum
- ❖ Curb expansion of bank credit

(D) Selective and direct credit control

- ❖ Was adopted after WW II Not really an instrument of credit control
- ❖ It is a device to effect specific economic activities; hence it is quantitative in character

- ❖ Ce Ba gives loan to com ba with directions as to purpose of the loans - make sure credit is directed to desired areas.

(E) Moral suasion

- ❖ Milder form of selective credit control
- ❖ Not accompanied by statutory or administrative compulsion
- ❖ Heart to-heart talks
- ❖ Appeal to national interests/aspirations
- ❖ Express displeasure for non-compliance with Ce Ba directions

III. THE LAW AND PRACTICE RELATING TO CENTRAL BANKS IN E.A.

1. Short historical background to the establishment of Ce Bas in E.A.

- ❖ Seen the role of E.A. Cu. Board.
- ❖ After independence E.A. countries wished to establish one central bank by devolving the E.A. C. Board
- ❖ The wish was based on
 - high hopes of a political federation based on the common history under British hegemony - E.A.H.C., E.A.C.S.O.
 - Feeling that establishment of national Ce Bas would reflect failure of political federation – first country to propose national central bank would be considered not to be in favour of a political union.
- ❖ In effort to make wish come true called a mission to study and report on the mechanisms of establishing E.A. Central Bank As early as 1962 – Blumenthal Commission proposed a “two-tier system” plan
 - i. National state banks – wholly owned by govt. of each state -
Function: carry out territorially all central bank functions; issue of common E.A. currency, fix local discount rates; fix minimum reserve requirements for commercial banks.
 - ii. Central Bank for E.A.

Function: Deal with state banks. Determine limits of credit creation by state banks.

Blumenthal suggested an elaborate system of management

- ❖ June 1963 – witnessed declaration of intention for a political union but by the end of that year – little progress on political union.
- ❖ From July 1964 each country had pressures relating to national policies esp. in the field of development finance and trade,
- ❖ Yet the E.A. countries were still desirous of having a common Ce Ba.
- ❖ In 1965 the E.A. governments asked for expert advice from the IMF on the form the E.A. Ce Ba should take. The meeting – IMF experts and representatives of the E.A. governments – learned of the national attitudes on the subject.
 - Tanzania: An E.A. Ce Ba could only work effectively under a political federation. Since there were no early prospects for a political federation and since establishment of Ce Ba was urgent each state should establish its own Ce Ba.
 - Uganda: An E.A. currency and central bank system could be evolved within the framework of semi –autonomous national banks linked to a Central Reserve Bank directing certain functions; but not on any other pattern. **Note:** before this meeting Uganda had already resolved (February 1965) to form the Bank of Uganda to function as a Central Bank, and be the sole agent of the E.A. Reserve Bank within Uganda. (Dictate on others?)
 - Kenya: A central bank responsible for common currency – to be centrally managed by agreement of the three governments together. [views secret – till budget speeches of 1965 – Each Finance Minister talked of forming Central Bank for his country] (Budget speeches read at the same time on same date – in Nairobi, Kampala & Dar es Salaam).

Causes of failure to establish E.A. Ce Ba:

1. Formation of a Ce Ba does not depend on emotional attitudes and wishful thinking
2. For a Ce Ba to effectively function for two or more countries the following are prerequisites:
 - (i) A strong political union. In the case of E.A., political union was more based on wishful thinking than reality.
 - (ii) Existence of a wide ranging harmony in financial attitudes which must be translated into one coherent policy in the monetary field.
In the case of E.A. we find that from 1964 each E.A. government was experiencing pressures relating to national policies in the fields of development finance and trade.

Political wishes had to succumb to material economic forces. The decision to establish a Ce Ba in each country was recognition of the hazards if not the impossibility of trying to operate a loose system of central banking, however strong the general wish.

See: E.A.F. PER HJ81 .C

Each E.A. country established its own central bank by Act of Parliament
 The Bank of Tz. Act, 1965 No. 12 of 1966
 The Bank of Ug. Act 1966 No. 5 of 1966
 The Central Bank of Kenya Act, 1966 No. 15 of 1966

Banks operating in Tanzania when the Bank of Tanzania was established.

Mainland: 1. National and Grindlays Bank
 2. Standard Bank Ltd
 3. Barclays Bank D.C.O
 4. Algemene Bank Nederland N.V.
 5. Bank of India Limited
 6. Bank of Baroda Limited
 7. Commercial Bank of Africa Ltd
 8. National Bank of Pakistan Ltd.
 9. Tanzania Bank of Commerce Ltd.
 National Cooperative Bank

Zanzibar: 1. The Peoples Bank of Zanzibar
 2. The Jetha Lila Ltd (small private Indian bank, ceased business in 1968)

Comm. Banks in E.A. by 1966

	Comm. Banks	Branch Offices
Tanzania:	9	68
Kenya	9	191
Uganda	8	

2. The laws governing central banking in Tanzania

a) Introduction

The Bank of Tanzania (BoT) was established by the BoT Act, 1965, No. 12 of 1966. This Act was repealed by the BoT Act, 1995, No. 1 of 1995. The reasons for repealing and reenacting the BoT Act were:

- To provide for the more definitely regulatory and supervisory powers of BoT over commercial banks and financial intermediaries
- To achieve consistency with the BFI Act, 1991
- To reflect central banking functions in the new financial atmosphere.

The 1995 Bank of Tanzania Act has been repealed and reenacted by the Bank of Tanzania Act, 2006, No. 4 of 2006. The reasons for passing this new law:

- To provide for more responsive regulatory role of the Bank of Tanzania in relation to the formulation and implementation of monetary policy;
- To provide for the supervision of banks and financial institutions; and
- To provide for other related matters

The Act is divided into five Parts:

- Part I: Preliminary (3 sections)
- Part II: The Bank (21 sections)
- Part III: Currency: (6 sections)
- Part IV: Other Operations of the Bank (31 sections)
- Part V: Miscellaneous (10 sections)

Section 2 provides that BoT Act is union law.

In addition to the BOT Act the central bank of Tanzania is also governed by the Banking and Financial Institutions Act, 2006 No. 5 of 2006 as amended by the Banking and Financial Institutions (Amendment) Act, No. 2 of 2007; and the Foreign Exchange Act, 1992.

The BFI Act is divided into XI Parts:

- Part I: Preliminary (3 sections)
- Part II: Licensing, Regulation and Supervision to Vest in the Bank (2 sections)
- Part III: Licensing, Ownership and Structure of banks and financial institutions (10 sections)
- Part IV: Capital Reserves and Accounts (8 sections)
- Part V: Activities and Investments (7 sections)
- Part VI: Supervision, Coordination and Control (5 sections)
- Part VII: The Deposit Insurance Fund (7 sections)
- Part VIII: Special Duties of Banks and Financial Institutions (7 sections)
- Part IX: Liquidation, Seizure and Reorganization (13 sections)
- Part X: Representative Offices of Foreign Banks or Financial Institutions (1 section)
- Part XI: Miscellaneous Provisions (9 sections)

b) Establishment and principal functions of the central bank of Tanzania

Section 4 provides that “There shall continue to exist a corporation going by the name and style of the Bank of Tanzania”. The Bank has attributes of a body corporate.

Section 5 spells out the blanket function of BoT as being the exercise of the functions of a central bank. After providing for this blanket function the Act enumerates the general functions of BoT as follows:

- a) To formulate, implement and be responsible for monetary policy, *including exchange rate policy*,
- b) To issue currency,
- c) To regulate and supervise banks and financial institutions *including mortgage financing, development financing, lease financing, licensing and revocation of licences and*
- d) *to deal, hold and* manage gold and foreign exchange reserves of Tanzania [S.5 (1)]

Section 5(3) accords the Bank statutory autonomy in its objectives and performance of its tasks.

The Bank is given the power and function to regulate and supervise clearance and settlement systems (S.6 (1)). It shall-

- a. *Regulate, monitor and supervise the payment, clearing and settlement system including all products and services thereof; and*

- b. *Conduct oversight functions on the payment, clearing and settlement systems in any bank, financial institution or infrastructure service provider or company.*

The Bank is given discretion to-

- *Participate in any such payment, clearing and settlement systems;*
- *Establish and operate any system for payment, clearing or settlement purposes; and*
- *Perform the functions assigned by or under any other written law for the regulation of payment, clearing and settlement systems. (S. 6(2))*

Note that section 70 of the BoT Act empowers the Minister to make regulations for effective implementation of the provisions of the Act.

The provisions of section 7 partly re echo those of section 5 of the repealed 1995 Act but also buttress them as follows-

- The Bank has to formulate, define and implement monetary policy directed to the economic objective of maintaining domestic price stability conducive to a balanced and sustainable growth of the national economy. (S. 7(1))
- It has to ensure the integrity of the financial system and support the general economic policy of the government and promote sound monetary, credit and banking conditions conducive to the development of the economy of Tanzania (S. 7(2))

Sections 8 – 15 (inclusive) deal with management of the Bank.

Section 16 imposes a duty of secrecy on the Board of Directors and staff of the Bank to keep secret matters/information relating to the Bank or to any transaction or customers of the Bank acquired in the course of employment or the discharge of his duties. [**Note:** A duty of secrecy is also imposed on commercial banks by section 48 BFI Act, 2006]

Sections 17 – 22 (inclusive) deal with capital, reserves and accounts of the Bank.

Section 23 exempts the Bank from liquidation procedures under the Companies legislation. May be liquidated only by Act of Parliament.

Section 24 provides for making of by-laws for the good order and management of the Bank.

[See also section 70 which empowers the Minister to make regulations necessary or desirable to give effect to the provisions of this Act].

c) Currency [Ss.25 – 30]

- ❖ The traditional function of central banks to issue currency is given to BoT under section 5(1) and this Part.
- ❖ Section 26 gives to the Bank the sole right to issue currency in the form of bank notes and coins in and for Tanzania. It also provides that the notes and coins issued by the Bank are the only legal tender ***[Legal tender means money, especially a particular coin or bank note, which is officially part of the country's currency at a particular time]***

- ❖ Section 25 provides for unit of currency – the shilling – which is divided into 100 cents.
- ❖ Section 27 provides for denominations, materials, form and designs of notes and coins –
 - Denominations shall be of the shilling or fractions thereof expressed in cents
 - Notes and coins shall be of such material, form, design etc. as the Bank, with the approval of the Minister, shall determine.
 - The bank is required to give notice in the Gazette of the denominations and other characteristics of the notes and coins it issues.
- ❖ Legal tender
 - Section 28(1) provides that
 - Notes are legal tender at face value for the payment of any amount.
 - Coins are legal tender at their face value
 - In case of a shilling or its multiple for the payment of any amount [a shilling, 5 shs., 10,20,50, 100 or 200]
 - In case of fifty cents [=/50] or below for the payment of any amount not exceeding *five hundred* shillings.
 - Section 28(2) gives the Bank power, on giving reasonable notice in the Gazette, to call in any notes or coins issued by it on payment of the face value thereof;
 - any notes or coins with respect to which a notice shall have been given under this subsection, shall cease to be legal tender on the expiration of such notice[S.28(3)]
 - Section 28(4) gives a discretion to the Bank to make payments after expiration of the notice, i.e., to give new notes/coins for the old although the old is no longer legal tender.
- ❖ Recovery of lost, stolen, damaged bank notes or tampered with coins
 - Recovery of the value of lost, stolen or damaged notes or tampered with coins is not allowed [S.29(1)]
 - However, the Bank may at its own absolute discretion, as of grace, refund the value of any lost stolen, damaged etc. notes/tampered with coins [S.29(3)]
- ❖ Destruction of coins and notes
 - Section 34 empowers the Bank to melt down, break up or deface any coin which has been called in or tampered with
 - The Bank is also empowered to destroy any bank notes which have been called in or mutilated.
- ❖ Criminalization of certain acts relating to currency
 - Section 352A of the Penal Code criminalizes wrongful issue of currency, be it of Tanzania or not. If convicted – imprisonment not exceeding five years.

- Section 332A criminalizes tempering with bank notes. If convicted – fine 5,000/= in respect of each note or one year imprisonment in default (See Written Laws (Miscellaneous Amendment) Act, 1990.
- Offences relating to coins are provided for in Chapter XXXIII of the Penal Code. These include
 - Counterfeiting coins is an offence punishable by life imprisonment. [S.354]
 - Clipping of coins –dealing with a coin in such a manner as to diminish its weight – is an offence punishable by imprisonment for seven years. [S.356]
 - Melting down, breaking up or defacing by stamping on a coin any name, word or mark is an offence punishable by imprisonment for two years or a fine of Shs. 50,000/= or to Both. [S. 357]

d) Other operations of the Bank

❖ Banker and fiscal *[pertaining to financial matters]* agent of the governments and public authorities

- Section 31(1) constitutes BoT banker and fiscal agent of the governments of the URT and Zanzibar.
- Section 31(2) empowers the Bank to act as banker and fiscal agent for any public authority.
- Section 32(1) provides for a blanket function of BOT as banker and fiscal agent of Governments and any public authority namely by
 - being official depository,
 - accepting deposits and
 - effecting payments for the account of the Governments or public authority.
- Section 32(2) empowers BOT, after consultation with the Government and public authority and the bank concerned, to select any other bank to be the official depository of the Government or public authority. In respect therewith the bank shall-
 - Maintain and operate special official accounts in accordance with arrangements made between the Bank and the Governments or public authority concerned;
 - Act as agent of the government for servicing the public debt – including issuance of payment of interest on and the redemption of bonds and other securities of the Governments;
 - Pay, remit, collect or accept for deposit or custody funds in Tanzania or abroad
 - Purchase, sell, transfer or accept for custody cheques, bills of exchange and other securities
 - Collect the proceeds, whether principal or interest, resulting from the sale for, or accruing to the interest of the governments or public authority, of securities or other property
 - Purchase, sell, transfer or accept for custody gold or foreign exchange

- Section 33 gives discretion to the Bank to charge for its services to Governments at such rates, on cost recovery basis, as the Bank shall determine.
- Section 34 permits the Bank to give direct advances and other short term credit to the governments subject to statutory limits
 - The advances should
 - ✓ be given for the purpose of off-setting fluctuations between receipts from the budgeted revenue and payments of the governments
 - ✓ be repayable within 6 months
 - ✓ bear interest at such market rate as shall be determined by the Bank.
 - The Bank may purchase, hold and sell Treasury bills issued by the governments which must mature not later than twelve months from the date of issue.
- The Bank is given by section 35 power to deal in Governments' securities in that
 - It may purchase, hold and sell negotiable stocks, bonds or similar debt obligations or other securities issued by the Governments
 - ✓ Such transactions shall bear interest at such market rate as determined by the Bank
 - ✓ Must mature not later than twelve months from the date of issue
 - These operations shall be for the purpose of offsetting fluctuations between receipts from the budgeted revenues and payment of the Governments.
 - Sub-section (2) of section 35 sets a limit to the total amount to be held by the governments as direct advances or as short term credit. These should not exceed one eighth of average budgeted revenues of each of the governments as defined in section 36.
- Section 36 defines annual budgeted revenues as the average of the actual collected revenues of the previous three fiscal years [S. 36(1)]
- Section 36(2) defines collected revenues as including taxes, levies, duties and fees, profits and income from any investment or undertaking and any contribution to the revenue of the governments from any political sub-division of the United Republic of Tanzania excluding loans, grants and other forms of economic aid and all borrowing whether short-term or long-term
- Section 37 prohibits the Bank from extending credit to the Governments and any public authority except as provided by sections 34 and 35.

❖ **Banker of banks and financial institutions**

Section 38 constitutes the Bank banker of banks and financial institutions. The Bank may-

- Open accounts
- Accept deposits and
- Collect money and other monetary claims for and on account of banks and financial institutions

- Provide additional services to banks and financial institutions including inter-bank clearings and the provision of safe deposit facilities
- Section 39(1) empowers the Bank to offer rediscount facilities to banks and financial institutions by purchasing, selling and re-discounting on behalf of banks, bills of exchange, promissory notes and other credit instruments so long as such instruments bear the endorsement or acceptance of a bank, and matures within one hundred and eighty days from the date of acquisition or rediscount by the Bank.
- The Bank is required by section 39(2) to set a limit of access to the rediscount facilities.
- The Bank is, by section 41, constituted lender of last resort by granting advances or contingent commitments on an exceptional basis and at penal interest rates published each year, to banks and financial institutions in Tanzania that are deemed to be **solvent but illiquid** if-
 - In the opinion of the Board, such advance or commitment is necessary having regard to the financial condition of the bank or the financial institution and to its systemic significance to the stability in the financial market; and
 - In the opinion of the Bank, the bank is solvent and provides adequate collateral and the request for financial assistance is based on the need to improve liquidity; or
 - Available collateral is insufficient and the Minister has on behalf of the Government concurred in writing on the advance or commitment proposed by the Bank to that effect;
 - The Minister on behalf of the Government, has confirmed in writing that separate funds or debt securities in bearer form with interest at market rates will be made available to the Bank by the Government to cover the advance or full amount of the commitment given in the event that it is realized; and
 - The Bank approves upon consent of the Board, each loan and each guarantee or other contingent commitment of the Bank or the benefit of a bank or other financial institution pursuant to this section.

[*Solvent* = having sufficient assets to meet debts and liabilities; capable of meeting financial obligations;
Illiquid = (of assets, investment, etc.,) not easily or readily realizable]

❖ **Controller, supervisor, regulator of banks and financial institutions**
 [BoT Act and BFIA]

- Section 5(1) BOT Act “The principal functions of the Bank shall be to exercise the functions of a central bank and, without prejudice to the generality of the foregoing ... to regulate and supervise banks and financial institutions including ... licensing and revocation of licences...”.
- **Through licensing of banks and financial institutions**
 - Section 5(1) vests licensing function in BoT
 - Section 4 BFIA vests licensing, powers in the Bank.

- Section 6 prohibits carrying on banking business without a licence issued by the Bank.
 - Section 7 empowers BoT to issue licence to engage in banking business to an entity established in accordance with the Companies Act, Companies Decree and the Cooperative Societies Act.
 - Section 8 provides for the mode and contents of an application for licence to engage in banking business.
 - How the application shall be dealt with is provided for in sections 9 and 10. Licence must be granted or rejected within 90 days of its submission.
 - Section 11 empowers BoT to suspend or revoke the licence granted.
 - Reasons for suspension (s. 11(2) BFIA)
 - ✓ Failure to meet minimum capital requirements [s.17 BFI Act]; or
 - ✓ Conducting affairs in a manner that is detrimental to depositors.
 - Reasons for revocation- (s. 11(3) BFIA)
 - ✓ Voluntary request for revocation;
 - ✓ Failure to commence operations within 12 months from the date the licence was granted unless such period is extended in writing by the Bank;
 - ✓ Failure to comply with prudential requirements;
 - ✓ Provided false or misleading information when applying for a licence;
 - ✓ Failure to comply with the terms and conditions of the licence or any remedial measures required under this Act;
 - ✓ Engaging in unsafe or unsound practices that threaten its financial condition or is detrimental to the interests of depositors;
 - ✓ Ceases to do business in the United Republic; etc.
 - It is mandatory that the Bank should suspend or revoke the licence that has been granted to a branch or subsidiary of a foreign bank or financial institution, if the licence of such foreign bank or financial institution granted by the supervisory authority at the home country has been suspended or revoked.[S.11(4)]
 - A revocation of licence must be published in the **Gazette** [S.11(5)]
- **By requiring banks to maintain minimum reserve requirements – cash and liquidity ratios**
- Cash ratio is required under section 44(1) BoT Act
 - Liquid assets ratio – Section 45 BoT Act and 21 BFIA
 - ✓ BoT may vary the ratios
 - ✓ Where variation – a 30 days notice must be given before such variation takes effect
 - ✓ Punishment for failure to comply with the ratio requirement – Sections 44(4) BoT Act
 - ✓ Ratios to apply uniformly to all banks
 - ✓ Failure to comply with the ratio requirement may lead to revocation of licence – Section 11(3) (c) BFIA

- **By requiring banks to furnish to BoT information at specified intervals** to enable BoT know how the banks perform and by requiring banks to publish their balance sheets in newspapers – section 46 BoT Act and section 32 BFIA. Failure to comply may lead to a penalty provided for under section 46(2) BoT Act.
- **By exercising supervisory powers over all banks [Sections 31 - 35 BFIA]**
 - ✓ **By carrying out inspections of all banks** [Section 31 BFIA and section 47 BoT Act] These provisions give BoT the right-
 - To access documents and articles – computers, books, minutes, accounts, cash, securities, etc.
 - To require examination of the said documents and articles
 - To send results of such examination to the Chairman of the Board of the inspected bank for necessary action
 - Should the examination show that a bank is not conducting its business properly thus likely to be detrimental to the interests of the bank itself or depositors to
 - Call upon the bank to take remedial measures as BoT may direct
 - Appoint a competent person to advise the bank on necessary remedial measures. Advice of such person is as good as the Bank's advice.
 - To penalize a bank which fails to comply with the remedial measures directed by BoT [Sections 31(10) BFIA]
 - ✓ **By giving directives** of general or specific character to Board of Directors of banks on how they should perform their functions [Section 33]
 - ✓ By conducting examination of banks and financial institutions (ss. 31 BFIA and 47 BoT)
 - ✓ By requiring banks and financial institutions to take prompt corrective action when the capital level of the bank or financial institution declines (s. 34 BFIA)
 - ✓ By supervising banks and financial institutions even outside Tanzania by entering into arrangements for sharing supervisory information outside URT (s. 35(2))
- **By approving voluntary liquidation of banks [S.50]**
 - The approval for voluntary liquidation shall be given to a bank or financial institution that appears to be solvent and has sufficient liquid assets to repay its depositors and creditors in full and without delay on such terms and conditions as the Bank may determine
 - Section 51 imposes duties on a bank or financial institutions that gets approval for voluntary liquidation.
 - Voluntary liquidation must be conducted under the supervision of BoT (s. 51(2) BFIA)
 - A statutory notice of voluntary liquidation to depositors and creditors and any other person otherwise entitled to funds or property held by the bank or financial institution as a trustee, fiduciary, lessor of a safe-keeping facility or bailee, is required under section 52(1).

- The mode and manner of distributing the notice is given in sub-sections (2)-(4) of section 52.
- Section 53 expressly provides that approval by the Bank of voluntary liquidation of a bank or financial institution shall not prejudice the rights of any claimant against such bank or financial institution to payment in full of a claim.
- **Seizure during voluntary liquidation, taking possession and compulsory liquidation (s. 55 BFIA)**
Where the Bank determines that-
 - The assets of a bank under voluntary liquidation are not sufficient to meet all liabilities; or
 - The voluntary liquidation process has been unduly delayed
 It may
 - ✓ seize the bank or financial institution concerned
 - ✓ take possession of it
 - ✓ take necessary measures leading to compulsory liquidation of the bank or financial institution concerned in conformity with the provisions of this Act.
- **Seizure in other circumstances [S. 56]**
The Bank may take possession of any bank or financial institution if- [S.56 (1)]
 - It refuses to comply with an order or directive of the Bank
 - It refuses to submit to or otherwise obstruct any inspection by the Bank
 - Its licence has been revoked
 - Has ceased to be an insured institution by the DIF
 - Has been adjudicated guilty of an offence under the Proceeds of Crime Act or Prevention of Terrorism Act, 2002
 - Bank has not approved voluntary liquidation
 - In the opinion of the Bank-
 - ✓ Its capital has fallen below the minimum required
 - ✓ It is insolvent
 - ✓ It is conducting its business in violation of any law or regulation or is engaging in any unsafe or unsound practice that is likely to cause insolvency or substantial dissipation of assets or serious prejudice to the interests of depositors or the Deposit Insurance Fund
 - Section 56(2) spells out the circumstances under which the Bank may take possession of a bank or financial institution that is undercapitalized.
 - Section 57 provides for the consequences of seizure and section 58 specifies the powers of the Bank upon seizure. Upon entering into possession of a bank or financial institution the Bank shall be vested with the full and exclusive power of management and control of the affairs of the relevant bank or financial institution including all rights, titles, etc.
 - Section 59 imposes obligations on the Bank upon taking management of a bank or financial institution. One of the obligations is that the Bank should, within 90 days after taking possession, establish a plan of resolution based upon any combination of restructuring, reorganization

or liquidation of the bank or financial institution that provides for expeditious resolution.

- Section 60 allows the Bank to establish and own temporarily a bridge bank or financial institution which may acquire part or all of the assets and liabilities of a bank or financial institution on the basis of the resolution plan.
- Section 61 says that where the resolution plan calls for liquidation of the bank or financial institution, then the liquidation shall proceed in terms of the provisions of section 41 and such regulations as the Governor may make.

(e)Management of foreign exchange and foreign reserves

Section 5(1) BoT Act provides that the functions of BoT include “to deal, hold and manage gold and foreign exchange reserves of Tanzania”.

Foreign exchange means

- (1) in theory any **foreign currency**. In practice, however, it means foreign currency which is readily convertible. Readily convertible currencies are easily acceptable and therefore can be used as payment between or among nations. Thus the US \$, the £ sterling, the German Deutsch mark, Japanese Yen qualify as foreign exchange. Note that the main quality of foreign exchange is its acceptability as means of payment between/among nations
- (2) Gold. Gold is foreign exchange because of its universal acceptability as means of settlement of accounts in international financial transactions.
- (3) Special Drawing Rights (SDRs) is a foreign exchange as well. Created in 1969. First distributed in 1970. This is essentially a reserve asset.

Why create SDRs

- Countries need monetary reserves to meet balance of payments deficits (where value of exports cannot pay for value of imports)
- Before creation of SDRs – a country’s reserves could be in either gold and/or reserve currencies (convertible) and/or the gold tranche (i.e. part of subscription of IMF member countries paid in gold (25% of total subscription)).
- In 1960s it was found that reserve assets could not increase at the same rate as their demand and use increased. After WWII world trade expanded very fast and many countries with balance of payments deficits found that their reserve assets could not pay for imports.
- Reserve assets could not be increased at will because-

= gold: availability as reserve asset depends on its

- i. production,
- ii. industrial use and
- iii. hoarding.

While gold mines are not in-exhaustive industrial use of gold has always increased – hence availability of gold as a reserve asset was limited.

= reserve currencies = their increase depends on the economic strength of the countries concerned. Additions of dollars and sterling to monetary reserves are governed not by demand for such reserves but by the size of the overall balance of payments of the U.S. and U.K. So could not be increased at will.

= the gold tranche = 25% of a country's subscription to IMF. 25% drawing at of a member. The balance of subscription in the country's currency. Where a country has exhausted its tranche and wants more – has to agree with IMF – conditions.

- Hence need for a new reserve asset. IMF sponsored proposals for a new scheme to create reserve assets. SDR as a reserve asset was proposed by a Yale University Professor and was accepted.
- SDR as a reserve asset has no objective existence. Its creation was based on the willingness of nations to accept it as a reserve asset and use it for settling international payments.
- When SDRs were adopted in order to give them legal force Articles of Agreement of the IMF were amended in order to put the scheme into effect. The amendment provided “Whenever there is a general agreement that the international liquidity needs to be increased, the IMF may create a new reserve asset, the Special Drawing Rights, and allocate them to the participating countries in proportion to their quotas in the Fund.”
- Allocation of quotas in the fund depends on the economic strength of member countries. USA – biggest quota. All 3rd world countries have 19% of all quotas.

Foreign Reserves

= A saving of foreign exchange = a fund in foreign exchange (convertible currencies gold and/or SDRs) ready to be used when needed to settle international payments

= Where value of exports is more than that of imports a

country may have foreign reserves.

= poor economies – no foreign reserves

= No reserves – trade on cash basis or on barter basis
No credit – no trust

Section 51(1) BoT Act requires the Bank to at all times use best endeavours to maintain a reserve of external assets at a level which is, at minimum equal to four months imports requirements and the requirements of international transactions of Tanzania for the same period.

Sub-section (2) of section 51 BoT Act provides that reserve of external assets shall, subject to the provisions of sub-section (4) consist of:-

- Gold
- Foreign exchange in the form of
 - Demand or time deposits with foreign central bank or with the Bank's agents or correspondents abroad;
 - Documents and instruments customarily used for the making of payments or transfers in international transactions;
 - Notes or coins
- Securities or guarantees by foreign governments or international institutions and Organizations.
- Section 51(4) empowers the Bank to include in its reserve of external assets any internationally recognized reserve assets, being a reserve asset not included in subsection (2) of this section, e.g. SDRs.

Section 52 BoT Act empowers the Bank to deal in gold and foreign currencies.

Section 53 BoT Act vests the Bank with power to administer any law relating to exchange control, e.g. the Foreign Exchange Act, 1992.

The Bank is banker to the Governments in relation to: [S.55 BoT Act]

- Administration of any payments agreement entered into by the governments
- Acting as fiscal agent of the governments transactions with international organizations or institutions of which the Government of the United Republic is a member
- Acting as a depository for the Tanzania currency holdings of international financial organizations or institutions of which the Government of the United Republic of Tanzania is a member.

COMMERCIAL BANKING IN EAST AFRICA**i. Historical and general aspects**

Historical background

1. Basic prerequisites for emergence of commercial banks
 - commodity production
 - money
 - widespread use of money
 - trade in money

2. Pre-colonialism: were economies of the E.A. countries ripe for emergence of comm. Banks?
 - mostly natural economy
 - here and there petty commodity production
 - in some areas there was trade due to Arab influence
 - in some towns one could find money –Sultan of Kilwa minted copper coins ci. 13th C.
 - Use of money not widespread

Therefore comm. – banks could not emerge from the E.A. economies rather they were imposed by the colonial masters.

3. Commercial Banks were established/imposed in E.A. as follows:-

Kenya & Uganda

- (i) The National Bank of India
(later National & Grindlays Bank).....1896

- (ii) The Std Bank of S.A
(later the Std Bank).....1910

- (iii) The National Bank of S.A.
(later Barclays Bank D.C.O.).....1911

- : The three were British banks in Both **origin** and **ownership** – had branches scattered all over the world. The names are misleading
- : After defeat of Germany in WWI the three banks opened branches in Tanganyika as well

Deutsch Ostafrika (Tanganyika)

- (i) Deutsche – Ostafrikanische Bank of Berlin
 - Branch in DSM 1905
 - Initially did commercial banking and also issued currency (a central bank function)
 - Function of currency issue was dropped in 1906
- (ii) Handelsbank fur Ostafrika
 - Branch at Tanga 1911 – sisal?
- (iii) Banque du Congo Belge
 - Belgian bank in Rwanda – opened 2 branches 1 in DSM the other at Kigoma

Growth of comm. banks

- Nat. & grindlays, Standard Bank and Barclays Bank were the pillars of commercial banking in Kenya and Uganda and Tanganyika (until late 60s)
- By 1954 had branches as follows

	Ugd	Keny.	Tg.
Nat & Grindlays	5	6	3
Std Bank	2	11	5
Barclays Bank	<u>5</u>	<u>8</u>	<u>8</u>
	12	25	16

- By 1958 the big 3 had 247 branches in Kenya alone

Reasons for establishing commercial banks in East Africa

How and why commercial banks were introduced in E.A. and why at that point in time?

Reasons given by textbook writers:

Jucker T. Fleetwood: **Money & Finance in Africa**

Newlyn : **Money in an African context**

The two authors give the following as reasons for introducing/establishing commercial banks in the colonies generally and E.A. in particular:

- (a) Ever-increasing trade between Britain and E.A.

- (b) Commercial bank services were demanded by the expatriate population and government officials to finance their ventures and govt. respectively
- (c) To avoid the cumbersome and costly methods of shipping currency **in specie**. There was, therefore, a need to establish commercial banks in order to
 - (i) facilitate trade
 - (ii) satisfy credit demands of expatriate population and government officials
 - (iii) do away with the problem of shipping currency **in specie**
 - (iv) **add:** harness possible current & future profits and gain

We maintain that what the two writers have given as reasons for establishing commercial banks **are not** reasons rather they are functions of commercial banks. The authors portray them as reasons in order to hide the actual reasons for introduction, nay, imposition of commercial banks in the colonies

Scientific/Real reasons for introduction imposition of comm.. banks in E.A. – from an historical socio-economic perspective

We must ask ourselves

Why were they introduced and why at that point in time – not before, not after

= Establishment/introduction of comm.. banks is linked with colonization – imposition of commodity production on people engaged in predominantly natural economy. The operations of these banks had the effect of accelerating a shift from subsistence farming to production for exchange on the international market

(Read Mittelman 1978 JMAS p.598)

= Colonialism is an aspect of capitalism which can no longer contain itself within its national boundaries, i.e., capitalism has reached the stage of imperialism and must necessarily outflow its boundaries for survival.

Cecil Rhodes is reported to have said in 1895 that Britain needed colonies in order to avert a bloody civil war.

So it was the development of capitalism to its highest stage – imperialism – which was the main reason for establishing colonies.

The main function of a colony was to service and back-up the capitalist economy in the imperialist country. In order to fulfill the above function it was necessary to do the following in a colony:

- : impose commodity production
- : monetize the economy
- : introduce commercial banks

Why commercial banks

- facilitate bringing capital into colonies – Export of capital
- Extend credit for production of raw/auxiliary materials/foodstuffs
- Extend credit for distribution of industrial commodities
- facilitate repatriation of surplus

- act as conduit pipe between mother bank and the colony in servicing capital

Local elements in commercial banking

Uganda: The Uganda Commercial Bank established in 1965 by statute

Tanzania: The National Cooperative Bank established in 1964 by statute

The Tanzania Bank of Commerce Ltd – 1965 – took over the business of Ottoman Bank - 60% shares - Government 40% shares – other commercial banks

LAWS GOVERNING COMMERCIAL BANKING IN E.A

- Laws were imposed .We are still applying many of the imposed laws. They are of two categories
 - (i) Substantive laws
 - Contractual relationship between banker and customer – applied Act – the Indian Contract Act 1872
 - Law and practice as developed by merchants
 - the Law Merchant – as refined to suit the circumstances of the time
 - Part of received law
 - - common law
 - - principles of equity
 - - statutes of general application. Reception dates - Tanganyika 22/2/20; Kenya 12/8/1897; Uganda 11/8/1902; Zanzibar 7/7/1897
 - Any other recognized body of commercial law (being international in character)
 - (2) Regulatory laws
 - To regulate formation, operation, control winding up etc. These too were imported
 - Companies Ordinance Cap. 212 (T), 486(K)
 - Bankruptcy Ord. Cap25 (T), 30 (K)
 - Bills of Exchange Ord cap. 215 (T)
 - Today we have the following pieces of legislation as regulatory laws-
 - Bank of Tanzania Act, 2006
 - Banking and Financial Institutions Act, 2006
 - The Companies Act
 - The Foreign Exchange Act, 1992

Institutional build up in the financial sphere in Tanzania from mid 1980s to the present time

- ❖ The financial build up has a history which starts from the 1960s

- ❖ Before 1967 pillars of commercial banking in Tanzania were the National and Grindlays Bank, the Standard Bank and Barclays Bank. There were also other commercial banks
- ❖ In 1967 the Arusha Declaration promulgated the policy of socialism and self reliance which was man-centred. The policy culminated in the nationalization and acquisition of all major means of production which were put under the state for the benefit of all the people. In the financial sphere all commercial banks were nationalized and in their stead was established the National Bank of Commerce by an Act of Parliament (a monopoly commercial bank on Mainland Tanzania. In Zanzibar there was the People's Bank of Zanzibar). In addition to these commercial banks Tanzania established financial institutions aimed at raising the standard of living of the people. These were the
 - Tanzania Investment Bank (by Act No. 20 of 1970)
 - the Tanzania Housing Bank (by Act No. 34 of 1972)
 - the Tanzania Rural Development Bank (TRDB) (by Act No. 7 of 1971)
 - ✓ By Act No. 10 of 1984 TRDB changed its name to Cooperative and Rural Development Bank.
 - ✓ And, by Act No 14 of 1985 CRDB was empowered to do commercial banking.

The aims and measures of the Arusha Declaration were initially successful with only a few frustrations. Later however a series of events and processes of both a local and global social economic nature took place. These events and processes (which we are going to list) frustrated not only the consolidation of the A.D. based measures but also the general development of the country.

- ❖ The main events included:-
 - oil crisis in early 70s which drained the country's foreign reserves
 - food shortage crisis of 1973/4
 - the war with Amin's Uganda
 - the ill fated and economically destabilizing development village scheme.
 - heavy indebtedness of govt. to local and foreign creditors
 - the poor and inefficient performance of the heavily bureaucratized, state patronized parastatal sector.
- ❖ Due to these events and processes as early as 1973/4 it became evident that a negative economic trend had set in. And, unfortunately that trend continued to gain momentum with Tanzania's balance of payments becoming unfavourable year after year. With a negative balance of payments, i.e., with no foreign reserves Tanzania became not creditworthy.
- ❖ By 1985/6 it had become certain that the negative economic trend was irreversible and indeed worsening.
- ❖ This worsening economic trend had a negative impact on the standard of living of the people. Much of the negative economic trend was ascribed to the policy of socialism and self reliance. This policy therefore increasingly came under fire.

- ❖ The Brettonwoods institutions pressed hard for acceptance by Tanzania of the Economic Recovery Programme bitter pill. That pressure became irresistible. The Second Phase Government gave in in 1985/6 by signing the IMF/IBRD conditionality package agreement with those institutions.

- ❖ The govt. of Tanzania on the other hand, in view of trends in the world – globalization necessitating liberalization of the economy – was seriously thinking about how to do away with the problems which had plugged the economy. The Government thought the answer to the economic problems was in the injection of capital into the economy. In order to get the much needed capital the Government decided to formulate a policy on the Government’s position on the following-

- the **role of both local and foreign capital participation in the economy,**
- **areas open to both local and foreign capital participation in the economy; and**
- **the acceptable forms of both local and foreign capital participation in the economy.**

Experts were assigned to prepare a national investment promotion and protection policy along the lines of the Government position. The policy was prepared.

- ❖ In 1989 the Government adopted the National Investment Promotion and Protection Policy.

- ❖ Highlights of the Policy

- Objectives

- to foster economic and social development of the people of Tanzania by building a more nationally integrated economy. Indeed this is a noble objective like that of A.D. The difference lies in the means of attaining the objective – AD – public enterprise now – private enterprise.
- to promote and protect private foreign capital
- to strengthen the incentive packages offered to investors both foreign & local

- Categorization of sectors of investment

The Policy specified priority sectors of investment

- “Controlled areas” – areas of major economic importance to the country . . . only public investment or joint public & private investment could be allowed.[iron & steel production; machine tool mfg.; chemical fertilizer & pesticide production; airlines]
- “Reserved areas” – areas of strategic importance to the country.

Exclusively for investment by the public sector **except** where special licence may be granted [banking, insurance, assurance]

This policy statement was operationalized by enactment of the National Investment (Promotion & Protection) Act 1990 No. 10 of 1990. This Act was repealed and replaced by the Tanzania Investment Act 1997, No. 26 of 1997.

So the first legislation that paved way for setting up private banks in Tanzania was the NI (P.P) Act 1990 – **Special licence** had to be applied for and granted before one could do commercial banking business in Tanzania.

After passing the National Investment (Promotion and Protection) Act, 1990 there was felt a need to put in place an acceptable legal framework. The exercise had already began by the Presidential Commission of Enquiry into the Monetary and Banking System. The recommendations of the Commission culminated into the enactment of the Banking and Financial Institutions Act, 1991, (which repealed the Banking Ordinance, 1960) the Foreign Exchange Act, 1992 (which repealed the Exchange Control Ordinance, Cap. 294) and the Bank of Tanzania Act, 1995 (which repealed and replaced the Bank of Tanzania Act, 1965) .

The Banking and Financial Institutions Act, 1991 laid down, among others, the procedure of applying for and obtaining a licence to do commercial banking in Tanzania and vested licensing powers in the Bank of Tanzania. Some of the banks which have been licensed include:

-	Std Chartered Bank (1993)	-	Foreign
-	Stanbic Bank (1995)	-	Foreign
-	Citibank (1995)	-	Foreign
-	Eurafrican Bank (1994)	-	Foreign
-	Greenland Bank (1996)	-	Foreign
-	Trust Bank (1994)	-	Foreign
-	Diamond Trust Bank	-	Local
-	First Adili Bank (1995)	-	Local
-	Akiba Commercial Bank (1997)	-	Local
-	CRDB (1996) ltd	-	Local
-	Exim Bank (1997)	-	Local
-	Kenya Commercial Bank (1997)	-	Foreign
-	Bank of Baroda	-	Foreign
-	NBC (1997)	-	Local
-	National Microfinance Bank Ltd	-	Local
-	The Peoples Bank of Zanzibar (1966)	-	Local
-	Kilimanjaro cooperative Bank Ltd (1996)	-	Local
-	International Bank of Malaysia (T) Ltd. (1998)	-	Foreign
-	Habib African Bank Ltd. (1998)	-	Foreign
-	Barclays Bank (T) Ltd. (2000)	-	Foreign
-	United Bank of Africa (2002)	-	Foreign
-	CF Union Bank Ltd. (2002)	-	Local
-	African Banking Corporation (T) Ltd. (2002)	-	Foreign

FUNCTIONS OF COMMERCIAL BANKS IN E.A.

I. MANAGEMENT OVER FINANCE CAPITAL

- Service capital by financing external and internal trade
- Undertake deposit banking, lend money at interest, invest and realize profits with the aim of accumulating capital and repatriating it to the metropolises

II. ACCEPTANCE OF DEPOSITS AND MAINTENANCE OF DEPOSIT ACCOUNTS

- One of the historical functions of banks e.g. pre-money banking institutions, gold smiths, money lenders – accepted deposits
- As bankers to the public commercial banks open accounts for customers, accept deposits from them and maintain deposit accounts
- By opening accounts and accepting deposits from customers the bank in effect operates as a capital mobiliser and centralizer
- The centralized capital is used by the banks to give credit facilities to those in need of funds – business of lending money at interest – source of income.
- Hence the bank needs the deposits for the purpose of doing business. It makes every effort to accumulate more and more funds from the public. The Bank offers attractive terms -
 - different types of account Current Alc, Savings/Alc, Time Deposit A/C, etc.
 - certain types of account attract interest
 - open branches
 - use mobile services
 - use agencies
- To maintain the confidence people have in the banks, the banks ensure that the accounts are properly kept.

III. DISCOUNTING OF BILLS AND COLLECTION OF BILL PROCEEDS

1. Discounting of bills

- To buy a bill at a price less than its face value.
The buyer of the bill becomes entitled to get the full value (the face value) of the bill at maturity when the bill is presented for payment.
- In effect the seller of the bill is given a credit facility
- By discounting bills the banker makes money (the difference between amount paid to seller and amount bank will get from the drawee/payer of the bill at maturity). A source of income to a bank

2. Collection of bill proceeds

With the rise of banking customers used to leave bills, notes and other securities of which they were holders with their bankers so that necessary presentation might be made and the amount received. The bank which

received the amount on behalf of the customer credited the amount in the customer's account.

When use of cheques developed, especially when crossings became part of the cheques, the need for and importance of banks as collectors of such proceeds and crediting same with the customers' accounts grew. For practical purposes it becomes obligatory on bankers to offer this service to customers.

- What collection of proceeds of a bill entails
 - (a) Receiving an instrument (bill/cheque/note) from a customer for purpose of collecting its proceeds from the drawee/ paying banker
 - (b) Physical presentment of the instrument by the collecting bank to the paying bank to collect the proceeds (S.45 BEA Cap. 215)
 - (c) Crediting the collected proceeds in the customers' account.
- Collection of bill proceeds is one of the principal functions of a banker. In performing that function the bank changes its legal status depending on the nature of the transaction -
 - Under (a) and (b) above the bank is complying with the instructions of the customer. Hence the relationship here is one of principal and agent. Customer is principal and banker is agent.
 - Under (c) after crediting the proceeds in the customer's account, the bank ceases to be an agent and assumes the position of debtor. So the customer has lent his money to the bank. Customer becomes creditor and banker becomes debtor.

Joachimson v. Swissbank Corporation

Duties of a Collecting Bank

1. To exercise reasonable care and diligence in
 - Duly presenting the instrument for payment. **Barclays Bank plc v. Bank of England** [1985] 1 All ER 385 emphasizes the importance of collecting banker physically presenting the bill to the paying bank. Presenting to the clearing house-not enough, when paying bank takes it away from clearing house – not enough.
 - Obtaining payment stated on the instrument
 - Crediting customer's account – no overcrediting nor undercrediting.
2. To conduct business with care and circumspection. **N.B.C. v. Said Ally Yakut** [1989] TLR 119 (HC) (Mwalusanya J.)

Said Ally Yakut (SAY) had a C/Alc at NBC Karagwe. On 5/5/1984 SAY deposited a cheque in his account at Karagwe NBC. The cheque worth Shs. 279,500/= was drawn on NBC Market Street DSM in his favour. On 7/5/1984 (only two days later) Yakut was allowed by NBC Karagwe to withdraw the amount deposited. The Branch Manager was behind these moves because he wanted Yakut to give some money to his relative. The cheque deposited on 5/5/1984 was never seen again –It was either destroyed or that it got lost. When a new Branch Manager took office at NBC Karagwe he summoned Yakut and wanted him to agree that they treat the shs. 279,500/= as an overdraft. Yakut refused. NBC sued him and lost because according to the judge-

: a collecting bank owes a duty of care to its customers in that it should conduct its activities with care and circumspection

: the bank was either grossly negligent or acted deliberately to incur loss.

It appears if a bank conducts its business according to known principles it may escape liability. In **CRDB Bank Limited v. Damas Joseph Mallya** [200]TLR a collecting bank after observing the value date procedure, i.e., upon expiry of 14 days from the day the cheque was deposited, allowed the defendant to draw. The cheque sent for collection was never paid and the defendant had drawn a substantial part of the amount deposited in the account of the defendant with the collecting bank. When the plaintiff bank turned to the defendant for return of the money or assistance to trace the drawer, the defendant proved to be uncooperative. The plaintiff bank sued the defendant to recover the money paid out by mistake of fact. The court was of the considered view that the requirement that money paid by mistake of fact must be refunded is that the law should not countenance unjust enrichment; the law should not permit a person to retain a benefit unjustly derived from the other. The court observed that in this case the mistake was to a matter of fact in that the collecting banker assumed that the cheque had in fact been cleared because as per the obtaining value-date procedure, fourteen days had elapsed without the cheque being dishonoured or without receipt of any kind of communication which would otherwise affect its payment. The court gave judgment in favour of the plaintiff bank.

3. To promptly inform the customer in case a cheque gets lost.

N.B.C v. Perma Shoe Co. [1988] TLR 224. (C.A.) (Makame Kisanga & Omar) R. presented his cheque drawn on NBC Ngara to the A bank (NBC Kashozi) for collection. The bank credited the R's account on 18.6.1982. More than a year later A informed R. that the cheque had been lost in transit when sent for collection at the Ngara NBC, debited the amount of the cheque credited in R's a/c on 18.6.1982 and required R to get a fresh cheque from the drawer. R could not get a fresh cheque as drawer had left the country. R. sued A claiming damages for loss of the cheque and compensation for depreciation in the value of the Tanzania Shilling.

H.C. (Mwalusanya, J.) decided in favour of R on the ground that the A had been negligent in failing to promptly notify R of the loss of the cheque

- awarded damages in the sum of shs. 34,500 the value of the lost cheque; and
- compensation in the sum of shs. 50,000/= due to deprecation of Tanzania shilling

... The A bank appealed against the decision of the H.C. to the Court of Appeal of Tanzania which upheld the decision of the H.C. It stated: “where a customer deposits a country cheque with a collecting bank and the cheque gets lost, the bank owes a duty of care to the customer to inform him promptly of such loss so that the customer may take appropriate steps that might be open to him to avert any or further consequences resulting from such loss.

That duty exists whether the cheque is lost by the bank itself or by a third party having possession thereof on behalf of the bank. Appeal dismissed:

4. **Duty not to commit or assist in the commission of the tort of conversion**

Conversion is that tort which is committed by a person who deals with goods/chattels not belonging to him in a manner which is inconsistent with the rights of the lawful owner whereby the said owner is deprived of the use and possession of them. (**A Concise Law Dictionary** by P.G. Osborn).

Conversion means the unlawful dealing with another person’s goods/chattels so as to deprive him/her of the use and possession of them.

According to **Winfield and Jolowicz on Tort**, edited by Rogers W.V.H. conversion is a wrong which is committed by dealing with the goods of a person which constitutes an unjustifiable denial of his rights in them [or the assertion of rights which are inconsistent with the rights of the true owner]

The use of the term “conversion” in connection with negotiable instruments implies wrongful conversion i.e., the unauthorized dealing with another persons goods in such a way as to deprive him of **possession**. This covers not only thieves but also innocent “agents” of thieves acting in complete ignorance of the previous conversion. Thus while a man who steals a cheque and cashes it, is liable for conversion, equally so is the banker who pays the thief. Again if the cheque was crossed and the thief consequently used a banker to make collection, that banker, too, would be liable for conversion.

When the customer has no title to the cheque its collection by his bank therefore amounts to a conversion because the bank is in effect however innocently assisting the customer to carry through the conversion. The bank has willfully interfered without legal justification with a chattel (in this case a cheque) in a manner inconsistent with the right of another wherey that other is deprived of the possession and use of it. See **Salmond on Torts** and **A.L. Underwood Ltd. v. Barclays Bank** [1924] 1 KB 775; Lord Chorley, **Law of Banking** p. 101

When the bank has committed conversion while acting as agent of the customer it has a right to be indemnified by the principal/customer should it

be ordered to pay damages/compensation. Practical problem – customer – insolvent, run away.

It can be noted that a collecting bank is at risk of being involved in the tort of conversion. The Bank may be involved although it does everything in good faith and without knowledge of the previous conversion.

The law thus provides some defences to a collecting banker

DEFENCES AVAILABLE TO THE COLLECTING BANKER

1. The first and main defence is the statutory protection – s 85 of the Bills of Exchange Act, Cap. 215, R.E. 2002.

Kenya: Cheques Act 1968 No. 41 of 1968

Section 85 of the BEA Act of Tanzania provides -

- (1) where a banker in good faith and without negligence -
 - (a) receives payment for a customer of an instrument to which this section applies, or
 - (b) having credited a customer's account with the amount of an instrument to which this section applies, receives payment thereof for himself and the customer has no title, or has a defective title, to the instrument the banker shall not incur any liability to the true owner of the instrument, by reason of having received payment thereof.
- (2) This section applies to the following instruments that is to say -
 - (a) cheques
 - (b)
 - (c)
 - (d)
- (3) For the purposes of this section the failure of a banker to concern himself with the absence of, or irregularity in endorsement of an instrument, shall not constitute negligence

In order to be availed with the statutory defence the court must be satisfied

- (a) that the bank acted in good faith. S.96 BEA defines acting in good faith = acting honestly (whether negligently or not)
- (b) that the bank acted without negligence
 - opening an a/c for a stranger without satisfactory references = negligence
 - collecting cheques for a customer although the transaction raises suspicions = negligence
 - collection of cheques payable to third party = negligence
- (c) that the bank collected for a customer (who is a customer – see later)

Other Defences

2. That the banker is holder for value of the instrument being collected
 - (i) where banker cashes (gives cash) a cheque payable elsewhere to oblige a customer – like a friend or tradesman could do: Customer to sign a form that banker to have recourse against him should – cheque be returned unpaid
Customer could as well endorse the cheque.
 - (ii) Where customer deposits a cheque and banker expressly or impliedly allows him to draw against it before it is cleared: Here banker could collect for himself.
 - (iii) Where customer pays in a cheque in specific reduction of an advance – not in the ordinary course of business on an overdrawn account – banker collect for himself.
 - (iv) Where banker under s. 27(3) BEA has a lien on the cheque

See **Jone's and Holden's studies in Practical Banking** pp. 260 - 263

Lien = a right to retain property belonging to the debtor until he has repaid the debt. Does not give special property to the lender and therefore no right of sale of the property. A banker's lien, however, includes a right of sale.

Other defences (**Sheldon** p. 48
(**Holden** vol. 2 pp.247-9)

3. That the bankers is a holder in due course of the instrument being collected (see later)
4. Estoppel – that the true owner is estopped from denying the truth of his representation
Greenwood v. Martins Bank Ltd [1932] All E.R. 318 W forged H's signature on cheques which were paid by the bank. H discovered the forgeries, taxed her with them. She promised to reform and begged him not to tell the bank. Eight months later W asked for money from H who refused her the money. She committed suicide as a result of that refusal. H then unveiled the whole story to the bank and later sued it for paying away his money against forged authorizations.
Held: H estopped from denying the authenticity of W's signature as his.
5. Contributory negligence – true owner contributed to the loss of the instrument by his negligence **Holden** vol. I pp. 246 - 247
6. Ex turpi causa non oritur actio
- where the transaction is illegal or is tainted with illegality one loses his right of cause of action.

Banker for collection and recent technological developments [Electronic Banking]

Cheque truncation

Crossed cheques must be deposited in the payee's bank which becomes constituted a collecting bank. A collecting bank owes a duty to its customer to present for payment all

cheques deposited for collection. Section 45 of the Bills of Exchange Act provides that a bill of exchange (including a cheque) must be duly presented for payment and that failure to do so discharges the drawer and indorser. The bill (cheque) must be presented 'at the proper place' and 'at a reasonable hour on a business day'. In the case of a cheque the proper place for presentment is the address of the branch of the drawee bank printed on the cheque. Although nowhere in the B.E. Act 'due presentment' is defined English cases tend to indicate that a **cheque must be physically presented for payment**. Thus, it follows presentment by electronic means would not meet the test of due presentment [See **Griffin v. Weatherby** (1868) LR 3QB 753 at p.760 in which the judge said "the document itself must be presented" and **Barclays Bank plc v. Bank of England** [1985] 1 All E.R. 385 in which Bingham J. held that where a cheque passes through the interbank clearing system **the collecting bank's duty to its customer is only discharged when the cheque is physically presented for payment at the branch of the paying bank on which it is drawn ...**

Physical presentment of cheques is a time-consuming and costly process because it involves physical transportation of each cheque from the branch of the collecting bank where it has been deposited by the payee for collection **via** the clearing house to the branch of the paying (drawee) bank on which the cheque is drawn. [For general process of clearing of cheques see **Barclays Bank plc v. Bank of England** [1985] 1 All E.R. 385]

To short circuit the cumbersome process banks resort to what is known as **cheque truncation**. Cheque truncation involves sending electronically from the collecting bank to the paying bank, data from the magnetic ink codeline at the Bottom of the cheque .

The data referred to above are

- the number of the drawee/paying bank,
- the account number, and
- the cheque number.

These data are encoded in machine readable form. When the cheque is deposited for collection

- the payee's account details and
- amount of the cheque

are also added in machine readable form.

The data from the magnetic ink code line at the Bottom of the cheque are electronically sent by the collecting bank to the paying (drawee) bank. That obviates the necessity to physically transport the cheque from the collecting bank to the drawee bank. The collecting bank retains the cheque.

The legal basis of using cheque truncation

- ❖ In England it became necessary to amend the law in 1996 to allow cheque truncation. A new section 74 was inserted into the Bills of Exchange Act, 1882. The amendment was effected through an order named Deregulation (Bills of Exchange) Order 1996. The law, as amended by insertion of section 74B into the BEA 1882, now permits the presentation of the cheque by means of electronic or similar message, which sets out the fundamental features of the cheque namely
 - the serial number,
 - the sorting code of the drawee bank,
 - the number of the account on which the cheque is drawn and

- its amount

the drawee bank is, however, given the right to demand that the cheque be presented physically, especially where it suspects fraud.

Please note that even in England it takes three days to clear a cheque notwithstanding use of the cheque truncation system. Indeed cheque truncation has simplified and shortened the process.

❖ The position in Tanzania

Section 46(2)(e) of the Bills of Exchange Act allows waiver of the requirement of presentment for payment. The section provides:

- 46(2) Presentment for payment is dispensed with, -
 - (e) By waiver of presentment, express or implied

So the collecting bank could agree with its customer that its duty should be discharged by electronic presentment of the cheque. That is fine. However that waiver does not cover drawer and indorsers of the cheque. These too must waive their right to physical presentment where a cheque is to be truncated and their liability on the instrument maintained.

The commercial advantages of eliminating the time consuming and costly process of physical presentation of cheques between banks may be good reason for recommending amendment of the BEA to allow presentment of cheques by electronic means. The law should allow a collecting bank to present a cheques for payment by notifying the paying bank of the cheques essential features by electronic means or otherwise instead of by presenting the cheque itself. The essential features of a cheque are

- it serial number
 - the paying bank's code
 - the drawer's account number
 - the amount of the cheque as entered by the drawer.
- Disadvantages of electronic presentation
 - ❖ paying bank cannot compare signatures
 - ❖ may have no advantage of detecting material alteration to the cheque
- So the law should also allow the paying bank upon suspicion to require physical presentation of the cheque
 - Cheques involving huge amounts should also be physically presented. The law to so provide.
- NOTE:**
- Section 6 of BoT Act 2006 makes BoT an overseer, regulator and supervisor of payment systems in the country
 - The provisions of section 6 of BoT Act [See also s.70] empowering BOT to oversee, regulate and supervise payment systems in Tanzania, alone are not

enough to legalize cheque truncation. There is a need to amend the BEA to accommodate technological developments or alternatively pass a separate piece of legislation to provide for this aspect.

IV. LENDING/ADVANCING MONEY OR GIVING OF CREDIT AGAINST SECURITY

❖ Definition of terms

- **Bank loan** means money lent by a bank
- **Overdraft** means the amount of money you owe to a bank when you have spent more money than you had in your account
- **Overdraft facility** means an agreement with your bank to overdraw your account up to a specified limit
- **Credit** means an amount of money that is put into someone's bank account or added to another amount (contrast **debit**)
- **Credit facility** means an agreement to give someone money for the purpose of doing something
- **Advance** means giving someone money for the purpose of enabling him to accomplish something

❖ The basis for a bank to lend out money deposited by its customers

- Banks are mobilizers and centralizers of capital – those with surplus deposit
- Banks give credit facilities/lend/advance money to those in need of money
 - lends to those who need to borrow
- What the bank lends is money deposited by its customers.
- What is the basis for banks to lend out money deposited by customers? We have to examine the relationship between a bank and its customer

: **Is it one of bailment** where you would have a bailor and bailee [S.100 LCO].

Bailment means

...the delivery of goods by one person to another for some purpose upon a contract that *they shall*, when the purpose is accomplished, *be returned* or otherwise disposed of according to the directions of the person delivering them.

When a customer deposits bank notes or coins in his bank he/she does not expect the bank to return to him/her the same notes [notes bearing same numbers] or same coins. So the relationship is not that of bailment. However, where valuables are deposited for safekeeping, the same valuables are returned. In such a case the relationship is that of bailment.

: **Is it one of trust** under which you have a trustee and beneficiary/cestui que trust

A trust is a relation between one person and another based on confidence by which property is vested in or held by the one person on behalf of and for the benefit of the other

Does your bank hold your money on your behalf and for your benefit? No. Once you deposit your money with your bank the bank may trade in that money as it wishes and make money out of it. The bank is not obliged to account to you for the money it has made by trading in the money you deposited. It is not obliged to pay interest to customers.

: **Is it one of agency** where you have a principal and agent? Primarily it is not one of agency. An agent is required to conduct business according to the directions of the principal and to render proper account to his principal on demand. The bank is not required to conduct business according to directions of customers nor is it required to render proper accounts to its customers on demand.

However, when acting as banker for collection, we have seen the relationship between the banker and customer is that of agency. As a collecting bank the bank is required to follow the instructions of the customer and must collect the correct amount which is due to the customer.

: **Is it one of debtor and creditor?**

It has been said that when a customer deposits his money with his bank, he lends that money to the bank Hence customer becomes creditor and the bank becomes debtor. In **Joachimson v. Swiss Bank Corporation** [1921] All E.R. 92 (C.A) the Court said:

The bank undertakes to receive money and to collect bills for its customer's account. The proceeds so received are not to be held in trust for the customer, but the bank borrows the proceeds and undertakes to repay them.

Money which the bank borrows from customers who deposits it becomes the bank's money to be dealt with as the bank wishes subject only to the obligation to repay such money on demand.

So a bank may lend out money deposited by customers because that money belongs to the bank. It is the bank's money.

Lending/advancing money means giving credit facility.

❖ **Elements of credit**

There are two elements of credit

- Trust
- Interest

Trust

Credit is based on trust – on confidence – that the borrower will repay. So money is advanced/lent to a “good” man. In the Shylock sense a good man is that man who is able to pay.

You may look at credit in any one of the two relationships. First, a rich man gives credit to a poor man whom he considers to be descent and industrious. The rich man does not demand anything from the poor man to back up the credit facility. No property is demanded. The poor man has no property to give to back up the credit facility. Here the rich man who has lent money to the poor man is interested in the life of the poor man – his talents and activities – his good health serve the rich man as a guarantee for the repayment of the money he lent to the poor man. The trust is backed up by the good health of the poor man (the good health serves as security for the money given)

The death of the poor man will mean death of the rich man’s capital plus customary interest. To the rich man the value of the life of the poor man is measured in terms of the credit given. In insurance this is reflected in the insurable interest a creditor has in the life of his debtor, to the extent of the debt.

Secondly is the relationship where the borrower is rich and has property to offer to back up the credit facility given. Here credit is given to facilitate production and distribution of commodities. It may also be given for consumptive purposes. Where credit is given for productive purposes it benefits both the lender and the borrower. . Borrower employs the credit in such a way as to get profit thus enable him repay principal sum plus customary interest. Here ability to repay is assured. Here the trust is backed by property as security. In case the borrower fails to repay the lender will fall on the property, sell it and recover his money.

Interest

Credit presupposes and essentially carries with it the element of interest. This is so because the banker is doing business – is using the money as capital. And, capital must always breed itself. There would be no point of lending in the absence of interest. (not in the capitalist sense). A loan which does not attract interest is known as **karadha** See **Khalfan v. Kichwa** [1980] TLR.

❖ Principles of good bank lending

A banker will always want to make sure that the amount of money lent out is repaid, and of course, plus some interest. So a banker will usually abide by the principles of good lending. And these are:

- (a) **Safety of the advance:** The loan must be safe in that it should be repaid. To ensure repayment the loan should be given
 - to a reliable borrower
 - who can repay from reasonably sure sources
- (b) **Viability of the Project** (measures suitability of the advance): The question here is whether or not the advance when applied to the project will yield returns as to be able to repay the advance plus interest. This really goes to the **economic viability** of the project
- (c) **Profitability:** Will the project yield profits? If yes, then the bank is likely to be repaid accordingly

Note: - The above principles serve as guidelines – they are a product of experience

- They are interwoven and cannot be isolated: Advantages supporting one or more principles may completely outweigh the weaknesses resulting from the failure of the proposal to meet other principles.

(d) **Security**

Cartoon [Bogi Benda] – Joyce intends to borrow from company. What security has she got to offer?

Much as the bank may be satisfied as to the safety of the advance because it lends to a reliable borrower, it is still advisable to demand and accept some security as insurance.

Security involves a transaction whereby a person to whom an obligation is owed by another person, called the “debtor”, is in addition to the personal promise of the debtor to discharge the obligation, afforded rights exercisable against some property of the debtor in order to enforce discharge of the obligation.

So: strictly, security is that transaction of offering some property for a loan/advance given. Security does not mean property. However, in everyday life the general meaning of security is associated with property -

In this sense security may be defined as some tangible, salable property or negotiable paper or a person on which/whom a money lender may rely to get payment of his credit plus interest from his debtor in the event of the latter’s default or insolvency/bankruptcy.

Reasons for demanding and accepting security against an advance

- (1) Every lender has a right to demand and accept some security against an advance he grants,

- (2) Much as an advance is granted to a reliable borrower, should he default in repayment the wise lender who has taken security will fall on the security, sell it and get his money back.
- (3) The possibility of a borrower to default in due repayments is always there. There are reasons why it is unsafe for lenders not to demand and accept security, rather rely on the bare promise of the borrower to repay. These include-
 - Contradictions in the capitalist mode of production. These make it possible even for the rich to fall victim of the system – go bankrupt/become insolvent – not a question of being industrious and descent
 - Workers' strikes, civil disorders, war damage, natural disasters. These may make the borrower fail to repay the advance.
 - Dishonesty, misallocation of funds/resources, misappropriations, poor maintenance of plants – indecency on part of borrower – low commercial morality. These factors may also lead to failure to repay advances

Note: Most of the reasons given above are beyond the powers/control of the borrowers.

A wise lender will, therefore, always demand and accept some security against the advance in order to protect him in the following circumstances-

- (1) in case borrower fails to repay – fall on the security, realize it;
- (2) in case borrower had other creditors – against unsecured creditors
- (3) in case of insolvency/bankruptcy of the borrower - against trustee in bankruptcy or official receiver.

It has already been pointed out that a lender has got a right to demand and accept some security to back up his advance. This security is particularly/especially important because of the high probability of borrowers becoming insolvent/going bankrupt. It is principally contradictions within the capitalist system that make it inevitable for some borrowers to become insolvent/go bankrupt.

Acceptable lending and security against advances principles

- (i) Lend on short term basis
 - A banker should preferably lend on short term basis in order to enable the capital lent to be turned over as many times as possible within a given period of time
- (ii) Amount lent out to be less than the value of security given. Market value of security must be higher than the amount lent out to allow a margin for depreciation. This will avoid the risk of market price fluctuations and overvaluation by borrowers which might leave part of the debt unsecured.
- (iii) Lend against a wide variety of securities Banks usually lend against a wide variety of securities in proportions worked out on the basis of practice and experience (usually by experts called actuaries). The intention is to avoid putting all the golden eggs in one basket. The advances and securities must

- be of such an extent and nature that they allow the bank to be liquid at the level of highest profitability.
- (iv) Find out the performance ability of applicant
Banks examine balance sheets and profit and loss account of the applicant in order to assess his performance ability.
 - (v) Lend to a person with very high repayment probability. Before considering taking any security an advance must first be secured by
 - the borrower's reliability, honesty, his business acumen, experience & skill – his general economic strength.
 - The economic viability (based on acceptable cost/benefit analysis) and the engineering feasibility of the project or economic venture for which the loan is sought.
 - (vi) Go for first class security
Bankers normally go for first class securities e.g. a legal mortgage as opposed to equitable mortgage.
 - (vii) Easy realizability of security
The security proposed must be easily realizable
 - (viii) Realization of security – a matter of last resort Realization of security should be avoided as much as possible, and should be resorted to only as a matter of last resort. It should be avoided because:
 - it may be costly
 - may lead to debtor's bankruptcy
 - may be legally involving
 - may give bad publicity to a money lender

Canons of a good banking security

Lenders/Bankers normally take into consideration certain basic principles when considering taking security. The principles/canons are-

- (a) The **value** of the security should be readily **ascertainable** and reasonably **stable** over the years providing a sufficient margin for depreciation.
- (b) The security should be readily **realizable** in all conditions with a simple title which preferably is transferable without undue cost or trouble, e.g. a quoted share may be sold within hours in a market or a life policy which can be promptly surrendered practically without cost compared to a building.
- (c) The bank should strive to obtain a **safe unquestionable title** without undue trouble and expense e.g. a house – check whether no other mortgage, (must search the relevant registry); whether encumbered in any way (matrimonial house).
- (d) Bank to satisfy itself that it will not incur liability to third parties arising out of its title to the security e.g., partly paid shares.

TYPES OF SECURITY WHICH BANKS PREFER

A. LAND

Defn. : The Land Ord. Cap. 113 defined land as the “surface of the earth and the earth below it including all substances forming part of or below the surface, things naturally growing on the land, buildings and other structures permanently affixed to the land”.

In this definition land included minerals, petroleum and whatever was affixed to the land “**Quicquid plantatur solo, solo cedit**” [Whatever is affixed to the land is part of the land]. Owner of land owned it from Bottom of the earth to the highest sky – **usque ad coelum**.

The Land Ordinance was repealed by the Land Act, 1999 No. 4 of 1999. Section 2 of the Act defines land as including “the surface of the earth and the earth below the surface and all substances other than **minerals** or **petroleum** forming part of or below the surface, things naturally growing on the land, buildings and other structures permanently affixed to or under land and land covered by water”.

Note: minerals + petroleum are excluded from the definition of land.

Land may be accepted by banks as security in the form of **mortgage**. In the Land Act the mortgage regime is provided for in Part X. In 2004 the whole of Part X of the Land Act, 1999 was repealed and replaced. This was done by the Land (Amendment) Act, 2004, Act No. 2 of 2004.

The Land Act 1999 as amended defines a mortgage as

- an interest in a right of occupancy or a lease securing payment of money or money’s worth or the fulfillment of a condition and includes a sub-mortgage and the instrument creating the mortgage (s.2)

Section 116 of the Act provides that a mortgage of land shall take effect as security only and not operate as a transfer of any interests or rights in the land from the mortgagor to the mortgagee but the mortgagee shall have, subject to the provisions of this Part, all the powers and remedies in case of default by the mortgagor and be subject to all the obligations that would be conferred or implied in a transfer of an interest in land subject to redemption.

The Act as amended in 2004 provides for a mortgage and informal mortgage. The 2004 amendment abolishes small mortgages which could be created under the 1999 Land Act.

❖ A Mortgage

- may be created by an occupier of land under a right of occupancy and a lessee (s. 113(1))
The occupier or lessee of land may create third party mortgages and second or subsequent mortgages. [S. 113(2)]
- must be created by an instrument in a prescribed form (s.113(1)). See (The Land (Forms) Regulations)
- must be registered in accordance with the provisions of the Land Registration Act, or in a prescribed register and the mortgage shall take effect only when it is registered. [S.113(4)]

- ❖ It is possible to create a mortgage of a matrimonial home (s. 114). However the 2004 amendment to the Land Act has strengthened the rules regarding the consent of a spouse or spouses to the mortgage of a matrimonial home with the aim of better protecting the interests of spouses. In particular-
 - Any document or form used in applying for or to grant a mortgage in respect of a matrimonial home must now be signed not only by the mortgagor but also by the mortgagor's spouse or spouses living in that matrimonial home. Alternatively there must be evidence from the document that it has been assented to by the mortgagor and the spouse or spouses of the mortgagor living in that matrimonial home;
 - Mortgagees are statutorily obliged to "take reasonable steps to ascertain whether the applicant for a mortgage has a spouse or spouses". [S.114(2)]

- ❖ An informal mortgage [s.113 (5)(a)] may be created
 - by a written and witnessed undertaking intending to charge the borrower's land with the repayment of money or money's worth obtained from the lender; or
 - through a lien by deposit of documents. [lien means the legal right to keep something belonging to someone who owes you money until the debt has been repaid]

The following documents may be deposited to serve as security for repayment of money or money's worth-

 - ✓ a certificate of a granted right of occupancy
 - ✓ a certificate of a customary right of occupancy
 - ✓ a document of a lease
 - ✓ any other document which may be agreed upon evidencing a right to an interest in land
 - ✓ any instrument intended to secure payment

The documents deposited are retained by the lender until the debt is repaid.

Mortgage of land as security

At common law (Land Ord) a mortgage is a conveyance (transference of property) of a legal or equitable interest in property by the borrower or third party – mortgagor – to the lender known as mortgagee as security for payment of the debt (Sheldon p. 390; Paget p.526)

The mortgagee acquires a legal right to exercise certain remedies in case of default by mortgagor in repaying the debt. The legal mortgagee gets rights **in rem** i.e. against the mortgaged property

The Land Act 1999, as amended, does not allow transfer of any interests or rights in the mortgaged land. However the lender is given certain remedies in case of default by the borrower.

S.116 (1) On and after the date of the commencement of this Act, a mortgage shall have effect as a security only and shall not operate as a transfer of any

interests or rights in the land from the borrower to the lender but the lender shall have subject to the provisions of this Part, all the powers and remedies in case of default by the borrower and be subject to all the obligations that would be conferred or implied in a transfer of an interest in land subject to redemption.

Remedies of the lender/mortgagee

- . S.125 abolishes foreclosure as a remedy
- . Appoint a receiver of the income of the mortgaged land [Ss. 126(a) and 128]
- . Lease or sublease the mortgaged land [Ss. 126(b) and 129]
- . Enter into possession of the land [Ss. 126(c) and 130]
- . Sell the mortgaged land [Ss. 126(d)]
- . [Sue the borrower for monies due]

Procedural requirements

- . Borrower/mortgagor in default
- . Lender/mortgagee to
 - Serve on borrower written notice of such default [S127(1)]
 - The notice must inform borrower of the following matters-
 - Nature and extent of the default
 - That the mortgagee may proceed to exercise his remedies against the mortgaged land; and
 - That after the expiry of thirty days following receipt of the notice by the mortgagor, the mortgagee may exercise the right to sell the mortgaged land.

Remedies open to a mortgagee in case of an informal mortgage or lien by deposit of documents-

- These would normally be specified in the memorandum of deposit
- Same remedies as those in a legal mortgage except that equitable mortgages are costly and slow to realize because mortgagee has to seek assistance of either the Court or mortgagor.

Advantages of mortgage over land as security

- The value of land is usually stable and in fact appreciates over time
- Land cannot be moved from one place to another
- A type of security to which the business community is used

Disadvantages

- May be costly to realize
- May cause bad publicity to lender who realizes

Apart from land other **things** may be mortgaged. And this is accomplished by the mortgagor putting the legal ownership of the thing (i.e, the legal estate) in the lender (mortgagee). Thus the mortgagor becomes relegated **to** an equitable interest in the form of his equity of redemption, **i.e., his right to** get back the property upon fulfilling the obligation. The mortgagee takes the documents of title to the thing mortgaged.

B.DEBENTURE (Debeo, Debere - I owe, To owe)

❖ Meaning and requirement for it validity

A debenture is an instrument usually under seal, issue by a company or public body as evidence of a debt or security for a loan of a fixed sum of money or interest.

It contains

- an acknowledgment of indebtedness;
- a promise to repay the amount mentioned in it; and
- normally the security offered by way of a fixed and a floating charge over the borrower's property.

The document is given to lender who becomes debenture holder.

It is not a subject matter of an agreement – not a contract

A debenture must be registered within a specified period of time [42 days – ss. 79 & 80 Companies Act, Cap. 212] Non – registration renders the debenture void and therefore the loan secured by such debenture becomes immediately payable. See **Shinyanga Regional Trading Co Ltd. and another v. The National Bank of Commerce** [1997] T.L.R. 78 (C.A.)

❖ Creation of a fixed and floating charge

A debenture in favour of a lending bank usually creates:-

- (a) A fixed charge on certain assets of the company.
 - goodwill (established reputation of a business which enhances its value)
 - uncalled capital
 - landed property & fixed plant and machinery of the company by way of legal mortgage.

A fixed charge prevents the borrower from disposing of these assets without the permission of the debenture holder.

- (b) A floating charge over the remainder of the assets of the borrower – such assets as are continually changing in the ordinary course of business of the company e.g. vehicles, stocks, book debts. Here the company is free to deal with those assets e.g. by selling them and using the proceeds to purchase fresh assets which themselves are then subject to the floating charge.

In **Government Stock and other Securities Investment Co. Ltd v. Manila Railway Co Ltd.** [1897] A.C. 8 at p. 86 Lord MacNaghten described a floating charge as an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern or until the person in whose favour the charge is created intervenes

❖ Fixation of floating charge

A floating charge becomes fixed or crystallizes if:

- (i) The borrower defaults in payment of interest or in repayment of part of the principal or commits some other breach of the terms of the debenture and the **lender thereupon takes some step (intervenes) to crystallize the charge.**
To crystallize the charge the lender usually takes the step of appointing a receiver.
Note: the mere fact that a company fails to meet the written demand of the lender for repayment does not of itself convert the floating charge into a fixed charge.
- (ii) The company goes into liquidation.
A floating charge automatically crystallizes at commencement of the winding up of the company, whether or not the company is in default to the holder of the charge:
Rationale. The licence given to the company to freely deal with the assets on which a charge floats depends on the company being an on going concern. If, therefore, the company ceases to do business automatically the licence relating to the assets determines.

❖ Expression of debentures

A debenture may be expressed to be a security either

- (a) for all sums owed by the company to the lender (an all “moneys” debenture); or
- (b) for a fixed sum (a fixed sum” debenture)

ad(a) The “all moneys” debenture -

- In the document the amount to be borrowed by the company is not disclosed when registering the document
- When a company wants to borrow again it does not need to execute a new debenture. It merely has to increase the stamp duty on the original document within a specified period (usually 30 days)

ad(b) “Fixed sum” debenture

- Amount of a “fixed sum” debenture has to be disclosed when registering the debenture with the relevant registry.
- With a “fixed sum” debenture if a company wants to borrow again additional “fixed sum” debentures have to be issued, stamped and registered (expensive)

N.B. Assets under debenture – be insured – policy assigned, registered and ceded to the bank.

C. SHARES AS SECURITY

❖ Definition

- Share means a definite portion of the capital of a company. It is personal property. A share may also be defined as any of the equal parts, usually of low

par value, into which the capital stock of a company is divided: ownership of shares carries the right to receive a proportion of the company's profits

- Stock - the capital raised by a company through the issue and subscription of shares entitling their holders to dividends, partial ownership and usually voting rights; the proportion of such capital held by an individual shareholder
- A share is indicated by the possession of a share certificate. The person named in the share certificate is the owner of a portion of the company issuing the certificate.
- A shareholder is a part-owner of a company
- Some share certificates do not indicate the names of owners. Sometimes the owner is indicated as "bearer". In such cases the certificates are "bearer certificates" and are fully negotiable – they become transferable by mere delivery and the transferee thereof gets a good title provided he has acted in good faith, for value and without notice of any defect in the title of his transferor.

❖ Registered shares

- Where share certificates bear the names of their owners they are required to be registered in the register held by the company issuing the shares.
- The register will have information about
 - the holder and number of shares held
 - other details
- The company **issues** the **certificate** in the **name** of the **registered owner**
- The share certificate is authenticated by the company's seal impressed on the certificate
- The issuing of a share certificate is *prima facie* evidence of title to the shares

❖ Shares as security

- Commercial banks do accept shares as security against advances. Shares are acceptable because they are choses in action capable of realization in money form and therefore property
- A bank will normally take a legal charge, as apposed to an equitable charge, over the shares. By taking a legal charge the bank is constituted legal owner of the shares.
- Procedure of taking a legal charge
 - (1) borrower deposits his certificate with the bank
 - (2) borrower completes a memorandum of deposit showing why the certificate has been deposited
 - (3) borrower signs a share transfer form
 - (4) bank sends the share certificate plus the share transfer form to the company issuing the shares

(5) Company issues a new share certificate in the name of the bank

- If the certificate is a bearer certificate
 - : Borrower deposits his certificate
 - : Borrower completes memorandum of deposit
 - : Bank retains the share certificate plus the completed memo of deposit
- Equitable charge – Procedure depends on strength of the charge required
 - : weakest – mere deposit of certificate.
 - : if charge is not that weak: deposit of share certificate and memorandum of deposit. The memorandum will contain clauses that protect the bank e.g., continuing security, whole debt clause etc
 - : if strong charge: The bank can in addition ask the holder of the certificate to sign an undated transfer form (blank transfer). This will enable the bank to sell or transfer the shares easily should the borrower default

❖ Realization on borrower's default

Very easy to realize-

- If legal charge – bank merely needs to sell the shares on the market
- If an equitable charge – no blank transfer form –the bank will have to rely on the goodwill of the registered holder or seek assistance of the court.

❖ Release of security

To release the security the bank reverses the procedure it followed when it took it.

Legal charge:

- bank to transfer shares back into the name of the mortgagor and obtain a new certificate in mortgagor's name
- Return certificate to mortgagor and mark the memorandum of deposit "cancelled".
- If bearer security – bank merely returns certificate to mortgagor.

Equitable charge

- Mark memorandum of deposit "cancelled"
- Destroy blank transfer form
- return certificate to mortgagor

❖ Advantages

- Absolute legal title available
- Easy and inexpensive to take
- Easy to realize
- Relevant notices come straight to the bank

❖ Disadvantages

- Fluctuations in value
- With a legal charge – problems likely to arise

- .. Forgery - **Sheffield Corp. v. Barclay** (1905) (of transfer forms)
- .. Possible claim of negligence
- .. responsibility for unpaid shares
- .. may be defeated by a prior equitable charge
- .. with a private limited liability company there could be restrictions of transfer of shares in the articles of association.

D. LIFE POLICY

- (1) A life policy may be used to secure an advance. This is based on the legal right the owner of the policy has in the proceeds of the policy. **The owner of the policy doesn't have the policy proceeds with him but that he can enforce his right of having them by an action if it is necessary. He has a chose in action.**

It is the capability of a life policy to be realized in money form that puts it in the class of property and hence capable of securing an advance.

What we have said is based on the text book definition of a contract of life assurance, which is "a contract by which the insurer, in consideration of a certain premium, either in gross sum or by annual payments undertakes to pay to the person for whose benefit the insurance is made, a certain sum of money or annuity on the death of the person whose life is insured. . . . sometimes the amount is payable either at death, or at the expiration of a stated number of years, whichever shall first happen". Holden p.130.

- (2) A bank may accept a life policy as security. He may either take a legal mortgage over the policy or an equitable mortgage

(a) **A legal mortgage:**

This is the most usual way of creating a security of a life policy in favour of the bank. A **deed is executed assigning** the assured's right to recover the policy money to the bank

Normally the deed carries the following salient features-

- (i) **The mortgage is to secure the payment of all sums owed by the customer**, either solely or jointly with any other person or persons, whether on balance of account or on guarantees or in respect of bills of exchange, promissory notes, and other negotiable instrument and including interest and other banking charges
- (ii) If the customer repays all sums which he owes the bank as aforesaid, the bank will, at the **customer's expense** reassign the policy to the customer .
- (iii) The security is to be a continuing security. This is to avoid application of the Rule in Clayton's case.
- (iv) The customer agrees to pay premiums punctually and to

produce the premium receipts to the bank.
In the event of the customer failing to pay premiums the bank may pay them and debit the amounts to the customer's account.

N.B. Normally an insurance company allows a 30 days grace – to allow payment of premium.

- (v) Customer agrees that at anytime and without his consent, the bank may sell and surrender the policy to the company or exchange the policy for a paid up policy or sell the policy to any other person.

Stamp duty must be paid on the deed.

The Insurance Company to be notified of the assignment by the bank

Things to watch out for when mortgaging a life policy -

- (1) Where a policy is taken for the “benefit” of a named beneficiary the person taking such policy should not assign it to the bank **without the consent of the beneficiary named** in the policy. If it is a wife who is the beneficiary the wife must be joined as a party when assigning the policy to secure the debt.

To avoid the possibility of a beneficiary claiming she was induced, it is desirable that her signature to the assignment should be witnessed by an independent person who should explain the legal position to her .

N.B. Where a husband effects a policy on his own life for the benefit of a named wife, this gives the named wife an immediate vested interest in the policy so that, if e.g. she dies before her husband, the interest passes to her executors as part of her estate.

- (2) Where a policy is executed by a husband “for the benefit of his named wife and children of the marriage” it may be accepted as security. However the lender should see to it that the beneficiaries are made party to the assignment and that the children are of full age.
- (3) Where a policy is for the benefit of many people – and it is difficult to get all of them to assign the policy in favour of the bank – bank to avoid such policy as security.
- (4) **Before the policy is accepted as security bank to satisfy itself that:**
- i. The policy is at least be 3 years old, that it has acquired a cash surrender value [Cash surrender value is a sum which will be paid by the insurance company upon the abandonment of the policy].
 - ii. The age of the assured is admitted either on the policy or by a separate letter of the Insurance Co.
 - iii. All the premia due are paid

- iv. The policy is unconditionally free from any charge
- v. And preferably that the policy is payable in Tanzania and in Tanzanian currency.

Enforcing the Security (Legal)

If life assured is dead or the policy has matured:

If death

Insurance Co. will require proof of death. Therefore, the bank must

- provide proof of death – by presenting certificate of death.
- present to the Insurance Co. the policy and the mortgage deed.

After receiving the documents the Insurance Co. will pay the bank the amount due.

Maturity of policy:

- Insurance Co. notifies bank date of maturity of the policy.
- Bank completes certain forms and sends them to Insurance Co.
- After receiving the forms the Insurance Co. pays bank amount due

Debt paid: Reassign policy – stamp duty

(b) Equitable mortgage on life policy

Created by an oral agreement between the parties or a deposit of the policy accompanied by a memorandum of deposit stating that the purpose of the deposit of the policy is to serve as security.

Debt paid: Cancel memorandum of deposit. (No reassignment)

Advantage of life policies as security

- (1) The value of the security can easily be ascertained
After 3 years the policy acquires “cash surrender value” i.e. a sum which will be paid by the Insurance. Company upon the abandonment of the policy.
- (2) A life policy can easily be realized
 - Should customer fail to repay debt when called upon to do so banker may surrender the policy (legal mortgage) and obtain payment of surrender value.
 - If customer dies – full amount of policy becomes payable. Bank may recover its debt.
- (3) A life policy is stable in value. The surrender value continually increases provided the premia are paid.
 - No need to allow for margin for depreciation.

Disadvantages

- (1) Customer may be unable to keep the policy by failing to pay premium. However banker may pay premium and debit customer's account.
- (2) Policy may be vitiated by the assured's non-disclosure of all facts and circumstances affecting the risk
- (3) Customer may die in circumstances that will not put the insurance

company in liability, e.g., if he commits a capital offence and is hanged or commits coincide

- (4) Policy may be vitiated if life assured breaks one of the conditions contained therein
- (5) The life assured may have no insurable interest in the life the subject matter of the contract.

How much will the bank normally give as advance on the security of a life policy?

An amount equal to or less than the **surrender value of the policy**

E. PLEDGE (PAWN)

- A pledge is the bailment of goods as security for payment of a debt or performance of a duty [S.124 Law of Contract Act (LCA)]
- A bailment is the delivery of goods by one person to another for some purpose upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them [S. 100 LCA Cap. 345]

The person delivering is called bailor and the person to whom the goods are delivered is called bailee

- In a pledge the bailor = “pawnor”
The bailee = “pawnee”
- A pledge has the following essential conditions:
 - bailment of goods pledged
 - bailment by way of security
 - for the payment of a debt or performance of a duty.
- Physical delivery or constructive delivery of the goods may create a pledge.
- Constructive delivery/bailment of goods is normally evidenced by documents of title e.g. a bill of lading, See **Sewell v. Burdick** (1880) 10 A.C. 74
- Rights and powers of the pledgee
 - retain the goods as security
 - if need be sell the property/goods pledged to recover the debt
- Obligation of the pledgee is to give any surplus to the pledgor/pawnor.
- So a pledge gives the pledgee not only a right to retain property given to him as security for the debt but also an implied power, if need be to sell the property pledged to recover any debt. If there be any surplus after satisfying the debt it must be given to the pledgor.
- The power of sale given to the pledgee was stated in **Re Morritt, Ex Parte Official Receiver** 18 Q BD 222. The Court said that a contract of pledge carries with it the implication that the security may be made available to satisfy the obligation and enables the pledgee in possession

(though he has not the general property in the thing pledged but a special property only) to sell on default in payment and after notice to the pledgor.

- The pledgee can exercise the power of sale if
 - there is **default** by the borrower/debtor
 - he has given **notice** to the debtor requiring him to repay within a stipulated period of time otherwise he will sell the property pledged.
- Property must be sold in market overt and the proceeds be applied as follows-
 - pay for costs of sale
 - pay the debt
 - balance if any be given to pledgor
- Banks do accept pledges as security
 - be in the form of a document known as letter of pledge which carries terms and condition relating to the goods pledged.

F. HYPOTHECATION

- (1) Where security has been taken over goods or the proceeds of goods which are not in the possession of the lender – that is said to be hypothecation of the goods
- (2) Note that the lender does not take possession of the goods. If he did that would amount to a pledge.
- (3) Where goods have been hypothecated the borrower/owner of the goods undertakes to give possession to the lender when called upon to do so .
- (4) Hart defines hypothecation thus-
“Where property is charged with the amount of the debt, but neither ownership nor possession is passed to the creditor it is said to be hypothecated”.
- (5) This form of security is accepted by the bank where it is inconvenient for the bank to take physical possession of goods for various reasons
 - crops in the field
 - stocks – in – trade -
 - stocks in a shop
- (6) However the borrower must execute a memorandum referred to as a “letter of hypothecation”. In this memorandum the goods to serve as security are enumerated. Moreover it is stated that the lender is to be given possession of the goods listed in the memorandum when the borrower is called upon to do so.
- (7) The memorandum, letter of hypothecation, is lodged with the lender/banker.
- (8) In fact by giving the letter of hypothecation to the bank, that amounts to giving the bank **constructive possession** of the goods.
- (9) It follows, therefore, that the transaction amount to a **pledge**.

Hypothecation of stocks is not a popular security.

- (1) When the bank calls upon the borrower to give possession – he may refuse to do so.
- (2) If the bank decides to seize the goods it may find out that it does not have incontestable rights to the goods named.

E.g. where the borrower has already sold the stocks to a bona fide purchaser

- (3) If the bank seizes the goods it may be sued for damages for trespassing against the goods. See e.g., **Vallabhji v. National and Grindlays Bank** [1964] E.A. 442, [K] in which necessary formalities relating to the letter of hypothecation were not complied with.

Facts. The Bank agreed to provide the appellants with overdraft facilities on the security of hypothecation over their stock – in – trade. The letter was signed but neither **attested** nor **registered** as required by statute. On being informed that the appellants were unable to pay the bank, it without formal notice caused the stock – in – trade to be seized under a power in the letter of hypothecation.

The appellants sued the bank for damages for, inter alia, trespass to the stock – in – trade. It was argued in court that the bank could not rely on the letter of hypothecation since necessary formalities of **attestation** and **registration** were not fulfilled. The court held that the bank was not entitled to seize the goods on the authority of the letter of hypothecation.

- (4) Therefore it is important to comply with formalities – attestation and registration

See also: Dodhia v. National and Grindlays Bank Ltd [EACA] 1970 E.A. 195

The goods/stock hypothecated must be insured, policy registered, assigned and ceded to the bank.

G. BANKER'S LIEN

- A lien is a right to retain goods of another in order to enforce fulfillment of an obligation. There is no right to sell the goods.
- A banker's lien is an exceptional type of lien
 - includes a power of sale
 - so it is not a true lien rather it is an implied pledge. See **Brandao v. Barnett** (1846) 3 CB 519 in which Lord Campbell defined a banker's lien (at p. 531) as an implied pledge.
- Banker's lien does not attach to each and every kind of property
 - Property subject to banker's lien is that property which comes into the hands of the bank **to be dealt with in his business** [See Lord Chorley at p. 204]
Banker's lien ordinarily attaches on bills, cheques or notes **paid into** the customer's bank to be collected and credited to his account.
 - Property not subject to banker's lien
 - : all types of property where there is an express agreement to that effect
 - : valuables deposited for safe custody
 - : securities deposited with the bank for safe custody
 - : money paid into the bank (may be subject to a right of set off)

but not lien)

- Can a cheque presented for encashment be subject to a banker's lien?
Melita Meyasi v. NBC [1977] LRT 42 Read **Tanzania Law Reform Bulletin** vol. 1 No. 2 December 1989 "Bankers Right of Lien: A New Horizon?" Pp. 68 – 78.

H. RIGHT OF SET OFF [combining accounts]

(Cash as security)

- A right of set off is an inbuilt security. It is a right given to the bank, upon the happening of a certain event, to combine the accounts of a customer in order to pay outstanding debt.
- E.g A Customer has
A/c A A/c B An event happens.
2 m - 1.8 m.
The bank sets off the credit balance of 2 m in A/c A against the debit balance of -1.8 m. in A/c B and wipes off the debt in A/c B leaving a credit balance of 200,000/= in A/c A.
- The right of set off is implied in the banker – customer relationship
- Where a customer has defaulted in payment normally the banker would first find out whether it can exercise a right of set off before falling on a security taken.
- In **Yahya Said Nkoloma v. N.B.C. Holding Corporation Ltd.** [to be reported in the 2000 TLR] the Court of Appeal of Tanzania elaborated on the right to combine accounts or right of set off. It stated:
There is a common law right of combination of accounts. A customer may have more than one account with a bank. In that case the bank has a right to combine the accounts and treat them as one. This is what is called combination of accounts. The accounts may be in one branch of the bank or in different branches of the same bank. ...

Combination of accounts is also referred to as a right of set off. This is a monetary cross-claim made in an action by a plaintiff, that is, a legal right by which a debtor is entitled to take into account a debt owing to him by a creditor when sued for a debt due from him to the creditor. ...

There are two instances in which a bank is entitled to combine accounts or to set off: First, whenever a customer is unable or unwilling to repay an overdraft incurred in one account although another account is in credit. Second, is where a customer draws a cheque for an amount exceeding the balance standing to the credit of the account involved but the deficiency can be met out of the funds deposited in another account. (See Ellinger and Lomnicka at p. 179).

Combination of accounts has three other exceptions: One, the right could be abrogated by a special agreement. Two, the right is inapplicable where the property was remitted to the bank and appropriated for a special purpose. Lastly, a customer's account cannot be combined with a trust account or an account to be utilized by the customer as a trustee.

- An immediate right of set off accrues if an event happens which determines the relationship and calls for ascertainment of the net amount due to or from the bank. Such events are-
 - death
 - insanity of customer (natural)
 - bankruptcy
 - insolvency
 - garnishee order
- In all other cases the bank's exercise of right of set off is subject to notice to the customer
Buckingham v. the London and Midland Bank Ltd (1895) 12 T.L.R. 70
Greenhalgh v. Union Bank of Manchester [1924] 2 K.B. 153
 - A bank cannot without reasonable notice set off a customer's balances if no right of immediate set off has arisen say by death, bankruptcy, insanity etc.
- In **Yahya Said Nkoloma v. N.B.C. Holding Corporation Ltd.**, the Court of Appeal considered the requirement of notice where the right of set off is not automatic. It stated:

It is our considered opinion that where there is no agreement to keep more than one account separate, then there is no need to give notice before exercising the right to combine accounts. However, where there is such agreement, then reasonable notice is required ...

But we would go further and say that where, as we have abundantly shown in this appeal, a customer is well aware of his commitments to a bank but deliberately avoids meeting them, then the bank is entitled, without notice, to combine accounts even if there is an agreement not to do so.
- There are restrictions on the banker's exercise of right of set off:
 - (a) All moneys must belong to the customer in his own right

A banker is not allowed to set off-

 - a trust account against a customer's own account
 - private account of partner against an overdraft of a partnership account unless there is a joint & several liability clause for the debts of the partnership.
 - joint a/c v. separate a/c unless joint a several liability.
 - (b) Any implied right of set off is subject to a banker's obligation to honour cheques properly drawn by the customer.

Except where an immediate right of set off has arisen a bank cannot just decide to set off a credit balance against a debit balance of a customer. A reasonable notice must be given to the customer. In practice, however, in most forms – e.g., mortgage or guarantee forms a provision is inserted empowering the bank to set off the customer's accounts without notice.

A right of lien or set off?

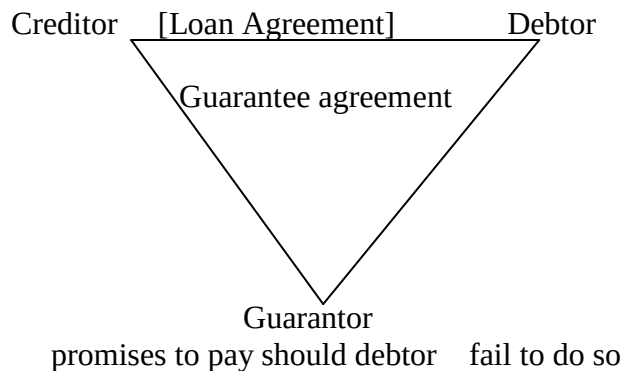
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Historical origin and socio-economic basis thereof and how they
relate to Tanzania ,N.N.N. Nditi, UDSM, 1977

I. GUARANTEE

Most popular type of security.

Is a promise by one person (guarantor/surety) to assume for the present or future debts of a second person (principal debtor), such promise is made to the person to whom the principal debtor is/will become, liable.



Conditions for a valid guaranty

- The guarantee must be issued by a willing (free consent) reliable and an undoubtedly good third party.
- The guarantor should guarantee something he has full knowledge of. So explain to him what a guarantee is all about and his liability under the guarantee agreement to make him decide whether to enter into the contract or not [consenting mind] See **Carlisle & Cumberland Banking Co. v. Bragg** [1911] 1 K.B. 489.
- Once guarantee contract has been concluded the creditor is not allowed to make any changes in his relation with debtor which may prejudice the position of the guarantor.

CHAPTER IV

BANKER AND CUSTOMER RELATIONSHIP

1. Definitions

(a) Statutory definitions of banker or bank

Bills of Exchange Act -

S.2 - “banker” includes a body of persons whether incorporated or not who carry on the business of banking. “Business of banking” has not been defined in the Ordinance.

BOT Act 2006, No. 4/2006

S.3 “bank” means an entity engaged in the banking business.

“banking business” means the business of receiving funds from the general public through the acceptance of deposits payable upon demand or after a fixed period or after notice, or any similar operation through the frequent sale or placement of bonds, certificates, notes or other securities, and to use such funds, in whole in part, for loans or investments for the account of and at the risk of the person doing such business.

Foreign Exchange Act, 1992 No. 1/92

S.4 “bank” means a bank within the meaning of section 3 of the B & FI Act

B & FI Act 2006, No. 5/2006

S.3 “bank” [has the same meaning as that given to that term in the BOT Act, 2006]

(b) Case – law definitions of banker or bank

United Dominions Trust, Ltd v. Kirkwood [1966] 2 QB 431; [1966] 1 All E.R. 968
 "... a bank or banker is a corporation or person (or group of persons) who accept moneys on current accounts, pay cheques drawn upon such accounts on demand and collect cheques for customers"

- if such minimum services are afforded to all and sundry without restriction of any kind and are a substantial part of the whole, the business is a banking business, even if another or other businesses are undertaken at the same time.

(c) Definitions of banker or bank by textbook writers

- (i) In **Sheldon's – Practice & Law of Banking** the terms are defined according to purpose/function or context in which the definition is required (p.159)
 "For the purposes of the BEA, the Cheques Act and the Stamp Act it would seem that there must be the functions of
 - receiving money from customers &
 - repaying it by honoring their cheques when required"
 in order to call a person a banker
- (ii) Dr. Hart [**Law of Banking** 4th Ed. p. 1] a bank or banker is a person or company who/which carries on the business of
 - receiving moneys from customers
 - collecting drafts for customers
 - honouring cheques drawn by customers provided there are sufficient funds in the customers a/cs to enable payment of such cheques.
- (iii) Paget 8th ed. p. 16 basis his definition on the Court of Appeal judgment in **United Dominions v. Kirkwood** – underlines the functions:
 - accept moneys on current a/c
 - pay cheques drawn on such a/cs on demand
 - collect cheques for customers

(d) Common features in these definitions -

- accept deposits
- open current a/cs
- honour cheques
- act as bank for collection

(e) Whether definitions are satisfactory

- Note emphasis on honouring cheques – but cheques began during the 17th century – no banks before that time?

(f) Definition – broad view -

- Initially – surplus – safe custody – deposit at a safe place – individuals, families, shrines, palaces – when in need – go and take – others allowed to borrow - grain, precious metals, etc. – no cheques
- Next with commoditization of the economy & consequent wide – spread use of money in transactions; need for establishment of firms and companies where huge sums of money could be deposited and borrowed – corporations were formed to specifically do the business of accepting money/repaying it on demand - lend such money - assist

customer in his financial transactions – discount his bills, collect his cheques – In short the banker was acting as a middleman.

- With spread of capital the world over banks fall under management by financial giants
 - simple role of bank as a middleman ceases
 - role of huge international banks (financial oligarchies) with branches scattered all over the world/controlling small banks in economically dominated countries – is one of a universal book – keeper, controlling world economies. You cannot define such a bank in terms of accepting deposits, opening C/Ac, honouring cheques, collecting drafts.

2. Definitions of a customer

- (a) No statutory definition
- (b) Case law

- (i) **Great Western Rly v. London & County Banking Co.** [1899] 2 QB

To make a person a customer there must be some sort of an a/c, either deposit or current, or some similar relation.

Issue: Whether discounting a cheque can, by itself, make a person a customer of a bank.

Held: Discounting a cheque does not, by itself, make a person a customer

- (ii) **Ladbroke & Co. v. Todd** (1914) 30 TLR 433 A thief who uses a stolen cheque to open an account becomes a customer.
 - (iii) **Woods v. Martins Bank Ltd** [1959] 1 QB 55, [1958] All ER. 166

The court was of the view that existence of an a/c is not necessary to create the banker – customer relationship

Facts: W sought advice from the bank relating to areas of investment of his funds. The bank advised W to invest in a Co. known as B.R. Ltd. Then W instructed the bank to collect his money from a certain Building Association and invest some of the money in B.R. Ltd. on his behalf and keep some of the money with the bank to be drawn by W as per his instructions.

N.B. The advice was given before an a/c was opened.

W's investments were lost.

Issue: One of the issues that were raised and discussed was whether the relation of banker and customer was established when the bank gave W advice on investment. Was the advice given to a customer?

As regards the time when banker – customer relationship began the court said that W became a customer of the bank **when the bank accepted to and advised W on investment of his capital.** This decision seems to have been based on two factors:

- Acceptance/willingness by the bank to give advice.

- Acceptance by the bank of instructions given to it by W.

So that the relationship may be said to begin the moment the parties enter into relations or negotiations which are to be considered part of the contract ultimately concluded (Paget 8th Ed. p. 73).

But the negotiations must be part of the process and lead directly to agreement.

(c) Text-book writers

- Sheldon p. 186 – a banking a/c – a must
- One becomes a customer as soon as money or a cheque is paid in and the bank accepts it and is prepared to open an account.
- People with no a/cs but keep valuable items with the bank either directly or through a customer – it would seem such people are customers.

Note: emphasis on existence of an a/c current/deposit but also likelihood that an a/c will be opened
: those who keep items of value – customers

II. How to conclude a banking contractual relationship

A. Opening of an a/c

(a) General procedural requirements

- Before the bank accepts a person as a new customer it must make a **diligent search** relating to the **integrity and responsibility** of the intending customer
- It is important for the bank to inquire as to the reliability of the intending customer because
 - Use of banking facilities has become widespread with great developments in commodity production
 - Since use of banking facilities, esp. use of cheques, has become wide spread, the **risk of accepting dishonest customers in great**; e.g. thief of a cheque
- The new intending customer must
 - be introduced to the bank by a customer of the bank i.e. Reference –
 - where necessary 2 referees
 - bank to comply with all other procedural requirements e.g. taking of specimen signature etc.
- Opening of A/cs for non-natural persons will be discussed in connection with obligations in respect of such a/cs

WHEN IS THE CONTRACT FORMED?

When banker and customer relationship is created.

But when is this relationship created?

In the **Great Western Railway v. London and County Banking Co.** [1901] AC 414 Court said to make a person a customer of a bank there must be either a current or deposit a/c or some similar relationship. Discounting cheques for 20 years does not make a person a customer. According to **Ladbroke & Co. v. Todd** (1914 – 15) All E.R. 1134 the relationship starts as soon as the

customer deposits money or hands in a cheque and the bank accepts it to open up an a/c for the customer. “The relation of banker and customer began as soon as the first cheque was handed in to the banker for collection and not when it was paid.”

The above two cases put emphasis on existence of an a/c in order to establish a banker and customer relation.

Those who keep valuables without having a/cs?

[Modern banks perform such multifarious functions that it is difficult to define the relationship between a banker and his customer in general terms.]

THE NATURE OF BANKER-CUSTOMER RELATIONSHIP

In **Foley v. Hill** (1818) 2 H.L. Case 28 English Reports g p. 1002 it was stated that banker – customer relationship is one of debtor – creditor. Where a/c is in credit, which is regarded as normal, banker is debtor and customer is creditor In **Joachimson v. Swiss Bank Corporation** [1921] All ER. 92 (C.A) Lord Atkin said: “The bank undertakes to receive money and collect bills for its customer’s account. The proceeds so received are not to be held in trust for the customer, but the bank **borrow**s the proceeds. . . .”

So, a bank is a debtor. But what type of debtor is the bank? The bank is not a common law debtor who is obliged to look for the creditor and pay him. A bank is a debtor who is under duty to repay the customer; **but only** when the customer instructs him to do so. Otherwise the bank, debtor, has full control of the money, can use it as it likes – invest and get profit, lend and get interest. The bank is not obliged to pay interest to the customer unless there is an agreement to that effect. Liability of the bank to pay the creditor is limited to the amount deposited.

So a bank is not an ordinary debtor who must seek out the creditor and repay his debt. Demand of customer is a condition precedent to repayment of the debt.

A debtor-creditor relationship is based on agreement – contract. Therefore a bank - customer relationship is based on contract. However, the terms and conditions of a banker-customer contract are not express rather they are implied. Hence, a banking contract carries with it implied obligations of a general nature and specific nature.

1. General obligations arising out of the contract

❖ **Obligation to repay the creditor/customer on demand according to his instructions**

= Instructions appear in a cheque. Cheque contains the terms of the customer’s order and it is a primary and fundamental obligation of the bank to obey the terms of this mandate exactly as they are given. In making payment in accordance with the customers’ mandate the banker has discharged his debt to that extent, and debits the a/c with the amount. The right to debit is conditional upon bank’s obeying the customer’s order exactly.

Post – dated cheque - Suppose a bank pays a post-dated cheque before the date written on the cheque. Will the bank have complied with the instructions of the customer?

= However, [before computerization of bank transactions and introduction of ATMs] when demanding money from the bank the customer must follow certain regulations

- (i) He must write an order addressed to the bank
- (ii) Order must be written/drawn in a proper form
- (iii) Order must be addressed to the branch of the bank where the a/c is kept
- (iv) Customer will be paid at the branch of the bank where the a/c is kept
- (v) Customer will be paid during bank office hours
- (vi) Customer will be repaid if there are sufficient funds in his a/c to meet the order (cheque) [No funds – question of repayment does not arise]
- (vii) Customer will not be repaid if there is a legal bar, e.g. a garnishee order [a court order addressed to the bank (debtor) warning it (the bank) not to pay its debt (the customer's/creditor's) to anyone other than the third party who has obtained judgment against the debtor's (bank's) own creditor (customer)]

= This fundamental obligation to repay the customer/creditor on demand was clarified by Lord Atkin in **Joachimson v. Swiss Bank Corporation** [1921] All E.R. 92 (C.A.) when he summarized the terms of a banking contract as they were then understood. He said in part-

The bank undertakes to receive money and to collect bills for its customer's a/c. The proceeds so received are to be held not in trust for the customer, but the bank borrows the proceeds and **undertakes to repay them**. The promise to repay is to repay at the branch of the bank where the a/c is kept and during banking hours.

= In sum – there is an implied obligation on the part of the banker to pay his customer on demand provided

- (a) the demand is in order
- (b) there are sufficient funds to the credit of the customer or that there is an overdraft facility extended to the customer
- (c) there is no legal bar/impediment

If the drawee bank refuses to pay or delays payment without good cause it will be held liable in damages to the customer for injury to the latter's credit under breach of contract.

Order/Demand/Instruction to pay authenticated by signature of the person giving the order. Forgery of drawer's signature -

❖ **Obligation to guard against forgeries**

(a) ***Duty to disclose forgeries is imposed on Both a bank and a customer.*** Either party to the banking contract who knows or has reason to suspect that a forgery is being perpetrated is under a duty to inform the other about it.

- failure of the customer to inform the bank about forgeries he is aware of relieves the bank from liability

Greenwood v. Martins Bank Ltd [1932] all E.R. 318 illustrates this point.

Facts. The plaintiff, who kept his account with the defendant bank, entrusted his wife the custody of the cheque book and pass book. In October, 1929, when he asked her for a cheque to draw pounds 20 she confessed to him that she had drawn out all the money in the account saying that it was needed to help her sister in legal proceedings. Out of consideration for his wife the plaintiff refrained from advising the bank of the forgeries for eight months. However, in June, 1930, when she told him that she wanted a further pounds 60 for the legal proceedings, he made inquiries and, discovering that there was no such litigation, he told her he was going to inform the bank, whereupon she shot herself.

The plaintiff brought an action against the bank for pounds 410 6s., the amount paid against the forged signatures.

Held H was estopped from denying the authenticity of Ws signatures as his. H was under a duty to inform the bank about W's forgeries as soon as he was aware of them so as to put the bank on guard. He breached that duty and was not to be heard to blame the bank on the payments made on the forged cheques. **In the words of the House of Lords "The husband had, by his silence, deprived the bank of its right of action against the forger and he was, therefore, estopped from setting up the forgeries against the bank."**

Had H informed the bank as required, the bank would have been held liable for paying against forged authorizations.

Note: (i) W's forgeries were so well perpetrated that the bank had no reason to suspect anything
(ii) if the bank had been warned of the forgeries and had gone ahead and paid, it would have been held liable to the customer to the extent of the amount paid against the authority of the customer.

(b) *Duty to exercise care when drawing and handling cheques*

The customer has a duty to exercise reasonable care in drawing his cheques and in handling them.

If the customer is careless or negligent in drawing his orders, forgery is committed and the bank pays – the bank will not be held liable to pay the customer.

London joint Stock Bank v. McMillan & Arthur [1918] A.C. 777 –is a case in point.

Facts: M & A were partners who had a clerk assigned to prepare cheques for petty cash and present them for signature to anyone of the partners. On one occasion the clerk with a view to committing fraud prepared a cheque, inserted a 2 in the space for figures with available blanks before and after the numeral. He wrote nothing where the sum is to appear in words. It was a bearer cheque. Being in a hurry one of the partners signed it noticing nothing unusual. The clerk then filled in £120 and in words One Hundred and Twenty pounds only.

When the forgery was discovered M & A sought to recover their money from the bank arguing that they authorized payment of £2 and not £120.

The Court said:

- when a customer draws a cheque or gives instructions to draw money he must exercise due care
- the customer must also exercise reasonable care in handling his instructions or cheques.

Observation

“It is beyond dispute that the customer is bound to exercise reasonable care in drawing cheques to prevent the bank from being misled.”

Sheldon p. 33 -

If customer draws the cheque in a manner which facilitates fraud he is guilty of a breach of duty as between himself and his banker, and he will be responsible to the banker for any loss suffered by the banker as a natural and direct (result) consequence of this breach of duty.

A customer will be said not to have exercised due care in the following instances (among others):

- where he does not insert the word “only”.
- where he signs blank withdrawal forms or leaves unfilled spaces in the cheque
“it is a well settled law that if a customers signs a cheque in blank and leaves it to a clerk or other person to fill it up he becomes bound by the instrument as filled up by his agent” [Sheldon p. 33; McMillan case]
- where he must cross the cheque and he does not do so.

See also **Tai Hing Cotton Mill Ltd v. Liu Chong Hing Bank Ltd. and others** [1985] 2 All E.R. 947 (PC.) in which the extent of duty of a customer was elaborated.

(c) Extent of customer`s duty to guard against forgeries

Tai Hing Cotton Mill Ltd v. Liu Chong Hing Bank Ltd and others [1985] 2 All E.R. 947 (PC) clarified the extent of duty of a customer to guard against forgeries.

The Co. was a customer of several banks, and maintained with each of them a current account. The banks honoured by payment on presentation some 300 cheques totaling approximately \$HK5.5m which on their face appeared to have been drawn by the Co. and to bear the signature of Mr. Chen, the company’s managing director, who was one of the company’s authorized signatories to its cheques. The banks in each instance debited the company’s current account with the amount of the cheque. These cheques, however, were not the company’s cheques. They were forgeries. On each an accounts clerk employed by the company, one Leung Wing Ling, had forged the signature of Mr. Chen.

Who to bear the loss? The company or banks?

Held: In the absence of an express agreement to the contrary the duty of care owed by a customer to his bank in the operation of his current account is limited to a duty to

- refrain from drawing a cheque in such a manner as to facilitate fraud or forgery and
- inform the bank of any unauthorized cheques purportedly drawn on the account as soon as he, the customer, becomes aware of it.

The customer is not under a duty to take reasonable precautions in the management of his business with the bank to prevent forged cheques being presented for payment nor is he under a duty to check his periodic bank statements so as to enable him to notify the bank of any unauthorized debit items, because such wider duties are not necessary incidents of the banker/customer relationship since the business of banking is not the business of the customer but that of the bank and forgery of cheques is a risk of the service which the bank offers.

In order to impose an express obligation on a customer to examine his monthly statements and to make those statements, in the absence of query, unchallengeable by the customer after the expiry of a time limit, the burden of the obligation and of the sanction imposed has to be brought home to the customer. [The banking contracts between the company and the banks did not do that and therefore the company was not in breach of any duty owed by it to the banks]

Here in Tanzania the Court of Appeal of Tanzania considered the duty of a bank to detect fraud when a bogus cheque is presented for payment in the case of **Silayo v. CRDB (1996) Ltd** [2002] 1 E.A. 288 (CAT)

❖ **Obligation not to divulge the state of the customers a/c: Duty of secrecy**

The general rule

= Sheldon p. 187

Nowadays the transactions between the bank and his customer are regarded as being of a peculiarly private character, and therefore it is considered that a banker may not divulge to third parties the state of his customer's a/c, except when legally called upon to do so, or at the request of his customer.

= Hence the banking contract carries an implied obligation that the bank shall not divulge the state of the customer's account - a duty of secrecy. This duty is recognized Both under common law and under statutory law. In **Tournier v. National Provincial and Union Bank of England Ltd.** [1923] All E.R. 550 (C.A.) the duty of secrecy was examined.

Facts: The bank was worried about the overdraft of its customer. As a result it disclosed to the employers of the customer the fact that his a/c was overdrawn and that the customer was thought to be gambling. It was held that the disclosure of information by the bank to the employer of the customer was a breach of the bank's contractual duty of secrecy owed to the customer.

In Kenya the duty of non-disclosure and the limitations to that duty were considered by the Court in the case of **Intercom Services Ltd. and Others v. Standard Chartered Bank Ltd.** [2002] 2 E.A. 391 (HCK)

In Tanzania in addition to the common law based duty this duty of secrecy is also imposed by statute. The B&FIA, 2006 in its section 48 imposes a duty on all banks and financial institutions not to divulge any information relating to, or to the affairs of their customers except in circumstances in which it is, in accordance with any written law or the practices and usages customary among bankers necessary or proper for the banks and financial institutions to divulge that information.

Exceptions

Exceptions to the duty to keep secret the affairs of a customer were clarified in **Tournier v. National Provincial and Union Bank of England Ltd.**[1923] All E.R. 550 (C.A.)

The Court pointed out four instances in which disclosure/divulgence is allowed

- (a) compulsion by law.
 - (i) - the law of evidence legislation may oblige a banker to produce copies of entries in a banker's books. [The expression "bankers' books" covers ledgers, day-books, cash books, a/c books & other records used in the ordinary business of the bank, whether those records are in written form or are kept on microfilm, magnetic tape or any other form of mechanical or electronic data retrieval mechanism [Banking Act, 1978 (ch.6 para 1 Eng).]. Entry in banker's books includes any form of permanent record kept by the bank by means made available by modern technology – **Barker v. Wilson** [1980] 1 WLR 884.
= Have a look at the Evidence Act (T) See ss. 76-81
 - (ii) Prevention and Combating of Corruption Act, 2007, No. 11 of 2007
Section 12(1) provides that the Director General may by writing authorize any officer to search any person [bank], if it is reasonably suspected that such person [bank] is in possession of property corruptly or illicitly acquired or to search any premises ... in or upon which there is reasonable cause to believe that any property corruptly or illicitly acquired has been placed, deposited or concealed.
 - (iii) The Public Leadership Code of Ethics Act, 1995 No. 13 of 1995
 - (iv) The Drugs and Prevention of Illicit Traffic in Drugs Act 1995, No. 9 of 1995
 - (v) The Mutual Assistance in Criminal Matters Act, 1991 No. 24 of 1991
 - (vi) The Proceeds of Crime Act 1991 No. 25 of 1991

Except for the Proceeds of Crime Act, 1991 all the other pieces of legislation provide for a procedure to be followed before a banker can disclose information relating to its customer.

The Proceeds of Crime Act, 1991 aims at combating serious offences especially by corporations and gives protection to a financial institution, its director officer or employee or agent who in the course of employment, discloses information about a customer. The relevant provision is section 70 which reads.

70 – (1) Where a f. i. has reasonable grounds for believing that information about an account held with it may be relevant to an investigation of, or the prosecution of a person for an offence, the institution may give the information to a police officer.

(2) No action shall lie against a f.i. or a director, officer, employee or agent of the f.i. acting in the course of his employment in relation to any action taken by that institution or person in terms of subsection (1)

Section 70 of PC Act is intended to combat serious offences as illicit traffic in drugs, trafficking in human beings etc.

The impact/effect of each of the above pieces of legislation is to erode the duty of secrecy

- (b) Duty to public to disclose – e.g. where the banker knows that a customer is trading with an enemy during a time of war.
- (c) where the banks' interest demands disclosure e.g. when a banker is making demand on a guarantor he may say what the principal debtor's overdrawn balance is.
- (d) Where the customer's interest demands disclosure –intending guarantor wants to know about the financial standing of the customer (intending borrower) – bank has to answer truthfully – disclosure here is in the interest of the customer – it would appear here there is an implied permission by the customer that the state of his a/c be disclosed to the intending guarantor
 - It is prudent that the banker should require the customer to be present when such information is disclosed.

The above case did not state one other exception

(e) where the customer permits

Note: Duty of non-disclosure does not end the moment the customer's a/c is closed. It continues.

Lord Denning remarked in **Bankers Trust Company v. Shapira and others** [1980] 1 W.L.R. 1274 that "[T]hough banks have a confidential relationship with their customers, it does not apply to conceal the fraud and iniquity of wrongdoers".

From Kenya we have the case of **Intercom Services Ltd and Others v. Standard Chartered Bank Ltd.** [2002] 2 E.A. 391 (HCK). A collecting bank conducted inquiries with signatories of cheque and officers of Central Bank. The inquiries resulted in freezing of funds and subsequent criminal prosecutions. The court considered whether the bank exceeded responsibility in its inquiries and disclosures and whether there was breach of confidentiality.

In Britain duty of non-divulgence was recently considered by the Court in

Barclays Bank plc v. Taylor, trustee Savings Bank of Wales and Border Counties and another v. Taylor and another [1989] 3 All E.R. 563 (C.A)

❖ **Banker's obligation relating to advise on investment**

- No duty

. However should bank decide to so advise it must exercise reasonable care & a skill in giving the advice. Failure to exercise reasonable care & skill will amount to negligence & banker may incur liability for negligence. In **Banbury v. Bank of Montreal** [1918] A.C. 626 a customer sought advice from the bank on the financial standing of a company in which he intended to invest his money. Upon the bank's advice the customer invested his money. The company was not good and the customer lost his money. He sued the bank for the advice it had given him leading to loss of his money. On whether a bank has an obligation to advise on investments the court said that there was no such duty.

However, if a bank undertakes to so advise than it must to so using reasonable care and skill or else it will incur liability if it advises negligently.

- . Duty is premised on reliance (bank has expertise) and special relationship
(**Hedley Byrne v. Heller** [1964] A.C. 465
See also: **Woods v. Martins Bank** [1959] 1 QB 55

❖ **Banker's obligation relating to appropriation of payments**

Meaning of appropriation – application of the funds paid in by the customer

Ruler relating to appropriation of payments:

- (i) Where a debtor owing several distinct debts to one person, makes a payment to him, either with express intimation, or under circumstances implying that the payment is to be applied to the discharge of some particular debt, the payments if accepted, must be applied accordingly (see S. 59 LCA)
 - Debtor has first right of appropriation – either expressly or by implication
- (ii) Where the debtor has omitted to intimate and there are no other circumstances indicating to which debt the payment is to be applied, the creditor may apply it at his discretion to any lawful debt actually due and payable to him from the debtor, whether its recovery is or is not barred by the law in force for the time being as to the limitation of suits (see S. 60 LCA)
 - Creditor has the second right to appropriate where the debtor has not; and he may apply the payment to any debt even that which is otherwise time-barred.
 - Where the bank appropriates as a creditor it must inform the customer of such appropriation. Notification of such appropriation makes it irrevocable. [See **Simson v. Ingham** (1923) 2 B & C 65; **Deeley v. Lloyds Bank Ltd** [1912] A.C. 756]
- (iii) Where neither party makes any appropriation (neither debtor nor creditor), the default rule of appropriate applies, in which case the law appropriates. Accordingly, the payment shall be applied in discharge of the debts in order of time, whether they are or not barred by the law in force for the time being as to limitation of suits. If the debts are of equal standing the payment shall be applied in discharge of each proportionately. (See S. 61 LCA)
 - Where neither debtor nor creditor appropriates then the law appropriates – This is the default rule of appropriation

Appropriation by law is regulated by the rule in **Devaynes v. Noble** (1816) 1 Mer. 529, popularly known as Clayton's case. The rule states that: In the case of current account payments in are, in the absence of any express indication to the contrary, applied in the discharge of the debts in order of time.

In other words the rule is to the effect that-

In a running account payments in are presumed to be appropriated to payments out in order in which the items occur

The rule can also be stated in the following words-

In a current account money first paid in is money first paid out. It is the first item on the debit side that is discharged or reduced by the first item on the credit side.

Explanation:

- (i) In case of a credit account money first paid in is money first paid out
Credit account

Date	Debit	Credit	Balance
1 Dec.	-	5,000,000/=	5,000,000/=
3 Dec.	-	2,000,000/=	7,000,000/=
5 Dec.	3,000,000/=	-	4,000,000/=
7 Dec.	2,000,000/=	-	2,000,000/=
9 Dec.	2,000,000/=	-	-

Withdrawal of 3,000,000/= on 5th May is presumed to have come from credit of 5,000,000/= of 1st December.

Withdrawal of 2,000,000/= on 7th December is presumed to have come from the balance of 2,000,000/= of the 1st December deposit

Withdrawal of 2,000,000/= on 9th December is presumed to have come from the deposit of 3rd December.

- (ii) In case of an overdraft account first item on the debit side is discharged or reduced by first item on the credit side – Here there is an overdraft facility of say shs. 10,000,000/= on which the customer can draw.

Overdraft facility of shs 10,000,000

Date	Debit	Credit	Balance on which to draw	Balance of the debt
8 Dec.	-	-	10,000,000/=	10,000,000/=
10 Dec.	2,000,000/=	-	8,000,000/=	10,000,000/=
12 Dec.	3,000,000/=	-	5,000,000/=	10,000,000/=
15 Dec.	1,000,000/=	3,000,000/=	4,000,000/=	7,000,000/=
17 Dec.	2,000,000/=	4,000,000/=	2,000,000/=	3,000,000/=
20 Dec.	2,000,000/=	3,000,000/=	-	-

The payment in of 15 Dec. wiped out the debit of 10 Dec. and reduced the debit of shs. 3,000,000/= on 12 Dec. by 1,000,000/=

The payment in on 17 Dec. discharged the balance of debit 2,000,000/= of 12 Dec. discharged the debit of 1,000,000/= of 15 Dec. and reduced by 1,000,000/= the debit of 17 Dec.

The payment in of 20 Dec. discharged the balance of 1,000,000/= of 17 Dec. and discharged the debit of 20 Dec.

- (iii) Where there are more than one overdrawn accounts payments in must be applied to discharge debits in order of time – be it in account A or B or C

Importance of the rules relating to appropriation of payments on bankers

- (a) Where debtor does not appropriate the banker creditor is allowed by law to appropriate. And, the banker is free to apply the payment to a debt which is otherwise time barred (the law of limitation) (s-60 LCO).
- (b) Proper use of the rule may protect the bank's interest

Explanation: Bank has allowed on overdraft of shs. 100,000,000/=. This overdraft facility has been guaranteed. Transactions & events that follow

Date	Debit	Credit	Balanced on Which to draw	Balance of debt	
10 Dec.	20,000,000/=	-	80,000,000/=	100,000,000/=	
11 Dec.	30,000,000/=	-	50,000,000/=	100,000,000/=	
12Dec.	guarantor dies: guarantee determines.				
13 Dec.	-	50,000,000/=	50,000,000/=	50,000,000/=	
14 Dec.	50,000,000/=	-	-	50,000,000/=	

On 12 Dec. when the guarantor died debtor had drawn 50,000,000/= and that amount was secured by the guarantee.

On 12 Dec. on death of the guarantor the guarantee determined and subsequent withdrawals were not guaranteed.

On 12 Dec. the death of the guarantor did not make the account cease to be a running account. So payment in of 13 Dec. (50,000,000/=) wiped out the debits of 10 Dec. (20,000,000/=) and 11 Dec. (30,000,000/=) – debits which were otherwise guaranteed.

The withdrawal on 14 December (50,000,000/=) was not guaranteed.

Proper use of the rule in Clayton's case:

Once informed about the death of the guarantor bank to make sure the rule does not apply to the account so as to render withdrawals unsecured. The rule in Clayton's case applies in the case of a running account. So bank must break the account on death of guarantor – withdrawals remain secured by estate of the deceased guarantor.

Since the account is broken payment in on 13 Dec. cannot be applied against withdrawals of 10 Dec. & 11 Dec.

The overdrawn balance of the old account is left as it stands and must not be taken into account in the working of the new account.

If the overdrawn account is not broken in this way (and if any form of charge does not guard against the risk), as the running account continues to operate, credits as they are paid in are deemed to repay the old overdraft (which was secured, or in respect of which there was a claim against a guarantor or his estate, or a deceased partner's private estate), while fresh debits as they are paid gradually build up a new overdraft which is not secured, or in respect of which there is no claim against a person or his estate.

Non-application of the rule in Clayton's case

- (i) For the rule to apply the account must be a running account. If the account has been broken the rule cannot apply
See **In re Sherry, London and County Banking Co. v. Terry** (1884) 25 Ch. D. 692
- (ii) In order for the rule to apply it must be the same account not different types of accounts. In **Bradford Old Bank v. Suitcliffe** (1918) 34 TLR 299 there were 2 accounts, a loan account and a current account. It was held that the 2 accounts could not be considered as one and that payments to the credit of the current account are appropriated to the current account and cannot be taken in reduction of the loan account.
- (iii) The rule in Clayton's case does not apply where a person has mixed trust moneys with his own money in his account. In such a case the money which he first withdraws from the account is deemed to be his own leaving the trust funds intact (draws for personal use). See **Re Hallet's Estate, Knatchbull v. Hallet** (1878) 13 Ch.D. 696.

As between claimants to the trust money however the rule applies. The first trust money paid in is the first money drawn out. **Re Stenning, Wood v. Stenning** [1895] 2 Ch. 433 illustrates this:

A solicitor kept trust moneys in his private account. The trust moneys were deposited on behalf of several clients on different dates. The solicitor used to draw from this account. At the time of his death he had drawn so much money that the balance could not satisfy repayment of trust moneys to all the clients.

It was held that the first trust moneys to be deposited was money that was first withdrawn

The rule in Clayton's case is one of evidence, not of law.

Joint debtors and **the rule in Clayton's case**

If joint customers are indebted to the bank and there is joint and several liability clause and one of the joint holders dies the bank will:

- be interested to recover the debt from all the joint debtors i.e. including the estate of the deceased.
- therefore break the account to avoid application of the rule in Clayton's case.

If the account is left to run, payments in will defray the overdraft so that the deceased's estate will not be involved in the repayment of the overdraft.

This may not be in the interest of the other joint holders because if the rule in Clayton's case applies liability of deceased will be reduced by payments in.

NEW DEVELOPMENTS: RE APPLICATION OF THE RULE IN CLAYTON'S CASE

In its application in relation to beneficiaries of trust moneys the rule in Clayton's case does not seem to be fair. The courts have thus developed some new guidelines to assist in the distribution of trust moneys as between beneficial claimants. In *Commerzbank Aktiengesellschaft v. IBM Morgan plc* [2004] EWHC 2771 (Ch.) the court sought to mark a difference between cases where appropriation of payments is concerned and tracing of money. It was pointed out in that case that Clayton's case was a case about appropriation of payments and not about tracing. The first payment

out is attributed to the first payment in and so on. But this rule can cause injustice when applied to tracing claims. The result can be “capricious and arbitrary”. [See also Goff and Jones, **Restitution**, 6th ed. Jones, 2002 para 2-039]

The court was referred to the judgment in *Barlow Clowes International Ltd. v. Vaughan* [1992] 4 All E.R. 22 (C.A.). The issue in this case involved distribution of investors’ funds. The fund was a common fund and was not allocated to individual investors. The investors had paid more than pounds 100 million in Barlow Clowes but the available funds were far short of the claims. The question was whether the funds were to be distributed applying the rule in Clayton’s case. It was said in that case:

- The rule is not convenient in the case of innocent parties with the right to trace;
- To adopt the fiction first in, first out was to apportion a common misfortune through a test which has no relation whatever to the justice of the case;
- The rule need only be applied when it is convenient to do so and when its application can be said to do broad justice having regard to the nature of the competing claims;
- The use of the rule was a matter of convenience and if it would result in injustice it would not be applied if there was a preferable alternative;
- The rule in Clayton’s case may not be appropriate and perhaps *prima facie* was not appropriate for those who had the common misfortune of falling victim of a large scale fraud;
- The rule does not apply in Canada and Australia in the case of competing beneficial entitlements to a mingled trust fund where there have been withdrawals from the fund;
- Where the rule does not apply it will normally be appropriate for the parties to be entitled to the mixed fund *pari passu*, i.e., the fund shall be shared rateably amongst the beneficiaries according to the amount of their contributions.

El Ajou v. Dollar Land Holdings (No. 2) [1995] 2 All E.R. 213 was also on the propriety of the application of the rule in Clayton’s case

2. **SPECIFIC OBLIGATIONS AND LIABILITIES ARISING OUT OF OPERATION OF A CUSTOMER’S ACCOUNT**

In cases of:

Under crediting
Under debiting
Over crediting
Over-debiting

(i) The Current a/c – Chequing a/c

- Money withdrawable by cheque
- Money at call
- Hence generally no interest payables except in rare cases
- Where there is Both a C/A/c and a D/A/c, it is an implied term of the contract between the parties that money paid in, cheques collected, etc., will be credited to the current a/c unless other instructions are expressly given. When overdrafts are allowed, they will be on the current a/c.

Payments to Credit: (Sheldon q. 188)

- Payments in to be evidenced by **paying – in - slips**
- Such slips should be signed or initialed by the customer or person paying in the credit on his behalf.
- All alteration should be initialed
- Slip to bear the correct date of paying in

Withdrawals:

- Without express agreement to the contrary, a customer is not entitled to draw against credits as soon as he has paid. Banker to be given sufficient time to make entries in his books.
- Banker entitled to debit his customer with any credit instruments [sent for collection but] returned unpaid, even though they have already been credited as cash to the a/c

DEPOSIT ACCOUNT:

- (1) Savings A/c
 - (2) Fixed Deposit Account (FDR)
- Attract interest.

PROBLEMS CONNECTED WITH ENTRIES IN THE A/Cs: MISTAKES IN ENTRIES

- (1) Over - crediting

The Pass Books:

It was a book kept by the bank showing the state of a/c of the customer. The bank passed this book to the customer who was expected to **examine all entries**, or especially (at least) **Entries to his debit** and return it to the bank.

It was stated that except for negligence or reckless disregard on the part of either the banker or the customer, **it ought** to constitute a **conclusive, unquestionable**, record of the transaction, between them and it should be recognized as such. The reason given for this proposition was that after full opportunity of examination on the part of the customer, all entries, were to be taken as being correct and conclusive.

The aim of the bank in using the passbook has been to protect its interest in case of mistaken/wrong entries. That if a customer discovers there is a mistake in the entry he should inform the bank. Once the customer has returned the passbook the bank should regard the account as an **account stated**, i.e., an account representing the true state of affairs; an account accepted as correct.

But what is the position of the pass book in law?

The position of the pass book in law; also true of bank statements

- (i) **Mistakes in favour of the customer:**

Let us trace court decisions:

- (a) In **Devaynes v. Noble** (1816) 1 Mer 529 the Court of Chancery

directed an enquiry into the nature and effect of the passbook. In the report of the enquiry it was stated that on delivery of the passbook to the customer, he “examines it, and if there appears any error or omission, brings or sends it bank to be rectified, or if not, **his silence is regarded as an admission that the entries are correct:**

The Court agreed with and accepted the above report and finding on the ground that the silence amounts to a representation of the correctness of A/c

(b) **Skyring v. Greenwood** (1826) 4 B & C 281.

This was a case of **over crediting**.

The bankers had credited a military customer with certain sums of money to which they thought he was entitled but to which he was not entitled and which were never received by the bankers, who had moreover, been officially informed of their mistake. They credited him for 5 years. He had been drawing money all this time. When they discovered the mistake the bankers sought to recover the amount drawn out by the customer by retaining subsequent moneys coming to their hands for the customer’s credit.

It was held that the bankers were not entitled to recover the money because the entries to credit were representation by the bank to the customer that the money had been received for the latter’s use and that **since the customer relying on the representation altered his position by spending more than he would otherwise have spent, The bank was estopped from denying the representation.**

This case showed that a credit entry (over crediting) may be regarded as a representation binding the bank, if the customer can show he has altered his position in reliance thereon.

In a 1950 case the Court imposed a duty on the banker to correctly inform the customer of his state of account. In **Lloyds Bank, Ltd. v. The Hon. Cecily K. Brooks** (1950) 6 Legal Decisions affecting Bankers, 161 **Lynskey J.** observed that the bank was under duty to keep a customer correctly informed as to the position of her account; not to over credit her statement of account and not to “authorize her or induce her by faithful representations contained in her **statement of account** to draw money from her account to which she was not entitled.”

Circumstances in which a customer is entitled to rely on bank’s representation were examined in the case of **Barclays Bank of Kenya v. Jandy** [2004] 1 E.A. 8 (CCK) the Court considered the limits of a customer’s duty of care owed to his bank. In this case a customer utilized a large unexpected credit placed in his account without making a query. The court examined a number of issues including (i) whether the customer breached his contractual duty of care, (ii) whether the customer breached warranty of authority and (iii)

whether the bank's statement of account amounts to positive representation by the bank made to the customer on which the customer is entitled to rely.

- (c) In **Holland v. Manchester & Liverpool District Banking Co. Ltd.** (1909) 25 TLR 386 a cheque was drawn on a banker by a customer whose a/c had a wrong entry and remained uncorrected. The bank having discovered the mistake (wrong entry – over crediting) dishonoured the cheque. The customer successfully sued the bank for damages.

The Court said:

- (1) the bank had no right to dishonour cheques drawn on the faith of it (the entries) so long as (they) it remained uncorrected
- (2) to have the entry subsequently corrected.

Damages awarded:

The Court further said: The passbook was prima facie evidence against the bank, on which the customer in the absence of negligence or fraud on his part was entitled to rely.

- (d) **Rectification of a wrong entry** (over crediting)

In the absence of any change of position a mistaken credit entry may probably be rectified within a reasonable time.

In **Commercial Bank of Scotland v. Rhind** (1860) 3 Macg. 643

Court observed, "it would indeed be a reproach to the law of Scotland, there being satisfactory evidence that, by the mistake of a clerk, there had been in the passbook, a double entry of the same sum to the credit of the respondent, the mistake could in no way be shown by the bank, and if he were entitled fraudulently to extort from them £80 beyond the amount of what is justly due to him."

N.B. The reverse case must hold true **"No amount of acquiescence on the part of the customer could justify a bank in withholding from him money really received for his credit, but omitted in the credit items of the pass book. The credit items are peculiarly within the knowledge and control of the banker, the debit within that of the customer."**

- (ii) **Mistakes to the Customer's Detriment: undercrediting/overdebiting**

Where wrong entries are to the detriment of the customer e.g, under crediting or overdebiting

1. Authority based on English cases shows that no estoppel can operate against the customer.

N.B. The customer got the passbook from the bank and later returned it to the bank – may have initialed it or not.

The bank, to protect its interests would like that the returning of the passbook by the customer to the bank – whether initiated or

not – should amount to a **representation** that the items in the passbook are **correctly stated**. So that customer should not later on be heard to deny the bank correctness of the items – e.g. here the amount credited in from of customer was less than the amount due to him – he should be estopped.

The Courts have maintained that the fact that the customer got the passbook and returned it to the bank does not go to show:

- (a) that the customer examined the passbook
- (b) that he examined it with any degree of care – these no duty imposed on the customer to examine the pass book
- hence no representation where bank cannot show the customer was obliged to examine the passbook indeed with due care.

Even if the passing of the book to & fro amounts to a representation, which is questionable, [it is difficult to see how the banker can act upon it so as to become ---- difficult to see how banker can act upon customer's representation so as to alter his position legal position. E.g, banker has entered £100 instead of £200 in favour of the customer. The book has passed to and fro. Then the customer discovers the mistake. It would sound strange for a bank to refuse correcting the mistake while in fact the bank has not changed its legal position.

N.B. Normally the bank does not refuse to correct a mistaken entry to the detriment of the customer

N.B. Even where customer has acquiesced – **Rhind's case** p.65[noted]

2. Where the a/c of the customer has been wrongly or over debited through paying of forged cheques.

The customer's signature has been forged. The bank has paid and debited the customer. The book has passed from bank to customer & back later customer discovers the mistake.

Who is to bear the loss? Bank or customer? That by returning the passbook to the bank the customer has made a representation that the entries are correct and this may induce the bank paying on forged cheques.

For the customer it may be argued that the representation does not induce the bank to pay upon the forgeries. **This only goes to show that the customer has not been able to assist the bank to discover the forgery.** But the customer was not duty bound to examine the passbook. The customer would however, be liable if he is aware of the forgeries and does not communicate his knowledge to the bank. – **Greenwood v. Martins Bank Ltd** [1932]

Tai Hing Cotton Mill Ltd v. Lin Chong Hing Bank Ltd & others [1985] 2 All E.R. 947 (PC)

... In order to impose an express obligation on a customer to examine his monthly statements and to make those statements, in the absence of query, unchallengeable by the customer after the expiry of a time limit, the burden of the obligation and of the sanction imposed has to be brought home to the customer

(iii) **Statements on loose sheets**

1. Statements from the bank to the customer showing the state of a/c of the customer: These statements are in the form of loose sheets. Sent periodically to the customer – not necessarily at the request of the customer -

The aim behind sending the statements periodically to the customer is to get the customer to know his state of account. So that if there is any wrong entries he should notify the bank; particularly where the entries are to the disadvantage of the customer e.g. over debiting or under crediting.

N.B. The sheets – not returned to the bank - So

- (1) Unless customer takes initiative to see the bank on a mistaken entry – sheet serves no useful purpose -
- (2) Because sheet not returned customer can not be said to have seen the sheet or read it.

So they **raise a presumption** that the customer has notice of the state of his a/cs though there is no return of the statement to the banker

DUTY TO EXAMINE PASS BOOK OR BANK STATEMENTS

- ❑ In **Chatterton v. London Country Bank** (1891) The Times, Jan. 21 the Court said that there is no implied term in the banking contract that impress a duty on the customer to examine his passbook at all. There being no duty he need not exercise any degree of care if he divides to examine it.
- ❑ The loose bank statements place the customer in an even stronger position because there are not intended to be sent bank to the bank.
- ❑ If the bank wishes that a duty be imposed on the customer to examine the bank statements then there should be an express agreement imposing such duty (See Tai Hing Cotton Mill Ltd case)
- ❑ The law appears to favour a bank customer
 - Bankers do keep and render to the customer detailed account of all payments received from or on his behalf and of all payments made to him or to his order. It is the bank's duty to do so (see Lord Chorley p.143, **Lloyds Bank Ltd. v. The Hon . Cecily K. Brooks**)
 - The bank and the customer are, in many cases, not of equal economic, professional etc. standing. The bank employs servants skilled in this form of accountancy. The customer does rely upon his banker's accuracy.

- Consequently a customer is not under duty to examine his periodic bank statements so as to enable him to notify the bank of wrong entries (See *Tai Hing Cotton Mill Ltd* case)
- So if a customer acts upon them, i.e., mistakes in his favour, bona fide so as to alter his position the bank will be estopped from claiming to have the mistake rectified.

Note recent developments:

- **Kleinwort Benson Ltd. v. Lincoln City Council** [1998] 4 All E.R. 513 – if one person pays money to another under a mistake of fact or of law which caused him or her to make the payment, he or she is prima facie entitled to recover it as money paid under a mistake. (See p. 317 **The Law Relating to Domestic Banking**). In banking the sort of mistakes which may allow recovery are:
 - Payment accidentally made on a countermanded cheque;
 - Payment made on a cheque where the drawer's signature is forged;
 - Payment made in the belief that the drawer has sufficient funds in his account;
 - Payment made to the wrong person (for example, if there are two Jumas with accounts at the bank);
 - Overpayment (double credits seem to be quite common);
 - Payment made by a confirming bank to the beneficiary of a letter of credit, where the bank believes wrongly that the documents are correct.
- If money paid by mistake is to be recoverable by a bank by way of an action in restitution, the following conditions must apply
 - Money must have been paid by mistake
 - The mistake must have caused the payment
 - The payment must not be within the bank's mandate or authority
- Defences open to the defendant
 - Bonafide purchase
 - Change of position
 - Ministerial receipt
 - Estoppel. In principle, money cannot be recovered if the payer is estopped from asserting his entitlement to it. In this context estoppel requires:
 - ✓ A representation made to the payee, or some breach of a duty owed to him or her by the bank
 - ✓ The payee's reliance on this representation or omission, to his or her detriment or so that it is inequitable for the payer to claim to recover [where someone has been overpaid, that is hardly a detriment, but it may be inequitable to call on him or her to repay once he or she has spent the money. See **Avon C.C. v. Howlett** [1983] 1 All E.R. 1073; and
 - ✓ That the payee is not at fault.
 - Representation
 - Reliance to one's detriment

In Tanzania this aspect was considered in the case of CRDB V. Damas Joseph Mallya [200..]TLR A cheque worth T.Shs 48,835,000/= , drawn on NBC Samora Branch, Dar es Salaam, in favour of the defendant was deposited in the defendant's personal account at CRDB Dodoma Branch. After observing the value date procedure, i.e., upon expiry of 14 days from the day the cheque was deposited, the defendant was allowed by the plaintiff to draw. Within a span of 12 days the defendant had withdrawn a total of T.Shs. 47 million from

the account. Out of the money withdrawn T.Shs. 8 million was deposited in an account of a company in which the defendant was director.

After these withdrawals it was discovered that the relevant cheque which had been sent by CRDB Dodoma Branch, a collecting bank, to the paying bank for payment had disappeared. The plaintiff bank turned to the defendant for return of the money or assistance to trace the drawer. When the defendant proved to be uncooperative, since he had four accounts in the same bank branch, the plaintiff bank decided to combine the accounts and therefore was able to recover T.Shs. 10,799,700/= out of the T.Shs. 47 million leaving a balance of T.Shs. 36,200,300/= the subject matter of this case.

The court considered various issues including whether and under what circumstances money paid under a mistake of fact is recoverable and held:

- (i) The general principle underlying the requirement that money paid by mistake of fact must be refunded is that the law should not countenance unjust enrichment; the law should not permit a person to retain a benefit unjustly derived from the other;
- (ii) In this case the mistake is as to a matter of fact in that the collecting banker assumed that the cheque had in fact been cleared because as per the obtaining value-date procedure, fourteen days had elapsed without the cheque being dishonoured or without receipt of any kind of communication which would otherwise affect its payment;
- (iii) Once there is payment by mistake the court should be concerned with who in the circumstances is a holder of unjust riches and who holds the card in the blame;
- (iv) Thus, once there is payment by mistake it should be left to the court depending on the facts of a particular case to decide on who should not be allowed to have unjust enrichment to the extent, for example, that in a fitting situation the payer can proceed against both the payee and the drawer at the same time, the payee being a necessary party;

3. OPENING, OPERATION AND OBLIGATIONS UNDER ACCOUNTS OF VARIOUS TYPES OF CUSTOMERS

- (i) Non-business associations e.g clubs i.e. without motive of commercial gain.
 - (a) Opening of account
 - A/c to be opened in the name of the society.
 - Details of the persons authorized to sign together with specimen of their signatures must be supplied to the bank.
 - A **copy of the resolution** which appointed the treasurer and any other signing officers must be kept in the bank's records
 - If there is a change in the signing officer – communication of such change to the bank is necessary - A new specimen signature to be supplied - Notification to be signed by the old officers whose signatures the bank has.
 - (b) Why a banking a/c?
 - keeping members' subscriptions
 - keep grants

- payments act

(c) Operation

A/c to be operated by the treasurer with one or more members of the committee of the society

(d) Borrowing by the society

Associations have no legal personality. As such if a society wants to borrow, someone connected with the society must undertake personal responsibility. He must guarantee in no uncertain terms which make him directly responsible for the debt (indemnity!!)

(ii) **Trust account. (for Minors) [ITF]**

1. Whether there is an objection to opening a deposit a/c under the style A in trust for (ITF) "B" or "A re B", where B is an infant (minor). No objection
But: the bank must make sue that withdrawals are made only by A (or in the event of his death by his executors or administrators) even after B attains majority or comes of age.
2. Whether the bank incurs any risk in opening and operating an account with a person describing himself or known, as a trustee.
The **only risk** is that of **becoming implicated in the consequences of a breach of trust**, if the banker permits the trustees to deal with the trust funds passing through the a/c, or represented by securities deposited by them in his hand, **in a manner which the Court might hold to be evidently inconsistent with the rights of beneficiaries.**
 - A trust creates a legal right of ownership in the trustee (a right in **rem**).
 - In law the beneficiary has no right in the property
 - But in equity, the owner is the beneficiary not the trustee. In equity the beneficiary can sue in his own name.

Since the trustee has legal ownership in the eyes of law and since the beneficiary has got beneficial interests only equity comes in to protect the interests of the beneficiary, who is, as far as equity is concerned, owner of the property.

To protect the beneficiary specifics rules were evolved. These rules have the effect of curbing mischief and frauds by the trustees and thereby protect the institution of trust.

Bankers have got special duty in dealing with trust a/cs.

The banker has the duty not to knowingly operate trust a/c against the interests of the beneficiary

N.B. A trust a/c raises no special duty to the banker. It is to be regarded as an a/c of the trustee, who is the legal owner and that the beneficiary is merely as an equitable owner.

- The party to the a/c is the trustee not the beneficiary who is here, a third party.

- In law the bank is liable only to the trustee i.e. the legal owner of the a/c and the **bank has to obey his instructions under the mandate of trust.**
- The bank must honour cheques drawn by the trustee except where the bank knows that the trustee is going to misappropriate the funds i.e. use the funds against the interest of the beneficiary
- But note: it is not the duty of the bank to find out how the trust money is going to be used before he pays the trustee.
- I.e. **there is no positive duty on the bank to protect {beneficial} equitable interests of the beneficiary.**
- **Bank is only obliged not to knowingly allow fraud to be perpetrated or committed against the beneficiary.**
- Example: Where bank can be regarded to have knowingly allowed fraud: where operation of the a/c is for the bank's interest. Here the bank knows and is privy to the fraud. This is true where, e.g., the trustee has his own private a/c which is overdrawn and instructs the bank to apply the trust fund to reduce or wipe out the overdraft.
- Mere suspicion by the bank that trust money will be misapplied by the trustee is not sufficient reason for the bank not to honour a trustee's cheque
- It may sometimes be difficult to reconcile the **banker's general duty** to honour his customers cheques, with his special **duty** when the customer is known to be a trustee, not to pay a cheque by which trust money is probably being misapplied. **Paget 8th edn p. 89 observes "Mere suspicion does not justify the banker in refusing payment of a cheque.** The suggestion made in **Re Gross, Ex Parte Adair** (1871) 24 L.T. 198 at p. 203, that a banker would be acting rightly in dishonouring a cheque drawn by a customer on a trust a/c because it was payable to a person known to be that customer's tailor, is exaggerated, and is not supported by **Re Gross, Ex Parte Kingston** (1871) 6 Ch. App. 632, which was the appeal from that decision.
Ground of liability on part of banker. Actual notice of and/or participation in a breach of trust is a sufficient ground of liability.

- (1) A banker would be held liable for parting with trust funds to a third person, even on a cheque, if **the inconsistencies were such that he must have known it was a misapplication of the funds even if no personal benefits accrued to the banker.** Paget p.89. (See **Selangor United Rubber Estates v. Cradock** (1968) 2 Lloyd's Rep. 289 discussing *Grory v. Johnston*, at p. 310 See also *Karak Rubber co., Ltd v. Burden* (1972) 1 Lloyd: Rep. 73.

In **Grory v. Johnston** 1868 L.R. 3H2. 1, Lord Cairns is said to have observed that in order to justify a banker in refusing to pay his customer's cheque some misapplication of the trust funds must be intended by the customer, and the banker must be privy to the intent to make this misapplication.

- (2) The banker will be held liable for breach of special duty relating to trust a/c if **the trustee uses the trust money for the benefit of the bank in Grory v. Johnston** (supra) "... if any personal benefit to the banker himself mere designed or stipulated for, that circumstance above all others would readily establish the fact of the bankers privy with the intended breach of trust."

Such personal benefit to the banker would obviously arise if a cheque drawn by a trustee in his own favour were credited to his overdrawn private a/c in reduction of the overdraft -

In **Foxton v. Manchester & Liverpool District Bank** (1881) 44 L.T. 406 a person in a fiduciary capacity – was an attorney -. He drew a cheque on his principal's a/c and credited it to his own overdrawn a/c. The bank was aware of the trust a/c and of the trustee's action of reducing or wiping out of his overdrawn a/c with the trust money. The bank was held liable for breach of trust.

OPENING OF, OPERATION AND OBLIGATIONS UNDER, JOINT A/C – IN CREDIT & IN DEBIT

JOINT ACCOUNTS

May be opened incorporating two or more persons, with or without instructions as to how the a/c is to be operated and by whom.

- (1) If A lodges a sum of money at a bank in the names of A.B and C without instructions, the banker would be liable if he repays the sum or any part thereof, on the order of A.
- (2) But if the instruction are that any one of them can draw on the accounts then the bank would not be liable if it pays on A's order.
- (3) Where a joint a/c is opened by a **husband and wife**, either having power to sign cheques, if a cheque is presented, in the handwriting of and signed by the wife and altered and duly initialed by the husband, the banker should have no objection to honouring the cheque
- (4) In the case of an **overdraft** created on an a/c standing in the names of two or more persons, certain **conditions** must exist in order to ensure the joint liability of all the a/c holders
 - (i) Cheques drawn upon the a/c must be signed by all; **or**
 - (ii) if signed by one or more with the authority of the others -
 - (a) Such authority must contain the words whether the a/c is in credit or overdrawn, or may become overdrawn in consequence of such payment' or words to such like effect; **or**
 - (b) A special request applying for the overdraft must be signed by all the account holders, **or**
 - (c) the parties must be partners in trade (as distinguished from a non-trading firm.)

Legal effects of Joint Liability: Any liability will be **joint** only not joint and several.
Results:

- (a) If one, or some, of the a/c holders is, or are, sued by the bank for the joint debt, the others or other, cannot be sued afterwards: **Kendall v. Hamilton** (1879) 4 A.C. 504
- (b) The bank cannot set-off credit balances, if any, on the separate a/cs against the joint debt; and
- (c) Unless the a/c holders are partners, the death of one of them will discharge his estate from liability.
 *In practice, it is usual to obtain an undertaking of joint and several liability in such cases. (see later)
 - Joint Rights: Any rights are joint unless there is an element of joint and several rights.

Rights and obligations of joint a/c holders

Brewer v. National Westminster Bank [1952] 2 All E.R. 650

Joint a/c – Mandate to honour cheques signed by joint customers – Forgery by one customer of other customer's signature – Action by innocent customer for a declaration that the bank had wrongfully debited the joint a/c with the amount of the forged cheques

Bank not held liable because the guilty & innocent a/c holders had a joint right against the bank. Since their right was joint and since the guilty party could not rely on his misconduct to sue the bank, the innocent a/c holder could not sue the bank.

Catlin v. Cyprus Finance Corp. (London) Ltd (Catlin, third party) [1983] Q.B. 759; [1983] 1 All E.R. 809

Joint a/c – H & W – mandate to honour only instructions signed by H & W – Bank transferring solely on H's instructions funds from the joint a/c to him for his own use – W bringing action against bank claiming damages for breach of mandate – W not joining H as party – whether bank owing duty to a/c holder jointly or severally – whether failure of W to join H as party fatal to her claim.

Held: The bank's agreement to honour only those instructions signed by Both a/c holders carried with it a duty not to honour instructions which were not signed in that manner. The duty was owed to the a/c holders severally, and accordingly, where a breach of the mandate occurred it could be enforced at the suit of the innocent a/c holder alone.

Brewer v. Westminster Bank Ltd [1952] 2 All E.R. 650 not followed – distinguished – In Brewer the forgery was so skilful that the Bank could not be said to have been negligent in paying. In Catlin the bank flouted an express mandate that payment of cheques – only against signature of Both a/c holders.

Bankruptcy of one of the joint account holders:

Bank cannot and should not honour cheques drawn by the other partner(s) because the trustee in bankruptcy may be interested in the a/c

On death of one of the joint holders

- (a) In case of a credit balance the general rule is that, as far as the bank is concerned the balance of the joint a/c devolves upon the survivor/s **unless** the a/c holders have indicated otherwise – e.g., that the personal representatives of the deceased would take over the interests of the deceased.

- (b) In case of a debit balance in the absence of a mandate whereby all joint a/c parties contract to be jointly and severally liable to the bank, **the liability is joint** only and on the death of one joint holder his estate is discharged from the debt. In such unlikely circumstances, the banker has to rely on the survivors to repay and the a/c may be continued unbroken.

Where **joint and several liability** has been established and it is desired to preserve the liability of the deceased's estate, the a/c should be broken; otherwise, under the rule in **Clayton's case**, credits paid in after his death will reduce his liability

ACCOUNTS OF PARTNERSHIPS

- a firm carrying on business for profit
- Need a written, verbal or implied agreement between the partners. [A partnership deed]
- Number of partners. 2 to 20 people
- A firm = all the partners in the firm
- **Rule:** One partner may bind the firm by any act done in the ordinary course of the firm's business. This rule facilitates business transactions e.g. in dealing with the bank.
- When opening the A/C:
 - S. 201(2)(b) Partner not allowed to open an a/c on behalf of the firm in his own name
 - All partners must give the bank specimen of their signature. This is important because the bank wants to know by whom cheques will be signed.
 - There is a form to be filled. "Application for a Partnership A/c."
 - In this form the partners "agree that any act done by any partner in relation to the a/c shall be deemed to be done for carrying out the business of the firm in its ordinary course"
 - So any one can negotiate an overdraft
 - Liability: Not limited. Each is fully liable E.g. 4 partners owing £100 to a creditor. He may sue one or all.
 - **Liability to the bank:**
"is joint and several". They partners agree in a declaration in the application form to be jointly and severally liable to the bank.
 - = Deceased's estate will be attached to recover debt of the bank
 - = Bank may have recourse to set-off against deceased's other accounts i.e. personal a/cs.

Partnerships

Lord Chorley pp. 161 - 163

- (1) Vide: Law of Contract Ord. 1961
- (2) Open joint a/c
- (3) **In general:** Each partner is agent of his firm to carry out transactions within the scope of the firm's business. Hence he can open an a/c in the firm's name, operate it etc. But there is no implied authority entitling him to open an a/c in his own name so as to bind the partnership
Vide: Alliance Bank v. Kearsley (1871) L.R. 6 C.P. 433)

In practice Partnerships are formed and run their business under the **articles of partnership** which commonly indicate the number of partners to operate the firms a/c.

Hence it is advisable for the bank to demand and inspect such articles of partnership – although it would appear the law does not require him necessarily to do so.

- (4) **Authority to overdraw:** This is implied for trading firms hence authority to operate an a/c implies this authority as well. However, when the authority has been expressly withdrawn and the bank is aware of it, no overdraft should be granted. So is the right to give security for overdraft.
N.B. Non trading partnerships have no implied authority to overdraw or borrow
- (5) **Revocation of authority:** by dissolution

OBLIGATIONS UNDER JOINT ACCOUNTS IN CREDIT AND IN DEBIT

JOINT A/C: - HUSBAND AND WIFE

- (1) Before a banker can deal with any person he must know what that person's legal status is. E.g. He can lend to an adult but cannot to a minor.
- (2) Husband and Wife joint a/cs
- A husband and wife may open a joint banking account
 - Instructions must be given to the bank that either may sign i.e. If the wife signs, she signs as an agent for her husband, and vice versa.
 - If no instructions – Both must sign.
- (3) **Liability:** At common law the **liability** of husband and wife or any other joint a/c holders, **is joint**.
This means either or Both will be responsible for repayment, but the bank has only one right of action. If the bank sues one party to judgment, that discharges the other. This is so even if the bank has not been able to recover the whole debt.
- (4) to protect itself from results of joint liability only the bank has included in the form of application for the joint a/c a clause establishing **joint and several** liability for any overdraft. This gives the bank a right to sue the parties together (i.e. jointly) or one after another (i.e. severally). I.e. the parties are individually as well as jointly liable.
- (5) **The doctrine of Survivorship.**
The common law joint ownership carries with it a **presumption** that the property will, on the death of one party pass to the survivor. Here the bank a/c is property. While Both parties are alive they together make up the owner. **Unless evidence is brought to show that one** party provided the money then the question of how much of the balance belongs to one and how much to the other does not arise. I.e. there is no question of "shares" – they are joint owners.
- (6) **Rebuttal of the presumption of survivorship.** Personal representatives of the deceased party may prove the following to by rebut the presumption:
- (i) that it was the deceased who paid in the money to make the joint a/c; and
 - (ii) that it was not the intention of the deceased that on his death the property should devolve to the survivor.

In **Foley v. Foley** (1911) 1 I.R. 231 (C.A)

The husband expressly stated, when he opened the joint a/c, that it was to provide for his wife, should he predecease her. This in fact happened and the widow was held entitled to the balance.

Marshall v. Crutwell (1875) L.R., 20 Eg. 328. An a/c was opened at a bank in the joint names of husband and wife. The husband was in failing health. All the money paid in to the a/c was proved to belong to the husband, and the wife's drawings were on account of household necessities only. The husband died.

Held: That the presumption of survivorship was rebutted, and [the executors and not the widow were entitled]; that the widow was not entitled to the balance.

(7) Banker's practical solution to the problem arising out of the presumption of survivorship:

- The doctrine above may lead to family squabbles. The bank may be implicated
- To avoid being implicated, the bankers have included in the application form for joint a/c a provision that the balance is to be held for the survivor.
- The bank thus avoids being implicated because by paying to the survivor he has complied with the instructions signed by the joint holders of the a/c

(8) Where husband and wife have serious dispute or have separated:

- Likelihood of one party withdrawing the whole amount or a substantial amount from the bank and disappear, the bank should take necessary precautions. The bank should advise the customer that it will no longer accept instructions given by one account holder, rather Both must sign. If the account holder does not heed to the advise of the bank then the bank may stop the account. In case joint a/c holders are in dispute and if the bank decides to stop the a/c it must do so temporarily & should submit the matter to court for determination – decide the legality of bankers' act to stop the a/c. **B.P.**

Chatwani v. P.V. Patel and NBC Civ. Case 43 of 1976. LRT No.

Where the Doctrine of survivorship does not apply bank to stop a/c on receiving notice of either death or bankruptcy of any of the partners.

OBLIGATIONS IN RESPECT OF ACCOUNTS FOR TRADING COMPANIES

Trading companies are broadly of two types namely public companies, private companies

- A public company is one which advertises itself by prospectus and invites the public to subscribe for shares. By this means the co. gets the money necessary to start business or expand it.
- A private co. does not appeal to the public for funds. Finds them from private sources.
 - (a) restricts the right to transfer shares
 - (b) limits number of members to 50
 - (c) prohibits invitation to the public to subscribe for any shares or debentures of the Co.

Whether public or private the company is normally a limited liability co.

Limit to the liability which members shall be obliged to pay to meet creditors demands in case of bankruptcy. Liability is limited to the amount of shares a member has taken – unpaid shares i.e. liability of share holders for the debts of the Co. is limited to the amount of their unpaid share.

Legal personality:

A limited liability co. has a legal existence of its own quite apart from that of the shareholders or members of which it is composed **Vide: Solomon v. Solomon & Co. Ltd. 1897** S. turned his one man business as about manufacturer into a limited co. under the Companies Acts. He was the managing director of the co. and held nearly all the shares. In his private capacity he lent money to co. when later a loan as needed. By way of security he took debentures from the co. entitling him to a first charge over the co's assets. Eventually the co. went into liquidation and S. claimed to have his debt from the co. satisfied before any of the other creditors of the co. were paid.

As a legal entity a co. can deal with the bank. Open a/c, operate it, borrow, give security etc.

The bank before opening & dealing with a co. must make sure whether the co. is a legal entity i.e. whether it has been legally constituted under the Co. Act, and what powers the co. has got.

- Legal constitution of a co. is evidenced by its having been issued with a co's legal birth certificate called "**Certificate of Incorporation**"
- Certificate of incorporation will be issued after the founder members have prepared Memorandum and Articles of Association and presented them to the Registrar of Co. who issues the birth certificate.
- The **Memorandum** regulates the affairs of the co. as against the outside world. The objects clause sets out the purposes for which the co. was formed & the way in which it is intended to do business. The co. has no legal power to do that which is not stated in the objects clause. That will be outside the scope of the business of the co.
- The **Articles of Association** govern the internal conduct of the Co. and deals with such matters as making calls on shares, the transmission & forfeiture of shares, proceedings at general meetings, voting of members and powers and duties of directors.
- For public Co. after incorporation of the co. the Registrar after certain formalities have been met, issues a certificate entitling the co. to commence business. It is known as "Trading or Commencing Certificate."

2. **Opening of the a/c (operation of the a/c)**

Once the Co. has been incorporated the banker may open an a/c for it.

Before opening the a/c the bank must demand and see.

- (a) The certificate of incorporation and
- (b) The memorandum of association and
- (c) The articles of association
- (d) A Board Resolution appointing signatories to the a/c of the co. and in the case of public companies
- (e) Trading or Commencing Certificate
 - The above documents will give the scope of powers of the co. in dealing with its business.

Ultra vires rule: A co. is bound by acts of its servants if only they were or are done within the scope of their authority – express or implied – as under the **memo** and **articles of association**.

For cheques: Normally banker should get a **mandate from the co. indicating the names and signatures of those who are authorized to draw cheques on co a/c** The bank must refer to the memo, and articles of ass. for clarification whether such mandate is itself **intra** or **ultra vires**

Since these are **open documents** everybody who deals with a co. is presumed to have notice of them

[Vide: **Mohony v. Liquidator of East Holyford mining Co.** (1875)

L.R. 7 H.L. 869, at p. 893 per Lord Hatherly]

The banker need go no further than studying the documents.

Resolution of Board of Directors authorizing signing of cheques should be demanded by the banker on opening a chequing a/c

- All along in the course of maintaining an a/c for a trading co. the banker must be careful to act strictly in accordance with the terms of authority or mandate as communicated to him.

- (3) **Borrowing on Overdraft:** to be done in accordance with **memo** and **articles of association**, or else, - ultra vires rule – and bank could lose its money except if it could sue the persons who took the money personally – difficult in view of the law of agency: where a contract has been expressly made on behalf of another, agent not liable on it personally nor can he enforce it personally for his own benefit.

OBLIGATIONS AND OPERATION OF ACCOUNTS OF ADVOCATES

DURATION AND DETERMINATION OF THE ACCOUNT

- (1) The banking contract continues until terminated by either the customer or the bank or by operation of the law.
- (2) Termination of the relationship may take place under any of the following factors:- - Chorley p. 257
 - (a) Mutual agreement
 - (b) Proper notice by one party to the other
 - (c) Death of the customer
 - (d) Mental disorder of the customer
 - (e) Bankruptcy or winding up of either party
- (3) Ad (a) Mutual agreement:
- (4) Ad (b) Notice to terminate:
 - by **customer:** The customer may terminate the relationship any time provided he communicates his intention to do so to the bank. He can give any reason.
 - With a current a/c it appears the customer need give no notice since he can recover the amount due to him on demand.
 - **By banker:** The bank must give reasonable notice before closing the account. The bank is duty bound to give reasonable notice. Joachimson v. Swiss Bank Corporation (A.C.) (1921)

All E.R. 92

- The banker must not suddenly close the a/c of any customer without giving reasonable notice.

Reason: The customer might have issued cheques which had no time to reach the clearing house and reach the paying bank.

- If a/c closed without reasonable notice and a cheque is dishonoured the banker would be held liable for damages for loss of credit to the customer.

After closure of the a/c any cheques should be returned. Any credit cheques should be credited in a suspense a/c pending the advice of the owner of the money suspense a/c to be kept till ex-customer is informed and comes to collect it.

- (5) Ad(c) Death of the customer (Natural person) Death of a customer terminates the authority the customers gave to the bank to operate his a/c.

Once the bank gets notice of death of the customer it must stop the a/c. Under s. 75 (2) of B.E.A. Cap. 215 – notice of death – revokes authority to pay cheques.

N.B. the a/c is stopped not closed.

The bank will keep the amount in the a/c for any person entitled to receive any balance outstanding to the credit of the customer's a/c.

Once the balance has been paid – account is closed.

- (6) Ad(d) Mental Disorder of customer

- Mental disorder renders the customer incapable to contract. But it is often very difficult to decide whether a person is so mentally disabled as to be deprived of contractual capacity.
- As such the bank should not pay when the customer is insane. In lucid periods however, the bank must pay. It is wise for banker to regard customer as sane – avoid wrongful dishonour
- If there is an appointed legal guardian or trustee, the bank may safely pay such appointee for the benefit of the mental lunatic.

- (7) Ad(e) **Bankruptcy:**

Where the bank learns of the bankruptcy of the customer it must stop the a/c and keep the balance if any. Note: after exercising its set off for the trustee in bankruptcy. Once the balance is given to the trustee in bankruptcy the a/c is closed.

Bankruptcy of the bank: relationship terminates – customer as creditor will get whatever is available -

- In the case of a limited co. the bank must stop the a/c as soon as it gets notice of voluntary liquidation or winding up order.

Termination under operation of the law

- Where a garnishee order has been served on the bank, or any other court order affecting the a/c – a/c to be stopped.-
- Where there is notice of an assignment of the balance in the a/c to a third party – stop payment – bank becomes trustee of the assignee. As against the customer the a/c is stopped and indeed closed.

Suspension of a/c

- Death of trustee – suspend – pending appointment of new trustee
- Bankruptcy of trustee - suspend
- mental incapacity – suspend

Withdrawal of balance in trust a/c – close a/c.**CRDB V. DAMAS JOSEPH MALLYA [200..]TLR**

A cheque worth T.Shs 48,835,000/= , drawn on NBC Samora Branch, Dar es Salaam, in favour of the defendant was deposited in the defendant's personal account at CRDB Dodoma Branch. After observing the value date procedure, i.e., upon expiry of 14 days from the day the cheque was deposited, the defendant was allowed by the plaintiff to draw. Within a span of 12 days the defendant had withdrawn a total of T.Shs. 47 million from the account. Out of the money withdrawn T.Shs. 8 million was deposited in an account of a company in which the defendant was director.

After these withdrawals it was discovered that the relevant cheque which had been sent by CRDB Dodoma Branch, a collecting bank, to the paying bank for payment had disappeared. The plaintiff bank turned to the defendant for return of the money or assistance to trace the drawer. When the defendant proved to be uncooperative, since he had four accounts in the same bank branch, the plaintiff bank decided to combine the accounts and therefore was able to recover T.Shs. 10,799,700/= out of the T.Shs. 47 million leaving a balance of T.Shs. 36,200,300/= the subject matter of this case.

The court considered various issues including whether and under what circumstances money paid under a mistake of fact is recoverable and whether the bank was right to combine the accounts of the defendant.

- Held:**
- (i) The general principle underlying the requirement that money paid by mistake of fact must be refunded is that the law should not countenance unjust enrichment; the law should not permit a person to retain a benefit unjustly derived from the other;
 - (v) In this case the mistake is as to a matter of fact in that the collecting banker assumed that the cheque had in fact been cleared because as per the obtaining value-date procedure, fourteen days had elapsed without the cheque being dishonoured or without receipt of any kind of communication which would otherwise affect its payment;
 - (vi) Once there is payment by mistake the court should be concerned with who in the circumstances is a holder of unjust riches and who holds the card in the blame;
 - (vii) Thus, once there is payment by mistake it should be left to the court depending on the facts of a particular case to decide on who should not be allowed to have unjust enrichment to the extent, for example, that in a fitting situation the payer can proceed against both the payee and the drawer at the same time, the payee being a necessary party;
 - (viii) Since the defendant made it impossible for plaintiff to get a duplicate cheque by being totally indifferent and uncooperative, justice dictates that the defendant should not escape liability;
 - (ix) In the circumstances of the case, i.e., his role in the whole transaction, the defendant is liable to refund the sum mistakenly paid out to him;
 - (x) While the general principle of combination of accounts or set-off would not apply in this case because technically the owners of the two accounts are two different entities, yet the bank has a right to trace the proceeds of the mistaken payment deposited into other accounts operated by the same customer even if under the veil of a company, provided the said sum is not yet withdrawn;
 - (xi) Although legally the customer is not owner of the account which holds part of the proceeds mistakenly paid out, where a customer is mistakenly paid by a banker in a situation where the customer is liable to refund the sum so mistakenly paid, the banker has a right to trace the proceeds of the mistaken payment deposited (whether by design or otherwise) into other accounts operated by the customer even if under the veil of a company provided the said sum is not yet withdrawn;
 - (xii) The bank was constituted holder for value of the lost cheque after it was deposited and subsequently, after observing the value-date procedure, the bank allowed the payee to withdraw.

Judgment for plaintiff.

Cases referred to:

1. Nhangwa v. Simon Chamlulu, (PC) Civil Appeal No. 87 of 1993 (Dodoma Registry, unreported)
2. CRDB Bank Ltd. v. Calist Silayo t/a Seleka Investment, Civil Case No. 5/98, (HC) Moshi Registry, (unreported)
3. Barclays Bank Plc v. Bank of England [1985] 1 All E.R. 385
4. NBC v. Perma Shoe Company [1988] T.L.R. 224
5. National Westminster Bank Ltd. v. Barclays Bank International Ltd and Another [1975] 1 Q.B. 654
6. Yahaya S. Makoluma v. NBC Holding Corporation Ltd, Civil Appeal No. 44/97