Law of Banking, Negotiable Instrument and Insurance

INTRODUCTION

The Law of Banking, Negotiable Instruments and Insurance is **a vast area of Commercial Law governing various commercial transactions** involving banks and their activities, negotiable instruments such as checks, shares or stocks and warehouse goods deposit certificates and insurance companies' and their activities.

A bank or banker is a business organization or a person engaged in the business of accepting money, valuable things and documents on deposit, lending the money it accepted on deposit to others, depositing and managing securities, buying and selling foreign exchange and gold and silver bullions and discounting commercial instruments and transferable securities having a future maturity date.

The Law of Banking is a special area of Commercial Law that **incorporates rules dealing** with;

- the definition of banks and banking transactions
- the specific requirements for the establishment and operation of banking business
- the various types of banks, i.e., commercial banks and central or national banks and their functions
- the powers and duties of central or national banks
- the various types of banking transactions or operations such as deposit of funds, bank transfers, deposit and management of securities, lending deposit of valuable things and documents, discount of commercial instruments and securities
- the rights and duties of banks and their customers

Negotiable Instruments are documents or papers incorporating or containing various types of rights which are transferred by endorsement and delivery or by mere delivery of the document. The Ethiopian Commercial Code recognizes **three types of documents** as **negotiable instruments**, i.e., **commercial instruments** /bills of exchange, promissory notes, checks, travelers' checks/, securities / **shares or stocks, bonds**/ and **documents of title to goods** / bills of lading and other types of way bills, warehouse goods' deposit certificates./

The Law of Negotiable Instruments is a branch of commercial law **dealing with**;

- the definition and types of negotiable instruments
- the formal requirements for the issuance and circulation of valid negotiable instruments
- the mode of transfer of negotiable instruments
- the definition, form and effect of endorsements
- the definition, form and effects of acceptance, acceptance for honor and payment or acceptance by intervention of negotiable instruments
- the rights and duties of the parties to negotiable instruments
- the performance of obligations arising out of negotiable instruments
- the remedies available to holders of negotiable instruments in cases of non performance

Insurance may be defined as an economic device by which a possible but uncertain risk of suffering a financial or economic loss resulting from loss or damage to property, incurring civil liability, illness or accident or death of the insured person is transferred from the person bearing it to another person, called the insurer, for consideration. It may also be defined as a

contract whereby one person, called the insurer, agrees to pay compensation or the agreed amount of money to another, called the insured or the beneficiary, against payment of a certain amount of money, called premium, where the insured property is lost or damaged, or where the insured liability is incurred or where the insured person falls ill or sustains bodily injury or dies.

Insurance Law is a branch of commercial law that **deals with**;

- the definition and types of insurance
- the requirements for the formation of a valid contract of insurance
- the requirements for the establishment and operation of an insurance business
- the basic principles governing insurance contracts
- the rights and duties of the parties to the contract

The material heavily depends on the Commercial Code of Ethiopia, which is the main law governing these areas. There are other legislations as indicated in the table below.

Laws and Reports

1. National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008, Federal Negarit Gazeta, Year 14, No. 50, Addis Ababa, 11th August 2008.
2. Banking Business Proclamation No. 592/2008, Federal Negarit Gazeta, Year 14, No. 57, Addis Ababa, 25th August 2008.
3. Licensing and Supervision of Insurance Business Proclamation No. 86/1994, Negarit Gazeta, Year 53, No. 46, Addis Ababa, 1st Feb., 1994.
4. Micro-Financing Business Proclamation No. 626/2009, Federal Negarit Gazeta, Year 15, No. 33, Addis Ababa, 12th May 2009.

5. National Payment System Proclamation No.718/2011, Federal Negarit Gazeta, Year 17, No 84, Addis Ababa, 18th July, 2011.
6. Supervision of Banking Business Directives of the National Bank of Ethiopia: SBB/1/1994 up to SBB/56/2013.
7. Supervision of Insurance Business Directives of the National Bank of Ethiopia: SIB/1/1994 up to SIB/34/2012.
8. Micro-finance Institutions Directives of the National Bank of Ethiopia: MFI/1/1996 up to MFI/25/2013.
9. Annual Reports of the National Bank of Ethiopia for 2011/12 (2004 Eth. F. Y) and preceding fiscal years, with focus on the Governors' Notes and Part IV on Monetary and Financial Development.

All the above laws and reports are available from website of the National Bank of Ethiopia. NBE report can be supplied to u electronically

Chapter one
Law of banking

Definition

- The term **bank** refers to an **institution** that deals in money and its substitutes and provides other financial services. Banks accept deposits, make loans, and derive a profit from the difference in the interest rates paid and charged respectively (**Major function of Banks**).
- Some banks also have the power to create money.
- The principal **types** of banking in the modern industrial world are commercial banking and central banking. A **commercial banker** is a dealer in money and in substitutes for money, such as checks or bills of exchange.

- The **basis** of the banking business is: borrowing from individuals, firms, and occasionally governments—i.e., receiving "deposits" from them.
- The banker makes profit by borrowing at one rate of interest and lending at a higher rate and by charging commissions for services rendered.
- A bank must always have cash balances on hand in order to pay its depositors upon demand or when the amounts credited to them become due. It must also keep a proportion of its assets in forms that can readily be converted into cash /**Liquidity**.
- Another type of banking is carried on by **central banks**, bankers to governments and "**lenders of last resort**" to commercial banks and other financial institutions.
- They are often responsible for formulating and implementing monetary and credit policies, usually in cooperation with the government.
- Some institutions often called banks, such as finance companies, savings banks, investment banks, trust companies, and home-loan banks, do not perform the banking functions described above and are best classified as **financial intermediaries**.
- Their economic function is that of channeling savings from private individuals into the hands of those who will use them, in the form of loans for building purposes or for the purchase of capital assets.

Development of banking transaction

A. International experience

- Banking is little known prior to 13th century.
- Banks have come into existence as a result of **commerce in Babylon**, in **Rom**e and in other cities of **Ital**y. The banking and credit services were mostly extended by **private individuals** until **institutionalized**

banks, the most ancient of which was the **Bank of Venice** of 1157, were established to serve the finance needs of governments and facilitate commerce.

- Many of earlier banks were primarily dealing with coin and gold.
- Of the earlier banks, the English banks were the most banks to develop many of the current bank services. They introduced the system of keeping valuable materials such as gold, foreign exchange, modern cheque, issued bank notes (**The first of which is issued by Scotland bank in 1661)**
- Most of the developed market countries have, however, started the **internationalization of banking with the rise of Eurocurrency and Eurobond markets in the 1960's and 70's** and furthered their reforms in the banking and insurance markets in the 1980s and thereafter. They have conducted the big and major reforms that led to the following:
  - ✓ Deregulation and internationalization of the banking and insurance markets,
  - ✓ Diversification of the banking and insurance products,
  - ✓ Increase of competition among the banks and insurers,
  - ✓ Development of electronic services,
  - ✓ Development of institutions that can combine the provision and marketing of

B. Ethiopian experience

- Ethiopia felt the need for having formal banking only after establishment of **Addis Ababa as its permanent capital in 1886**.
- It started it by establishing the **Bank of Abyssinia** on February 16 1906 in partnership with the British **owned** National Bank of Egypt after a 50-years-concession agreement was signed in 1905 between Emperor Minelik II and Mr. M. **Gillivray** (who represented the National Bank of Egypt). The bank has initial capital of 1 million shilling. It latter opened its branches in Harar, Dembi Dollo, Dire Dawa, Gore, Gambella and transit office in Djibouti.

- It established this bank with powers of **issuing bank notes**, selling shares and monitoring the legal tender as a central bank.
- It also required the deposit of all government and public funds in the bank and the making of all payments by the bank to be in cheque.
- The bank was, however, **liquidated for replacement by the Bank of Ethiopia** in 1931 (750,000 **pound sterling capital)** after necessary compensation was paid off.
- **With the Italian occupation (1936-1941),** the operation of the Bank of Ethiopia came to a halt, but a number of Italian financial institutions were working in the country. These were *Banco Di Roma*, *Banco Di Napoli* and *Banco Nazionale del Lavora* and *Braclays* bank did operate in Ethiopia b/n 1942-1943.
- With the **departure of the Italians** and the **restoration** of Emperor Haile Selassie's government, the State Bank of Ethiopia was established in 1943 with a capital of 1 million Maria Theresa Dollars by a charter published as General Notice No. 18/1943 (E.C).
- In 1945 the Agricultural Bank was established but was replaced by the Development Bank of Ethiopia in 1951, which changed into the **Agricultural and Industrial Development Bank** in 1970.
- **In 1946 Banque Del Indochine** was opened and functioned until 1963.
- In 1963, the Imperial Savings and Home Ownership Public Association (ISHOPA) and the Investment Bank of Ethiopia were founded. The later was renamed Ethiopian Development Corporation S.C. in 1965. In the same year, the Savings and Mortgage Company of Ethiopia S.C. was also founded.
- In 1963, the **State Bank of Ethiopia** split into the National Bank of Ethiopia and the Commercial Bank of Ethiopia S.C. with the purpose of segregating the functions of central banking from those of commercial banking. The new banks started operation in 1964

- The first privately owned company in banking business was the Addis Ababa Bank S.C., established in 1964. 51% of the shares of the bank were owned by Ethiopian shareholders, 9% by foreigners living in Ethiopia and 40% by the National and Grindlays Bank of London.
- Thus, until the end of 1974, there were state owned, foreign owned and Ethiopian owned banks in Ethiopia
- Following the 1974 Revolution, on January 1, 1975 all private banks and 13 insurance companies were nationalized and along with state owned banks, placed under the coordination, supervision and control of the National Bank of Ethiopia. The three private banks, Banco Di Roman, Banco Di Napoli and the Addis Ababa Bank S.C. were merged to form "Addis Bank." Eventually in 1980 this bank was itself merged with the Commercial Bank of Ethiopia S.C. to form the "Commercial Bank of Ethiopia," thereby creating a monopoly of commercial banking services in Ethiopia.
- Thus, from 1975 to 1994 there were **four state owned banks** and **one state owned insurance company**, i.e., the National Bank of Ethiopia (The Central Bank), the Commercial Bank of Ethiopia, the Housing and Savings Bank, the Development Bank of Ethiopia and the Ethiopian Insurance Corporation.
- With the demise of derg regime, a new economic policy was placed which changed economic role of government. That is free market economy was introduced.

Economic significance of banks

- Banking is important for **economic development**. It can enhance saving/b/c of interest/, can mobilize resources, can serve as financial intermediaries, can enhance investment, can increase production, and etc.

Types of Bank

A. National/central Bank

- They are primarily mandated to regulate financial institutions. They have different names in different jurisdictions. Bank of England in England, U.S federal reserve system in USA, bank of Japan in Japan and etc
- The major function of them is to **maintain monetary policy objectives**. Hence, the central banks have often contracted and expanded the **money supply through** the reserving, interest, premium and foreign exchange rules to control inflation, maintain price stability and balance of payments equilibrium, and achieve the goals of economic efficiency, growth and employment.
- Central banks are operated for the public welfare and not for maximum profit. The modern central bank has had a long evolution, dating back to the establishment of the Bank of Sweden in 1668.
- **Central banks typically alter/adjust the volume of their assets by six ways:**

1. "Open-market operations" consist mainly of purchases and sales of government securities or other eligible paper, but operations in bankers' acceptances and in certain other types of paper often are permissible. Open-market operations are an effective instrument of monetary regulation only in countries with well-developed security markets.
2. Loans to banks, generally called "**discounts" or "rediscounts**," are short-term advances against **commercial paper or government securities** to enable banks to meet seasonal or other special temporary needs either for loan-able funds or for cash reserves to replace reserves lost because of shrinkage in deposits.
3. Direct government borrowing from central banks.
4. Central banks buy and sell foreign exchange to stabilize the international value of their own currency. The central banks of major industrial nations engage in the so-called "currency swaps," in which

they lend one another their own currencies in order to facilitate their activities in stabilizing their exchange rates.

5. Many central banks have the authority to fix and to vary, within limits, the minimum cash reserves that banks must hold against their deposit liabilities.

The National Bank of Ethiopia

- It was created by order No 30/1963 and reconstituted by the Monetary and Banking Proclamation No 83/1994 as **an autonomous organ**, which is engaged in the provision of regular banking services to the government and other banks and insurance companies'.
- The **main purpose** of the bank is to foster **monetary stability financial system** and such other credit and exchange conditions as are conducive to the balanced growth of the economy of Ethiopia. / Art 6/
- The bank will have the following powers and duties that will help it to achieve its purpose, /Art 7/
  - ✓ Mint coin, print and issue legal tender currency.
  - ✓ Regulate the supply and availability of money and fix the minimum and maximum rates of interest that banks and other financial institutions may charge for different types of loans, advances and other credits and pay on various classes of deposits. (Art 7 and Art 30).
  - ✓ Implement exchange rate policy, allocate foreign exchange, manage and administer the international reserve fund of Ethiopia. This reserve fund consists of gold, silver, foreign exchange and securities, which are used to pay for imports into the country and pay foreign international debts and other commitments (Art 50).
  - ✓ License, supervise and regulate banks, insurance companies and other financial institutions such as savings and credit associations/co-operatives and postal savings.

- ✓ Set limits on gold and foreign exchange assets that banks and other financial institutions, which are authorized to deal in foreign exchange, can hold in deposits (Art 39).
- ✓ Set limits on the net foreign exchange position and on the terms and the amount of external indebtedness of banks and other financial institutions.
- ✓ Make short and long term refinancing facilities available to banks and other financial institutions.
- ✓ Accept deposits of any type from foreign sources.
- ✓ Act as banker, fiscal agent and financial advisor to the government/Art 24, 25/.
- ✓ Promote and encourage the dissemination of banking and insurance services throughout the country.
- ✓ Prepare periodic economic studies together with forecasts of the balance of payment, money supply, prices and other statistical indicators of the Ethiopian economy used for analysis and for the formulation and determination by the bank of monetary, savings and exchange policies.

Reading assignment

- ❖ **Vision, mission and strategic Objectives of NBE**

Commercial Bank of Ethiopia

- Commercial banks are banks with the power to **make loans**.
- Banks are required to maintain certain amount of money as a reserve.
- The name commercial bank was first used to indicate that the loans extended were short-term loans to businesses, though loans later were extended to consumers, governments, and other non-business institutions as well.
- In general, the assets of commercial banks tend to be liquid and carry less risk than the assets held by other financial intermediaries.
- The Commercial Bank of Ethiopia and all the privately owned banks in Ethiopia fall under this category as they are primarily engaged in receiving money on deposit and providing loans to the public.

Savings Banks

- A savings bank is a financial institution that **gathers savings** and that pay interest or dividends to savers
- The savings deposit departments of commercial banks, mutual savings banks or trustee savings banks (banks without capital stock whose earnings accrue solely to the savers), savings and loan associations, credit unions, postal savings systems, and municipal savings banks serve this function.
- The **earliest municipal savings banks** developed out of the municipal pawnshops of Italy.
- Local savings banks were established in The Netherlands through the efforts of a philanthropic/charitable or humanitarian/ society that was founded in 1783, the first bank opening there in 1817. During the same time, private savings banks were developing in Germany, the first being founded in Hamburg in 1778.
- The first British savings bank was founded in 1810 as a Savings and Friendly Society by a pastor of a poor parish/rural community/; it proved to be the forerunner of the trustee savings bank.

- The origin of savings banking in the United States was similar; the first banks were nonprofit institutions founded in the early 1800s for charitable purposes.
- With the rise of other institutions performing the same function, mutual savings banks remained concentrated in the northeastern United States.
- This type of specialized banking service is not yet introduced in Ethiopia and hence there is no bank, which may be considered as a savings bank. However, the commercial banks accept savings as one form of money deposit.

Investment Banks

- Investment bank is a firm that originates, underwrites/endorse/fund/guarantee/, and distributes **new security issues** of corporations and government agencies.
- The investment-banking house operates by purchasing all of the new security issue from a corporation at one price and selling the issue in smaller units to the investing public at a price sufficiently high to cover expenses of sale and leave a profit. The major responsibility for setting the public offering price rests on the investment bank because it is in close contact with the market, is familiar with current interest rates and yields, and is best able to judge the probable demand for the issue in question.

Development Banks

- It refers to a national or regional financial institution designed to provide medium- and long-term capital for productive investment, often accompanied by technical assistance, in less-developed areas.
- The number of development banks has increased rapidly since the 1950s; they have been encouraged by the International Bank for Reconstruction and Development (IBRD) and its affiliates.
- The large regional development banks include the Inter-American Development Bank, established in 1959; the Asian Development Bank,

which began operations in 1966; and the African Development Bank, established in 1964.

- They may **make loans for specific national or regional projects to private or public bodies** or may operate in conjunction with other financial institutions. One of the main activities of development banks has been the recognition and promotion of private investment opportunities. Although the efforts of the majority of development banks are directed toward the industrial sector, some are also concerned with agriculture.
- The Development Bank of Ethiopia is established with the purpose of providing long-term loans to **agricultural** and **industrial** undertakings, which are considered crucial in the development of the economy. It was intended to serve as the major financer for the various co-operatives and government owned farms and factories.

1) Vision of the Bank

To be one of the strongest and most reputable central banks in Africa

2) Mission of the Bank

To maintain price and exchange rate stability, to foster a sound financial system and undertake such other functions as are conducive to the economic growth of Ethiopia.

3) Values of the Bank

***A)* Core value**

- ✓ Promoting financial and monetary discipline /monetary policy related value

***B)* Individual Values**

- ✓ Integrity
- ✓ Neatness and good appearance
- ✓ Punctuality

- ✓ Team work spirit

C) Operational Values

- ✓ Commitment to Excellence in Service
- ✓ Confidentiality
- ✓ Continuous Improvement
- ✓ Transparency
- ✓ Accountability

D) Organizational Strategic Values

- Pursuit of Excellence and Professionalism

4) Strategic Goals

Goal 1: Carry out extensive and sound institutional transformation tasks.

Goal 2: Maintain price and exchange rate stability. (To avoid balance of payment & Inflation problem)

Goal 3: Maintain adequate international reserves.

Goal 4: Improve the soundness of the financial system.

Goal 5: Play a decisive role in economic research and policy advice to the Government.

Goal 6: Create an efficient Payment System.

Goal 7: Improve the currency management of the Bank.

Islamic Banking

General Overview of Islamic Banking

- "Islamic banking refers to a system of banking activity that is consistent with the Islamic law (Sheria). It is guided by principles of Islamic economics.
- At this juncture, it is important to note that Islamic law prohibits **usury**, that is, the collection and payment of interest which is commonly known as riba in Islamic discourse.
- In addition, Islamic law prohibits investing in businesses that are considered unlawful, or harem (such as businesses that sell alcohol or dork or business that produce media such as gossip columns or pornography which are contrary to Islamic values. In line with this, in the late 20th century a number of Islamic banks were established.

The Meaning of Riba

- The word **riba** literally means increase or excess. It covers both usury and interest. In Quranic verses it essentially refers to the practice of lending money for predetermined rate of return or interest.

- Muslim scholars have accepted the word riba to mean any fixed or guaranteed interest payment on cash advance or on deposits.

History of Islamic Banking

- The history of interest free banking could be divided into two parts. First, when it still remained an idea; second when it became a reality by private initiative in some countries and by law in others.

Interest Free Banking as an Idea

- Interest free banking seems to be of very recent origin especially in our country.
- But the earliest references to the reorganization of banking on the basis of profit sharing were written by Anwar Qureshi (1946), Naiem Siddiq (1948) and Mohamed Ahmed (1952). In the last forties it was followed by more elaborate exposition by Mawdudi in (1950).
- They have all recognized the need of commercial banks that use in profit and lose sharing mechanism and have **proposed a banking system based on the concept of mudarabh (profit and loss sharing)**.
- In the next two decades **interest free banking** attracted more attention because of the emergence of young Muslim economists. The first such works emerged in that of Muhammed vzair (1955). Another set of works emerged in the late sixties and early seventies, Abdullah al-araby (1967), Nejatullah Siddigi (1961.1969), Al Najjar (1971) and Baqir al-sadr (1961, 1974) were the main contributors. (**Private contributors**)
- The early seventies saw the **institutional involvement that** is conference of the finance Ministers of the Islamic countries held in Karachi in 1970, the Egyptian study in 1972, the first international conference on Islamic Economics in Mecca in 1976 etc.

The Coming in to Being of Interest Free Bank

- “The institutional and governmental involvement led to the application of theory to practice and resulted in the establishing of the first interest free banks”.
- The Islamic development bank, an inter-governmental bank established in (1975) was born of this process.
- The first private interest free bank is the Dubai Islamic bank; it was set up in 1975. In ten years, since the establishment of the first private commercial bank in Dubai, more than 50 interest free banks have come into being. In most countries the establishment of interest free banking had been by private; in Iran and Pakistan, however, it was undertaken by government initiative and covered all banks in the country.

Principles of Islamic Banking

- “The Islamic beliefs prevent the believer from dealing that involves usury or interest (riba).
- Is now operating in more than 45 countries of the world with an estimated 70 billion US dollar
- The guiding principle here is that of Quaran which presupposes two basic things. One is prohibition of interest and the other is sharing of profit and loss with the lender.
- The assumption behind is making money from money is prohibited as money is a medium of exchange. Again **uncertainty is prohibited** and investing in unlawful things such as alcohol is also prohibited.

Banks and the Money Market (Overview)

Commercial Banks

- **Commercial banks** are at the centre of most money markets, as both suppliers and users of funds, and in many markets, a few large commercial banks serve also as intermediaries.

- Money market refers to dealers in money.

Central Banks

- The reserves of the commercial banks, which are continually being redistributed through the facilities of the money market, are in fact mainly deposit balances that these commercial banks have on the books of the central bank or notes issued by the central bank, which the commercial banks keep in their own vaults

Responsibilities of Central Banks

- The **principles of central banking** grew up in response to the recurrent British financial crises of the 19th century and were later adopted in other countries. Modern market economies are subject to frequent fluctuations in output and employment. Although the causes of these fluctuations are various, there is general agreement that the ability of banks to create new money may exacerbate them.
- The first concern of a central bank is the **maintenance of a soundly based commercial banking structure**.
- Most governments and central banks have become intimately associated in the formulation of policy.

Relations with Commercial Banks

- One source of economic instability is the supply of money.
- The willingness of a central bank to offer support to the commercial banks and other financial institutions in time of crisis was greatly encouraged by the gradual disappearance of weaker institutions and a general improvement in bank management.
- The dangers of excessive lending came to be more fully appreciated, and the banks also became more experienced in the **evaluation of risks**
- In the United States for instance, the Federal Reserve System examines the books of the commercial banks and carries on a range of frankly educational activities.

- In other countries, such as India and Pakistan, central banks have also set up departments to maintain a regular scrutiny of commercial bank operations.
- These works are primarily intended to supervise cash flow problem of banks specifically commercial banks.
- In a very serious condition, central bank serves as **lender of last resort** to commercial banks.

The Central Bank and the National Economy

Relations with Other Countries

- Since no modern economy is self-contained, central banks must give considerable attention to trading and financial relationships with other countries.
- If goods are bought abroad, there is a demand for foreign currency to pay for them. Alternatively, if goods are sold abroad, foreign currency is acquired that the seller ordinarily wishes to convert into the home currency. These two sets of transactions usually pass through the banking system, but there is no necessary reason why, over the short period, they should balance. Unless the relationship between two are properly managed, it may result in “balance of payment problem”.

Economic Fluctuations

- As noted earlier, monetary influences may be an important contributory factor in **economic fluctuations**.
- An expansion in bank credit makes possible, if it does not cause, the relative **overexpansion of investment** activity characteristic of a boom.
- To avoid potential risks, central banks are required to regulate on amount of money to be given by loan and other factors.
- Hence banks play a crucial role in regulating the economy.

Supervision and Promotion of Banking Services

- Another responsibility of the central bank is to ensure that banking services are adequately supplied to all members of the community that need them
- In developing countries, central banks may encourage the establishment and growth of specialist institutions such as **savings institutions** and **agricultural credit** or **industrial finance corporations**.

Banks and Banking Transactions in Ethiopia

- Book IV Title III of the Commercial Code of Ethiopia which deals with banking transactions fails to provide a definition of a bank and banking transactions though the latter may be gathered from the various sections governing the various types of transactions undertaken by banks. Therefore, we have to refer to other laws to define and determine what banks and banking transactions are under the Ethiopian legal system.
- According to Art 2 (12) of the Monetary and Banking Proclamation No 83/1994, **banking business means** any operation involving receiving money on deposit, lending money, receiving commercial instruments on deposit, accepting, negotiating/ transferring, discounting commercial instruments and other evidences of debt, and buying and selling of gold and silver notes and foreign exchange. (**Refer amended proc 592/2008)**
- Similarly, Art 2 (2) of the Licensing and Supervision of Banking Business Proclamation No 84/1994 defines banking business as:

  "Any business involving acceptance of money on deposit, using such funds or deposits, in whole or in part, for loans or investments on the account of and at the risk of the person undertaking the business, purchasing, selling and deposit of negotiable instruments (shares, bonds and other securities/ and

checks, bills and notes, and buying and selling of gold and silver bullions and foreign exchange)".

- On the other hand, the **term bank is defined**, under Art 2(1) and (4) of the same proclamation, as **a share company** whose **capital is wholly owned by Ethiopian nationals** and/or **business organizations wholly owned by Ethiopian** nationals and which **is registered under Ethiopian laws** and which has **its head office in Ethiopia** and **licensed** to undertake banking business by the **national bank of Ethiopia**.
- The definition of a bank and this provision exclusively reserve the banking sector to Ethiopian nationals or business organizations wholly owned by Ethiopian nationals mainly on the ground of protection of domestic banks which are at an early stage of development, at least until they develop their financial and manpower capabilities, to be able to compete with foreign banks which have enormous financial strength, experience, technology and knowhow.

Role of Micro Finance Institutions

- According to the preamble of Proclamation No. 40/1996, the monetary and banking laws in force **do not provide for micro financing institutions** catering for the credit needs of peasant farmers and others engaged in small scale production and service activities.
- So it has become necessary to legislate on the licensing and supervision of the business of micro financing institutions.
- Although the development of microfinance institutions in Ethiopia started very recently, the industry has shown a remarkable growth in terms of outreach particularly in number of clients. Since the issuance of Proclamation 40/1996, which provides the establishment of microfinance institutions, **sixteen microfinance institutions (MFIs**) have been legally registered by the National Bank of Ethiopia (NBE)

and started delivering services, and two more applications by new MFIs are currently being processed. **By the way according to NBE report their number increased to 33 in 2011/2012 G.C**

- MFI are primarily established to finance small scale projects and local poor communities.

The Regulatory Framework for the Microfinance Industry and Micro and Small Enterprises

- The delivery of efficient and effective microfinance services to the poor required conducive **macroeconomic policies** and the **establishment and enforcement of legal and regulatory frameworks** of a country.
- An effective financial system provides the foundation for a successful poverty alleviation program. However, regulations in the microfinance industry do not only mean government regulations; it also involves **self-regulations** and code of conducts introduced by networks or associations.
- Regulatory frameworks governing the microfinance industry should ensure that the MFI has a sound portfolio (Collection) performance; low delinquency or default rate; high diversification to reduce the risk of specializing in the delivery of one loan product; ensure the safety of deposits through equity capital; ensure lower levels of liquidity risk; provide regular and high quality financial information and reduce the risk arising from dependence on subsidy and influence of donor.

- The Monetary and Banking Proclamation No. 83/1994 empowered the National Bank of Ethiopia (NBE **which was amended by proclamation 591/2008**) to license, supervise and regulate financial institutions such as banks, insurance companies, microfinance institutions and savings and credit cooperatives.

- Microfinance industry Proclamation No. 40/1996 (**As amended by 626/2009 Proclamation**), which aims to provide for the licensing and supervision of the business of micro financing clearly indicates the requirements for licensing microfinance institutions by empowering the National Bank of Ethiopia to license and supervise them. According to article 4 of the Proclamation, any institution that needs to engage in microfinance activity should fulfill the following: **requirements for establishing MFI**
  i. Obtain license from the National Bank of Ethiopia;
  ii. Formed as a company governed by the commercial code of 1960 (a share company owned fully by Ethiopian nationals and having its head office in Ethiopia);
  iii. Deposit the minimum capital required, i.e., 200,000 Birr in a bank; (it has now increased to ten million)
  iv. The directors and other officers meet requirements set by the bank.
- Furthermore, as to the **purpose and duty** of macro finance institutions, article 3 of the same proclamation provides:
  1. The purpose of micro financing institutions is granting credit, in cash or in kind, the maximum amount of which shall be determined by the bank.
  2. subject to conditions set under this Proclamation, a micro finance institution may carry out some or all of the following activities:
     a. accepting savings as well as demand and time deposits;
     b. drawing and accepting drafts payable within Ethiopia;
     c. borrowing money for its business purpose against the security of its assets or otherwise;
     d. purchasing such income generating financial instruments as treasury bills;

e. acquiring, maintaining and transferring of any moveable and immovable property including premises for carrying out its business;
f. providing counseling services to its clients;
g. encouraging income generating projects for urban and rural micro-operators;
h. rendering managerial, marketing, technical and administrative advice to borrowers and assisting them to obtain services in those fields;
i. managing funds for micro financing business; and
j. Engaging in other activities customarily undertaken by micro financing institutions.

Review Questions

1. **Briefly discuss the development of banking systems in the world and particularly in Ethiopia.**
2. Verify the different types of banks.
3. Discuss the Economic Significance of Banks.
4. Discuss the role of National Bank, Commercial Banks, Saving Banks, Investment Banks, Development Banks and Islamic Banks taking into consideration their specialization.
5. List down the vision, mission and goals of the National Bank of Ethiopia.
6. Discuss banking transactions in Ethiopia.
7. Under the Ethiopian Banking system there is **Nationality Test**; could this frustrate Ethiopian accession to WTO.
8. Pin point the role of micro finance Institutions in the realization of development.
9. Clearly show the regulatory framework for the microfinance industry and Small Enterprises

Chapter II

MAJOR BANKING TRANSACTIONS

2.1 Deposit of Funds (Definition)

- A **deposit of funds** is a **contract** whereby a person agrees to deliver and transfer the ownership of specified amount of money to a bank which agrees to repay them under the conditions agreed up-on in the contract or on the demand of the depositor.

Rights and duties of parties

- The bank, as the owner of money deposited, **has right to use** it in respect of its professional activities, i.e. the bank may lend it to its customers or invest it in areas which are allowed by the national bank **/Art 896/**.
- The contract of deposit of funds is almost identical to contracts of loan of money or other fungible things under Art **2471** of the Civil Code of Ethiopia in which the borrower becomes the owner of the money or fungible he borrowed and has the right to dispose of in any manner he wishes.
- However, where the deposit relates to "coins and other individual monetary tokens" and where there has been an agreement that they shall be refunded to the depositor in kind, the bank does not acquire the right of ownership and hence cannot dispose of such items. /Art 896 second proviso/. This rule applies; it seems, not to **coins and paper money that are a legal tender currency at the time of**

deposit unless they bear special signs which are of historic or sentimental importance to the depositor. It also applies to currencies or coins used previously in the history of a country and which are considered by the owner/depositor of historic importance.

Kinds of Accounts

- The **contract of deposit** of funds results in the **opening of an account** in the name of the depositor by the bank in which the latter enters all transactions made with the depositor (897).
- The **type of account opened** may either be a **current account** in which the depositor has the right to dispose of the deposit at sight or on demand. As the **repayment** may be demanded at any time, this type of deposit does not bear interest. / Art 897, 898. /
- The **other account** is a **saving account**, which is interest bearing and the right of the depositor to demand repayment may be limited. The insured may be prevented from withdrawing an amount which is greater than a certain amount of money within a certain period or to give notice of withdrawal. /Art 897, 98. /
- This type of deposit normally bears interest at a rate agreed upon between the parties provided that it does not exceed the maximum limit determined by the National Bank. Art 897, 898 (2). Where the person has several accounts, each account shall operate independently unless the parties agree otherwise. /Art 902/
- Contract of deposit does not give a right to overdraw (Overdraft) the money unless there are special agreements to the contrary (899). But if there are otherwise agreement such as contract of loan of article 2471 it is possible.

2.2 Bank Transfers (Definition)

- This transaction represents **one mode of transferring** money from one account to another upon the written and signed order of the transferor, and a means of performing money obligations.

- According to Art 903(1) of the Comm. Code, a bank transfer is a transaction whereby the bank, upon the written order of the depositor /transferor, debits the account of the transfer and credits the account of another depositor/the transferee with the amount specified in the instruction or transfer order.

Q) What is the difference between bank transfer and international or local transfer?

- Bank transfer requires the existence of **two separate accounts**, whereas, international transfers and local transfers do not require accounts by the transfer and the transferee and hence are commonly used modes of transfer.
- There **are no rules governing these types of transfer**, and the rights and duties of the parties are determined by the contract concluded between the bank and the transfer.

Types of Bank Transfers

- Bank transfer as defined by Art 903(1) may be **internal** where the accounts of the transfer and the transferee are opened within the same branch or **external** where the accounts of the transfer and the transferee are opened at two different branches of the same bank Art 904.
- The transfer can instruct the bank to transfer an amount which **does not exceed the balance of his account**.

Q) What if the bank was asked to transfer the amount more than what is actually kept in an account?

- In principle, the transferor cannot order the bank the transfer of an amount which exceeds the balance without a special agreement between the transferor and the bank under which the transfer under takes to deposit the agreed amount within a period determined in advance. The transfer made pursuant to this type of agreement is considered as a **loan or overdraft provided by the bank to**

transfer. / Art 905, 908, 899, 945 of the Commercial Code & Art 2471 of the Civil Code/.

Rights and duties of parties

- The **transferee** or the beneficiary of the transfer shall acquire **the right of ownership/title/** to the money to be transferred at the time when the bank debits the account of the transfer. And the transfer **may cancel the transfer at any time before his account is debited** and before the transferee acquires ownership right to the money. However, if the transfer order is communicated to the bank by the beneficiary as agreed according to Art 907(1), the transferor loses the right to cancel the order from the time the transfer order is issued and handed over to the beneficiary. /Art 906 and Art 907(2)./

2.3 Deposit of Securities

- No definition under civil Civil code. **But it can be defined as** a contract whereby an owner or of **securities** (**shares** or **stocks**, **government bonds** and company bonds (debentures) or other right holder agrees to deposit the securities with a bank which agrees to provide safe custody and handle or manage them for consideration.
- In other words, this is a transaction by which banks keep securities in their custody and perform all functions relating to them such as the collection of yields arising from securities deposited, i.e., dividends from shares/stocks, capital repayments and interest arising from bonds and handle purchase and sale of securities in the name and on behalf of the depositor.

Rights and duties

- According to Art 912 and 914 of the commercial code, the bank which deposits securities has the duty to handle the securities deposited and to collect interest, dividends, capital repayments amortization and any other entitlements arising out of securities as soon as they can be claimed.

- It needs (the contract) needs proper handling of securities (Article 912 & 913)

Q) What is the degree of care expected?

- Regarding degree of care expected of the bank, Art 913(1) provides that the bank must ensure the custody of the securities and act in relation there to (**handling and management**) with **due care required of paid bailee**, i.e., a person to whom goods are entrusted for specific purpose.
- Hence, a paid bailee, on the other hand, is liable for loss through mere negligence and must safeguard the property and the rights arising there from by every means in his power and provide the most effective possible appliances to this end. /please compare Art 2211(3) and 2720-22-civil code. /
- Where the contract of **deposit of securities is terminated** either by the decision of the depositor, the bank has the duty to restore them to the depositor or his agent or his creditors, even where the securities are registered in the name of a third party. Securities deposited by the usufractuary may be restored to the bare owner if the latter produces evidence of the death of the former./ Art 916 and 917 of the Commercial Code/

Q) **What about deposit of wills, insurance policies and other documents?** Our law does not say anything.

2.4 Hiring of Safes

- Banks take charge of their customers' **valuables** like jewelry, negotiable securities, and documents of title to properties, will, and deposit them, as they can be conveniently stored.

Modalities of deposit

- Banks deposit their customer's values in either of the following two ways:

1. By **accepting the valuables** for safe-custody or/ banks put them separately. Handing over to the bank those valuables. Now days this

mode is almost abolished. B/c it increases liability of banks for individuals valuables.

2. By **hiring out safe deposit boxes** to their customers. Hiring out safe for valuables. Will be managed by customers. Particulars of deposit /except dangerous things/ will not be disclosed to the bank. Customer's duty is paying of rental charge. Here customer will be provided with access key along with separate identification number.

N.B

- The **customer's right to deposit anything he wants in the safe box can be restricted in the contract** based on different considerations, like the banks and other customers' security and security of the public at large. The customer is not obliged to disclose the contents of his safe box. As a matter of fact, the bank has no interest in knowing the contents of the safe box since in such a case it is less likely to be held responsible for any loss or damage to the contents of the safe box.

Q) What if safe box was hired jointly?

- In such a case the banker should get the mutual consent of all the hirers in executing any instructions or making subsequent modifications.

Q) How such contract of hire safe be terminated?

- ✓ Mutually by parties consent
- ✓ Death of an individual
- ✓ Lapse of period of contract
- ✓ Non performance of obligation such as failure to pay rent and etc /article 923/

Definition

- Under Ethiopian law, a **contract of hire of a safe** is **defined** as a contract whereby a bank agrees to place at the disposal of the hirer a

safe or a compartment of a safe for a specified period of time on payment of a rent.

Rights and duties

- The bank under this transaction has the **duty** to prepare a room where the safes are to be kept called a strong room and prepare safes for the hirer, and take the necessary measures to ensure the up keep and safe custody of safes.
- However, the bank is under no obligation **for the deterioration or damage** of the contents of the safe. A person may hire a safe in a bank to deposit valuables such as gold, silver, diamond (jewelries), important documents such as title deeds, insurance policies, wills, inventions and works of art. However, the hirer may not deposit things that are dangerous by themselves such as explosives, inflammable things, narcotic drugs, guns and legal tender currency, which is supposed to circulate, or deposited through contracts of deposit of funds and not in hired safe, as this puts the money out of beneficial use. Violation **of this prohibition is a ground for the cancellation of the contract by the bank. /Art 922/**
- In addition to **making sure that the safe and** the strong room are not endangered by fire, water or breach by unauthorized third parties, the **bank must give immediate notice of the danger to hirers** and enable them to empty the content of their safes before the risk materializes. The bank has this obligation even where the danger occurs outside working days and hours of business. However, the bank is not required to give individual notices to each hirer. The bank may notify the hirers by means such as local radio or TV stations or through public announcements. /Art 920/
- The bank has also the obligation to allow the hirer or his agent to have access to the safe by providing him with keys and identification cards during working days and of hours of business. / Art 921/

- The obligation of the hirer on the other hand is the obligation to pay the rent on time and return the keys to the safe by emptying the contents of the safe upon termination or cancellation of the contract. /Arts 919 and 923/1//

2.5 Discount (Definition)

- Discount is a **contract** whereby a bank agrees to pay to a holder of a commercial instrument or security having a future date of payment an amount which is lesser than its actual value, against the surrender of the instrument and the undertaking to repay the value of the instrument by the holder where payment is not made at the maturity of the instrument (Article 941).

Rights and duties of parties

- The bank, which discounts a commercial instrument or a security, shall acquire all the rights of the beneficiary of discount on the instrument including **the right to demand payment** from the person or persons who are liable on the instrument. In addition, where the bank receives the full value of the instrument at maturity, the obligations arising out of discount shall be extinguished.

Q) What if the bank is not successful with its claim?

- If the bank is not successful in its claim for payment at maturity, it will have **two alternative remedies, Art 944(1**).
  - ✓ It may proceed against parties liable on the instrument under Art 790 of the commercial code, or the company which issued the share or bond, or
  - ✓ It may proceed against the beneficiary of the discount on the basis of the contract of discount (Art 941(1) and 943).

N.B

- ➢ The right of the bank is limited to the amount of money it has paid to the beneficiary plus commission, interest and expenses (944(2)).

2.6 Bank Lending (Definition)

- Is the most common and the most traditional one

- Art 2471 of the Civil Code, which also applies to loans provided by banks, defines a **contract of loan of money or other** fungible things as a **contract** where by a party called the **lender**, under stakes to deliver to the other party, the **borrower**, a certain amount of money or other fungible things and to transfer to him the ownership thereof on the condition that the borrower will return to him as much of the same amount and quality.

N.B

- Contracts of loan of money or other fungible things are **not subject to special form** and may be made in any manner. However, the contract or the repayment of loan of money exceeding five hundred Birr has to be proven by producing documents such as **receipts**, **accounts**, **registers** and so on. It may also be proven by **confession** of either party as to the existence of the contract of loan or its repayment, or the **oath** taken in court by either party. Art 2472. However, where the contract of loan is concluded between a bank and its customers, the contract of loan or its repayment may be proven even by **witnesses** or **presumptions /compare Art 2020-26** of the civil code/. As we have seen in the definition of contracts of loan, loans under ordinary circumstances are given by the lender by way of delivering the agreed amount of money at once. However, under special circumstances the loan may also be given by allowing the customer of the bank to overdraw his account up to the agreed amount for purposes of conducting his business. This type of loan is given usually for traders as means of payment of their obligations. / Art 945. / An open credit or overdraft loan may be given for limited or unlimited period of time, i.e. the bank may allow the customer to over draw his account for a period of one year, for instance, and the customer is expected to have the amount put at his disposal by the bank plus interest by the end of the period. The bank has the right to cancel contracts of loan made for unlimited period at any time.

Similarly, the bank may also cancel the contract on the death, incapacity of the beneficiary, or suspension of payment even where it is not established by a judgment of a court or because of his gross negligence in the use of credit granted. /Art 946/

Q) What are the conditions to extend loan to individuals?

- ✓ Credit-worthiness of the customer by studying the business and financial position of the customer,
- ✓ Credit history
- ✓ Requiring a security or collateral in the form of mortgage or pledge.

Refer to your course on the law of security devices, particularly to;

- Art 3041-3116 of the Civil Code - mortgage of immovable and special movables
- Arts 171-193 of the Commercial Code -mortgage of business
- Art 2825 – 2863 of the civil code regarding pledge of chattels/ corporeal movable things/ Arts 2863 – 2874 of the civil code pledge of incorporeal things
- Arts 947 – 958 of the commercial code pledge of securities

2.7 Documentary Credits (Definition)

- A documentary credit is a **credit provided to persons engaged in foreign trade** particularly **importers** who need to pay the price of goods in foreign exchange. This type of credit is required because it is only banks which are allowed to handle and deal in foreign exchange and importers are required to pay the price of **goods imported** from abroad through opening **letters of credits (Article 965)**

Types of Document credit

- Art 961 recognizes two types of document credits:

A. Revocable credits, which **credits do not constitute a binding agreement between the opening bank and the beneficiary**. Hence, it may be modified or cancelled by the opening bank at any time by a notice communicated to the correspondent bank prior to

payment or negotiation, or the acceptance bills there under by the latter. A documentary credit is presumed to be revocable in the absence of a provision that clearly specifies that it is irrevocable. / Art 962,961. / And,

B. **Irrevocable c**redits: are credits, which, on the other hand, **represent a definite undertaking between the opening bank and the seller/beneficiary or good faith holders of bills of exchange, drawn by the beneficiary**. Hence, the bank is obliged to pay the money specified in the credit. / Art 963. / This type of letter of credit may also be confirmed by the correspondent bank upon the request of the opening bank, and where irrevocable letters are confirmed by the correspondent bank / confirming bank/, a binding relation will be created between the beneficiary of the credit and the correspondent bank and the latter will be liable on the letter of credit. /Art 964 /

Chapter III LAW OF NEGOTIABLE INSTRUMENTS

Definition of Negotiable Instruments

- The word negotiable instrument consists of two words namely, negotiable which means 'transferable by delivery' and the word 'instruments' which means a written document by which a right is created in favor of a person.
- Thus, the term negotiable instruments literally refer to a document containing rights that can be transferred by delivery.
- Similarly, Article 715(1) of Ethiopian Commercial Code of 1960 defines the term negotiable instruments as **any document** incorporating a right to an entitlement in such a manner that it is not possible to enforce or transfer the right separately from the instrument.
- According to this provision, the **holder of negotiable instruments** can transfer the rights incorporated in the instrument by **transferring the instrument**. Similarly, a person who claims the rights incorporated in negotiable instruments may enforce or exercise them only if he **has possession of the instrument**, i.e., he should be a holder to whom the instrument is issued or transferred following the rules governing its transfer. He must also present the instrument to the person who is supposed to perform the obligations arising out of the instrument. (See also Art 716/1/).
- There are two basic things that distinguish negotiable instrument from other documents granting rights such as article 1185 and 1195. These two distinguishing features are, transfer of the instrument and possession of the instrument (Article **1185** talks about transfer of immovable's which demands registration of such contract on the immovable's registry whereas **1195** talks about the fact that the title granted by administrative authority on immovable will be presumed to belong to an owner of the immovable.

Q) Do you accept the definition given to negotiable instrument? Can you see any problem with the definition? Yes. Because

Ethiopian commercial code widely defined it while in other jurisdictions, Negotiable instrument is limited to promissory note, bill of exchange and chequees.

N.B

- ✓ The **rights** that could be **incorporated in negotiable instruments** may be rights for payment of money arising out of various contracts such as the **contract of loan**, **sale**, **lease**, or any **other contract performed by payment of a certain amount of money**.
- ✓ Another point is that negotiable instruments are issued or negotiated based on other **contracts**. For instance, a person may issue a bill of exchange to repay the money he has borrowed from the payee, the company issues a share certificate or debenture certificate as evidence of the person's right arising out of contract of partnership creating the company or a contract of loan respectively. / Art 211 and 429 of the Commercial Code/.

Classification of Negotiable Instruments

- Based on the purpose and rights incorporated in the instruments, **Article 715(2)** of the Commercial Code categorizes negotiable instruments into **three main types**, i.e.,
  A. Commercial Instruments,
  B. [Transferable] Securities and
  C. Documents of Title to Goods.

Nature and Purpose of Negotiable Instruments

A. Nature

- Negotiable instruments represent one form of **property rights**, i.e., exercised over incorporeal things "chose in action." In other words, they are **property rights** in relation to objects of property which do

not have physical or material existence and hence which cannot be perceived by the senses.

- A right of action under contract is a class of property known as '**chose in action'** and can be distinguished from a corporeal movable property/ a '**chose in possession'** which represent property rights exercised in relation to objects which have material or physical existence
- Negotiable instruments also represent **one kind of contract** as every instrument embodies a contract or promise to pay a certain amount of money or to deliver goods according to terms agreed up on. As a result, the **requirements necessary for the formation of a valid contract** must be fulfilled for **issuance of a valid and enforceable negotiable instrument**. For example article 733 excludes minors and judicially interdicted persons. Furthermore, **as a contract**, any declaration or promise made on negotiable instruments must be accompanied by the **signature** of the person bound by such declaration or promise. Art 734/1/ of the Commercial Code and Art 1728 of the Civil Code/. Failure to comply with the requirements as to capacity and signature may be raised as a defense against any person who claims based on the instrument Art 717/2/. The parties must give their **consent**, which must be **free from defects** such as mistake, fraud, duress. The **object** of the contract must also be legal and possible.

N.B

- ❖ Where the contract does not fulfill requirements as to consent and object, a party affected may raise it as a defense to avoid the contract and liability under the instrument. Art 717 /1/ of the Commercial Code and Art 1676 /1/ of the Civil Code./ However, because of the special nature of these instruments, such defenses cannot be raised against a person who acquires the instrument

following the rules of transfer applicable to the instrument, and in good faith. See Art 717/3/ of the Commercial Code.

- Furthermore, the transfer of negotiable instruments has a **special effect** compared to the transfer of other forms of property and other contracts. A person to whom such instrument is transferred, following the rules governing its **negotiation or transfer**, in **good faith**, before it's over due and before it is dishonored / a holder in due course/ will **have a better right on the instrument than the transferor** because he acquires it free from claims and defenses that could have been raised against the transferor. Similarly, a **person who has lost or who is dispossessed of a negotiable instrument may not recover it from the holder in due course.** Hence, the general principle governing contracts which transfer rights to other forms of property, particularly immovable properties and special movable properties, i.e., **no one may transfer a better title than he has, does not apply in the case of transfer of negotiable instruments**. See Art 717 /3/, 751/2/, 752, 849 and 850 of the Commercial Code. Compare Arts 1161-1167 and Art 1966 of the Civil Code.

B. Purpose

- The main purpose of negotiable instruments is **facilitation of commercial transactions**. Commercial instruments are substitutes for money and are used as means of performance of money obligations.

Types of Negotiable Instruments

A. Commercial Instruments

- Commercial instruments are **negotiable instruments incorporating rights for payment of a specified amount of money**. They are used as a substitute for money. These are bills of exchange, promissory notes, checks, travelers' checks and warehouse goods deposit certificates as the types of commercial instruments recognized under the Ethiopian law.

***B.* Transferable Securities**

- **Securities** are negotiable instruments incorporating rights for payment of money. The sources of such rights may be investments made in companies or loans provided to the government or its subdivisions through purchase of government bonds and treasury bills or to companies through the purchase of debentures.
- A person who invests in a company is entitled to share in the profits of the company if any, i.e., he has the right to receive dividends and to share in the assets of the company where the company is dissolved. /Art 345/ On the other hand, the person who has purchased a government bond or a treasury bill or a company bond, also called a debenture, acquires the right to receive repayment of the money he has given on loan plus interest. /Art 433/. Refer also to the provisions of Arts 2490-2511 of the Civil Code.

N.B

- ❖ All securities are not negotiable instruments. What makes securities negotiable instruments is **their transferability according to rules of negotiation**. Therefore, if it cannot be negotiated, it is difficult to circulate as money. **Bonds**, **stocks** and **transferable shares** are instances of securities which are negotiable instruments considered.

C. Documents of Title to Goods

- These are negotiable instruments containing rights of ownership over goods that are being transported or goods which are warehoused and which **enable their holders to receive such goods**. Refer Arts 571-576 and 610-619 of the Commercial Code regarding documents of title to goods under voyage and Arts 2814-2824 of the Civil Code regarding documents of title to goods warehoused.

LECTURE NOTES ON COMMERCIAL INSTRUMENTS

Definition

- Commercial instruments are negotiable instruments incorporating rights for payment of a specified amount of money.
- They are issued and negotiated for the purpose of performing an obligation.
- They are used as a substitute for money.
- Article 732(1) of the Commercial Code of Ethiopia defines "commercial instruments as negotiable instruments setting out on entitlement consisting in the payment of a sum of money. Sub-Article (2) of the same Article provides that bills of exchange, promissory notes, checks, travelers' checks and warehouse goods deposit certificates as the types of commercial instruments recognized under the Ethiopian law.

Types of Commercial Instruments

A. Bills of Exchange

- They are negotiable instruments incorporating an unconditional order, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a certain sum in money to or to the order of a specified person. Hence it consist an order to pay money.
- The person issuing the order is the drawer, the person ordered to pay is the drawee and the person who receives the payment is the payee. (involves three parties)
- The Commercial Code of Ethiopia does not provide a definition of bills of exchange.

Requirements to issue valid bill of exchange

- Art 735 enumerates the requirements to be fulfilled for drawing valid bill of exchange

  Accordingly, a bill of exchange must contain;

- The term “bill of exchange”
- An unconditional order to pay a certain sum in money
- The name of the person who is to pay (the drawee)
- The time of payment
- The place of payment
- The name of the person to whom or to whose order payment is made or an indication that it shall be payable to bearer
- The date when and the place where the bill is issued & signature.

Q) What if any of the above stated requirements are missed?

- A bill of exchange that does not contain any one of the above requirements **shall not be valid** and the drawer or any other party to the instrument can raise defect of form against any person who claims based on the bill. Art 717/1/

Q) Are there any exceptions to the principle? Yes

A. A bill which does not contain the time of payment is **presumed to be payable at sight or on demand.**

B. A bill which does not mention the place of payment, shall be deemed to be **payable at the domicile or at the address of the drawee**, and

C. A bill which does not provide place of issue, is deemed to have been drawn at the place mentioned beside the name of the drawer.

B. Promissory Notes

- A promissory note is defined as a document incorporating an unconditional promise in writing made by one person to another **signed by the maker**, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of a specified person or to bearer.
- This, definition implies that promissory notes are promise to pay money and they are only **two parties** i.e., the maker of the promise and the payee to whom payment is affected.
- No definition of promissory note under Ethiopian civil code.

Q) What are the requirements for the existence of valid Promissory note?

- Art 823 list requirements for validity of promissory notes, which are identical with the definition given above. These are:
  - The term “promissory note”
  - An unconditional promise to pay a sum certain in money
  - The time of payment
  - The place of payment
  - The name of the person to whom or to whose order payment is to be made or a statement that the note is payable to bearer
  - The date when and the place where the note is issued
  - The signature of the person who issues the instrument

Q) What is the effect of failure to comply with the requirements mentioned above?

- Failure to comply with these requirements results in the invalidity of the instrument **except** in the cases provided by Art 824, which fills gaps in case of absence of **time of payment**, **place of payment** and the **place of issuance**. (For failure to specify time it will be up on sight or demand, for failure to indicate place of payment, it will be at makers residence and for failure to place of issuance it will be at the place indicate beside the name of the maker).

Q) What is the difference between bill of exchange and promissory note?

Promissory Note	**Bill of exchange**
It contains promise to pay	Contains an order to pay
Maker is always primarily liable	Drawer is liable as a surety
Acceptance is not applicable	Demands acceptance
Demands two parties (maker & payee)	Demands three individuals (drawer, drawee & payee)

C. Checks

- A check is the **most widely** used form of commercial instrument.

- It is bill of exchange **drawn on a bank** and payable on demand

Q) What is the difference between bill of exchange and checks?

Bill of exchange	**Checks**
May be drawn on any one	Is drawn always on a bank
Cannot be crossed	Can be crossed
Demands acceptance	Acceptance is not a requirement

N.B

- It is also important to note that a drawer of a bill of exchange and a check or the maker of a promissory note may **antedate** or **postdate** it, provided that he has not committed a fraud.

Crossed Checks and Checks Payable into Account (Article 864)

- A **crossed check** is a check containing two parallel lines drawn across its face by the drawer or holder.
- A check may be crossed **generally** or **specially**.
- A check **crossed generally can only be paid to a bank**, which is the banker of the payee or holder, or to a person who is the customer of the drawee.
- A **check crossed specially** can only be paid to the bank specified in the crossing.

Q) What is the purpose of crossing checks?

- The whole purpose of crossing checks is to make sure that the check is paid to the intended person by preventing payment to other persons into whose hands the check might fall. It also helps to avoid or at least minimize risks associated with loss or theft of checks.

N.B

- The fact that a check is crossed does not mean that it cannot be negotiated as open checks. Negotiation of crossed checks shall have the same effect as the negotiation of open checks and the person to whom such check is transferred shall have the status of a holder in due course if the requirements are fulfilled.

- However, the **drawer or holder may prohibit negotiation** by inserting words such as ‘not negotiable’ or 'not transferable’ in the same manner as the drawer or endorser of an open check. A person to whom a crossed check containing such a provision is transferred shall not acquire a status of a holder in due course and does not acquire a better title than the transferor/ Art 865. / See also Art 842, which provides for the effect of transfer a non negotiable open check.

Q) What if a bank pays wrongly by violating article 864?

- A bank, which violates the provisions of Art 864 and pays the check to a person who is not entitled to receive payment, **shall be liable to pay compensation to the drawer** or holder which **does not exceed the value of the check. /866/1//.**
- However, a **drawee which paid a check** in which a crossing has been **altered**, **struck out** or **modified contrary to the law, in good faith**, and without negligence- believing that it is paying to the appropriate person- shall not be liable under Art 866(1).
- Where the drawer or holder of a **check writes transversally across the face of the check words such as ‘payable in account’ or any similar expression**, the drawee may not pay the check in cash to a person who is not its customer. Such check can only be settled by means of **crediting an account**, **by transferring from one account to another**, **set off** …Art 867(1). The bank that violates this provision and pays the check in cash at the counter shall have the liability to pay damages provided under Art 866.

Certificates of Deposit

- A **certificate of deposit** is a form of commercial instrument **issued by a bank**.
- It is an instrument containing an acknowledgement by a bank that **it has received a sum of money on deposit and a promise to repay the sum of money**.

- When a person deposits money in a bank he will be given the document showing the deposit of money which could be withdrawn by the depositor or the holder of the certificate.

N.B

- Under our law, a certificate of deposit is not considered as a commercial instrument. It is not even mentioned in our law but in common law countries, it is treated as a commercial instrument because it serves as means of payment of money similar to other type of commercial papers.

Agreements as to Payment of Interest

- According to Art 739 and 825 bills of exchange and promissory notes **payable at sight** or **at a fixed period after** sight may contain a provision regarding payment of interest
- On the other hand, the Amharic version of Art 835 of the Commercial Code provides that any provision according to which the drawer of a check agrees to pay an interest shall be of no effect..

Q) What is ur understanding of these articles? How can it be interpreted?

Examples

- The borrower of money or the buyer of goods on credit may be required to pay interest **on the loan or the price of the goods as a service charge** or price for the use of money by the borrower or buyer of goods on credit and a 'compensation' for the lender or seller on credit for giving up his right to use the money for various purposes and the benefit or gain he has lost as a result. When we see the provision of Art 739(1) in light of this purpose of interest, we may understand that agreement as to payment of interest inserted in bills of exchange and promissory notes payable at fixed period after sight is appropriate. Because in such cases the payee or holder of the instrument (the creditor) has given-up his right to receive payment

and use or invest it until the date of maturity and hence may be entitled to receive interest.

- ✶ However, the question is as to why the provision prohibits agreements as to interest in bills and promissory notes payable at a fixed period after date or those payable on a fixed future date which are similar to bills payable at a fixed period after sight, i.e., both are payable on a determinable future date. Taking into account the purpose of the agreement as to payment of interest and the maturity of these types of instruments, i.e., a future date, it is possible to conclude that payment of interest in these instruments is appropriate and there is no acceptable economic or legal ground to prohibit such agreements.
- ✶ Furthermore, by allowing such agreement to be made in cases of bills of exchange and promissory notes **payable at sight, Art 739 contradicts the provision under Art 835** that **prohibits the parties from agreeing on payment of interest in checks, which are always payable at sight or demand**. Allowing agreement as to payment of interest in cases where the economic and legal reasons justifying payment of interest are not present, i.e., on bills and notes payable at sight or demand may even encourage a person to wait until the last date of the period within which payment may be demanded with the purpose of collecting the interest and result in litigations and delay contrary to purpose of commercial instruments.
- ✶ **Therefore, the provision of Art 739 has to be read and interpreted in light of the purpose of interest and the spirit of Art 835, which prohibits such agreement on instruments payable at sprit or on demand.**

Opposition, Payment and Discharge

- The drawer or an endorser of a **bill of exchange** may oppose the payment of the value of the bill at **any time before payment** on the **grounds** of the bankruptcy of the holder.

- Similarly, the holder of a bill may oppose payment of a bill on the ground of **loss** or **theft** of bill before payment is made. /Art 779. / Opposition on these grounds may be made by notifying, in writing or orally, the drawee of the grounds of the opposition.
- However, **payment of a check** may be stopped by the instruction of the drawer at any time before payment without the need to prove the existence of a valid ground to do so. / Art 857. /
- The **drawer** who pays a bill at maturity or a check is validly discharged and **cannot be held liable** unless he has violated the opposition of payment or 'stop payment' order respectively. /Art 776 and Art 861/ The drawer must verify the signature of the drawer but not the signature of endorsers, as it does not have the specimen of signatures of all the potential endorser of the bill or check . /Art 776(3) and Art 860

Q) Is it possible to pay partially as he rights cannot be exercised separately from the instrument?

- The drawer which fully pays a bill or a check and the maker who full pays the note shall demand the surrender if the instrument that is receipted by the holder. /Art **859(1**) and Art **775(1**). /
- Where the cover held by the drawer is lesser than the amount of the instrument, the holder cannot refuse partial payment if the drawer decides to effect partial payment. In such a case the drawer cannot demand the surrender of the instrument as the holder cannot enforce the remaining rights without instrument / Art 715(1) 716(1) /. However, the drawee can demand the holder to specify such payment in the instrument and to give a receipt. / Art 859(4) and Art 759(3)/

Negotiation of Negotiable Instruments

- The **mode** of negotiation /transfer of negotiable instruments and **proof** of lawful ownership by the owner /holder depend
    a. The type of negotiable instrument concerned,
    b. The beneficiary of the rights contained in the instrument.

- With regard to mode of transfer, u can refer article 25-346,429-444.
- Negotiable instruments to order are transferred by endorsement followed by delivery of the instrument to the transferee called the endorsee. Endorsement consists of the signature of the transferor /called endorser usually on the back of the instrument with or without the word "pay", the name of the endorsee and the date of endorsement. However, **an endorsement may not contain a condition or conditions** and any condition attached to an endorsement shall be disregarded because it would be contrary to the main features of negotiable instruments particularly commercial instruments which always contain unconditional order or promise to pay a specified amount of money and affect their transferability. See Art 724, 725, 746/2/ 747, 748, 842, 843, and 844 of the Commercial Code.

Maturity of Commercial Instruments

- Bills of exchange and promissory notes may be made payable either at **sight** or on **demand**, at **fixed date**, at **a fixed period after sight/acceptance** or at a fixed period date. Refer to Arts 769 and 825 (1) (b), 770, 823,826, 854,855.
- Bills of exchange and promissory notes payable at sight or on demand are **mature** starting from the time of issuance and are payable on presentment.
- Checks are payable up on sight (824 & 825).

Acceptance of Commercial Instruments

- **Acceptance of commercial instruments refers** to the agreement of the drawee to pay the value of the instrument to the holder at its maturity.

Q) How will such acceptance be made?

- Acceptance shall be made on the instrument and may be expressed by **words** such as 'accepted' 'agreed' or any **other similar expression implying agreement** of the drawee and signed by the

latter. A **mere signature** of the drawee on the bill shall also constitute acceptance.

- No condition may be attached to acceptance because this may hinder the **negotiability** of bills a person may not be willing to receive such a bill and it would also be contrary to the definition of commercial instruments containing **unconditional order** to pay a specified amount of money.
- The **concept of acceptance applies to bills of exchange and not to promissory notes and checks** because of the following reasons.
  A. A promissory note shall not be accepted as it does not involve a drawee,
  B. On the other hand, a check cannot be accepted because it is always payable at sight or on demand.

Certification of Checks

- As we have seen above the concept of **acceptance** does not apply to commercial instruments **payable at sight and hence to checks**. However, checks may be **certified by the drawee**, upon the request of the drawer, provided that it has a sufficient cover. Where checks are so certified, the drawee will have the obligation to keep the amount of such check in a separate blocked account for the benefit of the holder of the check until the expiry of the period provided for presentment for payment i.e., six months from the date of drawing. /Art 832. /

Acceptance for Honor

- **Acceptance for honor represents** a **guarantee** to pay the value of commercial instruments by any person who may even be a signatory of the instrument. In other words, acceptance for honor constitutes a special way of forming a contract of surety ship guarantee in which a person guarantees the performance of obligations arising out of commercial instruments. [Art 766] Such acceptance may be given either on the commercial instrument or a separate piece of paper

attached to it, called an along or by a separate act or contract. Expressions such as 'accepted for honor' or 'good as acceptance for honor' or any other word implying guarantee plus the signature of the acceptor constitute acceptance for honor.

- Where the acceptance does not indicate the person for whose honor it is given, the law presumes that it has been given for the honor of the drawer or maker.
- The person who accepts a commercial instrument shall **be liable on the instrument in the same manner as the person for whom he has become a guarantor (768)**.

Intervention for Honor

- A person may accept or pay a commercial instrument by intervention for the honor of any person against whom the holder may have a right of recourse (803). The person who pays or accepts the instrument by intervention shall **have to give notice of his intervention** to the person for whose honor he has intervened **within two working days from the date of such intervention.** This seems to be intended to avoid double payment by debtor.
- This type of acceptance is expressed by words such as "accepted by intervention for the honor of" or similar words implying acceptance by intervention and the signature of the acceptor. It should also indicate the person on whose behalf it is given, in the absence of which the law presumes that it has been given on behalf of the drawer. (Art 804)

CHAPTER THREE

RIGHT OF RECOURSE OF A HOLDER OF COMMERCIAL INSTRUMENTS

Definition

- It refers to the right of a holder of commercial instruments to **institute legal action** based on the instrument for the purpose of recovering the unpaid value of the instrument.
- This right may even be exercised before maturity in cases of bills of exchange (Arts 780 and 868).

Q) Against whom the holder will exercise such right?

- The holder may exercise his right of recourse **against parties liable on the instrument**, i.e., signatories of the instrument in various capacities.
- These parties include the **drawer** of a bill of exchange and a check, the **maker** of a promissory note, **endorsers**, **acceptors**, **and acceptors for honor** and the **acceptor by intervention for honor**.
- Hence the right holder may sue the parties either jointly or severally.

Q) Can the holder of the instrument entitled to institute legal proceedings subsequently once he did on one of the parties to the instrument? Is there any limitation?

- Proceedings against one party shall not prevent the holder from instituting an action against the other parties even where such other parties signed the instrument subsequent to the party first proceeded against.
- The extent of the right of recourse of the holder is limited to the **unaccepted** or **unpaid value of the instrument**, **interest** where provision as to interest has been inserted in the instrument as per Article 739. (Such interest at the rate of 9% will be calculated starting from the date of maturity on the unpaid amount of the instrument, commission not exceeding 0.3% and expenses. However, if the right of recourse is exercised before maturity, /Art 780/ the holder shall be

entitled to a discounted amount to be calculated based on the official rate applicable at the place where the domicile of the holder is situated.

Q) What is the requirement for the holder to exercise such right?

A. Protest

- The holder who intends to exercise a right of recourse must have a **protest drawn up**.
- **Protest** is a written document drawn up by a notary public or by a court registrar evidencing non-acceptance or non-payment of a commercial instrument. However, since the office of the notary public are not established as intended and the registrars of courts do not draw up protests, both because of lack of awareness of their function in this respect and because commercial instruments, particularly bill of exchange and promissory notes are not commonly used, it is not possible at present to have protests drawn up by these officials.

Q) So what will be the answer then?

- The only alternative way of drawing up of a protest is according to Book VI of the Commercial Code containing the Transitory Provisions. Art 1178 provides that where there is no notary public or court registrar readily available (or performing the function of drawing up a protest) a protest may be drawn up by any person who is capable to perform juridical acts in the presence of two witnesses following the relevant provisions of the code.

Q) When does the protest be issued?

- Protest for non-acceptance has to be drawn up within the period of time provided for presentment of the instrument for acceptance by the law or the drawer or endorser. / Refer to Arts 759,757,758 and 781(3)/.
- For Instance, a protest for **non-payment of a check** shall be drawn up within the period provided for presentment for payment under Art

855, i.e., it must be drawn before the period of six months lapses (Art 869(1).

- Similarly, a protest for **non-payment of bills of exchange and promissory notes** shall be drawn up within the period of time provided for presentment for payment provided under Arts 770(1) and 774(1). In other words, protest for non-payment of bills of exchange and promissory notes **payable at sight** shall be drawn up within a period of **one year from the date of drawing.** However, in case of nonpayment of the other types of bills and notes, the protest has to be drawn up either within the period provided for payment or one of two working days following the last day on which the bill is payable, i.e. the protest may be drawn on one of the three days on which the instrument is payable or one of the two working days following the lapse of this period. /See Art 774(1) and Art 781(4). /

Q) What is the effect of failure to have a protest on the party entitled to institute legal proceeding?

- Failure to have a protest for non-acceptance or non-payment within the period provided by the law will **result in the loss of right of recourse of the holder (Art 796, 876**).

Q) Is there any exception to this general rule/principle? Yes.

- There are two exceptions. These are:
  A. A declaration by the drawee on the instrument alleging non acceptance (it is a sort of anticipatory breach of contract (Art 781(2),886,825(1)(C))
  B. A declaration of judgment in bankruptcy of the drawee or of the drawer of a bill,
  C. Where the holder is released (release clause to be written by drawer, endorser..) from the obligation to have a protest drawn up by provisions such as “retour sans frais”, “sans protet” or any similar expression implying permission to the holder to exercise his right of recourse without the need of protest. (Art 789,871).

N.B

- Where such release clause is made by the drawer, it shall be effective against all the parties to the instrument (including against those who received it through endorsement), but where it is made **by any other party**, the release shall be effective against the person who made it. In such cases the holder must have a protest drawn up in order to exercise his right of recourse against other persons. (See Art 789, 871 and 825).

B. Requirement of notice

- Refers to issuing of notice of nonpayment or acceptance to the drawer. Such notice has to be given within a period of four working days from the day of protest or from the day of presentment where drawing a protest is not necessary.

Loss of Right of Recourse

Q) What are the grounds to lose right of recourse on the instrument?

- Article 796 lists them. It includes among others;

A. Failure to present the instrument for acceptance or payment within the time provided by **the law** or **the instrument**.

B. **Failure to have a protest drawn up** in cases where the right of recourse cannot be exercised without a protest drawn up by a public officer or any person as per Art Art 796,825(1) (C).

Q) What is the holder fails to present the instrument with in time provided by law b/c of force majeure?

- Presence of force majeure wil results in extension of time to claim such right.
- However, the holder, to benefit from this provision, **must give a written, signed and dated notice of the force majeure to his endorser (if any) [or to a drawer/maker] immediately**. The holder must also present the instrument for acceptance or payment or have a protest drawn up immediately after the force majeure has terminated. However, if the force majeure continues to operate beyond thirty days

after maturity, the holder may exercise his right of recourse without the need to present the instrument or to draw up a protest. Art 797,876,825(1) (C)

Alternative Remedies to a Holder Who Has Lost His Right of Recourse

- A holder of a commercial instrument who has lost his right to recourse/ the right to seek judicial remedy to recover the unpaid value of a commercial instrument) may still have an opportunity to recover his money based on the obligation underling the issuance or the transfer of the commercial instrument or the provisions of the law (**unlawful enrichment**)?

A. Causal proceedings

- These are proceedings based on the contractual or extra-contractual obligations for the performance of which the instrument is issued or transferred.
- According to Arts **800 and 886**, the right to institute legal action based on the relations on which the issuance or the transfer of the bill or a check is based shall subsist (unless it is proved that it has been extinguished by novation/refer article 1826 I.e. substituting original obligation wz other/).
- However, for the holder to institute a **causal proceeding**, he must have a **protest for non-acceptance or nonpayment** and must offer to return the instrument together with the protest to the drawer or endorser.

B. Proceedings for unlawful enrichment

- A holder whose right of recourse is extinguished by reason of limitation of action /Arts 817 and Art 881/ or by reason of failure to present the instrument for acceptance or payment or failure to have a protest drawn up within the period provided by law or the instrument /as can be inferred from Art 799 (4)/, may institute an action based on the rules of unlawful enrichment against the drawer

and acceptor up to the amount of money by which they have unlawfully enriched themselves at his expense.

- The holder will be able to institute proceedings based on the rules of unlawful enrichment only if he is not able to bring causal proceedings (Art. 799).
- This right is given to the **holders of a bill of exchange and checks (Art. 799, 886),** but there is no reason why the holder of a **promissory note** should be prevented from exercising this right to recover the value of the instrument from the maker who has unlawfully enriched himself at his expense.

Part III
Insurance

Definition of Insurance _

- It can be defined in several ways. It can be defined from an **individual (Insured)** point of view which is a risk transfer mechanism (from insured to insurer), from **insurer** view point in which it is a risk distribution mechanism
- **Insurance** is a cooperative economic device to spread the loss caused by a particular risk.
- However this may not always be true for life insurance (692). I.e life insurance is not a risk distribution mechanism
- Insurance demands payment of **premium**.
- Insurance cannot avoid/prevent loss of life, death, injury, illness and etc rather it tries to provide a compensation mechanism

The Development of Insurance System

International development

- Insurance is the result of old practices. Historically there are two types of market; money market and non money market. In earlier society

people tend to support each other when someone's property is burnt (non economic/non monetary system)

- Early methods of transferring or distributing risk were practiced by Chinese and Babylonian traders as long ago as the 3rd and 2nd millennia BC, respectively.
- The Babylonians developed a system which was recorded in the famous Code of Hammurabi, / 1750 BC, and practiced by early Mediterranean sailing merchants. The Code deals wz insurance involved in transportation.
- The Greeks and Romans introduced the origins of health and life insurance in 600 AD.
- Towards the end of the seventeenth century, London's growing importance as a center for trade increased demand for **marine insurance**.
- Insurance as we know it today can be traced to the Great Fire of London, which in 1666 devoured 13,200 houses. In the aftermath of this disaster, Nicholas Barbon opened an office to insure buildings. In 1680, he established England's first fire insurance company, "The Fire Office," to insure brick and frame homes.

Domestic development

- It started wz the opening of Bank of Abyssiania. It started rending insurance service as an agent of foreign insurance company.
- Mr. Muzinger, an Austrian citizen, opened a full-fledged insurance branch in Addis Ababa as an agent for Balois Fire Insurance Company. Many representative offices were opened by expatriates until the Italian invasion in 1936.
- During the Italian occupation only Italian companies were allowed to operate in Addis Ababa and other central regions of the country and in Eritrea.
- In 1951, the **Imperial Insurance Company** was established by some enlightened Ethiopians.

- In 1970, the first proclamation on licensing and supervision of insurance services, proclamation NO.281/70 was enacted. An office for the supervision of insurance business was established under the Ministry of Trade and Industry. The office licensed only 15 companies anew.
- Military Junta on assuming power, it nationalized all previous 13 insurance companies. The Government merged the 13 companies and, by proclamation 26/ 1975, established the Ethiopian Insurance Corporation as a monopoly in insurance business. The Ethiopian Insurance Corporation functioned as a monopoly for nearly two decades until 1994.
- Wz the military junta demise, new economic policy was introduce to the country. The policy enhanced participation of **private sectors.**

Definition and Nature of Contracts of Insurance

- A **contract of insurance** is a contract whereby one party undertakes, in return for a consideration called a premium, to pay to the other party a sum of money on the happening of a certain event (death or attainment of a certain age, or injury) or to indemnify the other party against a financial loss arising from the loss or damage to property or from incurring civil liability. Refer article 654 for definition under Ethiopian legal system.
- The document containing terms and condition is called the" **insurance policy**"

Nature of contract of Insurance

- A contract of insurance is a type of **contingent** or **conditional contract**. As the name indicates, a contingent or conditional contract is a contract to do or not to do something, if some event, collateral to such contract, does or does not happen. Here performance of obligation is conditional or depends upon occurrence of certain things.

Q) What is the difference between insurance and contract for gambling?

1. Their object is different (risk compensation vs gamble for money)
2. II. In insurance there is an insurable interest whereas in gambling there is no insurable interest.
3. Insurance is based on principle of indemnification except for life insurance whereas there is no indemnification issue for contract for gamble.
4. Insurance is based on scientific calculation whereas in contract of gamble there is no calculation scientifically.

- There are **two types of insurance** namely; indemnity/compensation/ insurance and life insurance.

Distinguishing Characteristics of Insurance

- An insurance contract is **aleatory rather than commutative**. Aleatory contracts have a chance element and an uneven exchange. Under an aleatory contract, the performance of at least one of the parties is dependent on chance. In contrast, other commercial contracts are commutative. A commutative contract is one in which the values exchanged by both parties are theoretically even.
- An insurance contract is a **unilateral contract**. A unilateral contract is a contract in which only one party makes a legally enforceable promise.
- An insurance contract is a **conditional contract**. This means the insurer's obligation to pay a claim depends on whether or not the beneficiary has complied with all policy conditions. Example of conditions; payment of premium, proof of loss, giving immediate notice
- No assignment of right is authorized under indemnity insurance but in life insurance one can assign his rights. (696-698)
- The insurance contract is said to be a **contract of adhesion**, i.e., whose terms and conditions are not the result of negotiations between

the parties, and one party has to agree to the terms and conditions prepared by the other.

The Requirements to Carry on Insurance Business

- Art **656** of the Commercial Code provides that the law shall determine the conditions under which physical persons or business organizations may carry on insurance business.

Q) What are the requirements?

- The first requirement is establishing of share company (refer article 513 of commercial code & 6/1 of procl 86/1994. Here by Share Company, requirement on article 304 must be meet.
- Obtaining license from NBE
- Complying with minimum capital requirement (example 3 million for property insurance, 4 million for life insurance & 7 million for both)

Significance of Insurance

- Insurance has the following significances.

a. Indemnification for Losses
b. Reduction of worry and fear
c. Serves as source of investment funds
d. It is a means of control of loss
e. To enhance credit. It creates a confidence or a better credit facility. I.e it is advisable to extend loan on car that has insurance than the one without insurance.

BASIC PRINCIPLES OF INSURANCE

1, Principle of Utmost Good Faith

- The duty to make a full and true disclosure of material facts

2, Principle of Indemnity

- All contracts of insurance are contracts of indemnity, except those of life and personal accident insurances where no money payment can indemnify for loss of life or bodily injury.
- The purpose of indemnity is restitution. Restoring back to his former status.

3, Proximate Cause

- The insurer is liable only for those losses which have been proximately caused by the peril/danger/risk/ insured against. I.e considering the last cause of the risk.
- This will enable to decide whether z stated risk is covered under the policy or not.

4, Insurable Interest

- This is refers to existence in actual sense of the property or subject matter of insurance.
- Absence of insurable interest will make the policy the gamble or a wagering agreement.

5, Doctrine of Subrogation

- It applies only to property insurance.
- It is a situation in which the insurer that pays on behalf of the insured brings claim against third party at fault to take back the money it has paid.

6, Risk Must Attach

- If the subject-matter of insurance ceases to exist (e.g. the goods are burnt) or the insured ship has already arrived safely, at the time the policy is effected, the risk does not attach, and as a consequence, the premium paid can be recovered from the insurers because the consideration for the premium has totally failed.

7, Mitigation of Loss

- Insured must endeavor to minimize the risk.

8, Doctrine of Contribution

- Like the doctrine of subrogation, the doctrine of contribution also applies only to contracts of indemnity, i.e., to property insurances.
- The essential conditions required for the application of the doctrine of contribution are:

a. There must be double insurance
b. There must be either over-insurance or only partial loss

9, Reinsurance

- An insurer assuming larger risk from the direct insurance business may arrange with another insurer to off load the excess of the undertaken risk over his retention capacity.
- Such arrangement between two insurers is termed as '**reinsurance**.' Thus, by the device of reinsurance the original insurer transfers part of the risk to the reinsurer.

10, Third Party Interests in Liability Insurance

Assignment

Briefly examine tort immunity under Ethiopian civil code and third party liability insurance under proclamation 559/2008.