THE EXTERNAL GOVERNANCE ARCHITECTURE OF ZIMBABWE'S BANKING AND FINANCIAL SERVICES SECTOR

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Abstract

Zimbabwe has had an astounding number of bank failures with at least seventeen (17) banking institutions having collapsed from 1998 to 2015. The common attributes in virtually all the eighteen (18) banking institutions that collapsed during this period are that all of them were indigenously owned, had high levels of insider equity ownership concentration, and were structured as financial services conglomerates. These structures created perverse incentives for insider lending, abusive related party transactions and an appetite for greater risk-taking which ultimately precipitated the demise of these banking institutions. The fact that so many banking institutions collapsed within a relatively short period is indicative of the shortcomings, not only in the internal governance systems of the collapsed banking institutions but also in the external monitoring and supervision system. This paper investigates the role played by the weaknesses of the external regulatory framework in facilitating the collapse of so many banks. It also investigates whether the Banking Amendment Act, 2015 has resulted in a more robust and effective external governance framework for the all-important sector. The study establishes that the pre-amendment regulatory framework was not well suited to regulate and supervise financial services conglomerates, which had high levels of concentrated ownership and owner management. The entry of Mobile Network Operators into the provisions of banking and financial services further exposed the limitations of the pre-amendment regulatory framework. The Banking Amendment Act, 2015 made some notable improvements but also retained some of the shortcomings of the pre-amendment regulatory framework such as the sectoral model of monitoring and supervision. The jury is still out on the effectiveness of the changes made by the Banking Amendment Act, 2015 which largely depends on the quality of enforcement.

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1. Introduction

Zimbabwe liberalised and deregulated the banking sector in the early 1990s under the auspices of the Economic Structural Adjustment Programmes (ESAP). The United Merchant Bank was the first indigenous bank to be issued with a license in 1996. Its demise three years later heralded the dawn of an era of bank failures in Zimbabwe. It became the first of a series of bank failures with as many as eighteen (18) indigenous banking institutions having collapsed since then.[1] As part of efforts to improve the governance of banking institutions, the government of Zimbabwe passed the Banking Amendment Act, 2015 ('BAA'), which came into effect on the 13th of May 2016.[2] The BAA instituted a comprehensive revision of the legal framework governing the business of banking in Zimbabwe by amending the Banking Act [Chapter 24:20], the Reserve Bank of Zimbabwe Act [Chapter 22:15], the Deposit Protection Corporation Act [Chapter 24:29], the Schedule to the Reserve Bank of Zimbabwe Amendment Act, 2010 (No. 1 of 2010) and repealing the Troubled Financial Institutions (Resolution) Act [Chapter 24:28]. Such a comprehensive overhaul of the legislative framework was long overdue given the fact that the banking and financial services sector has been long riddled with scandals and the failure of local banking and financial services institutions.

1.1. Justification of the Study

The collapse of 18 indigenous financial services institutions in such a relatively short period indicates fundamental governance problems.[3] A study into the governance structures and practices of banking institutions is thus warranted. There is no single accepted definition of corporate governance. However, the most often cited definition is the one given in the seminal Cadbury Report which defined corporate governance

[1] J Nhavira, E Mudzonga & E Mugocha 'Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options' (2014) Zimbabwe Economic Policy Analysis and Research Unit elibrary.acbfpact.org 4 https://elibrary.acbfpact.org/cgi-bin/acbf?a=d&d=HASH3ed884ebb8382bd78228cc&gg=0.

[2] The BAA amended the *Banking Act* [Chapter 24:20], the *Reserve Bank of Zimbabwe Act* [Chapter 22:15], the *Deposit Protection Corporation Act* [Chapter 24:29], the Schedule to the Reserve Bank of Zimbabwe Amendment Act, 2010 (No. 1 of 2010) and repealed the Troubled Financial Institutions (Resolution) Act [Chapter 24:28],

[3] United Merchant Bank, Univeral Merchant Bank, Rapid Discount House Ltd, Barbican Bank Ltd, Royal Bank Zimbabwe Ltd, Time Bank, Trust Bank, Century Discount House (CDH), CFX Bank Limited, CFX Merchant Bank, National Discount House Limited, Intermarket Banking Corporation Limited, Intermarket Building Society,Renaissance, Interfin Bank, First National Building Society, Zimbabwe Building Society and Tretrad Investment Bank.

as '*the system by which companies are directed and controlled*'.[4] In this discussion it is defined it more comprehensively as:

> a framework, comprising formal and informal rules, accepted practices, and enforcement mechanisms, private or public, that together govern the behaviour of those in effective control of companies and their relationship with the companies' stakeholders.

Corporate governance should be properly understood as comprising two distinct aspects. The first comprises a set of internal rules and norms characterised by the fiduciary duties of directors and the constitutive documents of a company. The second aspect comprises external rules, norms and supervision.[5] External supervision is especially critical to the proper governance of banking institutions compared to other corporate entities because of the potential harm to the wider economy that can be precipitated by the collapse of a single banking institution. Financial problems in a banking institution can trigger a bank run, which can easily and usually spread to other banking institutions with dire consequences to the wider economy. Accordingly, banking institutions have traditionally been regulated, monitored and supervised to a far greater extent than their non-banking corporate counterparts. This paper investigates the impact of the BAA reforms on the effectiveness of the external governance framework which is one of the critical pillars for the proper governance of banking institutions.

1.2. Objectives of the Study

The objectives of the study are twofold. The first objective is to establish whether there were shortcomings in the architecture of the pre-amendment regulatory framework for the regulation, monitoring and supervision of banking and financial services institutions that contributed to the collapse of some banking institutions between 1998 and 2015. The second objective is to determine whether the BAA improved the laws governing the external regulation, monitoring and supervision of banking and financial services institutions in a way that reduces the bank failure rate in Zimbabwe.

1.3. Scope and Limitations

[4] Report of the Committee on the Financial Aspects of Corporate Governance 1992 para 2.5.
[5] C Zinca 'Corporate Governance of Banks- Present and Perspective' (201)2 *Economics Science Series* 278.

The BAA ushered in comprehensive reforms some of which were designed to strengthen the internal governance arrangements of banking institutions and others to bolster the external regulation, monitoring and supervision of banking institutions. The focus of this paper is the impact of BAA reforms targeted at the external regulatory and monitoring framework. It does not discuss the reforms targeted at the internal corporate governance arrangements in banks and other financial services institutions which will be discussed in the sequel to this paper. This paper is the product of desktop research focussing on the legislative changes introduced by the BAA. Consequently, the research does not include an empirical study of the extent to which banking institutions are observing the requirements of the BAA and the extent to which the regulatory agencies are enforcing them.

1.4. Proposition

This study is based on the proposition that high corporate governance standards lead to the stability of banking institutions and their increased performance and the attainment of these high corporate governance standards is anchored on a robust system of external regulation, monitoring and supervision.

2. Factors that led to the ineffectiveness of the pre-amendment external governance framework

The bank failure rate in Zimbabwe has been blamed on a myriad of factors chief among them being the failure of the regulatory and monitoring system to adjust to the new realities of financial conglomeration and excessive levels of insider ownership concentration.[6] The regulatory agencies have repeatedly failed to detect irregularities in the operations of many banking institutions that eventually collapsed until the problems had become entrenched and intractable.[7] The external supervision and monitoring function failed to curb repeated manifestations of poor governance systems such as inadequate board oversight, inexperienced management, undue influence by dominant shareholders, non-performing insider loans, excessive risk-taking, abusive

[6] Insider ownership concentration or owner management is whereby the controlling shareholder directly controls the management of the bank by doubling as the bank's Chief Executive Officer (CEO) or indirectly through the appointment of cronies or relatives to executive management positions who act in accordance with the instructions of the controlling shareholder or when management has significant shareholding within the bank.

[7] Nhavira, Mudzonga & Mugocha (n3 above) 44.

related party transactions (RPTs) and non-compliance with laws that were repeatedly cited as being the chief causes of the numerous bank failures including the wave of bank failures in the 2003-2004 banking crisis.[8]

2.1. Financial Services Conglomeration

The Zimbabwean financial services landscape is characterized by the conglomeration of financial services, which is the prevailing model of financial service provision in Zimbabwe. As discussed above, financial services conglomeration blurs the boundaries between different financial services such as banking, insurance and securities and renders ineffective the sectoral external supervision model. To effectively regulate and supervise financial conglomerates, the supervisory agencies have to be able to comprehensively monitor and address the different risks facing core banking and other financial activities that may be provided by a conglomerate of related financial services companies. Financial conglomeration in the context of weak external monitoring and supervision invited imprudent transactions between banking institutions that were part of corporate groups and related corporate entities. The controlling companies of most of the failed banking institutions used the depositor funds mobilized by the banking institutions as a ‘cash cow’ to fund the operations of the other companies within the group. Prime examples of this practice were Tetrad Holdings and Interfin Financial Holdings. The former used its asset management company, TFS Management, to prop the operations of the holding company and Tetrad Investment Bank, while the latter used Interfin Banking Corporation to prop the operations of Interfin Resources, Interfin Securities and Interfin Holdings Ltd.[9] Both institutions collapsed under the weight of Non-Performing Loans (NPLs) to related parties.

The pre-amendment regulatory framework was not designed to provide comprehensive group-wide supervision and regulation of financial services conglomerates. Controlling shareholders could easily avoid the more rigorous

[8] Reserve Bank of Zimbabwe Bank Supervision and Surveillance Annual Report 2005 www.rbz.co.zw 41; Reserve Bank of Zimbabwe Bank Supervision and Surveillance Annual Report 2012 www.rbz.co.zw, Reserve Bank of Zimbabwe Bank Supervision and Surveillance Annual Report 2014 www.rbz.co.zw.

[9] ‘Corporate incest that killed Tetrad’ https://www.sundaymail.co.zw/corporate-incest-that-killed-tetrad. ‘Former interfin bank bosses sued’ https://www.newsday.co.zw/2016/11/former-interfin-bank-bosses-sued-136m/.

regulatory regime of banks by simply being a controlling shareholder and executive director in the controlling companies. The rapid advancement and penetration of financial technology ('FinTech') particularly mobile phone-based electronic money (mobile money)[10] drove the conglomeration of financial services into previously uncharted territories. It brought Mobile Network Operators (MNOs) and technology companies into the business of providing financial products. Mobile money platforms evolved in leaps and bounds from being simply a money transfer service, at its inception, to a diverse financial product offering a wide spectrum of financial services including point-of-sale payment facilities, payroll, bill payments and insurance products. The rapid and widespread adoption of mobile money including and particularly by previously unbanked masses in the informal sector and rural demographics revolutionized and fundamentally altered how banking is conducted in Zimbabwe.[11] The result was the virtual conflation and blurring of lines between the previously unrelated business of banking and telecommunications and in the process making financial conglomeration in Zimbabwe much more complex.

Econet Wireless Zimbabwe Ltd ('Econet') best exemplifies the conglomeration of wireless telecommunications technology and the provisions of financial services. It established Ecocash, a mobile money transfer platform in 2011 and it grew at an exponential rate and grew so vast that Econet in 2018 unbundled its FinTech operations, notably Ecocash, into a separate company and Cassava SmartTech Zimbabwe Limited (Cassava SmartTech'). A banking institution, Steward Bank, which is now controlled by Cassava SmartTech, forms part and parcel of group-related companies.

MNOs naturally fell out of the regulatory ambit of the banking and financial services regulatory and monitory agencies. They are regulated by the Postal and Telecommunication Regulatory Authority (POTRAZ). The entry of MNOs into financial

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[10] Note that mobile money is distinct from mobile banking. Mobile banking refers to the situation where a bank account holder is able to transact via a mobile platform whereas mobile money account holders do not require a bank account.

[11] A Bara 'Mobile Money for Financial Inclusion: Policy and Regulatory Perspective in Zimbabwe' (2013) African Journal of Science, Technology, Innovation and Development 345-354 245. S Mago, & S Chitokwindo 'The Impact of Mobile Banking on Financial Inclusion in Zimbabwe: A Case for Masvingo Province' (2014) *Mediterranean Journal of Social Sciences* 228. S Mavhiki, T Nyamwanza & L Shumba Impact of Mobile Money on Traditional Banking Practises in Zimbabwe (2015) *International Journal of Economics, Commerce and Management* 10.

services not only created new avenues for regulatory arbitrage on the part of these MNOs but also raised regulatory challenges surrounding age-old banking law concerns notably depositor protection, know-your-customer requirements and adherence to anti-money laundering laws. The RBZ compensated for this lacuna by relying on the 2001 National Payment Systems Act[12] which it administers through the National Payments Systems (NPS) division which is assigned with the responsibility of licensing and supervising the operation of mobile money platforms. However, no coherent policy or regulations were put in place to regulate MNO-driven mobile money.

2.2. Multiple and Fragmented Financial Services Regulatory Agencies

The challenges to effective regulation and monitoring of the provision of banking and finance in Zimbabwe caused by financial services conglomeration were compounded by the fragmented and sector-specific model of supervision of financial services. Zimbabwe has five principal regulatory agencies that preside over the financial services sector.[13] This fragmented multiple-institutional approach to the regulation of the financial services industry, though followed by several countries is inherently problematic. The Achilles heel of the sectoral model of regulation and supervision is poor coordination between the multiple regulatory agencies.

Multiple institutions regulating different financial services provided by a financial services conglomerate are inherently incapable of forming a holistic assessment of the risk profile of a financial services conglomerate. The sectoral model of external supervision is predicated on the distinction between banking, securities trading and insurance and it has been rendered useless by financial services conglomerates that have obliterated the distinctions between banking, securities trading and insurance. The advent and explosive growth and penetration of MNO-driven mobile money and Fintech only served to complicate things further and inadvertently added POTRAZ into the pool of regulators of financial services. Poor coordination between the regulatory

[12] [Chapter 24:23].
[13] The Ministry of Finance, the Reserve Bank of Zimbabwe (RBZ), Insurance and Pensions Commission (IPEC), Deposit Protection Corporation (DPC) and the Securities and Exchange Commission of Zimbabwe (SECZ).

agencies has played a huge role in the overall ineffectiveness of the current external supervision model. The RBZ itself has decried the limitations of the multi-institutional approach and noted that:

> '*The weaknesses of the current regulatory arrangement where there are several regulatory agencies with limited formal arrangements to coordinate supervisory efforts create room for regulatory arbitrage and supervisory gaps in the financial sector*.'[14]

2.3. Insider ownership concentration (Owner-Management)

Banks are deemed to have a controlling shareholder if a shareholder, either directly or indirectly controls more than 10% or more of the voting rights.[15] Concentrated ownership in banks is generally the norm even in countries such as the United States of America (USA) and the United Kingdom (UK) where companies generally tend to have dispersed ownership.[16] This trend is largely attributed to the fact that banking institutions, particularly commercial banks, do not depend on equity funding as much as conventional companies but more on debt funding in the form of depositors' funds.[17]

The fact that banks generally have concentrated ownership is of great significance for two reasons. Firstly, concentrated ownership is generally associated with rent-seeking behaviour, abuse of minority investors and abusive transactions. A banking institution with a controlling shareholder with pronounced control and cash flow rights tends to have a higher risk profile because the controlling shareholder has greater incentives to increase the risk-taking of the banking institution.[18] Secondly, it intensifies the problem of moral hazard which is inherent in the business of commercial banking.[19]

Insider ownership concentration tends to exponentially amplify the above problems. There is an unavoidable conflict of interest between the goal to maximise equity returns and the protection of depositor funds that is intensified by insider ownership concentration. Owner-managers have perverse incentives to engage in self-serving

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[14] R T Magondo 'An assessment of the effectiveness of the regulatory tools in managing bank failures in Zimbabwe (Case of Interfin and Royal Bank)' (Unpublished Thesis, University of Zimbabwe, (2015) 42.
[15] G Caprio, L Laeven & R Levine 'Governance and Bank Valuation' (2007) *Journal of Financial Mediatio*n 589.
[16] Caprio, Laeven & Levine (n 17 above) 595.
[17] J Macey & M O' Hara 'The Corporate Governance of Banks' (2003) *FRBNY Economic Policy Review* 97.
[18] Caprio Laeven & Levine (n 17 above) 265; J R Barth, G Caprio and R Levine 'Bank Supervision and Regulation. What Works Best?' (2004) *Journal of Financial Intermediation* 209.
[19] Moral hazard refers to the temptation to unduly risk depositors' funds to boost the returns of the equity holders.

transactions such as parcelling out loans to themselves, cronies and relatives and related corporate entities. Insider-ownership concentration coupled with a weak regulatory and supervisory environment is a toxic combination that virtually encourages excessive risk-taking, self-serving RPTs and other corporate governance problems.[20]

The overwhelming majority of banks that were licenced between 1996 and 2015 were characterised by excessive levels of insider ownership concentration. The most egregious examples are United Merchant Bank, whose founder and CEO, Roger Boka was the sole shareholder of the bank. The other examples are Intermarket Banking Corporation which was 72% owned by its founder and executive chairman, First National Building Society in which the two founding directors held 89% of the shares and Trust Bank where the CEO held 47% of the shares of the holding company and 4.64% in Trust Bank.[21] The three founding directors of Interfin Financial Holdings controlled a combined 54.21% and two of them chaired the board of directors of two of the subsidiaries, Interfin Financial Services and Interfin Bank.[22] Renaissance Merchant Bank, which was part of Renaissance Financial Holdings, is a textbook example of insider ownership concentration. The three founding directors of the bank held 78.03% of the bank's total shareholding and collectively the group's executive management-owned 89.17% of the group's total shareholdings.[23] This background shows that insider-ownership concentration and its related corporate governance problems, notably insider NPLs, have been the common attribute among the banks that have folded since 1998.[24]

In response to the 2003-2004 banking crisis, the RBZ introduced measures to separate ownership and management through the 2004 Corporate Governance Guidelines which, inter alia, provided that no shareholder holding 10% or more shall be part of management or eligible for appointment as chairperson or deputy

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[20] T G Arun and J D Turner 'Corporate Governance of Banks in Developing Economies: Concepts and Issues' (2004) *Corporate Governance: An International Review* 9.
[21] Z Muranda 'Financial Distress and Corporate Governance in Zimbabwean Banks' (2006) *The international journal of business in society* 647-650.
[22] 'Looting Spree at Interfin Bank unearthed'' (2012) www.theindependent.co.zw.
[23] J Chinoperekweyi 'Corporate Governance in Banking: Nuggets from Canada, Georgia, Germany, U.K and Zimbabwe' Notion Press 2009.
[24] L Mambondiani 'Corporate Governance in Banks: Evidence from Zimbabwe's Banking Sector' (Unpublished Thesis, University of Manchester, (2011) 71.

chairperson of the board of directors.[25] The guidelines were made under the authority of section 45 of the Banking Act.[26] This was followed by several amendments to the Banking Act itself. The Banking Act provided that no person shall knowingly acquire a significant interest[27] in a banking institution without the written approval of the Registrar and no bank shall allow any person to acquire a significant interest in it without the written approval of the Registrar. The guidelines prescribed 10% as the threshold of what constituted a significant interest in a banking institution. However, the prescribed threshold of 10% shareholding which could not be acquired or exceeded without the Registrar's written approval was largely ignored, and concentrated insider ownership persisted. Allied Bank which was founded in 2015 with the assets of 3 failed banks, Trust Banking Corporation, Barbican Bank, and Royal Bank was registered with a controlling shareholder who controlled 99.5% of the bank's total shareholdings. Dominant shareholders were still allowed to remain as part of their bank's executive management. When Renaissance Merchant Bank was placed under curatorship in 2011 and when at the time of Interfin Bank Ltd's collapse, its dominant shareholders still retained their executive management positions. The continued owner-management by shareholders holding 10% or more of banking institutions' total shareholding after 2004 was with the tacit approval of the Registrar of Banks and the RBZ.

Insider and related party NPLs and NPLs to relatives and cronies of owner-managers lay at the centre of the collapses of the majority of banks listed above.[28] The RBZ in its 2014 Monetary Statement revealed that at the end of 2013, the total amount of insider loans in the banking system amounted to US$175 million, and of that figure insider loans amounting to US$117 were non-performing. An egregious example of the extent of these NPLs is Renaissance Merchant Bank. NPLs constituted 38% of the bank's total loan book and most of the loans were to related entities, executive management, and relatives of the Group CEO of Renaissance Financial Holdings.[29]

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[25] Reserve Bank of Zimbabwe 'Corporate Governance Guidelines' (2004) www.rbz.co.zw 4.
[26] Reserve Bank of Zimbabwe (n 27 above) 4.
[27] A significant interest was defined in section 26 of the Banking Act as a percentage of the share capital of a banking institution or the voting rights of members of a banking institution which equals or exceeds such a percentage as may be prescribed.
[28] C Nyoka 'Banks and the Fallacy of Supervision: The Case for Zimbabwe' (2015) *Banks and Bank Systems* 10.
[29] D Muleya 'Bank looted to a shell' (2011) https://www.zimbabwesituation.com/old/jun11_2011.html.

2.4. Politically motivated Bank Licensing Process

The liberalisation of the banking and financial services sector was seen as a key reform area of ESAP[30], not only to make the sector more competitive and more market-driven but to also drive general economic transformation and development.[31] The government's liberalisation of the banking and financial services sector was also driven by the politics of black empowerment. The banking and financial services landscape was, at the time, dominated by foreign-owned banks particularly Standard Chartered Bank and Barclays Bank.[32] Accordingly, one of the major aims of the government was to break the monopoly of foreign-owned banks that dominated the sector in the first decade of independence it perceived as catering mostly to white interests. That specific political consideration became the key driver for issuing banking licenses virtually only to indigenous groups.

However, banking licenses were not necessarily granted to deserving indigenous actors. The issuing of bank licences was also driven by less noble motives to establish distribution cartels for the ruling elite. The ruling elite was very distrustful of the emergence of an autonomous black bourgeois and deliberately sought to provide economic opportunities only to indigenous actors perceived loyal to the ruling party. Banking licenses were accordingly liberally issued to indigenous elites with political connections with little to no diligence being carried out on licence applicants.[33] This frequently led to exemptions being granted from some clear prescriptions of the law in the name of political expediency.

A glaring example of this is was the licencing of United Merchant Bank. Sole bank ownership of banks was not allowed even at the time when United Merchant Bank was licenced, but it was granted an exception due to the prevailing politics of black empowerment that surrounded the establishment of the bank.[34] It was therefore not

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[30] Economic Structural Adjustment Programme.
[31] T Moyo 'Financial Sector Liberalization and the Poor: A Critical Appraisal' (2001) www.saprin.org 15 http://www.saprin.org/zimbabwe/research/zim_fin_sect.pdf. Mambondiani (n 26 above) 130.; L Mambondiani, Ying-Fang Z, and A Thankom 'Corporate Governance and Bank Performance: Evidence from Zimbabwe' (2013) https://pdfs.semanticscholar.org/ 8. L A Sulaiman, S O Migiro & O A Aluko 'The Structural Adjustment Programme in Developing Economies: Pain or Gain? Evidence from Nigeria' (2014) Public and Municipal Finance 41.
[32] Moyo (n 33 above) 5; Mambondiani, Ying-Fang, & Thankom (n 33 above) 8.
[33] Muranda (n 23 above) 644.
[34]Moyo (n 33 above) 2.

surprising that United Merchant Bank quickly gained notoriety for liberally giving loans to its CEO's political cronies and coupled with loans to fund the CEO's other business ventures, the bank folded only three years after the granting of its license under the weight of NPLs.[35]

The collapse of United Merchant Bank should have served as a cautionary tale and should have induced regulatory authorities to be more circumspect in the issuance of banking licenses but far from circumspection, there was an explosion of licensing of indigenous banking outfits to politically connected elites. At the commencement of ESAP Zimbabwe had only twenty-one banks and by the time of the 2004 banking crisis, the number had risen to forty-one banks. The lax and politically contaminated process of bank licensing that characterised the early and median stages of the post-liberalisation period significantly contributed to the numerous incidences of bank failure.

3. Impact of the BAA on the External Governance Framework for the Banking and Financial Services Sector

The overarching goal of the external regulatory framework in the context of banking is predicated on mitigating risk and maintaining financial stability. In achieving these objectives, the underlying laws underpinning the regulatory system must address the unique challenges and risks obtaining in the financial services sector in the country. The content of the law is the necessary foundation of a robust regulatory system. Then, probably more important than the content of the law, are the enforcement mechanisms put in place to enforce the content of the law.[36] Did the BAA introduce provisions that better equip the regulatory and supervisory framework to better regulate financial services conglomerates, reduce the abuses that are associated with concentrated ownership and owner-management, and bring mobile money within the regulatory ambit of the financial services regulatory and supervisory authorities?

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[35] S Sithole & G Mtetwa 'Bank failures in Zimbabwe: Lessons from the 2003-2004 Bank-wide Liquidity Crisis' (2009) *University of Swaziland Research Journal* 44-56 45. D Nyagara, M R Nyagara & B W Mazviona 'An Essay on the Ethical and Corporate Governance Issues in the 2003/4 Zimbabwean Banking Crisis' (2014) *International Journal of Economics and Management Sciences* 3; J Pfumorodze & J C Nzonzo 'Some Reflections on Corporate Governance in the Banking Sector in Zimbabwe' (2010) *Indian Journal of Corporate Governance 53-56*; Muranda (n 23 above); Nhavira, Mudzonga and Mugocha (n 3 above) 42.

[36] R La Porta, F Lopez de-Silanes, A Shleifer & R Vishny 'Investor Protection and Corporate Governance' (2000) *The American Economic Review* 7.

3.1. Regulatory Agencies

Despite the limitations of the sectoral model discussed above, the BAA strangely elected to retain the model with minuscule provisions dedicated to the improvement of the coordination and cooperation between the regulatory agencies. The supervisory gaps and opportunities for regulatory arbitrage that the RBZ decried in its 2005 Annual Report remain because of the retention of the multiple and sectoral regulatory model and the inadequate provisions that were made by the BAA to improve the coordination between the regulatory and supervisory agencies. The retention of a sector-specific multi-regulatory agency model should have been followed by robust provisions in the BAA that encourage greater cooperation, coordination, and information sharing between these agencies.

A more streamlined and consolidated external regulatory structure would have been better suited to regulate the increasingly complex landscape of banking and financial services provision. Consolidation of multiple supervisory agencies increases the efficiency and effectiveness of external supervision in a financial services environment characterized by financial services conglomerates and MNO-driven mobile money.[37]
Zimbabwe had a choice between creating an integrated 'super-regulator' that would regulate all providers of financial services in an integrated manner or a dual regulatory model that has come to be known as the 'twin peaks' model which separates the supervision of market conduct and prudential supervision. Both models avoid the weakness and limitations of the sectoral model of supervision. The twin peaks model has largely emerged as the international best practice. The UK that championed the single regulator model itself abandoned the model in favour of the twin peaks model in the wake of the global financial crisis of 2007. The effectiveness of the 'twin peaks' model was demonstrated by the fact that the financial services sector in Australia, which pioneered the model, was not as adversely affected by the global financial crisis of 2007 compared to countries that used sector-specific models of regulation such as the US and the single regulator model such as the UK at the time.[38]

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[37] M Čihák & R Podpiera 'Is One Watchdog Better Than Three? International Experience with Integrated Financial Sector Supervision' (2006) International Monetary Fund WP/06/57 8.
[38] B Michael 'The 'Twin Peaks' Regulatory Model: The Future of Financial Regulation?' (2014) *Journal of Banking* 4.

The BAA also missed a golden opportunity to create a coherent and comprehensive framework for the regulation and supervision of MNOs providing mobile money platforms. It failed to address the regulatory overlaps between POTRAZ, the RBZ, and other financial services regulators regulating and monitoring MNO-driven FinTech products, particularly mobile money. Questions such as whether deposits into mobile money e-wallets constituted deposits that qualify for the deposit insurance scheme operated by the DPC, whether the same know your customer and anti-money laundering ('AML') requirements applicable to banking institutions also applicable to mobile money remained unanswered.

The BAA only mentions MNOs only once in its definition of mobile banking which inter alia, provides that registered MNOs can provide mobile banking services.[39] In addition, it amends section 81 of the Banking Act by expanding on the issues that can be provided for in the Regulations made by the Minister in terms of that section to include the registration, licensing, and control of providers on mobile money and mobile banking platforms. Given the extent of penetration of mobile money particularly that of Ecocash, a basic framework for the regulation of mobile money and a clear definition of the relationship and the required levels of cooperation between POTRAZ and the financial and monetary regulators were required to better place the financial services regulatory system in a position to effectively regulate and supervise MNOs providing mobile money products.

Although the BAA laid the foundation for the development of regulations governing mobile money providers, nearly five years passed before any such regulations were made. The Banking (Money Transmission, Mobile Banking, and Mobile Money Interoperability) Regulations, 2020[40] which provides a rudimentary framework for the regulation and monitoring of mobile money providers were only promulgated as a hasty 'knee-jerk' reaction to growing fears that mobile money was fueling the black market for foreign currency. The hastiness surrounding the promulgation of these

[39] Section 2 of the Banking Act as amended by the BAA, defines mobile banking as '"mobile banking" means an arrangement that allows a customer of a banking institution; or a licensee under the Postal and Telecommunications Act [Chapter 12: 05], or (any other operator of a wireless communication system to access any financial service activities through a mobile device, whether the arrangement is operated by the banking institution, licensee or operator concerned or by an independent operator.
[40] S.I 80 of 2020.

regulations, which were not preceded by any meaningful consultation or formulation of clear and informed policy objectives has left the key question surrounding the regulation of MNOs providing mobile money platforms unanswered and the overlapping between the scope of the regulatory authority of POTRAZ and the financial services regulators unaddressed.

3.2. The Bank Licensing Process

The process of licensing banking institutions is as critical as post-regulation monitoring and supervision. A rigorous and robust licensing system that effectively screens bank entry is critical in improving governance standards and minimising the risk of bank failures.[41] The licensing process can ensure that banking institutions have optimum corporate governance structures that minimise bank failure. The licensing process can prescribe the shareholding structure, the relationship between shareholders and management, minimum capital requirements, the qualifications of the principal officers, and the creteria for determining if they are fit and proper persons.

BAA built on the 2000 amendments to the Banking Act which took away the role of registering banks from the Ministry of Finance and vested it in the Registrar of Banks which reduced the scope of purely political consideration in the bank licensing process. The most significant changes ushered in by the BAA relate to the strengthening of the licensing process to prevent insider ownership concentration and to curb the abuses of the conglomeration of financial services.

3.3. Measures to curb ownership concentration and owner-management

The BAA combats insider ownership concentration by enforcing the separation between ownership and management. It prohibits the appointment to any management position of a shareholder who holds or exceeds the prescribed threshold of what constitutes a significant interest which the BAA sets at 5% of the total

[41] JR Barth, G Caprio & R Levine 'Bank Regulation and Supervision: What Works Best?' (2004) *Journal of Financial Intermediation* 210.

shareholding of the banking institution or its controlling company.[42] The BAA requires that a person who knowingly acquires a significant interest in a banking institution or its controlling company without the written approval of the Registrar and it imposes an obligation on the banking institution and or its holding company to ensure that no shareholders acquire a significant interest in the banking institution or its holding company without the written approval of the Registrar.[43] The effect of acquiring shares in breach of the above provisions is that the holder of the shares shall not be permitted to receive any dividends on the shares acquired in breach of section 15A or 15B and shall not be able to exercise any voting rights either in person or proxy of attached to the said shares and the Registrar may require the shareholder to divest himself or herself of the shares.[44]

The BAA also imposes a limit on the extent of shareholding that can be held by an individual or controlling company in a banking institution and provides that no individual can own shares in a banking institution or its controlling company that exceeds 25%.[45] The same restriction applies to artificial persons except for financial institutions, registered controlling companies, and foreign financial services institutions that have been approved by the Registrar.[46] Any shareholding that is in contravention of the foregoing requirements will essentially be rendered a nullity as it will not be permitted to have anyone exercise the voting rights on the shares or to receive any dividends payable on the shares.[47] The Registrar may refuse to register or cancel a controlling company's registration.[48] In addition to this, the Registrar is empowered to compel a shareholder who has or attempts to unlawfully or improperly influence a decision or the Board of Directors or a principal officer of a banking institution to divest

[42] Section 20 (3a) of the Banking Act as amended by section 12 of the BAA. For the purposes of determining whether a shareholder has a significant interest in a banking institution the shares in the same banking institution or controlling company which are held by a close relative of the individual shall be considered. See section 15B (6) (a) of the BAA.
[43] Section 15B (2) of Part III of the Banking Act as inserted by section 8 of the BAA.
[44] Section 15B of Part III of the Banking Act as inserted by section 8 of the BAA.
[45] Section 15A (1) (a) of Part III of the Banking Act as inserted by section 8 of the BAA. The Banking Amendment Bill had initially proposed a limit of 10%.
[46] Section 15A (b) of Part III of the Banking Act as inserted by section 8 as read with S15F (1) of the BAA.
[47]Section 15D (1) of the BAA.
[48] Section 15G (4) of Part III of the Banking Act as inserted by section 8; s15J (v) of Part III of the Banking Act as inserted by section 8 of the BAA.

all or a portion of the shareholder's holding in the banking institution or its holding company.[49]

The above measures, if fully implemented and enforced robustly, will reduce the influence of dominant shareholders reinforces, increase the independence of directors and ensure that only properly qualified professionals are appointed as executive directors of banking institutions. However, the Registrar, upon application, has the discretion to permit a shareholder to hold more than 25% of the shares of a banking institution if the Registrar is satisfied that the shareholding will not be contrary to the public interest, the interests of banking institution concerned and its depositors.[50] Further, the Registrar also has to be satisfied that the shareholder in question is a fit and proper person and in the case of a juristic person, the Registrar has to be satisfied that the persons in control of that entity are fit and proper.[51] If granting permission for a shareholding above 25% would result in a change of control of the banking institution or its controlling company, then the Registrar would have to seek the approval of the Minister through the Governor of the RBZ.[52]

The BAA extends introduced the requirement for the mandatory registration of bank holdings companies with the Registrar of Banks discussed previously. It extends this mandatory registration to a shareholder that holds a significant interest[53] in a banking institution or its holding company.[54] On the application for registration of a controlling company, the company has to furnish the Registrar with full particulars of the company's directors and officers and every shareholder controlling 5 or more per cent of the company's voting stock to determine whether the directors and specified shareholders are fit and proper persons.[55]

In the case of a body corporate, if it and an associate together control 5 or more per cent of the banking institutions or controlling company's voting stock, then the body

[49] Section 15E of the BAA.
[50] Section 15A (2) (a) of the BAA.
[51] Section 15A (2) (b) of the BAA.
[52] Section 15A (3) of the BAA.
[53] Section 15B defines a '*significant interest'* as five or more percent of the bank's or controlling companies voting stock.
[54] Section 15G (3) (d) of the BAA.
[55] Section 15G (3) (c) (d) of the BAA.

corporate is deemed to have acquired a significant interest. Further, the BAA also restricts the use of nominee shareholders and mandates banking institutions from registering or transferring shares other than in the name of the intended beneficiary.[56] The BAA imposes on banking institutions and their controlling companies an obligation to prevent a shareholder from acquiring a significant interest without the approval of the Registrar.[57]

3.4. Measures to curb abuses of financial services conglomeration

The BAA plugs some avenues for regulatory arbitrage that financial conglomeration creates by firstly restricting the right to control a banking institution to only registered banking institutions, foreign corporate entities approved by the Registrar, and controlling companies that have been registered by the Registrar. For a controlling company to be registered it has to apply to the Registrar and the Registrar has to be satisfied that the Applicant is a public company that is in sound financial condition, that its memorandum and article of association do not contain anything inconsistent with the Banking Act (as amended by the BAA), that its directors and officers are fit and proper persons with sufficient qualifications and experience the affairs of the controlling company.[58] In addition, the Registrar has to be satisfied that any shareholder, who holds five per cent or more of the company's voting stock, is a fit and proper person. The Registrar, before deciding whether to register the controlling company or to decline its application, has to, through the Governor of the RBZ, notify the Minister.

Bringing controlling companies within the regulatory ambit of the Registrar closes a major avenue of regulatory arbitrage which allowed controlling shareholders to avoid the more rigorous banking regulatory regime by simply being a controlling shareholder and executive director in the controlling companies and not directly of the banking institution itself. Controlling companies are now required to be registered with the Registrar.[59] However, more rigorous measures could have been introduced to curb

[56] Section 15C of the BAA.
[57] Section 15 B (2) (c) of the BAA.
[58] Section 15G (2).
[59] Section 15G of the BAA.

related party transactions (RPTs) between a banking institution and related corporate entities.

4. Conclusion and Recommendations

The pre-amendment regulatory framework was ill-equipped to regulate a banking and financial services sector characterised by high levels of insider equity ownership and conglomeration of financial services and other businesses that were not traditionally associated with the provision of financial services most notably telecommunications. Its multi-agency approach to regulation and supervision of banking and financial services players was plagued by poor coordination and created opportunities for regulatory arbitrage. These shortcomings were amplified by the bank licensing process that was compromised by political consideration and cronyism and the granting of exceptions by regulatory and supervisory that did not exist at law.

The BAA makes significant improvements to the legal framework that, at least on the surface, better places the regulatory and supervisory agencies in a position to address the above shortcomings particularly high levels of insider ownership concentration and owner management. By strengthening the licensing process and the overall role and authority of the Registrar reduces the influence of political considerations in the bank licensing process. The Registrar is now the central figure in regulating ownership patterns, preventing owner-management, and monitoring the conduct of companies that exercise control over banking institutions. The success of the BAA in curbing the challenges related to excessive ownership concentration, owner management, and conglomeration of financial services provision, will largely hinge on the effectiveness of the Registrar. The Registrar's effectiveness in this regard depends on a number of factors notably the extent of cooperation with the other regulatory agencies, adequate resources, and the independence of the Registrar, from undue influence, political or otherwise.

The retention of the sectoral regulatory and supervisory model remains a cause for concern given the poor coordination between the regulatory agencies and the limitations of this model in the supervision of the activities of financial services conglomerates. Considering that most banking institutions in the country are structured as financial conglomerates, a more streamlined regulatory structure that

enables the regulatory authorities to form a broader and more holistic view of the financial sector and to anticipate risks and trouble spots would have been preferable. The BAA failed to make adequate provisions for closing avenues of regulatory arbitrage created by the entry of MNOs into the provision of financial services.

No banking institution has collapsed since 2015 and this may very well be an indication that the reforms ushered in by the BAA have been successful. However, this might be attributable to the fact that by the time the BAA was enacted; all the banking instructions that were owner-managed or part of an owner-managed corporate group with excessively high levels of ownership concentration vested in individuals as opposed to corporate entities had collapsed. The real acid test is whether the post-amendment regulatory environment has been successful in preventing abusive RPTs between a banking institution and related corporate entities, non-performing insider loans, and the prevention of excessive ownership concentration and owner management.

Ultimately, the Holy Grail that will ensure the success of the reform efforts spearheaded by the BAA is enforcement. Laws are only good as their enforcement. As demonstrated in this paper, the challenges with the regulation and supervision of banking and financial services conglomeration were not so much an issue of the content of the law but the poor enforcement of the law, the granting of exceptions not provided for in terms of the law due to political influence and the granting of banking licenses to underserving but politically connected elites. Robust enforcement of the commendable provisions of the BAA will depend on the general quality of the enforcement of laws in Zimbabwe. A good and effective legal system characterized by adherence to the rule of law and uniform application of the law is critical to the robust and effective enforcement of laws. This is where formidable challenges lie not only for the enforcement of banking laws but the law in general in Zimbabwe which has over the years gained an unsavoury reputation for poor adherence to the rule of law and selective application of the law.