**Banking Law and Practise**

**LEGAL SYSTEM OF KENYA**

We know that everybody around talks about law according to one’s own perception. Before studying the statutory provisions of law, interpretation and significance of law, it is important to know what law is all about. Law in general sense is defined as under:

“The law consists of rules that regulate the conduct of individuals, businesses, and other organizations within society”

**Significance of law**

Law is to maintain rights, uphold justice and redress wrongs. Law ensures public order, balance, harmony, peace among the persons within the state and inter-states. We can easily conceive that in the absence of law and legal system there would have been disorder, unrest and chaos all around us.

**Jurisprudence**

For understanding law, we must have preliminary understanding of jurisprudence.

The legal experts term civil law as science of jurisprudence. Some concepts of jurisprudence are given below:

“Jurisprudence means the knowledge of law, or knowledge of just and unjust”

It deals with laws that are enforceable by the courts.

**Kinds of Jurisprudence**

The jurisprudence has been classified as under:

* Analytical Jurisprudence
* Historical Jurisprudence
* Ethical Jurisprudence

**Analytical jurisprudence**

It covers the following areas:

It analyses the prevalent law that is the principles of law as exist now. It also studies theory of legislation, precedent and customs and study of different legal concepts such as property, possession, trust, contract, negligence etc

**Scope of Analytical jurisprudence**

It analyses the basic principles of civil law, it does not pay any attention to the evolutionary process and their ethical aspects that is whether they are good piece of law or otherwise. We can say that analytical jurisprudence does not consider the historical and ethical aspects.

Its scope can be underlined as given below:

* An analysis of the law
* Treatment of a complex idea or concept in its elementary sub-divisions
* Examination of the relations between civil law and other forms of law
* A study of the legal source of law
* An investigation of the theory of legislation, precedent and custom
* Classification of the entire body of law with reasons thereof.
* A treatment of rights, their kinds and classes, their creation, transfer and extinction
* Dealing with legal liability, its kinds, extent and incidence
* To investigate such legal concepts as property, possession, trust, contracts, persons, acts, intention, motive, negligence. etc.

**Historical jurisprudence**

It studies history of law and evolution of law over a period of time and also amendments, introduction of new principles of law.

**Scope of Historical Jurisprudence:**

It studies the principles of law in their origin and developments that take place over a period of time.

This branch is not the same thing as legal history.

**Ethical jurisprudence**

It deals with the law that should be in an ideal state. It lays down the different purposes which should be fulfilled in an ideal state. It studies the modifications in the existing law in order to achieve these purposes and objects. The main object of ethical jurisprudence is the attainment of justice.

**Scope of Ethical Jurisprudence:**

Ethical jurisprudence deals with the law in the ideal state with law as it should be. Law exists to fulfill certain purposes. It is for this branch of jurisprudence to lay down what those purposes are and whether they are fulfilled by the law existing at any given time. It considers the modifications necessary in the existing law so that it may fulfill the objects for which it exists. The other two branches are concerned with an analysis of the law as it is or as has been without being concerned with its adequacy or inadequacy. Ethical jurisprudence has as its object the attainment of justice.

**Advantages of study of jurisprudence**

The following are the advantages of studying this science:

Jurisprudence is the “grammar of law” and teaches the lawyers and the legislator's proper use of legal terms. It ensures homogeneity and accuracy in legal phraseology.

 A person who has studies jurisprudence will be able to study foreign laws intelligently if need be,

**Concepts/ Definition of Law**

Some of the definitions/concepts from the writings of eminent jurists are given below:

**According to Blackstone:--**

“Law signifies a rule of action, and is applied indiscriminately to all kinds of action”.

**According to Holland:--**

“Law refers to a general rule of action, taking cognizance only of external acts enforced by a determinate authority, which authority is human, and among human authorities is that which is permanent in a political society”.

**According to Hobbs**

“The commands of him and them that have coercive power”

**According to Austin**

“A law is a rule of conduct imposed and enforced by the sovereign”

**According to Salmond**

“Law is the body of principles recognized and applied by the State in the administration of justice”

**According to John Erskine**

“Law is the command of a sovereign, containing a common rule of life for his subjects and obliging them to obedience”.

**According to De Montmorency**

“Coercion is a weapon of law which law has forged, but it is not the basis of law.”

**According to Pound**

“Law is the body of principles recognized or enforced by public and regular tribunals in the administration of justice”

**According to Wilson**

“Law is that portion of the established thought and habit which has gained distinct and formal recognition in the shape of uniform rules backed by the authority and power of Government.”

**According to Green**

“Law is the system of rights and obligations which the state enforces.”

**According to Lord Radcliff**

“You will not mistake my meaning or suppose that I depreciate one of the great human studies if I say that we cannot learn Law by learning Law. If it is to be anything more than just a technique it is to be so much more than itself; a part of history and sociology, a part of ethics and a philosophy of life

**Classification of Law**

The law is classified into the following branches:

Imperative Law

- Physical or Scientific Law

- Natural or Moral Law

##

**Imperative Law**

**The three ingredients of imperative law are explained in detail**

**Imperative law is a general rule**

It is a rule of general application as distinguished from particular application. A rule which applies only to one individual or one set of circumstances at a given time but never afterwards will not be a rule of imperative law. The rules of conduct laid down by a father for the guidance of his son; or by a master for his servant, though laid down by a superior and enforced by physical force, are not imperative law, because they are not of general application.

On the other hand, ‘general’ does not mean absolutely general, or applicable to all. Thus traffic rules, though applicable to drivers of vehicles only, are imperative law, for they apply generally to all drivers. The rules requiring ministers or the President to take an oath on entering upon office, though applicable to a few or even one individual form part of imperative law for the oath is to be taken by President after President, Minister after Minister, etc. thus “General” here signifies the fact that wherever a particular set of circumstances comes into existence, the rule should be invariably applicable, with exception –though the one affected may be an individual (the Minister) or to class of persons ( the drivers of vehicles).

**Imperative law has some authority behind it:**

It is given by some superior, may be human or divine. Every rule of imperative law is given by some authority –whether divine or religious or political.

**Imperative law is enforced by superior power:**

There must be some punishment on breach of imperative law. Rules of imperative law are enforced by some superior power, and the punishment takes such form as bodily or mental suffering. The superior enforces it by either physical force or any other form of compulsion, such as ridicule, contempt or censure. Those subject to imperative law are bound to follow it; thus compulsion is necessary. A rule which people may or may not observe cannot form a part of imperative law.

**Illustrations**

**Divine law** is imperative law on the following basis:

1. It is laid down by a superior authority (God);
2. It is followed compulsorily;
3. Its breach constitutes a sin and is punished with divine wrath.

**Civil law** (the law of the land) is also a form of imperative law on the following basis; --The superior power is the sovereign

 --the compulsion is fear of punishment by the state.

--it is enforced by the physical force of the state. Civil law decides whether an act is innocent or criminal.

**International Law**

International law has been differently defined by different jurists.

Salmond takes it as “those rules which govern sovereign states in their relations and conduct towards each other”. Other definitions are: “ the body of rules which by custom or treaty civilized states regard as binding upon themselves in their relations with one another, and whose violation gives the injured party a legal right to redress”; ( Wheaton), “The aggregate of rules to which nations have agreed to conform in their conduct towards one another”; (Lord Russel).

**Sources of law**

 According to Salmond, following are the main sources:

* **Formal sources**
* **Material sources**

**Formal Sources**

Formal sources are comprised of statutes and decision of the courts.

**Material sources**

Material sources are comprised of legal sources and historical sources. Legal sources are comprised of the following:

* Legislation
* Precedent
* Customs
* Agreement

 The main instruments under the legal sources are legislation and precedent.

First of all Precedent is explained**.**

**Precedent or Case Law:**

The decisions made by superior judiciary contain interpretation of law are called case law or precedents. The decisions can be relied upon/cited as precedents in future at the time of adjudication of the cases.

**Principles of binding precedent are underlined below**

**-** The decision relied upon must be based upon the interpretation of law.

-The precedent must have nexus to the central point of the case.

 - The facts of the precedent being cited and the case being adjudicated upon must be the similar.

**Sources of Law**

**Formal Sources**

**Material Sources**

**Historical Sources**

**Legal Sources**

**Legislation**

**Precedent**

**Customs**

**Agreement**

**Process of legislation**

**Parliament: Law/ statutes are made by the parliament.**

It is also called legislature and consists of, National Assembly, Senate and President of Kenya.

**Process of legislation—Explained**

Parliament/federal legislature has been given powers to make laws by the constitution of Kenya (1973) 4th schedule in two lists that is:

A bill can be presented in either house whether national assembly or senate and after being passed by simple majority shall be transmitted to other house. When the bill is passed by both houses of the parliament, it is then presented to the president for assent.

If the bill presented to President is not given assent or sent back to the parliament for any amendments, it will be considered in the joint sitting of the both houses of the parliament and if passed shall be again presented to the President for his assent. Now the bill will become the act of parliament and president does not have powers to withhold assent.

The bill when passed by the parliament is called an **Act**.

**Money Bills**

Money bill shall originate in the national assembly and after being passed shall be presented to the president for assent. Money bill shall not be presented to the senate. The rest of the procedure is the same as explained above.

**Ordinance**

Under the constitution of Kenya, the President can promulgate an ordinance, if any house of parliament is not in session. The ordinance shall stand repealed after one hundred twenty days, if it is not presented or passed by the parliament.

The process of legislation has also been explained through a figure on next page.

**Process of Legislation**

When National Assembly is in Session

When National Assembly is not in Session

Money Bill

All Other Bills

National Assembly

Senate

President

Assent

 Reject

**Act/Law**

**Sent for reconsideration to Parliament (Joint sitting of National Assembly and Senate)**

 President

 Ordinance

**Financial System & Banking**

**Financial System**

Complete and complex ever changing set of rules, regulations, procedures, practices policies, conducts; role of institutions (financial institution), Governments, Policy makers and central bank taken together may be called financial system.

 The financial system does have its impacts on individuals, businesses, corporations and governments alike. At times in your life, you will be a saver and at other times, you may be a borrower. The financial system channels funds from savers to borrowers and makes it possible for both to achieve their objectives. When the financial system works efficiently, it leads to better health of the economy.

**Purpose of the financial system**

Most of us at one time or another may need more funds than you have on hand for one purpose or another. At the same time, others spend Jess than their incomes. Those who have surplus funds may be willing to let someone else use their savings if they are compensated for doing so.

The mismatch of income and spending for individuals and organizations / creates an opportunity to trade. The investor can use the funds saved by different classes of people. The investor would be better off by earning a profit from investing funds in a new venture and savers who have lent their money would be better off 'by receiving the return that the investor pays them for lending their funds.

 Now we can easily understand the functions provided by the financial system in an economy. It moves funds from those who want to spend less than they have available to those who have a desire to purchase durable goods or those who have productive investment opportunities. This matching process increases the economy's ability to produce goods and services. In addition, it makes house- holds and businesses better off by allowing them to time purchases according to their needs and desires. A smoothly functioning financial system thus im­proves the economy's efficiency and people's economic welfare.

The financial system provides channels to transfer funds from individuals and groups who have saved money to individuals and groups who want to borrow money. Savers (or lenders) are suppliers of funds, providing funds to borrowers in return for promises of repayment of even more funds in the future.

**The financial system brings together savers and borrowers in following two ways.**

**Direct Finance** In direct finance, individual savers through financial markets hold the claims issued by individual borrowers.

**Indirect Finance** In indirect finance individual saversthrough financial intermediaries hold claims over the portfolio of assets of the borrowers.

Financial markets provide play field to the financial instruments. Financial instruments are traded by household, business firms, government and foreigners in wide variety of financial markets or markets for financial instruments.

Financial market can at preliminary stage be termed as market for bonds and stock markets.

**Functions of Financial Markets and Financial Intermediaries**

The function is explained through the following figure:

****Those who have saved and lending funds, the Lender Savers are at the left side & those who must borrow funds to finance their spending, the Borrower-Spenders are at the right. The arrows show that Funds flow from lender savers to Borrower – spenders via two routes i.e.; through financial markets (Direct Finance) and through Financial intermediaries i.e. Banks etc. (Indirect Finance)

In direct finance borrowers borrow funds directly from lenders in financial markets by selling them securities or bonds which are claim on borrowers’ future income or assets.

**Types of Financial Markets**

Financial markets are divided as under:

1. Foreign exchange market.
2. Stock market.
3. Bond market.

Financial markets are one arena in which savers’ surpluses are transferred to borrowers. Savers can buy stocks and Bonds and Business borrowers can obtain funds by issuing stocks and Bonds

**Financial Institutions: (Global Perspective)**

Financial institutions are also called Financial Intermediaries, these include the following:

Commercial Banks

Credit Unions

Savings and Loan Associations

Mutual Saving Banks

Mutual Funds

Finance Companies

Pension Funds etc.

 The role of Financial Institution is to act as Financial Intermediary or to provide function of Financial Intermediation, role of go-between for savers and borrowers.

 Banks are the largest financial intermediaries. Banks lend to many sectors of the economy.

However, banks and other financial institutions compete with one another and this competition has advantage for savers, borrowers and system as a whole.

**Key Services Provided by Financial Institutions**

 In addition to matching individuals who have excess funds with chose who need them, the financial system provides three key services for savers and bor­rowers. These services are *risk sharing, liquidity,* and *information.* Financial markets and financial intermediaries provide these services in different ways, making various financial assets and financial liabilities more attractive to individual savers and borrowers. Many financial decisions made by savers and borrow­ers are shaped by the availability of these services.

**Risk Sharing**

One advantage of using the financial system to match indi­vidual savers and borrowers is that it allows the sharing of risks. *Risk* is the chance that the value of financial assets will change relative to what you ex­pect. Most individual savers are not gamblers and would like to seek a steady return on their assets rather than erratic swings between high and low earnings. Indeed, individuals prefer stable returns on the collection of assets they hold. A collection of assets is called a portfolio. For example, you might hold some government treasury securities, some shares of stock, and some shares in a mutual fund. Although one asset or set of assets may perform well and an­other may not perform as well, but overall returns tend to average out. This splitting of wealth into many assets is known as diversification. As long as the individual returns do not vary in the same way, the risk of severe fluctuations in a port­folio's value will be reduced. The financial system provides risk sharing by al­lowing savers to hold many assets. .

**Liquidity**

The second service, the financial system offers to savers and borrowers is liquidity, which is the ease with which an asset can be exchanged for money to purchase other assets or exchanged for goods and services. Savers view the liquidity of fi­nancial assets as a benefit. When they need their assets for their own consump­tion or investment, they can exchange them easily. In general, the more liq­uid an asset, the easier it is to exchange the asset for something else. You can eas­ily exchange the currency notes for purchasing a book or anything else because it is highly liquid. You can also cash a check within a short period of time to buy clothes. However, selling a car would take more time because personal property is not very liquid. By holding financial claims (such as stock or bonds) on a factory, individual investors have more liquid savings than they would if they owned the machines in the factory. The reason is that the investor can more easily sell the claim than a specific machine in order to buy other assets or goods. Liquid as­sets allow an individual or firm to respond quickly to new opportunities or un­expected events. Financial assets created by the financial system, such as stocks, bonds, or checking accounts, are more liquid than cars, machinery, or real estate.

Financial markets and intermediaries provide trading systems for making financial assets more liquid. In addition to creating financial assets, the finan­cial system provides mechanism for increasing the liquidity of financial assets. Investors can readily sell their holdings in gov­ernment securities and stocks and bonds of large corporations, making those assets very liquid. During the past two decades, the financial system has made many other assets liquid besides stocks and bonds. One measure of the efficiency of the financial system is the extent to which it can transform illiquid assets into the liquid claims that savers want.

**Information**

A third service of the financial system is the collection and communication of information, or facts about borrowers and expectations about returns on fi­nancial assets. The first informational role the financial system plays is to *gather* information. That includes finding put about prospective borrowers and what they will do with borrowed funds. Obtaining such information would be costly and time-consuming for savers, who of course want all the facts before lending their money. Working through the financial system, a prospective investor is likely to learn more about the borrower than he would if he tried to make the investment on his own.

Another problem that exists in most transactions is asymmetric informa­tion. This means that borrowers possess information about their opportunities or activities that they don't disclose to lenders or creditors and can take ad­vantage of this information. Sometimes, financial arrangements have to be structured so that borrowers do not take advantage of asymmetric information at the expense of lenders.

The financial sys­tem specializes in information gathering and monitoring, and arrangements exist for solving problems of asymmetric information."

The second informational role the financial system plays is **communication of information.**

Savers and borrowers receive the benefits of information from the financial system by looking at asset returns. As long as financial market participants are informed, the information works its way into asset returns and prices. Information is communicated to borrowers as well as to savers. The incorporation of available information in asset returns is the distinguishing fea­ture of well-functioning financial markets.

**Structure of Financial Market**

Financial markets are categorized as under:

- Debt and equity markets.

- Primary Markets and secondary markets.

- Exchange markets and over-the-counter market. (OTC)

- Forward contracts and future markets.

**Debt and Equity Markets**

Debt instruments such as issuing bonds. These may be short term (Maturity less than one year), long-term (maturity ten year or longer) and intermediate term (maturity between one and ten years). Second method of raising funds is by issuing equities

**Primary Market and Secondary Markets**

Primary Market is a financial market in which new issues of a security such as Bonds or stocks are sold to initial buyers whereas in secondary Markets there is further sale of already issued securities.

**Exchange and Over-the-Counter Markets**

Secondary Markets can be organized in the following ways:

Through organizing/establishing Stock Exchange through Over-the-Counter (OTC) markets, (Dealers in these markets are in computer contact and know the prices set by one another, OTC markets are very competitive.

**Money Market and Capital Market**

Money Market is a financial market which deals in short term debt instruments. Capital market deals in long term debt instruments

**Forward Contracts and Futures Market**

Under Forward Contract, buyers and/sellers agree to trade certain quantity of commodity for a specific price at a specified date in future, contracts are formally made in commodities exchange markets.

**Financial Regulations**

Respective Governments regulate financial markets and financial institutions around the world, which is necessary for the maintenance of financial stability, build confidence of all stake holders in the system.

There are also international norms, practices and protocols which are required to be observed by all participants, trading across the borders such as Uniform customs and practices for documentary credits (UCP 600)

**FINANCIAL INSTRUMENTS & BANKING LAWS & PRACTICES**

**Financial Instruments**

We have discussed financial system and financial institutions, now shall move on to financial instruments. Financial instruments are the vehicles by which financial markets channel funds from savers to borrowers and provide returns to savers. We shall discuss major instruments or securities, traded in the financial sys­tem. For convenience, we analyze money market and capital market instru­ments separately. Both money market and capital market assets are actively traded in financial markets.

**Money Market Instruments**

The short maturity of money market assets doesn't allow much time for their returns to vary. Therefore these instruments are safe investments for short-term surplus funds of households and firms. However, ill making investment decisions, savers must still consider the possibility of default—the chance that the borrower will be unable to repay the entire amount borrowed plus interest at maturity.

**Government Treasury Bills**

Government Treasury securities are short-term debt obligations of the government. They are also the most liquid money market instrument because they have the largest trading volume. The federal government can raise taxes and issue currency to repay the amount borrowed, so there is virtually no risk of default. Treasury securities with maturities of less than one year are called Treasury bills (T-bills). Although individuals can hold them, the largest holders of T-bills are commercial banks, followed by other financial in­termediaries, businesses, and foreign investors.

**Bill of exchange and other Commercial Papers**

Commercial paper provides a liquid, short-term invest­ment for savers and a source of funds for corporations. High-quality, well-known firms and financial institutions use commercial paper to raise funds. Because these borrowers are generally the most creditworthy, the default risk is small, but the interest rate is higher than that on Treasury bills. The growth in the commercial paper market during the past two decades is part of a shift by many corporations toward direct finance (and away from bank loans).

**Bill of exchange Defined and Explained**

It is an important form of a negotiable instrument and has been defined in section 5 of the Negotiable Instruments Act, 1881 the said definition is reproduced below:

 “A bill of exchange is an instrument in writing containing an unconditional order, signed by maker, directing a certain person, to pay on demand or at fixed or determinable future time a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument”.

The following are the ingredients of a bill of exchange:

1. It must in writing
2. It must contain an order to pay and addressed to some person
3. The order must be unconditional
4. The order must be signed by the maker
5. The order must direct to pay or demand or at a fixed or determinable future time.
6. The sum ordered to be rapid must be certain.
7. The payment should be ordered to be paid to a certain person, or to his order, or to the bearer.

##

**Explanation of different features of a bill of exchange**

A promise or order to pay is not “conditional, within the meaning of this section and section 4, by reason of the time for payment of the amount or any installment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain.

The sum payable may be “certain” within the meaning of this section and section 4, although it includes future interest or return in any other form or is payable at an indicated rate of exchange, or is payable at the current rate of exchange and although it is to be paid in stated installments and contains a provision that on default of payment of one or more installments or interest. Or return in any other form the whole or the unpaid balance shall become due.

A promise order to pay is not ‘conditional’ nor is the sum payable uncertain within the meaning of this section or section 4 by reason of the sum payable being subject to adjustment for profit or loss, as the case may be of the business of the maker.

Where the person intended can reasonably be ascertained from the promissory note or the bill of exchange; he is a ‘certain person’ within the meaning of this section and section 4, although he is misnamed or designated by description only.

An order to pay out of a particular fund is not unconditional within the meaning of this section; but an unqualified order to pay, coupled with—

1. an indication of a particular fund out of which the drawee is to reimburse himself or a particular account to be debited to the amount, or \
2. a statement of the transaction which gives rise to the note of bill, in unconditional

An essential character of a bill of exchange is that it shall contain an order to accept or to pay and that acceptor should accept it, in the absence of such a direction to pay the document will not be a bill of exchange or a hundi.

**Bankers' Acceptances**

These instruments are designed to facilitate international trade, bankers' ac­ceptances are instruments that establish credit between parties who do not know each other. A banker's acceptance is a check like promise that the bank will pay the amount of funds indicated to the recipient. It is issued by a firm (usually an importer) and is payable on a date indicated. The bank that marks the draft "accepted" guarantees the payment to the recipient (usually an ex­porter or its representing bank). The issuing firm is required to deposit funds in the bank sufficient to cover the draft; if it does not do so, the bank is still obligated to make good on the draft. The bank's good name is likely to enable an importer to buy goods from an overseas exporter that lacks knowledge about whether the importer will be able to pay. In recent years, acceptances have generally been resold in Secondary markets and held by other banks, households, and businesses.

**Repurchase Agreements,**

Repurchase agreements, also known as repos or RPs, are used for cash management by large corporations. They are very short-term ' loans, typically with maturities of less than two weeks. In many cases, a firm gives money as loan to a bank overnight. For example, if a large company has idle cash, it purchases T-bills from a bank that agrees to buy them back the next morning at a higher price, reflecting the accumulated interest. The T-bills serve as collateral; that is, if the borrower defaults, the, lender receives the T-bills.

**Federal (Fed) Funds (in U.S Perspective)**

 Federal funds instruments represent overnight loans between banks of their deposits with the Federal Reserve System (the U.S. central bank). Banking regulations require that banks deposit a percentage of their deposits as reserves with the Fed. If a bank is temporarily low on reserves, it can borrow funds from another bank that has reserves greater than the required level. The federal funds market reflects the credit needs of commercial banks, so money market analysts watch the federal funds rate (the interest rate \charged on these overnight loans) closely. When it is high, banks need additional funds; when it is low, banks have low credit needs

**Eurodollars**

 Eurodollars are U.S. dollars deposited in foreign branches of U.S. banks or in foreign banks outside the United States (not necessarily in Europe). Rather than being converted into the currency of the foreign country, the de­posits remain denominated in dollars. U.S. banks can then borrow these funds. Eurodollar funds raised abroad have become an important source of funds for U.S. banks.

**Negotiable Bank Certificates of Deposit**

A certificate of deposit (CD) is a fixed-maturity instrument sold by a bank to depositors; it pays principal and interest to the certificate holders. This is an American terminology for terms deposits.

**Capital Market Instruments**

 Since capital market instruments have longer maturities than money market instruments, they are subject to greater fluctuations in their returns. For this reason, borrowers who seek to use funds for a long period of time and savers with long investment horizons invest in them. All capital market debt instruments contain some risk of default; however, since government securities are backed by sovereign undertaking hence carry little risk.

**Government Treasury Securities**

Securities and bonds are issued by the government to finance budget deficits such as Federal Investment Bonds issued by Govt. of Kenya with maturity of 5 to 10 years. These are traded through Stock Exchange, hence liquidity is ensured.

**U.S. Government Agency Securities (In U.S Perspective)**

U.S. government agency securities are intermediate-term or long-term bonds issued by the federal government or government-sponsored agencies. For example, the Farm Credit System issue bonds to raise money to finance agricultural activities, and the Government National Mortgage Association (GNMA) issues bonds to finance home mort gages. Many such securities are officially guaranteed by the government (with a pledge of the government's "full faith and credit"); others, are implicitly guaranteed, so the default risk is still low.

**State and Local Government Bonds issued in United States**

State and local government bonds (often called municipal bonds) are intermediate-term or long-term bonds issued by municipalities and state governments. These governmental units use the fund borrowed to build schools, roads, and other large capital projects. The bond are exempt from federal income taxation (and also income taxation by the issuing state). These bonds are often held by high-tax-bracket house- holds, commercial banks, and life insurance companies.

**Stocks**

Stocks are issued as equity claims by corporations and represent the largest single category of capital market assets.

**Corporate Bonds**

Corporate bonds are intermediate-term and long-term obligations issued by large, high-quality corporations to finance plant and equipment spending. Typically, corporate bonds pay interest twice a year and repay the principal amount borrowed at maturity. There are many variations, however. Convertible bonds, for example, allow the holder to convert the debt into equity (for a specified number of shares). By using such variations, firms can sometimes lower their borrowing costs by giving bond buyers an extra re­turn if the firm does exceptionally well. Corporate bonds are not as liquid as government securities because they are less widely traded. Corporate bonds have greater default risk than government bonds, but they generally fluctuate less in price than corporate equities.

Although the corporate bond market is smaller than the stock market in the United States, it is more important for raising funds because corpora­tions issue new shares infrequently. Most funds raised through financial markets take-the form of corporate bonds. Investors in corporate bonds are a diverse group, including households, life insurance companies, and pension funds.

**Mortgages**

Mortgages are loans (usually long-term) to households or busi­nesses to purchase buildings or land, with the underlying asset (house, plant, or piece of land) serving as collateral. Residential mortgages are issued by commercial banks. Mortgage loans for industrial and agricultural borrowers are made by life insurance companies and commercial banks.

**Commercial Bank Loans**

Commercial bank loans include loans to businesses and consumers made by banks and finance companies. Secondary markets for commercial bank loans are not as well developed as those for other capital market instruments, so loans are less liquid than mortgages.

**WAPDA Bond**

It is an instrument of capital market in Kenya. It serves as source of funds to this institution

Bonds in general are issued as equity claims on corporations and represent largest single category of capital market assets.

**Debentures: (Corporate Bonds) --- Global Perspective**

Through debentures intermediate-term and long-term loans are raised by the company of strong credit rating.

**An Overview of Banking Laws & Practices**

There are different laws/ statutes promulgated by the legislature. There are also laws/ statutes relating to banks and banking business. Some of the statutes relating to banking and other fields are stated below for reference purposes:

* Banking Companies Ordinance
* Negotiable Instrument Act
* Limitation Act
* Arbitration Act
* Criminal Procedure Code. (CrPC)
* Civil Procedure Code (CPC)
* Contract Act.
* Sales Tax Act

**What is banking practice?**

A banking practice refers to’ normal banking practice’ carried on over a long period of time. Such normal banking practices carry the sanctity of law and courts do recognize such practices while deciding cases. Banking practices are complimentary to law not contradictory to law.

**Some of Banking Practices**

Secrecy concerning customer’s affairs:

A banker is required to maintain secrecy of its customers account however under special circumstances; banker may produce statement of account under some statutory requirements to a court of law or to authorized persons/ department.

Exchange of inter-bank credit reports is one of the global banking practices.

**Banker’s Right of Set-Off:**

Law entitles banks to set—off its claims from customer credit balances. However, courts have formulated rules, which require business norms to be followed as well.

**Safe-Custody Services (Lockers Facility)**

This relationship is governed by the law of bailment. (Legal relationship of Bailer and Bailee is established between the customer and the banker while availing lockers facility). Courts while adjudicating cases also pay due consideration to normal banking practices.

 Banking Practice of Closing a Customer’s Account under Following Circumstances:

* Frequently drawing cheques without sufficient balance in the drawer’s account.
* Depositing cheques for collection which are frequently returned uncollected.
* Issue cheques and then issue stop-payment instruction to the bank.

Banks may close account of such customers after issuing reasonable notice.

 From the above discussion, we can conclude that in banking statutory provisions and banking practices move side by side. It is important to understand that banking practices are complimentary to law these are in no case contradictory to law. Law shall always prevail over practices.

**EVOLUTION OF BANKING**

**Historical Overview of Banking**

Before we move on to evolution of banking in Kenya, it would be quite interesting to have a glimpse of historical evolution of banking over a period of time.

 Today, we look around us chain of banks rendering host of services to their customers. These banks cater to the commercial and industrial needs of all countries which include die highly developed and industrialized countries, the less developed countries and the countries which are at the take-off stage. Thus there are the industrial banks, the commercial banks, the joint stock banks, the co-operative banks, the agricultural banks, rural development banks, lead banks and so many other types of banks and credit institutions which are functioning. They not only meet the requirements on a national basis, but also on an international basis and what may be called as an ever expanding advancement in banking. The Banks now-a-days are performing so many functions that it would not be a misnomer to suggest that they have become the custodian of the monetary economies of the world. When we talk of great scientific developments and inventions, banking as it stands today is also a wonder of the world.

Banking as we see today is the result of evolutionary development during the course of centuries. It would also be necessary to see how Banking has come to its present stage. There has been all round development in the world and the banking today is not what it was in the earlier rudimentary form. To develop true perception, we need to know as to in what manner Banking today has come to be what it is and in what manner this transition has taken place.

The banking system, as it exists today, is the product of a number of centuries and is not the development of any particular period. In all the countries of the world. Banking has been in existence in one form or the other. So far as the present system is concerned, the word, *bank is* said to be of Germanic origin, cognate with the French word *banque* and the Italian word, *banca,* both meaning *bench.* In fact, this word may have derived its meaning from the practice of Jewish money-changers of Lombardy, a District in North Italy, who, in the middle ages, used to do business sitting on Benches in the market place. In case such an interpretation is provided, then it *also* finds support from a number of other derivations of the word such as the French word, *Bancjue Route* and the Italian word, *Banka Rotta,* both of which mean Broken Bench. This practice can be understood if we analyze the situation when a money-changer failed and his bench was broken as a result of his failure.

*Macleod,* however, does not agree with this view and says, *"The* Italian money-changers as such were never called *Benchieri* in the middle ages". It may be more correct to say that the word bank is derived from the German word *back* which means a Joint Stock Fund, which was Italianized into *Banco,* when the Germans were me masters of a major part of Italy. *Professor Ram Chandran Rao* has said: "whatever be the origin of the word *bank,* it would trace the history of banking in Europe from the middle ages

When we come to the Roman age, the State Banks were not functioning but there were private banks duly regulated by the Government. *Aristotle* stated that:

"Charging of interest on money was unnatural and immoral and on this account, banking could not develop for sometime."

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We should also remember that in ancient times, commercial banking was associated with the business of money-changing. They also met the financial requirements of the ruling government. *Adam Smith* has stated as under:

"The earliest banks of Italy, where the name began, were finance companies..... to make loans to and float loans for the government of cities in which they were formed.... After these banks had been long established, they began to do what we call banking business, but at first they never thought of it.

It was only in the 12th century that the Banks, in the modem sense of the term, were established in Venice and Geneva, which were doing the business of receiving deposits and lending money, and were not only money-lenders. In Florence alone, there were about 80 bankers known to the whole of Europe such as Bardi, Medici, Peruzzi and others of great repute. The Bank of Venice founded in 1157, was the first Public Banking Institution. The Bank of Barcelona and the Bank of Geneva were established in 1401 and 1407 respectively and the Bank of the Venice and the Bank of Geneva continued to operate until the end of the 18th Century. The private banking houses such as the famous house of Fuggers and Augsburg enjoyed more eminence than Peruzzi and Bardi in the 14th Century and the Medici in the 15th Century in Italy. The bankers of Lombardy settled in the locality which is now known as the famous Lombard Street in London and to them belonged the credit of planting the seed of modem banking in England. Public banks like the famous Bank of Amsterdam was established in 1609 and these banks helped in the development of trade and commerce. These banks received heterogeneous metallic money and credited deposits in their books which were transferable through bank cheques. Thus, the mercantile payments now began to be settled by means of payment through cheques.

In Britain, people used to deposit their cash and bullion at the Royal Mint having faith in the King and the royal family as an institution.

*Edward III* exchanged various foreign coins and provided foreign exchange to the travelers and also supplied British money.

This faith was betrayed by *Charles I* in 1640 A.D. by capturing a very big amount of £1, 30,000 bullion left for safe custody with the Royal Mint. The merchants then started entrusting their valuables and cash to their cashiers, who also misappropriated them, and the merchants took resort to goldsmiths for keeping custody of valuables in their strong rooms. These goldsmiths used to give receipts which were known as Goldsmith's Note, which was made payable to the bearer and on demand which transformed the said receipt into the position of a bank-note which gained circulation and currency in due course of time. These notes with the passage of time became payable to the bearer on demand and enjoyed circulation. Thus, we can say that the goldsmiths became the precursor of the modern, bank-note and the fore-runners of the modem banking institutions.

Thus the development of banking in England was greatly helped by the activities of the London goldsmiths during the age of Queen Elizabeth L For sometime, the deposits were made without interest. Later on, the goldsmiths tarred lending these amounts to others like that of Dutch Bankers and when it was found profitable by them, *they* started giving interest on this money to their customers instead of charging any fee for safeguarding their money. The goldsmiths started giving loans for long duration and some money was kept by them for daily payments. The trouble arose when *Charles 11* under the Cabal Ministry borrowed heavily from them and repudiated all debts there by the goldsmiths as well as English Banking received a rude setback.

*Walter Bagehot* has stated that the government perpetrated one of those monstrous frauds which are likewise gross blunders. *Charles II* set up the Exchequer. He would pay to none and as has been stated by *Geoffrey Crowther*  the goldsmiths were ruined. As a result of this, there was the growth of private banks which finally led to the establishment of the Bank of England in 1694. It is again interesting to refer to *Geoffrey Crowther* to trace the history of modem English banking, who has stated as under:

"The present-day banker has three ancestors of a particular note. One we have already met; the merchant, whose high and widespread reputation or credit enables him to issue documents that will be taken all over the known world as titles to money. To this day the title of "merchant banker” is reserved by usage to the older cosmopolitan and more exclusive private banking firms, nearly every one of which can trace its ancestor to a trader in commodities, more tangible (though hardly more profitable) than money. The banker's two other ancestors are the money-lenders and the goldsmiths. Lending and borrowing arc almost as old as money itself and the village money-lender is found even in quite primitive communities. He is not usually regarded as a very lovely object; usurer is one of the oldest terms of abuse. But the services he performs are undoubtedly useful and necessary, even though the reward he extracts in return may usually be rapacious..... The goldsmith ancestor of the modern bank is purely an English affair.

The goldsmiths were loosing their faith and earned a bad reputation for sometime and people doubted their *bona fides.* However, they started a new system of having current account with them and the borrowers could withdraw money at any time. This was the stage which gave birth later on to the present banking system. Till then, there was no public bank: The Bank of England was started in 1694 A.D. with its monopoly of issue of notes. There were joint stock companies doing banking business- and they were flourishing in London. These companies introduced deposit banking and cheque currency and many other services which a bank can offer.

So far as the Bank of Amsterdam is concerned, it was one of the greatest banks of the 17th century and its position was not less than the position which was held by the Bank of England. In fact, it had importance in the international world as a whole and one can get a good reference about the working of these banks from *Alfred Marshal}* who in his book, "Money, Credit *and Commerce,* 1923", has slated that these famous banks besides, acting as the fiscal agents for the government, were also responsible for the counterpart of such of the work of the modem stock exchanges. In fact, these banks acted as go-between the lenders and borrowers of funds and also as the holders of cash and old securities. In this connection, it would be interesting to refer to *Adam Smith* who in his famous book, *"Wealth of Nationsf/,* published in 1776, has described the main function of the Bank of Amsterdam as under:

"This bank received both foreigncoin, and light and worn coin of the country at its intrinsic value in the gold standard money of the country, deducting only so much as necessary for defraying the expense of coinage, and the other necessary expense of management. For the value which remained, after this deduction was made, it gave a credit in its books. This credit was called bank money which, as it represented money exactly according to the standard of the mint, was always of the same real value, and intrinsically worth more than current money...., it could be paid away by a simple transfer, without the trouble of counting or the risk of transporting it from one place to another.

We have already seen that the Bank of England was started in 1694 as a result of the actions of *Charles II* who had borrowed very heavily from the goldsmiths and like his father had repudiated his debts. The Bank of England was also started on account of the financial difficulties of *William III* who was at war with France. Patterson suggested a way out of difficulties and offered to rise of £1,200,000 which he was prepared to loan to the government if certain concessions including the right to issue notes were given to the proposed institution. For this purpose the Tonnage Act was passed. In the year 1708 another important Act was passed which prohibited any other bank with more than six partners from issuing promissory notes and bank-notes. This Act gave the monopoly of note issue to the Bank of England, so far as the Joint Stock Banks were concerned, but left private banks having not more than six partners free to issue notes. These banks however, thought that the business of note issue was not profitable and they gave it up. Printed cheques were issued for the first time between 1749-59. The Bank of England did not have any branch outside and the private banks started playing an important role. After the middle of the 18th century there were about 300 banks. Then came the crisis of 1825 and it tolled the death knell for the small country banks and of the note as the foundation of the banking system. In 1826 an Act was passed which allowed the banks to be started with unlimited liability, consisting of more than six partners, with the right to issue note provided they had no office within the radius of sixty-five miles from London. Thus the new joint stock banks were started. Even at this time the monopoly of note issue given to the Bank of England by the Act of 1708, was interpreted to mean monopoly of Joint Stock Banking in London because during those days note issue was regarded as the most important as well as the most paying function of banks.

The modem banking institution had to wait for another century and four decades until the passage of the Banking Act of 1833 which provided for the establishment of the Joint Stock Banks.

In 1833, when the Charter of the Bank was revised, as a result of the studies made by one *Joplin,* a new clause was added and it gave legislative sanction for the establishment of Joint Stocks Banks in London and in 1834, The London and Westminster Bank was started in England, which is the first of the big five ones. In 1844 Peel Act was passed which provided for the extinction of the right of note issue and laid the foundation of the note by Bank of England. With the passing of the Peel's Act, 1844, new banks with the right of note issue could not be started and those which already existed could not increase their circulation and thus greater emphasis was thereby laid on deposit banking and cheque currency.

There was amalgamation of banks after 1890 and the number of Joint Stock Banks in England and Wales came down from 104 in 1890 to 12 in 1956 although the number of bank offices increased from 2203 to 10700 by the end of 1961. The Currency and Bank Note Act, 1920 also regulated the issue of bank-note. The Securities Management Trust Ltd. was organized in 1929. In 1930 Bankers Industrial Development Corporation was formed. In 1947, the Labor Government nationalized the Bank of England and the power to appoint its Governor, Deputy Governors and Directors was vested in the Crown. This Act of the Labor Government had significant impact throughout the world.

“An Act to regulate the acceptance of deposits in the course of '. business; to confer functions on the Bank of England with respect to the control of institutions carrying on deposit-taking businesses; to give further protection to persons who are depositors with such institution to make provision with respect to advertisements inviting the making of deposits; to-restrict the use of names and descriptions associate with banks and banking; to prohibit fraudulent inducement to make deposit; to amend the Consumer Credit Act, 1974 and me law wit respect to instruments to which section 4 of the Cheques Act, applies; to repeal certain enactments relating to banks and banking; and for purposes connected therewith.”

The significance in law of the terms 'bank’, banker' and 'banking business" depends upon the particular operation which is in question an upon the particular statute/if any, under which the question arises. To take an obvious instance, only a banker may reap the benefit of the protective sections contained in different statutes.

In short the effect of the Banking Act, 1979 is, generally speaking, that a person or institution may accept deposits in the course of carrying on deposit taking business for the purposes of the Act unless he or it is a party recognized or licensed by the Bank of England or he or it is exempted or its business falls within the exceptions of section 1(3) or, again, the deposit is I the type included in sub-section (5). *Vide* section 1(4), 'deposit' is defined as sum of money paid on terms:

(a) Under which it will be repaid, with or without interest or premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it; and

(b) Which are not referable to the provision of property or service or the giving of security?

The penalty for contravention is liability to a fine or imprisonment both; but the civil liability of the acceptor of the deposit is not affected.

Thus so far as the English banking system is concerned, the entire matter is now covered by the Banking Act, 1979 which governs all the important aspects of the banking life in England

As per Sheldon's *"Practice and Law of Banking",* 10th Edn., p. 163, so far as the classification of banks is concerned, firstly, there is the Bank of England, incorporated by Royal Charter and not affected by the Companies Act. Secondly, there are the National Saving Banks, the National Giro and the Trustee Saving Banks. Thirdly, there are the great Joint Stock Banks, registered under the Companies Act with limited liability. Fourthly, there is at least one Joint Stock Bank with unlimited liability, namely, C. Hoare & Co., Coutts & Co. which is now a wholly owned subsidiary of National Westminster Bank Ltd. though it is still a clearing bank in its own right. There used to be many banking partnerships with unlimited liability but, with N.M. Rothschild & Sons becoming a limited company in 1970, it seems that there remains no banking partnership in England and Wales of any size. , Fifthly, there are the Scottish, .Irish, Overseas and Foreign Banks whose principal places of business are outside the precincts of England and Wales. Some of the earlier overseas banks were incorporated by Royal Charter, *e.g.,* the Chartered Bank, British Bank of the Middle East, and so on. Sixthly, there are so called Merchant Banks, which are now without exception incorporated under the Companies Act, the shares of many of them being quoted on the London Stock Exchange. These banks are engaged in deposit banking but their more important role is in the provision of finance, both by way of loan and acceptance credit and in acting as financial advisers to a large range of commercial companies/especially where 'take-over bids', mergers and amalgamations are concerned. Most of them are also prepared to act as investment advisers.

In conclusion, we can say that banking is not a static rather it is a dynamic concept. It is product of centuries and the development which has taken place is the product of the method of trial and error and experiences which were made and the results that followed relating to the acceptance of money and valuables as deposits, keeping them as such, lending them, whether to private individuals or to states or other bodies and for controlling the multifarious and multi-dimensional activities which in the beginning were only trivial and could be ignored but with the growth of time, became international in character and multi-dimensional in nature calling for actions on the part of the states as the actions on the part of the individuals failed and state control became eminent. Thus, one cannot understand the development of banking merely by looking at a particular period of time and one will have to consider the development by taking into account the progress as it has taken place during the centuries and by understanding the movement from one stage to the other.

**Evolution of banking in Kenya:**

Commercial banks constitute the most important source of institutional credit in the economy. As the country’s largest deposit institutions and the main source of short-term credit, they form the heart of the financial system.

At the time of independence, there were two banks incorporated in the undivided India in first half of 1940s’ whose owners were Muslims. After independence they decided to establish their head office in Kenya, thus laying the foundation of banking in this country.

The National Bank of Kenya was set up in November 1949 in crises conditions following the first trade deadlock with India. The original intention was to establish it sometime in 1950. The plans for its establishment had to be advanced in view of the critical situation, which developed especially in the jute trade as a result of India’s refusal to accept the exchange rate of the Kenyai Rupee following the Indian devaluation of 1949. The bank was set up through an Ordinance on 19 November 1949 and started its operations with five offices located at important jute centres. It played a notable role in financing the jute trade in collaboration with the Jute Board. In 1952, the National Bank of Kenya took over the agency work of the State Bank of Kenya to transact government business and manage currency chests at places where the state bank did not have an office of its own.

Prior to nationalization, the government owned 25 percent of the share capital while others held the remaining 75 percent. Following nationalization, the capital held by others was transferred to and invested in the federal government. Prior to nationalization, a Central Board of Directors governed the National Bank but consequent upon nationalization, the Central Board was dissolved and in its place an Executive Board consisting of a President who is the chief executive and four other members were appointed for the general direction and superintendence of the affairs and business of the bank.

All Kenya banks were nationalized with 100 percent federal government ownership in 1974 and by now all nationalized banks stand disinvested and privatized. These aspects shall be discussed in detail in due course of time’

There were as many as thirty-four foreign banks with 172 branches at the time of in dependence. With the closure of many of the banks, the number had declined to twenty-one by June 1980. The Indian Banks, which numbered nine were entrusted to the Custodian of Enemy Property after the 1965 Indo-Pak war. Among foreign banks, a distinction was usually made between banks having their head offices in India and those with head offices in other countries. Foreign banks, other than the Indian banks, were commonly known as exchange banks in the early years. The term owed its origin to the fact that, prior to independence; foreign banks in the Indo-Kenya subcontinent were engaged primarily in the financing of foreign trade. Seven exchange banks incorporated abroad were operation in Kenya at the time of independence. Most of thse banks were of British origin. There were twenty-nine Indian Banks operating in the territories of Paksitan at the time of Independence but they gradually curtailed their business and their number stood at nine in 1965 when they were taken over by the Custodian of Enemy Property. The banks that were taken over were: (1) State bank of India; (2) Central Bank of India Ltd.; (3) Bank of India Ltd.; (4) United Commercial Bank Ltd.; (5) Punjab Commerce Ltd.; (7) United Bank of India Ltd.; (8) Bank of Baroda Ltd.; and (9) United industrial bank Ltd. Besides, there were as many as twelve non-schedule Indian banks which were also taken over by the Custodian of Enemy property following the 1965 Indo-Kenya War.

Very few foreign banks have been attracted to Kenya during the financial liberalization period. Indeed several have sold out to private Kenyai banks and terminated operations in Kenya.

 **Evolution of Commercial Banks in Kenya**

As already discussed that at the time of independence, there were only two banks, which were incorporated in undivided India and whose owners were Muslims ,they opted to shift their Head Offices in Kenya. With the establishment of SBP, the other banks also came into existence and by 1973 number of banks increased to fourteen.

**Nationalization of Banks in Kenya:**

In 1974, the banks in Kenya were nationalized through an Act called Nationalization Act, 1974. From 1991, the policy of liberalization of economy has been adopted whereby, nationalized banks have been de-nationalized and banking sector has been disinvested. At present banking sector is visibly growing at tremendous pace. These aspects shall be discussed at length in due course.

**LECTURE 5**

**THE BANKS (NATIONALIZATION) ACT, 1974**

**Nationalization of Banks**

We have gone through the evolutionary process of banking in Kenya. We know that by June 30th 1948 the number of branches in Kenya was only eighty one. However with the establishment of State Bank of Kenya and efforts of the government, the number of schedule bank increased to 14 with 3323 branches all over Kenya and also 74 branches in foreign countries by Dec 31st 1973. The commercial banks grew at tremendous speed and mobilized savings from the public and also contributed a lot in financing business and corporate sector. However it was considered that although banking sector was growing but the fruits of development were limited only to the urban population and corporate sector whereas most of the sectors, people and under develop regions were not getting due share. As such it was decided that banks should be nationalized. For the implementation of this objective Nationalization Act 1974 was promulgated.

**Objectives of Nationalization**

The nationalization was carried out with a view to achieve the following objectives:

-- Disbursement of funds to the desired channels to achieve the priorities set out by the government for social welfare projects.

-- Equitable distribution of credit to different classes, sectors and regions.

 **Salient features of The Bank (Nationalization) Act, 1974**

The Act extends to the whole of Kenya.

**Act to override other laws.-** This Act shall have effect not withstanding anything contained in any other law for the time being in force or in any agreement, contract, award memorandum or articles of association or other instrument.

**Statutory Definitions**

**The followings definitions as contained in section 3 of the Act, which are reproduced below**

1. **"Bank" means**
2. A company registered under the Companies Act, 1913 (VII of 1913), and transacting, in or outside Kenya, the business of banking as defined in clause (b) of section 5 of the Banking
3. Companies Ordinance, 1962 (LVII of 1962), in respect of which no proceedings under Part III or Part IV of the said Ordinance have been taken or are pending immediately before the commencing day; and
4. A banking company incorporated by or under any law within the legislative competence of
5. Parliament, including the State Bank, the National Bank of Kenya, the Industrial
6. Development Bank of Kenya and the Agricultural Development Bank of Kenya, but does not include;-
7. A bank which is an enemy firm within the meaning of the Defense of Kenya Rules, or
8. A banking company incorporated outside Kenya and transacting banking business in Kenya, or
9. A co-cooperative bank registered under the Co-operative Societies Act, 1925 (VII of
10. 1925), or any other law for the time being in force relating to co-operative societies, not being a co-operative bank which is a scheduled bank; or
11. A Government Savings Bank to which the Government Savings Bank Act, 1873 (V of 1873), applies, or
12. A corporation or company owned or controlled by a Province and carrying on banking business only within that Province, or
13. va corporation or company established in Kenya in pursuance of an agreement between the Government of Kenya and Foreign Government or institution for transacting banking business in or outside Kenya;
14. **(1A) “board"** means Board of Directors constituted under this Act;
15. **"Commencing day**" means the Ist day of January, 1974;

**(4A) “Loans and advances**" means "loans, advances and credit" as defined in the Banking Companies Ordinance, 1962 (LVII of 1962),

1. **"Prescribed"** means prescribed by rules made under this Act;
2. **"State Bank"** means the State Bank of Kenya established under the State Bank of Kenya Act, 1956 (XXXIII of 1956); and

Other words and expressions used but not defined in this Act shall have the same meaning as in the Banking Companies Ordinance, 1962 (LVII of 1962).

**Provisions regarding transfer of ownership of banks are contained in section 5 of the Act which is reproduced below**

1. The ownership, management and control of all banks shall stand transferred to, and vest in, the Federal Government on the commencing day.
2. All shares in the capital of a bank held by persons other than the Federal Government, a Provincial Government, a corporation owned or controlled by the Federal Government or the State Bank shall stand transferred to, and vest in, the Federal Government on the commencing day, free of all trusts, liabilities and encumbrances.

**(2A)** if any bank issues any additional share capital after the commencing day, then, without prejudice to the provisions of sub-section (1), a Provincial Government, a corporation owned or controlled by the Federal Government and the State Bank may contribute to the share capital so issued.

1. The vesting of any shares in the Federal Government under sub-section (2) shall not affect the right inter se of a shareholder and any other person who may have an interest in such shares and such other person shall be entitled to enforce his interest against the compensation awarded to the shareholder under section 6.
2. The safety of all deposits in banks shall stand guaranteed by the Federal Government.
3. The provisions of this Act and the vesting of the shares of the banks in the Federal Government thereunder shall not in any way affect the status of the banks as bodies corporate
4. The Federal Government or a corporation owned or controlled by the Federal Government may, from time to time, sell all or any of its shares in the capital of a bank, other than the State Bank, to such persons, and on such terms and conditions, as it may determine.

**Procedure regarding compensation for transfer of ownership of shares in a bank is contained in section 6 which is reproduced below:**

1. Every person who stands registered as the holder of any share of a bank the ownership, management and control of which stands transferred to the Federal Government by virtue of section 5 shall be entitled to receive from the Federal Government by way of compensation per share an amount determined in accordance with the provisions of section 7 in the form of bonds of the Federal Government, repayable at par at any time within a period of fifteen years in accordance with a redemption programmed formulated by the Federal Government and bearing interest at the rate of one per cent above the bank rate notified by the State Bank from time to time:

Provided that, in formulating the redemption programmed, the Federal Government may make provision for preferential redemption of the bonds of such class of persons who are of meager means such as orphans, widows and pensioners, and the amount of compensation payable to whom does not exceed such maximum amount, as the Federal Government may deem fit:

Provided further that, where the amount so determined is not exact multiple of one hundred rupees, the amount in excess of the nearest lower multiple of one hundred rupees shall be paid in cash.

1. The bonds shall be negotiable and eligible as security for advances.

**The previous management was removed as per provisions contained in section 8 of the Act which is reproduced below:**

1. Every person holding office in any bank as chairman, director or chief executive by what-ever name called, other than a person who holds such office by virtue of his appointment or nomination by the Federal Government or the State Bank, shall stand removed from his office on the commencing day and this removal shall not entitle him to any compensation and no such claim shall be entertained by any court, tribunal or other authority.
2. The vacation of his office by a Chairman, Director or Chief Executive under subsection (1) or otherwise shall not in any way absolve him of his liability, if any, under any law, contract or otherwise howsoever subsisting immediately before the commencing day or the day on which he ceases to hold such office.
3. A Chairman, Director or Chief Executive by whatever name called ceasing to hold office under any of the aforesaid provisions shall entrust or cause to be entrusted to the person succeeding him in that office, intact and in as good order as they existed on the day immediately preceding the commencing day all properties, all books of accounts and other records and documents belonging to or in the custody or control or pertaining to the affairs, of the bank.
4. Central Board of the banks mentioned in the Schedule, and all local bodies, area boards, managing committees, executive committees and similar other bodies for the management of any bank shall stand dissolved, and all members of such bodies shall stand removed from office, on the commencing day.

**Kenya Banking Council**

1. At the time of promulgation of this Act, Kenya banking council was established to oversee the working and performance of nationalized banks. However, the council was dissolved vide Banks (Nationalization) (Amendment) ordinance 1997, the main features as contained in section 9 of the Act are given below:
2. The Kenya Banking Council (hereinafter referred to as the Council) shall stand dissolved forthwith.
3. All assets, properties and rights of the Council shall stand transferred to and vest in, and all liabilities and other encumbrances of the Council shall stand transferred to and become the liabilities and encumbrances of, the State Bank.
	1. Employees of the Council, including its members,-
	2. who are on deputation or secondment from any public sector financial institution shall revert to, and continue to be employed by, their parent institutions on terms and conditions governing their employment in their parent institutions; and
	3. Who do not fall in clause (a) shall become employees of the State Bank on terms and conditions governing their employment with the Council.
	4. Every contract or instrument to which the Council is a party shall continue to be in force and effective as if the State Bank had been a party thereto instead of the Council.
	5. Any legal proceedings or, as the case may be, any application pending before any authority by or against the Council may be continued by or against the State Bank.
	6. Where under any statute or statutory instrument, the Chairman or a member of the Council is nominated for a specified assignment of task, the vacancy caused by operation of this section shall be filled by a person nominated by the State Bank.

**Provisions regarding management of banks are contained in section 11 which is reproduced below:**

1. Subject to sub section (2) a bank shall have a Board consisting of-
	1. A President, who shall be its Chief Executive; and
	2. Not less than five and not more than seven other members.
2. The Federal Government may, if it deems necessary, appoint a Chairman of the Board in respect of a bank.
3. The Chairman, the President and other members of the Board-
4. shall be appointed by the Federal Government in consultation with the State Bank, for a term of three years, on such terms and conditions as may be fixed by the General Meeting of the bank:
5. provided that the Chairman and the President shall be appointed from amongst professional bankers whose names are included in a panel of bankers qualified to be the Chairman or the President,
6. which panel shall be determined, maintained and varied, from time to time, by the State Bank;
7. may be removed for misconduct or physical and mental incapacity before the expiry of the three years term by the Federal Government in consultation with the State Bank;
8. shall stand removed if he becomes ineligible on any of the grounds specified in sub-section(12);
9. May be re-appointed by the Federal Government, in consultation with the State Bank of Kenya, for a further period of three years.
10. The general direction and superintendence of the affairs and business of a bank, and overall policy making in respect of its operations, shall vest in its Board.
11. The Board shall determine-
12. the credit policies of the banks;
13. evaluation criteria for the performance of the employees of the bank other than the President;
14. personnel policies of the bank including appointment and removal of officers and employees;
15. guidelines for entering into any compromise with borrowers and other customers of the bank; and
16. Any other policy matter.
	1. The Chief Executive and other officers of the bank shall act in accordance with the policies, criteria and guidelines determined by the Board.
	2. The board shall appoint committees from amongst the executives of the bank, and determine the powers, functions and duties of such committees.
	3. Where the Federal Government has appointed a Chairman he shall preside over the meetings of the Board, and in case a Chairman has not been appointed, then the president shall preside over the meetings of Board. In the absence of the Chairman or the President, as the case may be the directors may elect one of its members to preside over the meetings.
	4. The President, subject to the control and directions of the Board, shall exercise powers of management of the affairs of the bank.
	5. All selections, promotions and transfers of employees of banks except the President and decisions as to their remuneration and benefits shall be made by the President in accordance with evaluation criteria and personnel policies determined by the Board.
	6. The Board, the President and other officers shall exercise their powers and discharge their duties in accordance with sound banking principles and prudent banking practices and shall ensure compliance with regulations and directions that may be issued by the State Bank from time to time.
	7. No person shall be eligible for appointment as the Chairman, the President, or a member of the Board if-
		1. he is or has at any time been, adjudged an insolvent or has suspended payment or has compounded with his creditors; or
		2. he is a minor or is found a lunatic or of unsound mind; or
		3. he is not citizen of Kenya; or
		4. he was at any time in the service of Federal Government or a corporation controlled by any such Government or in the service of a bank and was dismissed; or
		5. he is a person against whom any action has been taken or any proceedings are pending under section 412 of the Companies Ordinance, 1984, (XLVII of 1984), or section 83 of the Banking Companies Ordinance, 1962 (LVII of 1962); or
		6. he is, or has been convicted for tax evasion under any law for the time being in force; or
		7. he is a member of the Senate, National Assembly, any Provincial Assembly or an elected Member of a local council constituted under any law relating to local councils; or
		8. He is holding an office in a political party.

**Effects of Nationalization**

**Pros:**

* Availability of funds to the government for meeting its social sector targets
* Equitable distribution of credit to the different sectors, industries and regions.
* Centrally coordinated policy frame work

**Cons:**

* Excessive government control leading to the decisions on non professional considerations.
* Lack of fair market competition leading to absence of availability of innovative and diversified products to the customers.
* Neglect of personalized services to the customers.
* Mismanagement leading to alarming size of nonperforming loans portfolio.

Nationalization Act is an important part of our statutory history. We have, at length discussed objectives merits and grey areas of nationalization. At present the world is heading forward with the notions of disinvestment, privatization and free market and banking industry is no exception to it. At present banking industry is passing through this phase and visibly performing well.

**LECTURE 7**

**Banking Companies Ordinance, 1962**

**Introduction**

Law relating to Banking Companies is governed by Banking Companies Ordinance, 1962.

 As we have seen that there are other laws which are related to the banking transactions and are of interest to different stake holders as such we shall take into account these ancillary statutes/ laws besides this ordinance.

**Application of other laws shall not be barred under section2**

This ordinance shall have l**imited application to certain financial institutions**

1. The provisions of sections 6,25A, 25AA, 29,31,32,33,40, 41,41A, 41B, 41C, 41D, 42, 83, 84, and 94 of this Ordinance shall, with such modifications as the State Bank may determine from time to time in relation to activities which have implications for the monetary or credit policies of the State Bank, apply to the Investment Corporation of Kenya, the National Investment Unit Trust, the Kenya Industrial Credit and Investment Corporation, the House Building Finance Corporation, the National Development Finance Corporation, the Bankers Equity Limited, the Pak-Libya Holding Company Limited, the Kenya Kuwait Investment Company Limited, the Saudi-Pak Industrial and Agricultural Investment Company Limited, the Small Business Finance Corporation, the Regional Development Finance Corporation, Investment Finance Companies, Venture Capital Companies, Housing Finance Companies Corporations or Institutions which carry on one or more of the businesses enumerated in section 7 of this Ordinance, save and except for leasing companies and modaraba companies, as the Federal Government may from time to time, by notification in the Official Gazette, specify in this behalf.
2. All notifications issued by the Federal Government which are inconsistent with the provisions of sub-section (1) including such notifications in respect of the National Development Leasing Corporations, Leasing Companies and Modaraba Companies shall stand rescinded with immediate effect.

The Federal Government shall have powers to suspend the operations of Ordinance under section 4. The Federal Government, if on a representation made by the State Bank in this behalf is satisfied that it is expedient so to do, may by notification in the Official Gazette suspend for such period, not exceeding sixty days, as may be specified in the notification, the operation of all or any of the provisions of this Ordinance, either generally or in relation to any specified banking company. The Federal Government may, by notification in the official Gazette, extend from time to time, the period of any suspension under sub-section (1) for such period or periods, not exceeding sixty days at any one time, as it thinks fit so however that the total period does not exceed one year.

A copy of any notification issued under this section shall be laid on the table of the Federal Legislature—

* if it is in session, **within three days** of the issue of the notification; and
* If it is not in session, as soon as it meets after the issue of the notification.

The banking companies Ordinance 1962 has been divided in five parts, comprising of 94 sections. We shall also cover the banking companies rules, 1963. We shall discuss this ordinance in greater detail but to have a glimpse of the scope of the ordinance, the main topics to be covered are given below for ready reference.

**PART 1 – Preliminary**

Following topics are covered under this Part

* Title, extent and commencement
* Application of other laws not barred
* Limited application of Ordinance to certain financial institutions
* Power to suspend operation of Ordinance
* Definitions:

“Approved securities”
“banking”
“banking company”
“branch” or “branch office”
“creditor”
“company”
“debtor”
“demand liabilities”

“family members”
“gold”
“loans, advances and credit”
“managing director”
“prescribed”
“private company”
“registrar”
“scheduled bank”
“secured loans or advance”
“securities”
“State Bank”
“substantial interest”

* Ordinance to override memorandum, articles, etc

**PART II**

 **Business of Banking Companies**Following topics are covered under this Part

* + Forms of business in which banking companies may engage.
	+ Use of the word ”Bank” or any of its derivatives.
	+ Prohibition of trading.
	+ Disposal of non-banking assets.
	+ Prohibition of employment of managing agents and restrictions on certain forms of employment.
	+ Restrictions on removal of records and documents.
	+ Requirement as to minimum paid-up capital and reserve.
	+ Regulation of paid-up capital subscribed capital and authorized capital and voting rights of shareholders.
	+ Election of new directors.
	+ Appointment of director by State Bank.
	+ Restriction on term of office of directors.
	+ Vacation of Office.
	+ Restriction on commission, brokerage discount, etc., on sale of shares.
	+ Prohibition of charge on un-paid capital.
	+ Prohibition of floating charge on assets.
	+ Restrictions as to payment of dividend.
	+ Prohibition of common directors.
	+ Reserve Fund.
	+ Cash Reserve.
	+ Restriction on the nature of subsidiary companies.
	+ Restrictions on loans and advances.
	+ Power of State Bank to control advances by banking companies.
	+ Power of State Bank to collect and furnish credit information.
	+ Preparation of special reports.
	+ Recovery of certain dues of banking companies as arrears of land revenue.
	+ Power of Federal Government prohibit acceptance of deposits by banking companies incorporated outside Kenya.
	+ Deposits.
	+ Licensing of banking companies.
	+ Prohibition of advertising for deposits and collection.
	+ Disruptive union activities.
	+ Restrictions on opening of new, and transfer of existing place of business.
	+ Maintenance of liquid assets.
	+ Assets in Kenya.
	+ Unclaimed deposits and articles of value.
	+ Half-yearly returns and power to call for other returns and information.
	+ Power to publish information.
	+ Fidelity and secrecy.
	+ Guidelines by the State Bank.
	+ Accounts and balance-sheet.
	+ Audit.
	+ Submission of returns.
	+ Copies of Balance Sheets, and Accounts to be sent to Registrar.
	+ Display of audited balance sheet by banking companies
	+ Incorporated outside Kenya.
	+ Accounting provisions of this Ordinance not retrospective.
	+ Inspection.
	+ Responsibility of State Bank.
	+ Power of the State Bank to give directions.
	+ Power of the State Bank to remove directors or other managerial persons from office.
	+ Power of the State Bank to supersede Board of Directors of a banking company.
	+ Limitations.
	+ Prosecution of directors, Chief Executives or other Officers.
	+ Further powers and functions of the State Bank.
	+ Certain provisions of the Ordinance not to apply to certain banking companies.

**Part –IIA**

**Transaction of Banking Business Illegally By Companies, etc.**Following topics are covered under this part

* Power to call for certain information, etc.
* Special provisions.
* Power to make declaration.
* Consequences of a declaration under section 43B.
* Deposit of cash and preservation of assets, etc.
* Statement of assets and liabilities to be submitted to State Bank.
* Consequential provisions for winding up, etc. 54

**Part –III
Suspension of Business and winding up of Banking Companies**following topics are covered under this part

* High Court defined.
* Restriction on stay order.
* Restriction on compromise or arrangement between banking companies and creditors.
* Power of State Bank to apply to Federal Government for suspension of business by a banking company and to prepare scheme of reconstruction or amalgamation.
* Procedure for amalgamation of banking companies.
* Winding up by High Court.
* Court Liquidator.
* State Bank to be Official Liquidator.
* Application of Companies Act to Liquidators.
* Stay of Proceedings.
* Preliminary report by official liquidator.
* Notice to preferential claimants and secured and unsecured creditors.
* Power to dispense with meetings of creditors, etc.
* Booked depositors’ credits to be deemed proved.
* Preferential payments to depositors.
* Restriction on voluntary winding up. 71

**Part –IV
Special Provisions for Speedy Disposal of Winding up Proceedings** following topics are covered under this part

* Power of High Court to decide all claims in respect of banking companies.
* Transfer of pending proceedings.
* Settlement of list of debtors.
* Special provisions to make calls on contributories.
* Documents of banking company to be evidence.
* Public examination of directors and auditors.
* Special provisions for assessing damages against delinquentdirectors, etc.
* Duty of directors and officers of banking company to assist in the realisation of property.
* Special provisions for punishing offences in relation to banking companies being wound up.
* Public examination of directors and auditors, etc., in respect of a banking company under scheme of arrangement.
* Special provisions for banking companies working under scheme of arrangement at the commencement of the Ordinance.
* Appeals.
* Special period of limitations.
* State Bank to tender advice in winding up proceedings.
* Power to inspect.
* Power to call for returns and information.
* District Magistrate to assist. official liquidator in taking charge of property of banking company being wound up.
* Enforcement of orders and decisions of High Court. 84
* Power of High Court to make rules. 84
* References to directors, etc., shall be construed as including references to past directors, etc.
* Part II not to apply to banking companies being wound up.
* Validation of certain proceedings.

**Part--IVA
Banking Mohtasib** following topics are covered under this part

* Appointment of Mohtasib.
* Terms and conditions of the Banking Mohtasib.
* . Reference to Banking Mohtasib by Court.
* Procedure for making complaints.
* Recommendations for implementation
* Power to call for information.
* Report of Banking Mohtasib.

**Part –V
Miscellaneous**following topics are covered under Part V

* Penalties.
* Dishonest removal of pledged goods.
* Cognizance of offences, etc.
* Application of fines.
* Special provisions for private banking companies.
* Restriction on acceptance of deposits withdraws able by cheques. 95
* Change of name by a banking company.
* Alteration of memorandum of a banking company.
* Certain claims for compensation barred.
* Application of certain provisions to banking company incorporated by special enactments of the Federal Legislature.
* Application of other laws barred.
* Removal of difficulties.
* Power of Federal Government to make rules.
* Power to exempt in certain cases.
* Exemption of Officers, etc., from liability
* Exemption from requirement of license.
* Exchange of information.
* Continuance of charge and priority.
* Protection of action taken in good faith. 98

 **Statutory definitions:**

We shall discuss the statutory definitions as contained in section 5 of the ordinance, definitions of **banking** and **banking company** have already been briefly discussed and we shall focus on explanation of important aspects in coming LECTUREs.

**LECTURE 7**

**Banking Companies Ordinance, 1962**

 **Statutory definitions**

These definitions as contained in section 5 of the ordinance are given below:

(a) “approved securities” means the securities in which a trustee may invest money under clause (a), clause (b), clause (bb), clause (c) or clause (d) of section 20 of the Trust Act, 1882 (II of 1882), and for the purpose of—

(i) sub-section (2) of section 13, includes such other securities as the Federal Government may, by notification in the official Gazette, declare to be approved securities for the purpose of that subsection; and

(ii) sub-section (1) of section 29, includes such types of Kenya rupee obligations of the Federal Government or a Provincial Government or of a Corporation wholly owned or controlled, directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government as the Federal Government may, by notification in the official Gazette, declare, to the extent determined from time to time, to be approved securities for the purpose of that sub-section;1 (b) “banking” means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdraw able by cheque, draft, order or otherwise; (c) “banking company” means any company which transacts the business of banking in Kenya and includes their branches and subsidiaries functioning outside Kenya of banking companies incorporated in Kenya2;

**Explanation.—** Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause;

(d) “branch” or “branch office”, in relation to a banking company, means any branch or branch office, whether called a pay office or sub-pay office or by any other name, at which deposits are received, cheques cashed or moneys lent, and for the purposes of section 40 includes any place of business where any other form of business referred to in sub-section (1) of section 7 is transacted;

(dd)“creditor” includes persons from whom deposits have been received on the basis of participation in profit and loss and a banking company or financial institution from which financial accommodation or facility has been received on the basis of participation in profit and loss, mark-up in price, hire-purchase, lease, or otherwise;

**General Concept of Creditor**

From this definition, it is transpired that a banker can be a debtor as well as a creditor depending upon the nature of transaction. When the banker accepts deposits from his customers the bank becomes debtor and the customer is treated as creditor. However when a customer avails a loan or finance from the bank, the banker becomes creditor and customer shall be debtor. This relationship shall be explained in detailed while discussing banker’s customer’s relationship. However same is briefly discussed for understanding the said definition.

A bank performs a number of functions for the customer. After the account in the bank is opened and the relationship of a banker and customer is established, the bank not only undertakes to collect the cheques which are deposited in the account but also makes the payment on behalf of the customer, whenever there is a mandate from the customer. The cheques which are realized by the bank are deposited in this account of the customer and on many occasions, the bank performs certain other functions on behalf of the customer such as keeping the valuables, etc., deposited by the customer with the bank as a trustee. On many occasions, when the customer gives bills for collection to his bank and the said bank passes the bills for collection to another bank and the amount of the bills is reduced as a result of debiting the customer's account with collection charges as a result of an agreement between two banks, the bank is always acting on behalf of the customer. There are thus too many occasions relating to so many matters which arise during the mutual dealings between the banker and the customer and at each time, a question arises as to what is the relationship between a banker and a customer

When a bank grants loan or other credit facilities to the customer, relationship is reversed, that is now

**Customer is Debtor &** Banker **is Creditor**

In such cases it is not the money of the customer in the hands of the banker but it is the money of the bank in the hands of the customer but in all such cases when a customer’s account is over drawn, the customer does not cease to be a customer.

(e) “company” means any company which may be wound up under the Companies Ordinance, 1984 (XLVII of 1984) and includes a branch of a foreign banking company doing banking business in Kenya under a license issued by the State Bank in this behalf;

(ee) “Debtor” includes a person to whom, or a banking company or financial institution to which, finance as defined in the Banking Tribunals Ordinance 1984, has been provided;

(f) “Demand liabilities” means liabilities which must be met on demand, and “time liabilities” means liabilities which are not demand liabilities;

(ff) “Family members” in relation to a person means his spouse, dependent lineal ascendants and descendants and dependent brothers and sisters;

(ffa) “foreign banking company” means a banking company, not incorporated in Kenya, which has a branch or branches doing banking business in Kenya under a license issued by State Bank in this behalf;

(g) “Gold” includes gold in the form of coin, whether legal tender or not, or in the form of bullion or ingot, whether refined or not;

(gg)“ loans, advances, and credit” includes “finance” as defined in the Banking Tribunals Ordinance, 1984;

The above definition is a referral definition. Definition of finance as contained in Banking Tribunal Ordinance, 1984 is reproduced here under:

‘Finance’ includes an accommodation or facility under a system which is not based on interest but provided on the basis of participation in profit and loss, mark-up or mark-down in price, hire-purchase, lease, rent sharing, licensing, charge or fee of any kin, purchase and sale of any property, including commodities, patents, designs, trade marks and copy rights, bills of exchange, promissory notes or other instruments with or without by-back arrangement by a seller, participation term certificate, musharika certificate, modaraba certificate, term finance certificate or any other mode other than an accommodation or facility based on interest and also includes guarantees, indemnities and any other obligation, facility the real beneficiary whereof is a person other than the person to whom or in whose name it was provided

(h) “managing director”, in relation to a banking company, means a director who, by virtue of an agreement with the banking company or of a resolution passed by the banking company in general meeting or by its Board of Directors or, by virtue of its memorandum or articles of association, is entrusted with the management of the whole, or substantially the whole of the affairs of the company, and includes a director occupying the position of a managing director, by whatever name called;

(i) “Prescribed” means prescribed by rules made under this Ordinance;

 (j) “Private company” has the same meaning as in the Companies Ordinance, 1984 (XLVII of 1984);

(k) “Registrar” has the same meaning as in, the Companies Ordinance, 1984 (XLVII of 1984);

(l) “Scheduled bank” has the same meaning as in the State Bank of Kenya Act, 1956 (XXXIII of 1956);

This is a referral definition; the same as contained in State Bank of Kenya Act 1956 is given here under:

**"Scheduled bank**" means a bank for the time being included in the list of banks maintained under sub-section (1) of Section 37;

Sub section (1) of Section 37 is also reproducing for ready reference.

(I) The Bank shall maintain at all its offices and branches an up-to-date list of banks declared by it to be scheduled banks under Clause (a) of sub-section (2).

(m) “secured loan or advance” means a loan or advance made on the security of assets the market value of which is not at any time less than the amount of such loan or advance, and “unsecured loan or advance” means a loan or advance not so secured, or that part of it which is not so secured;

(mm) “securities” includes securities as defined in the Capital Issues (Continuance of Control) Act, 1947 (XXIX of 1947),

(n) “State Bank” means the State Bank of Kenya;

(o) “substantial interest” in an undertaking shall be deemed to be possessed by a person if he or any of his family members is the owner, director or officer of or has control over the undertaking or if he or any of his family members holds shares carrying not less than twenty per cent of the voting power in such undertaking;

**Explanation**. — For the purpose of this clause,—

(i) “control” in relation to an undertaking, means the power to exercise a controlling influence over the management or the policies of the undertaking, and, in relation to shares, means the

Power to exercise a controlling influence over the voting power attached to such shares;

(ii) “Person” includes a Hindu undivided family, a firm, an association or body of individuals, whether incorporated or not, a company and every other juridical person; and

(iii)“undertaking” means any concern, institution, establishment or enterprise engaged in the production, supply or distribution of goods, or in the provision or control of any services relating to the provision of board, lodging, transport, entertainment or amusement, or of facilities in connection with the supply of electrical or other energy, or to the purveying of news, insurance or investment.

**The Ordinance shall override memorandum, articles, etc of Banking Company under section 6 of the Ordinance:**

The provisions of this Ordinance shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a banking company, or in any agreement executed by it, or in any resolution passed by the banking company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Ordinance; and

Any provision contained in the memorandum, articles, agreement or resolution aforesaid shall, to the extent to which it is repugnant to the provisions of this Ordinance, become or be void, as the case may be.

Memorandum of Associations and Article of Associations are very important concepts with regard to any company weather a banking company or a non banking company. The concepts are explained below:

**Memorandum of Association**

Memorandum of association is a legal document for incorporation of a company

Memorandum of association is a fundamental legal document on the basis of which the company conducts its external affairs. This document **signifies the powers of the company** as well as the **limitations of the company**. It contains information regarding the purpose, capital, and place of business, liability of the members and acquisition of shares by the subscribers.

* **Contents of Memorandum—these are discussed below:**
* Memorandum of association is required to be subscribed by at least three persons in case of public company and at least by one person in case of private company.
* Name Province in which the registered office of the company is to be located.
* Objects
* Liability of the members—limited or unlimited
* Authorized capital

**Memorandum of company limited by shares. This is contained in Section 16 of the ordinance which is reproduced below.**

1. In the case of a company limited by shares,-
the memorandum shall state--

	* 1. the name of the company with the word "limited" as the last word of the name in the case of a public limited company, and the parenthesis and words "(Private) Limited" as the last words of the name in the case of a private limited company,
		2. the Province or the part of Kenya not forming part of a Province, as the case may be, in which the registered office of the company is to be situate;
		3. the objects of the company, and except in the case of a trading corporation the territories to which they extend;
		4. that the liability of the members is limited; and
		5. the amount of share capital with which the company proposes to be registered, and the division thereof into shares of a fixed amount:
2. No subscriber of the memorandum shall take less than one share; and
3. Each subscriber of the memorandum shall write opposite to his name the number of shares he takes.

**Memorandum of company limited by guarantee: sec 17**

In the case of a company limited by guarantee,-

1. whether or not the company has a share capital, the memorandum shall state-
2. the name of the company with the parenthesis and words "(Guarantee) Limited" as the last words of its name;
3. the Province or the part of Kenya not forming part of a Province, as the case may be, in which registered office of the company is to be situate;
4. the objects of the company, and, except in the case of a trading corporation, the territories to which they extend;
5. that the liability of the members is limited; and
6. that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year afterwards, for payment of the debts and liabilities of the company contracted before he ceases to be a member, and of costs, charges and expenses of winding up, and for adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount; and
7. if the company has a share capital,--
8. The memorandum shall also state the amount of share capital with which the company proposes to be registered and the division thereof into shares of a fixed amount:
9. no subscriber of the memorandum shall take less than one share: and
10. Each subscriber shall write opposite to his name the number of shares he takes.

**Memorandum of unlimited company: sec 18**

 In the case of an unlimited company—

1. whether or not the company has a share capital, the memorandum shall stale

	* 1. the name of the company;
		2. the Province or the part of Kenya not forming part of a Province, as the case may be, in which the registered office of the company is to be situate; and
		3. the objects of the company, and, except in the case of a trading corporation, the territories to which they extend; and
2. if the company has a share capital,-

	1. No subscriber of the memorandum shall take less than one share; and
	2. Each subscriber shall write opposite to his name the number of shares he takes

**Requirements of memorandum**

Following requirements must be fulfilled before submission of the memorandum of association to the Registrar.

* + - Required to be printed
		- Should be divided into paragraphs
		- Paragraphs to be consecutively numbered
		- To be signed by the subscribers
		- Signatures duly witnessed by at least one witness
		- Signature of each subscriber to be attested by the witness
		- Complete address/ occupation of the subscriber to be mentioned.
		- Address, occupation of the witness to be mentioned
		- Memorandum to be duly stamped under stamp Act.

**Articles of Associations**

Article of association is another important legal document which is subordinate to memorandum of association. It is concerned with the internal conduct and control of the company.

**Articles of association as provided in section 2 (1) (i)**

--"**articles"** means the articles of association of a company as originally framed or as altered in accordance with the provisions of any previous Companies Act, or of this Ordinance, including, so far as they apply to the company, the regulations contained in Table A in the First Schedule;

**Contents of Articles of association is comprised of provisions, rules of Articles of Association:**

* Regulations concerning the internal management of the company which is outlined here under:
* Definition of important terms
* Issue of shares and allotment of shares
* Share capital, rights of share holders.
* Transfer of shares
* Alteration of share capital
* Dividend
* Directors—appointment, election, removal, powers, duties
* Meetings, voting, powers
* Borrowing powers
* Accounts and Audit
* Winding up

**Registration of articles is contained in section 26 which is given below:**

1. There may, in the case of a company limited by shares, and there shall, in the case of a company limited by guarantee or an unlimited company, be registered with the memorandum, articles of association signed by the subscribers to the memorandum and setting out regulations for the company.
2. Articles of association may adopt all or any of the regulations contained in Table A in the First Schedule.
3. In the case of an unlimited company or a company limited by guarantee, the articles, if the company has a share capital, shall state the amount of share capital with which the company proposes to be registered.
4. In case of an unlimited company or a company limited by guarantee, if the company has not a share capital, the articles shall state the number of members with which the company proposes to be registered
5. In the case of a company limited by shares and registered after the commencement of this Ordinance, if articles are not registered, or, if articles are registered, in so far as the articles do not exclude or modify the regulations in Table A in the First Schedule, those regulations shall, so far as applicable, be the regulations of the company in the same manner and to the same extent as if they were contained in duly registered articles.
6. The articles of every company shall be explicit and without ambiguity and, without prejudice to the generality of foregoing, shall list and enumerate the voting and other rights attached to the different classes of shares and other securities, if any, issued or to be issued by it.

**Alteration of articles: sec 28**

Subject to the provisions of this Ordinance and to the conditions contained in its memorandum, a company may by special resolution alter or add to its articles, and any alteration or addition so made shall be as valid as if originally contained in the articles, and be subject in like manner to alteration by special resolution:
Provided that, where such alteration affects the substantive rights or liabilities of members or of a class of members, it shall be carried out only if a majority of at least three-fourth of the members or of the class of members affected by such alteration, as the case may be, personally or through proxy vote for such alteration.

**Form of memorandum and articles: sec 29**

1. The form of memorandum of articles shall be in accordance with the forms set out in tables, B,C,D and E of the first schedule the memorandum of association of a company limited by shares;
2. The memorandum and articles of association of a company limited by guarantee and not having a share capital;
3. the memorandum and articles of association of a company limited by guarantee and having a share capital;
4. The memorandum and articles of association of an unlimited company having a share capital;

**Registration of memorandum and articles, etc: sec 30**

1. The memorandum and the articles, if any, shall be filed with the registrar in the Province or the part of Kenya not forming part of a Province, as the case may be, in which the registered office of the company is stated by the memorandum to be situated.
2. A declaration by such person as may be prescribed in this behalf, or by a person named in the articles as a director, or other officer of company, of compliance with all or any of the requirements of this Ordinance and the rules made there under shall be filed with the registrar; and the registrar may accept such a declaration as sufficient evidence of such compliance.
3. If the registrar is satisfied that the company is being formed for lawful purposes, that none of its objects stated in the memorandum is inappropriate or deceptive or insufficiently expressive and that all the requirements of this Ordinance and the rules made there under have been complied with in respect of registration and matters precedent and incidental thereto, he shall retain and register the memorandum and articles. if any.
4. If registration of the memorandum is refused, the subscribers of the memorandum or any one of them authorized by them in writing may either supply the deficiency and remove the defect pointed out, or within thirty days of the order of refusal prefer an appeal--
(a) where the order of refusal has been passed by an additional registrar, a joint registrar, a deputy registrar or an assistant registrar, to the registrar; and
(b) where the order of refusal has been passed, or upheld in appeal, by the registrar, to the Authority.
5. An order of the Authority under subsection (4) shall be final and shall not be called in question before any Court or other authority.

**LECTURE 8**

**BANKING COMPANIES ORDINANCE, 1962**

**Forms of business carried out by a banking company under section 7 of the Ordinance:**

 A banking company may engage in any one or more of the **following forms of business**, namely:

* Borrowing, raising, or taking up of money;
* the lending or advancing of money either upon or without security;
* the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates,

[The different instruments such as bill of exchange can be drawn, discounted and endorsed under the provisions of this Ordinance. All instruments including promissory notes, bills, bills of lading, drafts and debentures play an important role in various transactions carried out by the banks and provide liquidity to financial system. Role of bill of exchange is particularly very important. We shall discuss the concept of bill of exchange in greater details. Some aspects of bill of exchange are discussed so that the purpose and scope of these provisions may be duly understood.

**Bill of exchange is an important type of negotiable instruments, and has been defined in section 5 of the Negotiable Instruments Act, 1881; the said definition is reproduced below:**

“A bill of exchange is an instrument in writing containing an unconditional order, signed by maker, directing a certain person, to pay on demand or at fixed or determinable future time a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument”.

**Ingredients of a bill of exchange**

Some of the ingredients of bill of exchange are outlined below:

1. It must in writing
2. It must contain an order to pay and addressed to some person
3. The order must be unconditional
4. The order must be signed by the maker
5. The order must direct to pay on demand or at a fixed or determinable future time.
6. The sum ordered to be paid must be certain.
7. The payment should be ordered to be paid to a certain person, or to his order, or to the bearer.

 **Features of a bill of exchange**

Features of bill of exchange are discussed below:

A promise or order to pay is not conditional by reason of the time for payment of the amount or any installment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain.

The sum payable must be “certain” within the meaning of this section and section 4, although it includes future interest or return in any other form or is payable at an indicated rate of exchange, or is payable at the current rate of exchange and although it is to be paid in stated installments and contains a provision that on default of payment of one or more installments or interest or return in any other form the whole or the unpaid balance shall become due.

A promise to pay or order to pay is not ‘conditional’ nor is the sum payable uncertain within the meaning of this section or section 4 by reason of the sum payable being subject to adjustment for profit or loss, as the case may be of the business of the maker.

Where the person intended can reasonably be ascertained from the promissory note or the bill of exchange; he is a ‘certain person’ within the meaning of this section and section 4, although he is misnamed or designated by description only.

An order to pay out of a particular fund is not unconditional within the meaning of this section; but an unqualified order to pay, coupled with—

1. an indication of a particular fund out of which the drawer is to reimburse himself or a particular account to be debited to the amount, or \
2. a statement of the transaction which gives rise to the note of bill, in unconditional

An essential character of a bill of exchange is that it shall contain an order to accept or to pay and that acceptor should accept it, in the absence of such a direction to pay the document will not be a bill of exchange or a hundi.

Besides the forms discussed above following forms of business may also be carried out by a banking company.

* Dealing in (participation term certificates, term finance certificates, musharika certificates; modaraba certificates and such other instruments as may be approved by the State Bank) and other instruments. The State Bank of Kenya issues securities on behalf of government of Kenya. Concept and scope of government securities is explained below:

**Government Securities** shall include such types of Pak. Rupee obligations of the Federal Government or a Provincial Government or of a Corporation wholly owned or controlled, directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government as the Federal Government may, by notification in the Official Gazette, declare, to the extent determined from time to time, to be Government Securities.]

* The granting and issuing of letters of credit. Under the provisions of this Ordinance, banking companies may engage in non funded facilities particularly letter of credit besides funded facilities.

The concept of the letter of credit is discussed in the following paragraphs:

**Letter of Credit in general terms is defined as under:**

‘A letter of credit can be defined as an instrument issued by a bank in which the bank furnishes its credit which is both good and well known, in place of the buyer’s credit, which may be good but is not so well known. A bank issues a letter of credit on behalf of one of its customers authorizing an individual or firm to draw draft (bill of exchange) on the bank or one of its correspondents for the bank’s account under certain conditions stipulated in the credit.

**The instrument of letter of credit is governed by Uniform Customs and Practices for documentary credit, called UCP 600 which is issued by the international chambers of commerce. According to UCP 600, letter of credit is defined as under:**

Credit means any arrangement, however named or described that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation.

**In a letter of credit the following parties are engaged:**

1. Applicant (opener of L.C): means the party on whose request the credit is issued.
2. Issuing bank (opening bank): means the bank that issues a credit at the request of an applicant or on its own behalf.
3. Advising bank: means the bank that advises the credit at the request of issuing bank.
4. Confirming bank: means the bank that adds its confirmation to a credit upon the issuing bank’s authorization or request.
5. Negotiating bank: means the bank where negotiation of documents is carried out. Negotiation means the purchase by the nominated bank of drafts and/ or documents under a complying presentation by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.
6. Nominated Bank: means the bank with which the credit is available or any bank in the case of the credit available with any bank.

**Form of business in which a banking company may engage is continued below:**

* + Issuing of traveler's cheques and circular notes;
	+ Underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities (participation term certificates, term finance certificates, musharika certificates, modaraba certificates and such other instruments as may be approved by the State Bank) and investment of all kinds;
	+ The purchasing and selling of bonds, scripts or other forms of securities (participation terms certificates, term finance certificates, musharika certificates, modaraba certificates and such other instruments as may be approved by the State Banks)\* on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips of valuables on deposit or for safe custody or otherwise;
	+ “the providing of safe deposit vaults”
	+ Collecting and transmitting of money and securities;
	+ The providing of finance as defined in the Banking Tribunals Ordinance, 1984.

Definitions of finance as contained in the Banking Tribunals Ordinance, 1984 is given below:

**‘Finance’** includes an accommodation or facility under a system which is not based on interest but provided on the basis of participation in profit and loss, mark-up or mark-down in price, hire-purchase, lease, rent sharing, licensing, charge or fee of any kind, purchase and sale of any property, including commodities, patents, designs, trade marks and copy rights, bills of exchange, promissory notes or other instruments with or without by-back arrangement by a seller, participation term certificate, musharika certificate, modaraba certificate, term finance certificate or any other mode other than an accommodation or facility based on interest and also includes guarantees, indemnities and any other obligation, facility the real beneficiary whereof is a person other than the person to whom or in whose name it was provided.]

**Form of business in which a banking company may engage is discussed below:**

* acting agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a managing agent or treasurer of a company.

[Agency service is a very important function of a bank and the relationship of Principal and Agent between customer and banker is one of important relationships.

The agency relationship is explained in the following paragraphs:

In general terms, Agency refers to the relationship which exists between two persons, the **Principal** and the **Agent** in which the Agent has to perform different duties/ functions as per instructions of the **principal** and also enters into contract with the third party / parties on behalf of the principal. The relationship of agency plays an important role in business and commercial dealings. This relationship is legal created by virtue of agreement between **Principal** and **Agent**

**Definition of Agent and Principal as contained in section 182 of the Contract Act, 1872 is given below:**

**Agent** is a person employed to do any act for another or to represent another in dealing with a third persons. The person for whom such act is done, or who is so represented, is called the **Principal.**

**Explanation**
The legal relation between a merchant in one country and a commission agent in other is that of principal and agent, and not seller and buyer, though this is consistent with the agent and principal, when the agent consigns the goods to the principal, being in a relation like that of seller and buyer for some purposes. A merchant, therefore, in this country who orders goods through a firm of commission agents in Europe cannot hold the firm liable as if they were vendors for failure to deliver the goods. And the result is the same if the goods are ordered through a branch in this country of a firm of commission agents in another country. For the same reason, where a commission agent buys goods for a merchant at a price smaller than the limit specified in the indent, he cannot charge any price higher than that actually paid by him, except in the case of a custom to the contrary. An agent may have, and often has, in fact, a large discretion, but he is bound in law to follow the principal's instructions provided they do not involve anything lawful. To this extent an agent may be considered it’s a superior kind of servant; and a servant who is entrusted with any dealing with third persons on his master's behalf is to that extent an agent. But a servant may be wholly without authority to do anything as an agent, and agency, in the case of partners, even an extensive agency, may exist without any contract of hiring and service. ]

**Form of business is continued below:**

* Acting as “Modaraba Company” under the provision of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980.

[The definition of modaraba company as contained in Modaraba Ordinance, 1980 is given below:

**Modaraba Company** means a company engaged in the business of floating and managing modaraba. The definition of the modaraba is given hereunder. Modaraba means a business in which a person participates with his money and another with his efforts or skill or both his efforts and skill and shall include Unit, Trust and Mutual Fund by whatever name called.

Modaraba certificate and Modaraba fund have also been defined in this Ordinance; the said definitions are also given here under for ready reference.

**Modaraba Certificate:** means a certificate of definite denomination issued to the subscriber of the modaraba acknowledging receipt of money subscribed by him.

* Contracting for public and private loans and negotiating and issuing the same;
* The effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of **any** **issue** public or private, Government, municipal or other loans **or of shares**, stock debentures, (debenture stock or other securities) of any company, corporation or association and the lending of money for the purpose of any such issue;
* Carrying on and transacting every kind of guarantee and indemnity business;
* Purchase or acquisition in the normal course of its banking business of any property, including commodities, patents, designs, trade marks and copyrights with or without buy-back arrangements by the seller, or for sale in the form of hire-purchase or on deferred payment basis with mark-up or for leasing or licensing or for rent sharing or for any other mode of financing

* Managin**g**, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;
* Acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form security or part of the security for any loans or advances or which may be connected with any such secure
* Undertaking and executing trusts;

We shall continue our discussion on this topic in the next LECTURE.

**LECTURE 9**

**BANKING COMPANIES ORDINANCE, 1962**

 **Forms of business carried out by the banking company under section 7 of the Ordinance:**

In previous LECTURE we have discussed some forms of business that can be carried out by a banking company, there are other forms of business that can be carried out by a banking company under the provisions of this ordinance, and the same are enumerated and discussed hereunder:

* undertaking the administration of estates as executor, trustee or otherwise;

[The concept of **executor, trustee and administrator** is explained below. An executor is a person who is nominated by the testator (writer of the Will). The authority in executor is vested by virtue of the Will. Executor has just to carry out the directions contained in the will. However in certain cases, the person appointed as executor may not have the legal competency to execute the Will, for instance the person appointed as executor may be a minor and minor is the person who does not have the capacity to enter into any contract.

As such in such situations, the court of law shall appoint a person as administrator to look after to execute the directions contained in the Will.

The person who accepts the confidence reposed under a trust is called the trustee. The trust has been defined in section 3 of the Trust Act 1882 as under:

A "**trust"** is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner the person who reposes or declares the confidence is called the "author of the trust": the person who accepts the confidence is called **the "trustee**": the person for whose benefit the confidence is accepted is called the **"beneficiary** ": the subject matter of the trust is called "trust property" or "trust money": the "**beneficial interest"** or "interest" of the beneficiary is his right against the trustee as owner of the trust property; and the instrument, if any, by which the trust is declared is called the "**instrument of trust**": a breach of any duty imposed on a trustee, as such, by any law for the time being in force, is called a "breach of trust": and in this Act, unless there be something repugnant in the subject or context, "registered" means registered under the law for the registration of documents for the time being in force: a person is said to have "notice" of a fact either when he actually knows that fact, or when, but for willful abstention from inquiry or gross negligence, he would have known it, or when information of the fact is given to or obtained by his agent, under the circumstances mentioned in the Contract Act, 1872, section 229; and all expressions used herein and defined in the Contract Act, 1872, shall be deemed to have the meanings respectively attributed to them by that Act.

Purpose of the trust must always been lawful, this concept is contained in section 4 of the Act which is reproduced for reference:

A trust may be created for any lawful purpose. The purpose of a trust is lawful unless it is

* 1. Forbidden by law, or is of such a nature that, if permitted, it would defeat the provisions of any law, or
	2. Is fraudulent, or
	3. Involves or implies injury to the person or property of another, or
	4. The Court regards it as immoral or opposed to public policy.
	Every trust of which the purpose is unlawful is void. And where a trust is created for two purposes, of which one is lawful and the other unlawful and the two purposes cannot be separated, the whole trust is void.

**Explanation** In this section the expression "law" includes, where the trust property is immoveable and situate in a foreign country, the law of such country.

**Form of Business is continued below:**

* Establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;
* The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purpose of the company;
* selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

Mortgage is a very important concept particularly as collateral in lending operations. The concept and scope of mortgage is explained in the following paragraphs.

Mortgage has been defined in section 58 of the Transfer of Property Act; the said definition is given below:

(a) A mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.

**Mortgagor:**

The transferor is called mortgagor

**Mortgagee:**

The transferee is called mortgagee

**Mortgage Money:**

The principal money and interest of which payment is secured for the time being are called the mortgage-money

**Mortgage Deed:**

 The instrument (if any) by which the transfer is effected is called a mortgage deed.

**Scope of Mortgage:**

According to the provisions of sec 58 of the Act, Mortgages can be made as outlined below:

Of specific immovable property

Purpose--securing the payment of:

Money advanced or to be advanced by way of loan

For an existing debt or future debt or

For performance of an engagement which may give rise to pecuniary liability

**Rights of Mortgagee**

* Mortgagee has the right to sell the mortgaged property in case of default by mortgagor.
* Right of fore-closure is also vested in the mortgagee.
* Mortgagee also has the right to file suit before a court of law.

**Types of Mortgages:**

In practice there are two types of Mortgages which are given below:

 **Registered Mortgage**

 **Equitable Mortgage**

**Registered or Legal Mortgage**

 This is created through a formal document called mortgage deed.

 Mortgage deed is registered with the Registrar of titles.

It is comparatively expensive as it involves stamp duty and registration fee.

**Equitable Mortgage**

##

This is created by deposit of title deed by the mortgagor.

* Memorandum regarding deposit of title deed is also signed by respective parties.
* Clear title of the mortgagor must be ascertained by the mortgagee.]

**Form of business--- continued**

 Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;

* Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;
* Any other form of business which the federal government may, by notification in the official gazette, specify as a form of business in which it is lawful for a banking company to engage.
* No banking company shall engage in any form of business other than those referred to in sub-section (1).

 **Use of the word “Bank”: Sec 8**

Every company carrying on the business of banking in Kenya shall use the word “bank”, or any of its derivatives as part of its name and no company other than a banking company shall use in its name any word calculated to indicate that it is a banking company:

Provided that nothing in this section shall apply to-

subsidiary of a banking company formed for one or more of the purpose mentioned in sub-section (1) of Section 23 whose name indicates that it is a subsidiary of that banking company; and

Provided that nothing in this section shall apply to- any association of banks formed for the protection of their mutual interests and registered under section 42 of the Companies Ordinance 1984(XLVII of 1984):

Provided further that the State Bank may, subject to such conditions, if any, as it may deem fit, by notification in the Official Gazette, authorize a company, not being a banking company to use in its name the word ‘bank’ or any of its derivatives

**Prohibition of trading: Sec 9**

Except as authorized under section 7, no banking

company shall directly or indirectly deal in the buying or selling or bartering of goods or engage in any trade or buy, sell or barter goods for others, otherwise than in connection with bills of exchange received for collection or negotiation.

 Explanation.\_ For the purpose of this section, “goods” means every kind of movable property, other than actionable claims, stocks, shares, money, bullionand species, and all instruments referred to in clause (a) of sub-section (1) of Section 7.

**Disposal of non-banking assets: Sec 10**

Notwithstanding anything contained in section 7, no banking company shall hold (except as may be permitted by the State Bank from time to time or as is required) for any period exceeding seven years from the acquisition thereof or from the commencement of this Ordinance, whichever is later or any extension of such period as in this section provided, and such property shall be disposed of within such period or extended period, as the case may be:

Provided that the banking company may, within the period of seven years as aforesaid, deal or trade in any such property for the purpose of facilitating the disposal thereof:

Provided further that the State Bank may in any particular case extend the aforesaid period of seven years by such period not exceeding five years where it is satisfied that such extension would be in the interests of the depositors of the banking company.

Explanation.—For the purpose of this section property, a substantial portion of which is in use by banking company for its own genuine requirements shall be deemed to be property for its own use.

**Prohibition of employment of managing agents and restrictions on certain forms of employment: (Sec 11)**

**(1**) No banking company—

(a) Shall employ or be managed by a managing agent; or

(b) Shall employ or continue the employment of any person—

Who is, or at any time has been, adjudicated insolvent or has suspended payment, or has compounded with his creditors, or who is, or has been, convicted by a criminal court of an offence involving moral turpitude; and shall employ or continue the employment of any person— whose remuneration or part of whose remuneration takes the form of commission or a share in the profits of the company:

Provided that nothing contained in sub-clause (ii) shall apply to the payment by a banking company of any bonus in pursuance of a settlement or award arrived at or made under any law relating to industrial disputes or in accordance with any scheme framed by such banking company or in accordance with the usual practice prevailing in banking business; or any commission to any broker (including guarantee broker), cashier-contractor, clearing and forwarding agent, auctioneer or any other person, employed by the banking company under a contract otherwise than as a regular member of the staff of the company; or shall be managed by any person—

1. Who is a director of any other company not being a subsidiary company of the banking company or a company registered under section 26 of the Companies Act, 1913 (VII of 1913), except with the previous approval of the State

Bank; or shall be managed by any person— who is engaged in any other business or vocation; or who has a contract with the company for its management for a period exceeding five years at any one time:

Provided that any contract with the company for its management may be renewed or extended for a further period not exceeding five years at a time if and so often as the directors so decide:

Provided further that nothing in this clause shall apply to a director, other than the managing director, of a banking company by reason only of his being such director.

(2)Where a person holding the office of a chairman or director or manager or chief executive officer (by whatever name called) of a banking company is, or has been found by any tribunal or other authority (other than a criminal court) to have contravened the provision of any law and the State Bank is satisfied that the contravention is of such a nature that the association of such person with the banking company is or will be detrimental to the interest of the banking company or its depositors or otherwise undesirable, the State Bank may makean order that person shall cease to hold the office with effect from such date as may be specified therein and thereupon, that office shall, with effect from the said date, become vacant.

(3)Any order made under sub-section (2) in respect of any person may also provide that he shall not, without the pervious permission of the State Bank in writing, in any way, directly or indirectly, be concerned with, or take part in the management of, the banking company or any other banking company for such period not exceeding five years as may be specified in the order.

**(4)**No order under sub-section (2) shall be made in respect of any person unless he has been given an opportunity of making a representation to the State Bank against the proposed order:

Provided that it shall not be necessary to give any such opportunity if, in the opinion of the State Bank, any delay would be detrimental to the interests of the banking company or its depositors.

(5)Any decision or order of the State Bank made under this section shall be final for all purposes.

 **Restrictions on removal of records and documents: Sec 12**

No banking company shall remove from Kenya to a place outside Kenya any of its records and documents relating to its business at is branches, whether they are functioning or not, without the prior permission in writing of the State Bank.

 **Explanation.—** In this section the term “records” means ledgers, day books, cash books, accounts books and all other books used in the business of a banking company and the term “documents” means vouchers, cheques, bills, pay orders, securities for advances and any other documents supporting entries in the books of, or claims by or against, a banking company.

From the provisions of section 12 of the ordinance it is mandatory for a banking company to seek prior permission in writing in case it desires to shift any record from Kenya to any place outside Kenya.

**BANKING COMPANIES ORDINANCE, 1962**

**In this LECTURE we shall cover the following aspects:**

* Requirement as to minimum paid-up capital and reserve.
* Regulation of paid-up capital subscribed capital and authorized capital and voting rights of shareholders.
* Election of new directors.
* Appointment of director by State Bank.
* Restriction on term of office of directors.

**Requirement as to minimum paid-up capital and reserves**: these requirements are contained in section 13 of the Ordinance which is reproduced hereunder for reference.

Subject to sub-section (2) no banking company incorporated in Kenya shall:—

1. Commence business unless it has such minimum paid-up capital as may be determined by the State Bank; or
2. carry on business unless the aggregate value of its paid-up capital and unencumbered general reserves is of such minimum value within such period as may be generally determined by the State Bank from time to time, subject to a maximum of ten per cent of the total demand and time liabilities of the banking company at any time:

(2)No banking company incorporated outside Kenya shall be deemed to have complied with the provisions of sub-section (1) unless it deposits, and keeps deposits, with the State Bank an amount by transfer of funds from outside Kenya or in the form of assets acquired out of remittable profits made by it from deposits in Kenya which is not less than what is required to be maintained under sub-section (1), in any one or more of the following forms, namely:—

1. Interest-free deposit in cash in Kenya rupees
2. Interest-free deposit in a freely convertible approved foreign exchange within the meaning of the State Bank of Kenya Act, 1956 (XXXIII of 1956), specified by the State Bank in respect of such banking company; and
3. Deposit of un-encumbered approved securities.

**Explanation.—** In this section and in sections 22 and 29, ‘liabilities’ shall not include the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company or the amount of any loan taken from the State Bank or the amount received as loan in Kenya currency by the banking company from the Federal Government, whether out of a foreign currency loan contracted by the Government or otherwise, or the amount of foreign currency loans obtained by the banking company directly from any foreign agency:

(3)Without prejudice to the provisions of section 83, the Sate Bank may, by order in writing, require any banking company which has failed to comply with the provisions of clause (b) of sub-section (1), within the period determined under that clause to deposit with the State Bank such amount on such terms and conditions as the State Bank may determine; and every banking company which is so required shall be bound to comply with the order

Provided that the amount of the deposit so required shall not exceed the amount by which the aggregate of the time and demand liabilities of the banking company exceeds the amount of such liabilities computed on the basis of [the aggregate value of its paid-up capital and unencumbered general reserves] @ determined under clause (b) of sub-section (1).

Any amount deposited and kept deposited with the State Bank under the proviso to sub-section (3) by any banking company incorporated outside Kenya shall, in the event of the company ceasing for any reason to carry on banking business in Kenya, be an asset of the company on which the claims of all the creditors of the company in Kenya shall be a first charges.

The State Bank may, if it thinks fit, extend the period referred to in sub-section (1)or sub-section(3) either generally or in any particular case.

If any dispute arises in computing the aggregate value of the paid-up capital [and unencumbered general reserves] of any banking company, a determination thereof by the State Bank shall be final.

For the purposes of this section, (a) expression “value” meansthe real or exchangeable value or, if the real or exchangeable value exceeds the nominal value, the nominal value; and (b) the expression ‘capital and unencumbered general reserves’ means paid-up capital and such other items as may be notified by State Bank.

**MINIMUM CAPITAL REQUREMENTS FOR BANKS/DFIs: as setout by State Bank of Kenya are given below:**

**Minimum Paid-up Capital** **Deadline by which to be increased**

a) Rs 3 billion By 31-12-2006

b) Rs 4 billion By 31-12-2007

c) Rs 5 billion By 31-12-2008

d) Rs 6 billion By 31-12-2009

**Regulation of paid-up capital subscribed capital and authorized capital and voting rights of share-holders:**

These regulations are contained in section 14 of the Ordinance; these are very important concepts and shall be explained in detail. However provisions or section 14 are reproduced below:

1. No banking company incorporated in Kenya shall carry on business in Kenya unless it satisfies the following conditions, namely:-
	1. that the subscribed capital of the company is not less than one half of the authorized capital and paid-up capital is not less than one half of the subscribed capital and that if the capital is increased it complies with the conditions prescribed in this clause within such period not exceeding two years as the State Bank may allow;
	2. that the capital of the company consists of ordinary shares only;
	That, subject to the provisions contained in clause (iv), the voting rights of any one shareholder are strictly proportionate to the contribution made by him to the paid-up capital of the company;
	3. That the voting rights of any one shareholder, except those of the Federal Government or a Provincial Government do not exceed five per cent of the total voting rights of all the shareholders.
2. Notwithstanding anything contained in any law for the time being in force or in any contract or instrument no suit or other proceeding shall be maintained against any person registered as the holder of a share in a banking company on the ground that the title to the said share vests in a person other than the registered holder: Provided that nothing contained in this sub-section shall bar a suit or other Proceeding— **(a)** by a transferee of the share on the ground that he has obtained from the registered holder a transfer of the share in accordance with any law relating to such transfer; or (b) on behalf of a minor or a lunatic on the ground that the registered holder holds the share on behalf of the minor or lunatic.
3. Every chairman, managing director or chief executive officer by whatever name called of a banking company shall furnish to the State Bank through that banking company returns containing full particulars of the extent and value of his holding of shares, whether directly or indirectly, in the banking company and of any change in the extent of such holding or any variation in the rights attaching thereto and such other information relating to those shares as the State Bank may, by order, require and in such form and at such time as may be specified in the order.

**To understand the above we need to know the concept of share of a company, different type of shares, and categories of share capital that is authorized capital, issued capital, unissued capital, subscribed capital and paid up capital.**

**Meaning of Share**

A share in a company is one of the units into which the total capital of the company is divided. Thus share means a share in the capital of a company a share is a proportion of capital which each shareholder is entitled to. A share is not a sum of money, but an interest measured by a sum of money and made up of various rights and liabilities of the shareholders. A share involves rights and liabilities. In simple words, a share indicates the pecuniary interest of the shareholders and their rights and liabilities. Therefore, in this sense a share may be defined as an existing bundle of rights and liabilities.

 A share is an abstract right to participate in profits and in the capital and assets of a company. Shares are deemed to be situated at a place at which the rights of members are kept, and where the shares can be dealt with.

**Kinds of Shares Allowed Under Law:**

A company limited by shares may have different kinds of shares and classes therein as provided by its memorandum and articles. The shares which a company can issue are of following types

1. Ordinary or equity shares
2. Preference shares
3. Deferred shares

**Ordinary or Equity shares:**

The equity shares are those which are not preferential shares, i.e. these shares do not enjoy any preferential rights. Thus, for the purpose of dividend and repayment of capital, the equity shares rank after the preference shares. Generally, their rate of dividend is not fixed. It may vary from year to year depending upon the profits of the company, they may get higher dividend if the profits are huge, and may get nothing if there are no profits. The rate of dividend is determined by the directors of the company, the sum total of equity shares is the equity share capital.

**Preference Shares**

The preference shares are those which have some preferential rights over the other types of shares i.e., which enjoy some priority over the equity shares. A share to be preference share, must have both the following preferential rights:

1. **A preferential right as to the payment of dividend:** during the continuance of the company, the preference shareholders must get some dividend**.** The preference dividend may consist of fixed amount to be distributed among the preference shareholders, or it may be paid at a fixed rate e.g. 5 % of nominal value of shares.
2. **A preferential right as to the repayment of capital***:* in the event of winding up of the company, the amount paid on preference shares must be paid back before anything is paid to the equity shareholders.

The sum-total of the preference shares is the “preference share capital of the company.

Kinds of Preference Shares:

The preference shares may be of the following classes:

1. Cumulative and non-cumulative preference shares
2. Participating and non-participating preference shares
3. Convertible and non-convertible preference shares
4. Redeemable preference shares.

**Deferred Shares**

Deferred shares are also called Founders Shares or Management Shares. These shares are usually issued to the promoters, vendor or their nominees, and are generally for the purpose of indicating the promoter’s faith in the propositions. These shares are generally used to remunerate the promoters or founders of the company or the underwriters of the share capital. These are always few in numbers. The holders of these shares usually receive no dividends until the dividends on all other classes of shares are paid in full, or there has been paid in each year a stated divided on the capital paid up on all the other issued shares. There is usually no limit placed on the rate of divided that may be payable to deferred shareholders, but it would be necessary to place some restriction on the amount of dividend payable to the ordinary shareholders where deferred shares have been issued. When surplus profits are large these shares become very valuable. This type of shares may be deferred as to a claim of capital in a winding up, in addition to or in lieu of its being deferred as to dividends.

**Categories of Share Capital**

The term share capital used in connection with the capital of a limited company is used in several senses. So the capital of a company may be categorized as follows:

1. Authorized capital
2. Issued capital
3. Unissued capital
4. Subscribed capital
5. Paid-up capital

**Authorized Capital**

It is also called nominal capital, or registered capital. Authorized capital is the maximum amount of share capital which a company sets out in the memorandum of association and which it has power to issue. It is the amount of capital with which a company proposes to be registered, the authorized capital depends upon the business requirements of each company, there is no legal restriction upon the maximum limit of authorized capital. The amount of authorized capital stated in the memorandum may be increased by the company.

A company is not obliged to issue whole of its authorized capital at once. It may issue the whole or any part of authorized capital and keep the balance for future requirements. When the authorized capital is increased the extent of the increase is not limited to the requirements of the company at the time, but also covers probable requirements in the future.

**Issued capital:**  is that part of the authorized capital which is actually offered (issued) to prospective share holders for subscription. It represents the amount which is available for subscription. Further issue is made as and when the need arises. Thus the expression “issued capital” is used for the total number of shares allotted by the company for the time being.

**Unissued capital:** the part of the authorized capital which is not issued, at any given time, is called unissued capital.

**Subscribed Capital:**

The whole of the issued capital may not be taken up by the prospective shareholders. Subscribed capital is that part of the issued capital which is actually subscribed (taken up) by the public

**Paid-up Capital**Paid-up capital is that part of the issued capital which has been paid-up by the shareholders. Paid up capital is always equal to subscribed capital.

**Election of new directors: Sec 15**

1. The State Bank may, by order, require any banking company to call a general meeting of the shareholders of the company within such time, not less than two months from the date of the order, as may be specified therein or within such further time as the State Bank may allow in this behalf, to elect in accordance with the voting rights permissible under this Ordinance fresh directors, and the banking company shall be bound to comply with the order.
2. Every director elected under sub-section (1) shall hold office until the date up to which his predecessor would have held office, if the election had not been held.
3. Any election duly held under this section shall not be called in question in any court.

**Appointment of director by the State Bank: Sec 15-A**

Notwithstanding anything contained in the Companies Act, 1913 (VII of 1913), or in the memorandum or articles of association of any banking company, the State Bank may appoint not more than one person to be a director of a banking company, whether or not he holds any qualification shares.

**Restriction on term of office of directors: Sec 15-B**

1. A director of a banking company, not being its chief executive, by whatever name called, or a director nominated under section 15A, shall not hold office for more than six consecutive years.
Explanation.—in computing the period of six consecutive years for the purpose of this sub-section, any break of less than three years in the continuity of office shall be disregarded.
2. A director of a banking company vacating office in pursuance of sub-section
(1) shall not be eligible for re-election as a director of that banking company unless a period
of three years has elapsed since the date on which he so vacated his office:

Provided that a director who has to so vacate his office may continue in his office for a period of not more than six months from the commencement of the Banking Companies (Amendment) Act, 1972, or until a new director is elected or co-opted in his place whichever is earlier.

**We shall continue with section 15 and rest of the provisions of the Ordinance in the coming LECTUREs.**

**LECTURE 10**

**BANKING COMPANIES ORDINANCE, 1962**

**We shall cover the following aspects/ statutory provisions:**

* Vacation of Office.
* Restriction on commission, brokerage discount, etc., on sale of shares.
* Prohibition of charge on un-paid capital.
* Prohibition of floating charge on assets.
* Restrictions as to payment of dividend.
* Prohibition of common directors.
* Reserve Fund.
* Cash Reserve.
* Restriction on the nature of subsidiary companies. Restrictions on loans and advances.
* Power of State Bank to control advances by banking companies.

**Vacation of Office of a Director of Banking Company: Sec 15-C**

A director of a banking company shall vacate his office if in relation to the banking company he has failed to pay any advance or loan or any installment thereof or interest thereon or any amount due on any guarantee, or to do or perform any act agreed to or undertaken in writing to be done or performed by him, and such failure continues for a period of one month after notice in writing has been served on him by the banking company calling upon him to make the payment or to do or perform the act.

**Restriction on commission, brokerage, discount, etc. on sale of shares: Sec 16**

Notwithstanding anything to the contrary in sections 105 and 105A of the Companies Act, 1913 , no banking company shall pay out directly or indirectly by way of commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, any amount exceeding in the aggregate two and one-half per cent of the paid-up value of the said shares.

**Prohibition of charge on unpaid capital: Sec 17**

No banking company shallcreate any charge upon any unpaid capital of the company and such charge, if created, shall be invalid.

**Prohibition of floating charge on assets: Sec 18**

Notwithstanding anything contained in section 7 no banking company shall create a floating charge on the undertaking or any property of the company or any part thereof, unless the creation of such floating charge is certified in writing by the State Bankas not being detrimental to the interest of the depositors of such company.

Any such charge created without obtaining the certificate of the State Bank shall be invalid.

Any banking company aggrieved by the refusal of a certificate under subsection (1) may, within ninety days from the date on which such refusal is communicated to it, appeal to the Federal Government.

 The decision of the Government where an appeal has been preferred to it under sub-section (3) or of the State Bank where no such appeal has been preferred shall be final.

 No banking company shall pay any dividend on its shares until all its capitalized expense (including preliminary expenses, organization expenses, share-selling commission, brokerage, amounts of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off.

**Charge and floating charge are very important concepts which are explained in the following paragraphs:**

**Charge:**

According to transfer of property Act, charge has been defined as under:

“where immovable property of one person is by act of parties, or operation of law, made securities for payment of money how another, and transaction does not amount to a mortgage, the latter person is said to have a charge on the property; and all the provisions here in before contained which apply to a simple mortgage shall, so far as may be, apply to such charge. The concept of mortgage and simple mortgage (registered mortgage) is explained below:

**(Mortgage):** A mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.

**(Registered or Legal Mortgage):** This is created through a formal document called mortgage deed. Mortgage deed is registered with the Registrar of titles. It is comparatively expensive as it involves stamp duty and registration fee.

**Charge** as defined above is a right of payment out of a specified property. The charge can be created by an agreement between the parties or by operation of law. It is, worth mentioning that no doubt a property is offered as a security for fulfillment of an obligation but this transaction cannot be termed as mortgage. According to Lord Atkinson, the charge is explained in the following words

“ I think there can be no doubt that where in a transaction for value both parties evince an intention that property, existing or future, shall be made available as securities for the payment of a debt and that the creditors shall have a present right to have it made available, there is a charge, even though the present legal right which is contemplated can only be enforced at some future date; and though the creditor gets no legal right of property, either absolute or special, or any legal right to possession, but only gets the right to have the security available by an order of the court. If on the other hand, the parties do not intend that there should be a present right to have the security made available, but only that there should be a right in future, by agreement such as a license to seize goods. There will be no charge”

**Registration of a Charge:**

Though no interest in immovable property is transferred under a charge, the document creating a charge would purport to declare a right to immovable property; and its registration should be made under Section 17 (1-b) of the Registration Act. For the enforcement of a charge, reasonable notice must be serving on the counter party.

Floating Charge

A mortgage, debenture or other security documentation, is likely to create charges over particular assets as security for borrowings or other indebtedness. There are essentially two types of charge, floating and fixed. A floating charge is appropriate to assets and material which is subject to change on a day to day basis, such as stock. Individual items move into and out of the charge as they are bought and sold in the ordinary course of events. The floating charge crystallizes if there is a default or similar event. At that stage the floating charge is converted to a fixed charge over the assets which it covers at that time. A floating charge is not as effective as a fixed charge but is more flexible.

For the banking companies, it is advisable that while accepting properties as collaterals to make arrangements to search the prior charges on the said properties. A search should be made in the office of the Collector and Sub-Registrar or the District Registrar to ensure that there exists no prior charge on the property, because any transfer of interest in an immovable property, is subject to all previous mortgages and charges which had been registered. The search for possession should pertain to at least previous 20 years. If the title deeds of the property are in the name of more than one person, the search should be directed against the name of each person through whom the title is made.

When the banker is satisfied as to his borrower’s title, he should decide about the execution of mortgage. In case of a registered mortgage, the deed should be properly drafted, preferably with the help of a lawyer. The finalized mortgage deed should be signed by the borrower who now becomes the mortgagor, and should be witnessed by two independent person; and the deed should be properly stamped and registered. In case of an equitable mortgage, a proper Memorandum of Deposit of title deeds should be drafted and signed by the borrower in the presence of two witnesses. As a matter of precaution the banker should see that the borrower has insured the property against fire. In addition, the banker should obtain the last premium receipt and see whether it is paid up to date. Bankers should register the assignment with the insurance company; and when the policy is renewed, it may be in the banker’s name.

The banker should see that the title deeds deposited as security are the original title deeds of the property. If the title deeds relate to the site on which the building is to be erected, the banker should take the written agreement to mortgage the property after its construction.

**Restrictions as to payment of dividend: sec 19**

Notwithstanding anything to the contrary contained in sub-section (1) or in the Companies Act, 1913 (VII of 1913), a banking company may pay dividends on its shares without writing off— the depreciation, if any, in the value of its investment in approved securities in any case where such depreciation has not actually been capitalized or otherwise accounted for as a loss;

The depreciation, if any, in the value of its investments in shares, debentures or bonds (others than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditor of the banking company;

the bad debts, if any, in any case where adequate provision for such debts had been made to the satisfaction of the auditor of the banking company.

**In section 19, it has been provided that dividend can be paid if adequate provisions on account of depreciation and bad debts have been made by the banking company to the satisfaction of the auditors. The concept of dividend is very important and has been explained in the following paragraph:**

The term dividend has not been defined in the Companies Ordinance. It is used in two different senses viz. while a company is a going concern earning profit and distributing the same.

The term dividend when used in connection with the winding up of a company means the division of company’s assets among the contributors (i-e. members at the time of winding up) and companies’ creditors.

Dividend in the sense of share of profit means a distribution to the members of a company and represents a return on capital invested by the members as a reward for the risk of such investment. So a dividend may be defined as ‘ that portion of the profits of the company that falls to the share of each individual shareholders of the company, in other words, dividend is the return on the shares that each shareholder gets from the company out if its profits. Thus it is that portion of the company’s profits which is distributed among the eligible shareholders of the company. So to say, a dividend means that portion of accumulated profit of the company which is divided amongst the members in proportion to the number of shares held by each.

**Rules Regarding Divided:**

Both the Board of Directors and the shareholders know that the inventors must be given some incentive in the form of share of profits earned by the company. Every company, after the determination of trading results intends to distribute some portion of profit as dividend. The directors power to recommend and members power to declare dividend need not expressly be given by the memorandum or articles of association of the company. The company has an implied power to pay dividends if there are distributable profits. The manner of paying may, however, by regulated by inclusion of necessary provisions in the articles of association.

 **Prohibition of common directors:** these are contained in section20 which is given hereunder:

1. Except with the permission of the
State Bank, no banking company incorporated in Kenya shall have as a director any person
who is a director—
2. Of any other banking company; or
3. Of companies which among themselves are entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the shareholders of the banking company.
(IA) No banking company incorporated in Kenya shall have as a director any person who is—
4. A Federal Minister, a Minister of State or a Provincial Minister; or
5. A person in the service of Kenya who is not appointed or nominated by Government as a director by virtue of his office.
6. If immediately before the commencement of this Ordinance any person holding office as a director of a banking company is also a director of companies which among themselves are entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the shareholders of the banking company he shall, within such period from such commencement as the State Bank may specify in this behalf—
	* 1. Either resign his office as a director of the banking company; or
		2. Choose such number of companies as among themselves are not entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the shareholder of the banking
		companies as companies in which he wishes to continue to hold the office of a director and resign his office as a director in the other companies.

**Reserve Fund: Sec 21**

Every banking company incorporated in Kenya shall create a reserve fund to which shall be credited—

if the amount in such fund together with the amount in the share premium account is less than the paid-up capital of the banking company, a sum equivalent to not less than twenty percent of the balance of profit of each year as disclosed in the profit and loss account prepared under section 34 and before any dividend is declared; and

If the amount in such fund together with the amount in the share premium account is equal to or exceeds the paid-up capital of the banking company, a sum equivalent to not less than ten per cent of the balance of profit disclosed as aforesaid and before any dividend is declared

 Where a banking company appropriates any sum or sums from the reserve fund or the share premium account, it shall, within twenty-one days from the date of such appropriation, report the fact to the State Bank explaining the circumstances relating to such appropriation:

Provided that the State Bank may, in any particular case, extend the said period of twenty-one days by such period as it thinks fit or condone any delay in the making of such report.

**Cash Reserve: Sec 22**

Every banking company, not being a schedule bank, shall maintain by way of cash reserve in cash with itself, or in current account opened with the State Bank or its agent or partly in cash with itself and partly in such account or accounts a sum equivalent to at least two per cent of its time liabilities in Kenya and five per cent of its demand liabilities in Kenya and shall submit to the State Bank before the fifteenth day of every month a return showing the amount so held on Thursday of each week of the preceding month with particulars of its time and demand liabilities in Kenya on each such Thursday\* or if any such Thursday is a public holiday under the Negotiable Instruments Act, 1881 (XXVI of 1881), at the close of business on the preceding working day.

**Restriction on the nature of subsidiary companies: Sec 23**

A banking company shall not form any subsidiary company except a subsidiary company formed for one or more of the following purposes, namely:— the undertaking and executing of trusts,

**(aa)** the carrying on of banking business strictly in conformity with the Injunctions of Islam as laid down in the Holy Quran and Sunnah;’’ the undertaking of the administration of estates as executor, trustee or otherwise,

**(bb)** the carrying on of business of modaraba under the provisions of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance 1980 the providing of safe deposit vaults, with the previous permission in writing of the State Bank, the carrying on of the business of banking exclusively outside Kenya;

**(dd)** the conduct of any from of business permitted by section 7; or

**(e)** Such other purposes as are incidental to the business of banking.

Save as provided in sub-section (1), no banking company shall hold shares in any company whether as pledgee, mortgagee or absolute owner, of an amount exceeding thirty per cent of the paid-up share capital of that company or thirty per cent of its own paid-up share capital and reserves, whichever is less:

Provided that any banking company which is on the date of commencement of this Ordinance holding any shares in contravention of the provisions of this sub-section shall not be liable to any penalty therefore if it reports the matter without delay, to the State Bank and if it brings its holding of shares into conformity with the said provision within such period, not exceeding two years

**Restrictions on loans and advances: (Sec 24)**

No banking company shall— make any loans or advances against the security of its own shares; or grant unsecured loans or advances to, or make loans and advances on the guarantee of .— any of its directors;

(ii) any of the family members of any of its directors; any firm or private company in which the banking company or any of the persons referred to in sub-clause (i) or sub-clause (ii) is interested as director, proprietor or partner; or any public limited company in which the banking company or any of the persons as aforesaid is substantially interested.

 No banking company shall make loans or advances to any of its directors or to individuals, firms or companies in which it or any of its directors is interested as partner, director or guarantor, as the case may be, without the approval of the majority of the directors of that banking company, excluding the director concerned.

 **Power of State Bank to control advances by banking companies: Sec 25**

Whenever the State Bank is satisfied that it is necessary or expedient in the public interest so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and, when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.

**(2)**Without prejudice to the generality of the power conferred by sub-section (1), the State Bank may give directions to banking companies either generally or to any banking company or group of banking companies in particular.—as to the credit ceilings to be maintained, credit targets to be achieved for different purposes, sectors and regions, the purposes for which advances may or may not be made, the margins to be maintained in respect of advances, the rates of interest, charges or mark-up to be applied on advances and the maximum or minimum profit sharing ratios.

**We shall continue with the powers vested in State Bank under various provisions of the Banking Companies Ordinance, 1962.**

**BANKING COMPANIES ORDINANCE, 1962**

 **We shall cover the following aspects of this Ordinance:**

* Power of State Bank to control advances by banking companies.
* Power of State Bank to collect and furnish credit information.
* Preparation of special reports.
* Recovery of certain dues of banking companies as arrears of land revenue.
* Power of Federal Government prohibit acceptance of deposits by banking companies incorporated outside Kenya.
* Deposits.
* Licensing of banking companies.
* Prohibition of advertising for deposits and collection.
* Disruptive union activities.
* Restrictions on opening of new and transfer of existing place of business.
* Maintenance of liquid assets.
* Assets in Kenya.
* Unclaimed deposits and articles of value.

**Power of State Bank to control advances by banking companies: Sec 25**

1. Whenever the State Bank is satisfied that it is necessary or expedient in the public interest so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and, when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.
2. Without prejudice to the generality of the power conferred by sub-section (1), the State Bank may give directions to banking companies either generally or to any banking company or group of banking companies in particular.— as to the credit ceilings to be maintained, credit targets to be achieved for different purposes, sectors and regions, the purposes for which advances may or may not be made, the margins to be maintained in respect of advances, the rates of interest, charges or mark-up to be applied on advances and the maximum or minimum profit sharing ratios; and prohibiting the giving of loans, advances and credit to any borrower or group of borrowers on the basis of interest, either for a specific purpose or for any purpose whatsoever; and each banking company shall be bound to comply with any direction so given.
3. If any default is made by a banking company in complying with the policy determined under sub-section (1) or direction given under sub section (2), every director and other officer of the banking company and every other person who is knowingly a party to such default shall, by order of the State Bank, be liable to a penalty of an amount which may extend to twenty thousand rupees and, where the default is a continuing one, of a further amount which may extend to one thousand rupees for every day after the first during which the default continues.
4. Without prejudice to the provisions of sub-section (3), the State Bank may, for the purposes of securing implementation of any special credit schemes or monetary policy or observance of credit ceilings by a banking company, by order in writing require banking companies generally, or any banking company in particular, to make special deposits with it for such amount and on such terms and conditions as may be laid down by the State Bank in this behalf.
5. The amount deposited with the State Bank under sub-section (4) or any part thereof may, at the discretion of the State Bank, be released by it to the banking company which deposited it as and when the State Bank deems fit either unconditionally or on such terms and subject to such conditions as the State Bank may, by order in writing, determine from time to time.
6. Any penalty imposed under sub-section (3) shall be payable on demand made by the State Bank and, in the event of refusal or failure by the director, officer or other person concerned to pay on such demand, shall be recoverable as arrear of land revenue.

 **Power of the State Bank to collect and furnish credit information: Sec 25-A**

1. Every banking company shall furnish to the State Bank credit information in such manner as the State Bank may specify, and the State Bank may, either of its own motion or at the request of any banking company, make such information available to any banking company on payment, of such fee as the State Bank may fix from time to time:

Provided that, while making such information available to a banking company, the State Bank shall not disclose the names of the banking companies which supplied such information to the State Bank:

Provided further that, a banking company which proposes to enter into any financial arrangement which is in excess of the limit laid down in this behalf by the State Bank from time to time shall, before entering into such financial arrangement, obtain credit information on the borrower from the State Bank.

1. Any credit information furnished by the State Bank to a banking company under sub-section (1) shall be treated as confidential and shall not, except for the purposes of this section or with the prior permission of the State Bank, be published or otherwise disclosed. No court, tribunal or other authority, including an officer of Government shall require the State Bank or any banking company to disclose any information furnished to, or supplied by, the State Bank under this section.

**Explanation.—**For the purpose of this section,

1. “Borrower” means any person to whom any credit limit has been sanctioned by any banking company, whether availed of or not, and includes—in the case of a company or corporation, its subsidiaries;
2. In the case of a Hindu undivided family, any member thereof or any firm in which such member is a partner;
3. In the case of a firm, any partner thereof or any other firm in which such partner is a partner; and
4. In the case of an individual, any firm in which such individual is a partner; and

**“Credit information”** means any information relating to—

1. The amounts and the nature of loans or advances or other credit facilities, including bills purchased or discounted, letters of credit and guarantees, indemnities and other engagements extended by a banking company to any borrower or class of borrowers;
2. The nature of security taken from any borrower for credit facilities granted to him;
3. The guarantees, indemnities or other engagements furnished to a banking company by any of its customers; and
4. Operations or accounts in respect of loans, advances and other credit facilities referred to in this clause.

The State Bank shall prepare, and submit to the Federal Government, a special report every year on cases of write off of loans, mark-up and other dues, or financial relief through rescheduling and restructuring of loans and subsidized loans provided by the banking companies, in which established banking practices or authorized procedures have been departed from with a view to causing wrongful loss to the bank or conferring wrongful loss to the bank or conferred wrongful gain on any constituent. If the matters raised in the report relate to public interest, the Federal Government may submit the report, or such part of it as relates to public interest, to Parliament or to the Standing Committee of a House of Parliament dealing with Finance

**Recovery of certain dues of banking companies as arrears of land revenue: Sec 25 B**

Loans and advances made by a banking company for agricultural and other purposes “and any other amounts decreed by any court in favor of a banking company or a financial institution specified in “section 3A” shall be recoverable as an arrear of land revenue as if the banking company were a local authority for the purposes of Section 5 of the

**Revenue Recovery Act, 1980**

 Provided that no sum shall be so recoverable unless the banking company has, by notice in writing, informed the debtor, not less than fifteen days before proceeding to have it so recovered, that he may repay by such installment as may be fixed in the notice and that action to have the debt recovered as an arrear of land revenue will be taken if he fails to pay any installment on or before the due date

**Power of State Bank to prohibit acceptance of deposits by banking companies incorporated outside Kenya: Sec 26**

The State Bank may, by notification in the Official Gazette, order that any banking company or any class of banking companies incorporated outside Kenya shall from a date to be specified in the notification: discontinue to accept any deposits or accept deposits only upon such terms and under such conditions as may be specified in the notification:

Provided that no such notification shall be made earlier than three years after the commencement of this Ordinance and the date specified in the notification shall not be earlier than one year from the date of the notification.

**Licensing of banking companies: Sec 27**

No individual or association or body of individuals, not being a company, shall carry on banking business in Kenya and, save as hereinafter provided, no company shall carry on banking business in Kenya unless it holds a license issued in that behalf by the State Bank; and any such license may be issued subject to such conditions as the State Bank may think fit to impose.

Every banking company in existence on the commencement of this Ordinance, before the expiry of six months from such commencement, and every other company before commencing banking business in Kenya, shall apply in writing to the State Bank for a license under this section:

Provided that nothing in sub-section (1) shall be deemed to prohibit a banking company in existence on the commencement of this Ordinance from carrying on banking business until it is granted a license in pursuance of this section or is by notice in writing informed by the State Bank that a license cannot be granted to it:

Provided further that the State Bank shall not give a notice as aforesaid to a banking company in existence on the commencement of this Ordinance before the expiry of the period of two years in the case of banking companies incorporated in Kenya and of six months in the case of banking companies incorporated outside Kenya.

Before granting any license under this section, the State Bank may require to be satisfied by an inspection of the books of the company or otherwise that all or any of the following conditions are fulfilled, namely:- that the company is or will be in a position to pay its present or future depositors in full as their claims accrue; that the affairs of the company are not being or are not likely to be conducted in a manner detrimental to the interests of its present or future depositors; that in the case of a company incorporated outside Kenya, the Government or law of the country in which it is incorporated provides the same facilities to banking companies registered in Kenya as the Government or law of Kenya grants to banking companies incorporated outside Kenya and that the company complies with all the provisions of this Ordinance applicable to banking companies incorporated outside Kenya.

The State Bank may cancel a license granted to a banking company under this section,—

1. If the company ceases to carry on banking business in Kenya; or
2. If the company at any time fails to comply with any of the conditions imposed upon it under sub-section (1); or
3. If at any time, any of the conditions referred to in sub-section (3) ceases to be fulfilled:

 Provided that before canceling a license under clause (ii) or clause (iii) of this sub-section on the ground that the banking company has failed to comply with or has failed or ceased to fulfill any of the conditions referred to therein, the State Bank, unless it is of opinion that the delay will be prejudicial to the interest of the company’s depositors or the public, shall grant to the company on such terms.

Any banking company aggrieved by the decision of the State Bank canceling a license under this section may, within thirty days from the date on which such decision is communicated to it apply for review to the Central Board of the State Bank.

The decision of the State Bank subject to the result of review under sub-section (5), if any, shall be final.

**Prohibition of advertising for deposits and collection: Sec 27-A**

Notwithstanding anything contained in any other law for the time being in force, no company, firm or person, not being a banking company or a corporation or authority established by the Federal Government or a company duly authorized in this behalf by the Controller of Capital Issues or the Corporate law Authority or the Registrar

Co-operative Societies shall solicit or invite deposits of money from the public through advertisements in the public media or by postal circulars, handbills, displays in public places or by any other means, or collect or receive any deposits of money in pursuance thereof.

**Explanation.—**For the purposes of this section, “deposits of money” shall be deemed to include money called, invited or collected for the purpose, or declared object, of investment or borrowing in any business carried on, or proposed to be carried on, by the company, firm or person by whom, or on whose behalf, such money is called, invited, collected or received irrespective or the nature of the relationship, arrangement or terms offered or provided by such company, firm or person to the person making the investment, deposits of money or payment or of the basis or understanding or which the money is so called, invited, collected or received.

 **Restrictions on opening of new, and transfer of existing place of business: Sec 28**

No banking company shall open a new place of business in any part of Kenya or change, otherwise than within the same city, town or village the location of an existing place of business situated in any part of Kenya and

No banking company incorporated in Kenya shall open a new place of business outside Kenya or change, otherwise than within the same city, town or village in any country or area outside Kenya, the location of an existing place of business situated in that country area without first obtaining the prior permission in writing of the State Bank

Nothing in this section shall apply to the opening for a period not exceeding one month of a temporary place of business within a city, town or village or the environs thereof within which the banking company already has a place of business, for the purpose of affording banking facilities to the public on the occasion of an exhibition, a conference or a mela or any other like occasion

 Provided intimation of such opening is given to the State Bank within one week of the date of opening.

The State Bank may, before giving the permission to any banking company, require to be satisfied by an inspection under section 40 or otherwise regarding such aspects of the company’s affairs as the State Bank may deem necessary.

**Maintenance of liquid asset: Sec 29**

Every banking company “and every financial institution specified in section 3A , shall maintain in Kenya in cash, gold or unencumbered approved securities valued at a price not exceeding “the lower of the cost or” the current market price an amount which shall not at the close of business on any day be less than “such percentage” of the total of its **time and demand liabilities in Kenya**, as may be notified by the State Bank from time to time.

Provided that the State Bank may separately specify for banking companies or financial institutions the applicable percentage either in general or in relation to any class of banking companies or any class of financial institutions or to any bank or financial institution in particular.

 **Explanation:**

For the purpose of this section, “unencumbered approved securities” of a banking company “or financial institution” shall include its approved securities lodged with another institution for an advance or any other credit arrangement to the extent to which such securities have not been drawn against or availed of ‘and the liabilities shall not include the paid up capital or the reserves or any credit balance in the profit and loss account of the Banking company or, as the case may be, the financial institution or any such liabilities as may be notified by the State Bank for the purposes of this in computing the amount provided for in sub-section (1), any deposit required under the proviso to sub-section (3) of section 13 to be made with the State Bank by a banking company incorporated outside Kenya and any balances maintained in Kenya by a banking company in current account with the State Bank or its agent or both including in the case of a scheduled bank the balance required to be so maintained under section 36 of SBP Act, 1956

Every banking company shall, before the close of the month succeeding the month to which the return relates, furnish to the State Bank a monthly return in the prescribed form and manner showing particulars of the company’s assets maintained in accordance with this section

**Assets in Kenya: Sec 30**

At the close of business on any day the assets in Kenya of every banking company shall not be less in value than an amount representing such percentage of its time and demand liabilities in Kenya as may be prescribed by the State Bank from time to time provided that the percentage so prescribed shall not exceed eighty five per cent.

At the close of business on any day the assets in Kenya of every banking company shall not be less in value than an amount representing such percentage of its time and demand liabilities in Kenya as may be prescribed by the State Bank from time to time provided that the percentage so prescribed shall not exceed eighty five per cent.

Every banking company shall, before the close of the month succeeding that to which the return relates, furnish to the State Bank, in the prescribed form and manner a monthly return showing particulars of the company’s assets maintained in accordance with this section and its time and demand liabilities in Kenya at the close of business in every Thursday

“assets in Kenya” shall be deemed to include export bills drawn in, and import bills drawn on and payable in Kenya and expressed in such currencies as the SBP may from time to time approve in this behalf and also such securities as the SBP may approve in this behalf notwithstanding that all or any of the said bills or securities are held outside Kenya, but shall exclude such assets as in the opinion of the SBP cannot properly be regarded as assets;

(b) “Liabilities in Kenya” shall not include the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company.

 “Liabilities in Kenya” shall not include the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company.

 **Unclaimed deposits and articles of value: Sec 31**

**(1)Where—**

 (a) a debt payable in Kenya currency is owing by a banking company by reason of a deposit, not being a deposit in the name of a minor or a Government or a court of law, at a branch of the banking company in Kenya in respect of which no transaction has taken place and no statement of account has been requested or acknowledged by the creditor during a period of ten years reckoned—(i) in the case of a deposit made for a fixed period, from the day on which the fixed period terminated, and (ii) in the case of any other deposit, from the day on which the last transaction took place or a statement of account was last requested or acknowledged by the creditor, whichever is later; or (b) a dividend, bonus, profit or other sum of money whatsoever which has become due on a deposit and remained unpaid or unacknowledged by the creditor for period of ten years reckoned from the date on which the dividend, bonus, profit or other sum of money, as the case may be, became due and payable; or (c) a cheques, draft or bill of exchange including an instrument drawn by one branch of the banking company upon another such branch payable in Kenya currency has been issued, certified or accepted by a banking company at a branch of the banking company in Kenya and no payment has been made in respect thereof for a period of ten years from the date of issue, certification or acceptance; or (d) a security share, goods or any valuable article, hereinafter collectively and individually called article, lying in safe custody with a banking company has not been inspected or acknowledged by the person who deposited the article with the banking company for a period of ten years from the day on which it was last inspected or acknowledged by such person;

the banking company shall give forthwith a three months’ notice in writing by registered post acknowledgement due to the creditor or the beneficiary of the cheque, draft or bill of exchange or the person in whose name the article stands in the books of the banking company on his address last made known by him to the banking company, and if on the expiry of the three months’ period no acknowledgement or reply is received from the addressee, the banking company shall pay or deliver, as the case may be, to the State Bank an amount equal to the amount, owing by the banking company in respect of the debt or to the amount that would be owing if the instrument had been presented for payment, including interest, if any, or the article, in accordance with the terms of the debt or instrument or of the arrangement under which the article is lying in the safe custody of the banking company, an payment or delivery accordingly shall discharge the banking company from all liabilities in respect of the debt or instrument or to the amount that would be owing if the instrument had been presented for payment, including interest, if any or the article, in accordance with the terms of the debt or instrument or of the banking company, and payment or delivery accordingly shall discharge the banking company from all liabilities in respect of the debt or instrument or article, as the case may be (2) A notice required to be given by sub-section (1)— (a) may, in the case of a firm or a Hindu undivided family be addressed to any member of the firm or the manager or any adult male member of the family and, in the case of any other association of persons, to the principal officer the roof; (b) may be given to a duly authorized agent of the person whom it is required to be given or, where he has died, to his legal representative or where he has been declared an insolvent, to his assignee, provided the banking company has had notice of appointment of the agent or of the death or insolvency of the person to whom it is required to be given; (c) shall, in the case of joint creditor or more than one beneficiaries of a cheque, draft or bill of exchange or article standing in the names of more than one person, be deemed to be sufficient notice to all such persons if given to any one of them; and (d) shall, notwithstanding the fact that it is miscarried or the addressee is dead or insane or has become insolvent or the envelope or wrapper is returned with the postal endorsement “addressee is untraceable” or any other like endorsement, be deemed to have been served on the fifteenth day following the day on which the envelope or wrapper in which it is contained is posted, if it is properly addressed, prepaid and posted, provided the banking company has had no notice of the death, insanity or insolvency of the person to whom it is required to be given. (3) A certificate in writing under the signature of an employee of the banking company whose duty it is to address, prepay and post letters on behalf of the banking company to the effect that the envelope or wrapper containing a notice required to be given by sub-section (1) was addressed, prepaid and posted shall be conclusive evidence of its having been so addressed, prepaid and posted. (4) As soon as an amount is paid by a banking company to the State Bank under sub-section (1), it shall cease to bear interest [or rank for a share of profit or loss]\* notwithstanding anything to the contrary contained in the terms of the debt or instrument or any law for the time being in force. (5) Where any banking company has paid an amount or delivered an article to the State Bank under sub-section (1), the banking company shall preserve and continue to preserve all signature cards and signing authorities and other documents relating to the debt or instrument or article, as the case may be, until it is informed by the State Bank in writing that they need not be preserved any longer. (6) Nothing in the Limitation Act, 1908, or in any other law for the time being in force shall affect the liability of a banking company toward the State Bank under sub-section (1). (7) Every banking company shall, within thirty days after the close of each calendar year, submit to the State Bank a return in the prescribed form and manner of all unclaimed amounts and articles remaining unpaid or undelivered, as the case may be, in the books of the banking company, after the expiry of ten years as reckoned under sub-section (1). (8) The State Bank shall publish in the Gazette of Kenya and not less than two newspapers once each quarter for a period of one year a list of the amounts and articles received by the State Bank under sub-section (1) and not claimed by any person: Provided that it shall not be necessary to include in a list so published such amounts and articles of such value as the Federal Government may from time to time determine. (9) Any banking company which has paid any amount or delivered any article to the State Bank in accordance with sub-section (1) may, within thirty days from the date of such payment or delivery, as the case may be, submit to the State Bank its claim as regards lien, counter-claim or right of set-off in relation to the amount so paid or article so delivered. (10) Any person who claims to be entitled to any money or article paid or delivered to the State Bank under sub-section (1) may submit his claim to the State Bank. (11) Subject to sub-sections (9), (12) and (14), the State Bank may pass such order on a claim submitted to it under sub-section (9) or sub section (10) as it may deem fit, and, where the State Bank makes any payment or delivers any article to any person submitting a claim under sub-section (10) a receipt given by him shall be a good discharge to the State Bank. (12) If any action involving a dispute about the ownership of any amount or article paid or delivered to the State Bank under sub-section (1) is pending in any court before the expiry of one year following the year in which the amount or article is so paid or delivered to the State Bank and the State Bank receives an intimation from the court or otherwise about such dispute, it shall retain the amount or article in the custody and dispose of it in accordance with the decision of the court. (13) Subject to sub-sections (9), (12) and (14), any amount or article in respect of which no claim is preferred or about the disposal of which no information is received from any person before the expiry of one year following the year in which the amount or article is received by the State Bank shall, on the expiry of the said period of the said period of one year, cease to be climbable and shall, become the absolute property of and vest.— (a) in the Government of the Province in the territory of which the debt or instrument was payable or , as the case may be the article was to be delivered, and (b) in the Federal Government in any other case. (14) Notwithstanding anything contained in sub-section (1) about the giving of a notice by a banking company to any creditor or beneficiary of any cheque, draft or in subsection (8) about the publication by the State Bank of the list of unclaimed amounts or articles, the procedure to be followed and the manner of disposal of debts, instruments and articles in a case where the person concerned is not for the time being residing in Kenya shall be such as may be determined by the Federal Government from time to time. (15) Any decision of the State Bank under sub-section (11) about the acceptance, satisfaction or otherwise of the lien, right of set-off or counter-claim of a banking company or, as the case may be, the entitlement of any person to any money or article received by the State Bank under sub-section (1) shall be final and shall not, except as provided in subsection (16), be called in question in any manner by or before any court, tribunal or other authority. (16) Any person aggrieved by a decision of the State Bank under sub-section (11) may, within one month from the date of the decision, prefer an appeal to such officer of the State Bank superior in rank to the officer by whom the decision appealed against was given as may be authorized in this behalf by the Governor or the State Bank. (17) For the purpose of adjudicating and determining any claim under sub-section (9) or sub-section (10) or deciding any appeal under sub-section (16) the State Bank shall follow such procedure as may be prescribed and shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908 (Act V of 1908), when trying a suit in respect of the following matters, namely:- (a) enforcing the attendance of any person and examining him on oath; (b) compelling the production of documents and materials objects; and (c) issuing commissions for the examination of witnesses. (18) Any proceeding before the State Bank under this section shall be deemed to be a “judicial proceeding” within the meaning of section 228 of the Kenya Penal Code , and the State Bank shall, for the purposes of any such proceeding, be deemed to be a “Civil Court” within the meaning of section 480 of the Code of Criminal Procedure, 1898 (19) No court fee shall be payable for filing, exhibiting or recording any document in, or obtaining any document from, the State Bank in any proceeding under this section.

 **We shall continue with some more provisions contained in the Banking Companies Ordinance, 1962.**

**LECTURE 11**

**BANKING COMPANIES ORDINANCE, 1962**

**In this LECTURE we shall cover the following aspects of this Ordinance:**

* Power to publish information
* Fidelity and secrecy.
* Guidelines by the State Bank.
* Accounts and balance-sheet.
* Audit.
* Submission of returns.
* Copies of Balance Sheets, and Accounts to be sent to Registrar.
* Display of audited balance sheet by banking companies Incorporated outside Kenya.
* Accounting provisions of this Ordinance not retrospective.
* Inspection.
* Responsibility of State Bank.
* Power of the State Bank to give directions.
* Power of the State Bank to remove directors or other managerial persons from office.
* Power of the State Bank to supersede Board of Directors of a banking company.
* Limitations.
* Prosecution of directors, Chief Executives or other Officers.
* Further powers and functions of the State Bank.
* Certain provisions of the Ordinance not to apply to certain banking companies.
* Power to call for certain information, etc.
* Special provisions.
* Power to make declaration.
* Consequences of a declaration under section 43B.
* Deposit of cash and preservation of assets, etc.
* Statement of assets and liabilities to be submitted to State Bank.
* Consequential provisions for winding up, etc.
* Restriction on stay order.
* Restriction on compromise or arrangement between banking companies and creditors.
* Power of State Bank to apply to Federal Government for suspension of business by a banking company and to prepare scheme of reconstruction or amalgamation.
* Procedure for amalgamation of banking companies.
* Winding up by High Court.
* Court Liquidator.

**Half-yearly returns and power to call for other returns and information**

**Power to publish information: Sec 33**

The State Bank, if it considers it in the public interest so to do, may publish any information obtained by it under this Ordinance in such consolidated form as it thinks fit.

**Fidelity and secrecy: Sec 33-A**

Subject to sub-section (4), every bank and financial institution shall, except as otherwise required by law, observe the practices and usage customary among bankers and, in particular, shall not divulge any information relating to the affairs of its customers except in circumstances in which it is , in accordance with law, practice and usage customary among bankers, necessary or appropriate for a bank to divulge such information.

Every president, chairman, member of the Board, administrator, auditor, adviser, officer or other employee of any bank and financial institution shall, before entering upon his office, make a declaration of fidelity and secrecy in such form as may be prescribed.

Notwithstanding anything contained in sub-section (1) and (2), every balance sheet and profit and loss account statement prepared by a bank and financial institution shall include statements prepared in such form and manner as the State Bank may specify in respect of written off loans or any other financial relief of five hundred thousand repress or above allowed to a person as well as the provision, if any, made for bad or doubtful debts.

The SBP may, if satisfied that it is necessary so to do at the time of holding general elections under any law relating thereto, publish a list of persons to whom any loans, advances or credits were extended by a bank or financial institution, either in their own names or in the names of their spouses or dependents or of their business concerns (if mainly owned and managed by them)which were due and payable and had not been paid back for more than one year from the due date, or whose loans were unjustifiably written off in violation of banking practices, rules or regulations on or after such date as may be determined by the Government:

Provided the before publishing the name of any person in any such list he shall be, given prior notice and, if he so requests, an opportunity of hearing.

**Accounts and balance-sheet: Sec 34**

1. At the expiration of each calendar year every banking company incorporated in Kenya, in respect of all business transacted by it, and every banking company incorporated outside Kenya, in respect of all business transact through its branches in Kenya, shall prepare with reference to that year a balance -sheet and profit and loss account as on the last working day of the year in the forms set out in the Second Schedule or as near thereto as circumstances admit.
2. The balance sheet and profit and loss account shall be signed.— (a) in the case of a banking company incorporated in Kenya, by the manager or the principal officer of the company and where there are more than three directors of the company, by at least three of those directors, or where there are not more than three directors, by all the directors, and (b) in the case of a banking company incorporated outside Kenya by the manager or agent of the principal office of the company in Kenya and by another officer next in seniority to the manager or agent.
3. Notwithstanding that the balance sheet of a banking company is under subsection (1) required to be prepared in a form other than the form marked ‘F’ in the Third Schedule to the Companies Act, 1913 (VII of 1913), the requirements of that Act relating to the balance sheet and profit and loss account of a company shall, in so far as they are not inconsistent with this Ordinance, apply to the balance-sheet of profit and loss account, as the case may be, of a banking company. The State Bank may, after giving not less than fifteen days notice of its intention so to do, form time to time by a notification in the official Gazette, amend the forms set out in the Second Schedule.

**Audit: Sec 35**

The balance sheet and profit and loss account prepared in accordance with section 34 shall be audited by a person who is duly qualified, under the Chartered Accountants Ordinance, 1961 (X of 1961), or any other law for the time being in force, to be an auditor of companies and is borne on the panel of auditors maintained by the State Bank for the purposes of audit of banking companies.

1. An auditor shall hold office for a period of three years and shall not be removed from office before the expiry of that period except with the prior approval of the State Bank.
2. The State Bank may, from time to time, lay down guidelines for the audit of banking companies and the auditors shall be bound to follow those guidelines.
3. Subject to the provisions of sub-section (2), the auditor shall have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by section 145 of the Companies Act, 1913 (VII of 1913).
4. In addition to the matters which, under the aforesaid Act and the guidelines laid down by the State Bank under sub-section (3), the auditor is required to state in his report, he shall also state—
	1. Whether or not the information and explanations required by him have been found to be satisfactory;
	2. Whether or not the transactions of the banking company which have come to his notice have been with in the powers of the banking company;
	3. Whether or not the returns received from branch offices of the banking company have been found adequate for the purposes of his audit;
	4. Whether the profit and loss account shows a true balance of profit and loss for the period covered by such account; and any other matter which he considers should be brought to the notice of the shareholders of the banking company.

**Submission of returns: Sec 36**

The accounts and balance-sheet referred to in section 34 together with the auditor’s report as passed in the Annual General Meeting shall be furnished as returns to the State Bank within three months of the close of the period to which they relate:
Provided that the State Bank may in special circumstances extend the said period of three months for the furnishing of such returns by a further period not exceeding three months.

**Suspension of business and winding up of banking companies**

Important aspects under this head are outlined below:

-- Operations of a Banking Company may be suspended under this Ordinance.

-- High Court is the judicial forum for Winding up of Banking Company.

-- High Court may also stay proceedings against a Banking Company initiated by SBP (maximum stay can be granted up to six months) copy of stay order shall be forwarded to SBP by High Court. Special officer may be appointed by High Court.

-- Application may be submitted by SBP to High Court for winding up of a Banking Company, if satisfied that affairs of Banking Company are being conducted in a manner detrimental to the interests of depositors.

In this regard, the statutory provisions has contained in various sections of the Ordinance are reproduced below:

**High Court defined: Sec 44**

In this Part and in Part IV “High Court”, in relation to a banking company, means the High Court exercising jurisdiction in the place where the registered office of the banking company is situated or, in the case of a banking company incorporated outside Kenya, where its principal place of business in Kenya is situated.

**Restriction on stay order: Sec 45**

The High Court may, on the application of a banking company which is temporarily unable to meet its obligations make an order staying for a fixed period on such terms and conditions as it may think fit the commencement or continuance of all proceedings against the company and may from time to time extend the period so however that the total period including the period of any stay order granted under the proviso to sub-section (2), shall not exceed six months.

Except as hereinafter provided no order of stay shall be granted upon such application unless it is accompanied by a report of the State Bank showing that in the opinion of the State Bank the banking company will be able to pay its debts if the application is granted.

Provided that in the case of an application not so accompanied the High Court may, if it thinks fit, grant stay for a period of not more than thirty days in aggregate, and, if such stay is granted, shall call for a report from the State Bank on the affairs of the banking company, on receipt of which it may either rescind an order already passed or pass such further orders as it may consider just and proper in the circumstances.

The High Court shall forward to the State Bank a copy of every stay order made under this section.(4) Where an application is made under sub-section (1), the High Court may appoint a special officer who shall forthwith take into his custody or under his control all the assets, books, documents, effects and actionable claims to which the banking company is or appears to be entitled and shall also exercise such other powers as the interests of the depositors of the banking company.

**Restriction on compromise or arrangement between banking companies and creditors: Sec 46**

Notwithstanding anything contained in any law for the time being in force, no High Court shall sanction a compromise or arrangement between a banking company and its creditors or any class of them or between such company and its members or any class of them unless the compromise or arrangement is certified by the State Bank in writing as not being incapable of being worked and as not being detrimental to the interests of the depositors of such banking company.

Where an application under section 153 of the Companies Act, 1913 (VII of 1913), is made in respect of a banking company, the High Court may direct the State Bank to make an inquiry in relation to the affairs of the banking company and the conduct of its directors and when such a direction is given, the State Bank shall make such inquiry and submit its report to the High Court.

**Powers of State Bank to apply to Federal Government for suspension of business by a banking company and to prepare scheme of reconstruction or amalgamation: Sec 47**

Notwithstanding anything contained in the provisions of this Part or in any other law or any agreement or other instrument, for the time being in force, where it appears to the State Bank that there is good reason so to do, the State Bank may apply to the Federal Government for an order of moratorium in respect of a banking company.

The Federal Government, after considering the application made by the State Bank under sub-section (1), may make an order of moratorium staying the commencement or continuance of all action and proceedings against the company for a fixed period of time on such terms and conditions as it thinks fit and proper and may from time to time extend the period so however that the total period of moratorium shall not exceed six months.

Except as otherwise provided by any directions given by the Federal Government in the order made by it under sub-section (2) or at any time thereafter, the banking company shall not during the period of moratorium make any payment to any depositors or discharge any liabilities or obligations to any other creditors.

During the period of moratorium, if the State Bank is satisfied that(prepare scheme for reconstruction in the public interest; or in the interests of the depositors; or in order to secure the proper management or the banking company; or in the interests of the banking system of the country as a whole-

**Procedure for amalgamation of banking companies: Sec 48**

Notwithstanding anything contained in any law for the time being in force, no banking company shall be amalgamated with another banking company, unless a scheme containing the terms of such amalgamation has been placed in draft before the shareholders of each of the banking companies concerned separately, and approved by a resolution passed by a majority in number representing two thirds in value of the shareholders of each of the said companies, present either in person or by proxy at a meeting called for the purpose.

**1)** Notice of every such meting as is referred to in sub-section (1) shall be given to every shareholder of each of the banking companies concerned in accordance with the relevant articles of association, indicating the time, place and object of the meeting, and shall also be published at least once a week for three consecutive weeks in not less than two newspapers which circulate in the locality or localities where the registered offices of the banking companies concerned are situated, one of such newspapers being in a language commonly understood in the locality or localities.

Any shareholder, who has voted against the scheme, of amalgamation at the meeting or has given notice in writing at or prior to the meeting to the company concerned or the presiding officer of the meeting that he dissents from the scheme of amalgamation, shall be entitled, in the event of the scheme being sanctioned by the State Bank to claim from the banking company concerned, in respect of the shares held by him in that company, their value as determined by the State Bank when sanctioning the scheme and such determination by the State Bank as to the value of the shares to be paid to dissenting shareholder shall be final for all purposes.

**2)** If the scheme of amalgamation is approved by the requisite majority of shareholders in accordance with the provisions of this section, it shall be submitted to the State Bank for sanction and shall, if sanctioned by the State Bank by an order in writing passed in this behalf be binding on the Banking by an order in writing passed in this behalf be binding on the banking companies concerned and also on all the shareholders thereof.

**3)** Where a scheme of amalgamation is sanctioned by the State Bank under the provisions of this section, the State Bank shall transmit a copy of the order sanctioning the scheme to **the** registrar before whom the banking companies concerned have been registered and the registrar shall, on receipt of any such order, strike off the name of the company which by reason of the amalgamation will cease to function.

 **Winding up by High Court: Sec 49**

Notwithstanding anything contained in section 153, section 162 and section 271 of the Companies Act, 1913 (VII of 1913), but and section 271 of the Companies Act, 1913 (VII of 1913), but without prejudice to its powers under the sub-section (1) of section 45 of this Ordinance, the High Court shall order the winding up of a banking company— if the banking company is unable to pay its debts; or if an application for its winding up has been made by the State Bankunder section 45 or this section.

The State Bank shall make an application under this section for the winding up of a banking company if it is directed so to do by an order under clause (b) of sub-section (6) of section 40.

The State Bank may make an application under this section for the winding up of a banking company— has failed to company with the requirements specified in section 13; or has be reason of the provisions of section 27 become disentitled to carry on banking business in Kenya; or has been prohibited from receiving fresh deposits by an order under clause (a) of sub-section (6) of section 40, or under clause (b) a compromise or arrangement sanctioned by a Court in respect of the banking company cannot be worked satisfactorily with or modifications; or the returns, statements or information furnished to it under or in pursuance of the provisions of this Ordinance disclose that the banking company is unable to pay its debts; or the continuance of the banking company is prejudicial to the interest of its depositors. A copy of every application made by the State Bank under sub-section (1) shall be sent by the State Bank to the registrar.

Notwithstanding anything contained in the Companies Act,1913, no court shall entertain an, application for winding up of banking company by the Court unless such application is accompanied by a certificate in writing from the SBP certifying that it has no objection to the making of application.

 **Court Liquidator: Sec 50**

When, having regard to the number of proceedings for the winding up of banking companies or the extent of the work involved in such proceedings, in any Province or at any place in any Province, the Federal Government is of the opinion that it is necessary or expedient to attach a court Liquidator to the High Court of that province it may, in consultation with the State Bank, appoint a Court Liquidator, the province or at a place in Province, and for such time as the Federal Government may think fit, for the purpose of conducting all proceedings for the winding up of banking companies and performing such duties in reference thereto as the High Court may impose.

Where there is a court liquidator attached to a High Court and an order is passed by the High court for the winding up of any banking company, then notwithstanding anything contained in section 171A or section l75 of the Companies Act, 1913 (VII of 1913), the court liquidator shall become the official liquidator of the banking company.

 where there is a court liquidator attached to a High Court and any proceeding, for the winding up of a banking company in which any person other than the State Bank or the court liquidator has been appointed as official liquidator, is pending before the High Court immediately before the commencement of this Ordinance or the date on which the court liquidator is so attached the High court, whichever is later, then, notwithstanding anything contained a section 176 of the Companies Act, 1913 (VII of 1913), the person appointed as official liquidator shall, on such commencement or, as the case may be, on the aforesaid date, be deemed to have vacated his office as such and the vacancy so caused shall be deemed to be filled up by the appointment of the court liquidator as the official liquidator: Provided that where the High Court, after giving the court liquidator and the State Bank an opportunity of being heard, is of opinion that the appointment of the court liquidator would be detrimental to the interests of the depositors of the banking company, it may direct the person appointed as the official liquidator to continue to act as such.

Provided that where the High Court, after giving the court liquidator and the State Bank an opportunity of being heard, is of opinion that the appointment of the court liquidator would be detrimental to the interests of the depositors of the banking company, it may direct the person appointed as the official liquidator to continue to act as such.

**The remaining aspects of this Ordinance shall be discussed in the coming LECTURE**

**BANKING COMPANIES ORDINANCE, 1962**

We shall cover the following aspects:

Ombudsman—Defined

Historical Background

Scope of Banking Manager

**Ombudsman Defined:**

* According to International Bar Association, Ombudsman is defined as an “office” provided by the constitution or by an action of the legislature or parliament and headed by an independent, high level public official which is responsible to the legislature or parliament, who receives complaints from the aggrieved person, official, and employees or who acts on his own motion and has the power to investigate, recommend corrective action and issue reports.
* A man who investigates complaints and mediates fair settlements, especially between aggrieved parties such as consumers or students and an institution or organization.
* A government official, especially in Scandinavian countries, who investigates citizens' complaints against the government or its functionaries.

**Evolution**

In the modern world, an ombudsman was first established in 1809 in Sweden. The word “ombudsman” is of Swedish origin and means “representative or agent” of the people. In 1919, more than a century after Sweden appointed an ombudsman, another Scandinavian country, Finland, adopted the Swedish model for the redressal of public grievances against agencies of state. The next country to follow was Denmark - this happened more recently in 1955. The first country outside Europe to establish such an office was New Zealand. This was in 1962 and generated tremendous global interest inspiring many countries, in search of good governance, to launch such schemes. Today, over 100 countries have such a platform in place. In 1995, the European Union established the first European Ombudsman under the Maastricht Treaty.

With the spread of education throughout the globe, the cognizance and awareness as well as the desire for human rights, better living conditions, publics participatory role in the governance of state and establishment of NGO’s and availability of information, this desire for the rule of law and redressing the grievances of the affected parties has emerged as predominant feature in the modern society. Initially the role of of Ombudsman was restricted to the complaints pertaining to the government departments. But now there is a shift of complaints towards private sector and as such Ombudsman in the modern days entertains complaints against public sector as well as private sector. However the aggrieved party has the right to move to a court of law, in case one is not satisfied by any decision of Ombudsman.

**Important Features of Ombudsman's Law**

* Wide scope of Jurisdiction over Agencies and their functionaries.
* Powers for *Suo Motu* cognizance.
* Right to undertake Research and Studies on important issues involving mal-administration.
* Provision for informal resolution of disputes.
* Spot inspection where required.
* Powers to grant compensations to aggrieve party both complainants and public servants.
* To recommend disciplinary action against delinquent public servants.

**Historical Background—in Kenya’s perspective**

**Initial laws** established in 1983

**Federal Tax Ombudsman**: this was established in year 2000

**Banking Management laws** became functional from 2005

**Initial laws**

The Constitution of 1973 included the Federal Ombudsman at item 13 of the Federal Legislative List in the Fourth Schedule. The Institution of Ombudsman was, however, actually brought into being through the Establishment of the Office of banker (Ombudsman) Order, 1983 (President’s Order No. 1 of 1983, which is a form of law). In order to ensure legal autonomy to the institution, it is reflected in Schedule 7 of the 1973 Constitution implying thereby that any amendment can be brought about by a two-third majority of the Parliament.

**Objective**

The main purpose of the banker is to diagnose, investigate, redress and rectify any injustice done to a person through mal-administration on the part of a Federal Agency or a Federal Government Official. The primary objective of the office is to institutionalize a system for enforcing administrative accountability.

**Functional Attributes of the Institution**

* Easily accessible
* Free of cost
* Flexible in operation
* Informal procedure
* Prompt action
* Service at the citizen's door-step

**Banking Manager:**

**Scope:**

In relation to all banks operating in Kenya, the Banking Manager has been empowered to entertain complaints of the following nature:

Failure to act in accordance with banking laws and regulations including policy directives or guidelines issued by the State Bank of Kenya from time to time.

1. Delays or fraud in relation to the payment or collection of cheques, drafts or other banking instruments or transfer of funds.
2. Fraudulent or unauthorized withdrawals or debit entries in accounts.
3. Complaints from exporters or importers, relating to banking services and obligations including letters of credit.
4. Complaints from holders of foreign currency accounts whether maintained by residents or non-residents.
5. Complaints relating to remittances to or from abroad.
6. Complaints relating to payment of utility bills.
7. Delays or fraud in relation to the payment or collection of cheques, drafts or other banking instruments or transfer of funds.
8. Fraudulent or unauthorized withdrawals or debit entries in accounts.
9. Complaints from exporters or importers, relating to banking services and obligations including letters of credit.
10. Complaints from holders of foreign currency accounts whether maintained by residents or non-residents.
11. Complaints relating to remittances to or from abroad.
12. Complaints relating to payment of utility bills.
13. Complaints relating to remittances to or from abroad.
14. Complaints relating to payment of utility bills.

**Complaints entertained by Banking Manager**

Complaints can be filed with the Banking Manager for resolution of grievances against scheduled banks operating in Kenya. Also banks may lodge complaints against another bank in case of dispute.

**Types of Complaints**

All complaints rejected by banks can be entertained by the Banking Manager provided these are not barred by time or records pertaining thereto have not been destroyed by the bank in accordance with its laid down record destruction policies. Rejected complaints may also be sent to Banking Manager along with all related correspondence and the Complaint Form, without the need to give 45 days notice to the concerned bank.

The Banking Manager handles complaints relating to violation of banking laws and regulations, excessive delays and inefficiency, poor service, discriminatory actions, etc.

 **Appeal Process:**

**Complainant's right of appeal** A complainant not satisfied with the decision of the Banking Manager has the right to appeal to the **Governor**, State Bank of Kenya within 30 days from the date of the order of the Banking Manager. If the complainant does not choose to go into appeal or does not accept the decision of the State Bank of Kenya in appeal, the complainant has the right to go to a court of law.

 **Bank's right of appeal** In case a bank is not satisfied with the Banking Manager's order in the matter of a complaint, it may file an appeal with the Governor, State Bank of Kenya within thirty days. However, if no appeal is filed, or the State Bank of Kenya does not uphold the appeal, the Banking Manager's order shall become final, operative and binding upon the bank.

  **Benefits of Manager Scheme:**

* Globally a phenomenal success
* A cost free service
* Cost effective for both complainants and banks
* Unlike the courts, legal representation is neither required nor advantageous
* Accessible, friendly, informal and flexible
* Complainants retain the right to take the matter to court if not satisfied
* Ombudsmen are also successful because they may provide remedies where none may be available through the formal system.

**The provisions regarding establishment of the office of Banking Manager are contained in section 82 of Banking Companies Ordinance, 1962. The respective statutory provisions are reproduced hereunder.**

**Appointment of Manager: Sec 82-A**

1. There shall be a Banking Manager who shall be appointed by the President in consultation with the Governor of the State Bank of Kenya.
2. The Banking Manager shall be a person of high integrity and unimpeachable banking or legal credentials who is not a share-holder of a banking company or financial institution and is not or has not, been a bank defaulter.
3. The jurisdiction of the Banking Manager in relation to banking transactions shall be to— (a) enquire into complaints of banking malpractices; (b) perverse, arbitrary or discriminatory actions; (c) violations of banking laws, rules, regulations or guidelines; (d) inordinate delays or inefficiency and (e) corruption, nepotism or other forms of maladministration.
4. The Banking Manager shall hold office a period of three years and shall not be eligible for any extension of tenure or for re-appointment under any circumstances whatsoever.
5. The Banking Manager shall not hold nay other office of profit in the service of Kenya or occupy any other position carrying the right to remuneration for the rendering of services.

**Terms and conditions of the Banking Manager Sec 82-b**

1. The Banking Manager shall be entitled to the same salary and allowances as a Judge of a High Court.
2. The Banking Manager may be removed from office on the ground that he has been guilty of misconduct or that he is incapable of properly performing the duties of his office by reason of physical or mental incapacity. Provided that he shall have the right to file an appeal before the Federal Services Tribunal.
3. The Banking Manager shall be provided with a secretariat to be appointed in consultation with the State Bank. Appointments to the Secretariat may be made on deputation from the State Bank of Kenya or other banks or otherwise on the basis of professional qualifications and the costs of the Secretariat shall be shared by banks in such proportions as may be determined by the State Bank of Kenya.
The Banking Manager shall have the power and responsibility—
	1. To entertain complaints from customers, borrowers, banks or from any concerned body or organization;
	2. To facilitate the amicable resolution of complaints after giving hearings to the complainant and the concerned bank; and
	3. In the event that complaints cannot be resolved by consent, to give finding which shall be acted upon in the manner set out herein.
4. The Banking Manager shall exercise his powers and authority in the following manner:-
	1. In relation to all banks operating in Kenya.— The Banking Manager shall be authorized to entertain complaints of the nature set out herein below:-
		1. failure to act in accordance with banking laws and regulations including policy directives or guidelines issued by the State bank from time to time.
		2. Provided that if there is a dispute as to the proper interoperation of any regulations, directions or guidelines, the same shall be referred to the State Bank for clarification. delays or fraud in relation to the payment or collection of cheques, drafts or other banking instruments or the transfer of funds;
		3. fraudulent or unauthorized withdrawals or debit entries in accounts;
5. Complaints from exporters or importers relating to banking services and obligations including letter of credits;
6. Complaints from holders of foreign currency accounts, whether maintained by residents or non-residents;
7. Complaints relating to remittances to or from abroad;
8. Complaints relating to mark-up or interest rates based on the ground of a violation of an agreement or of state bank directives; and
9. Complaints relating to the payment of utility bills.
	1. In relation to banks in the public sector. — The Banking Manager shall be authorized to entertain complaints against such banks on the following additional grounds as well—
10. Corrupt or mollified practices by bank officers;
11. Gross dereliction of duty in dealing with customers; and
12. Inordinate delays in taking decisions.

**Reference to Banking Manager by Court**: **Sec 82-C**—

 if at any time during the pendency of a case, a court trying a case relating to recovery of loan by a banking company is of the opinion that the management of the banking company has prima facie acted in a malafide manner, or in violation of banking rules and regulations, it may reference to the Banking Manager for inquiring into the matter and passing such order in accordance with the provisions hereof as may deem fit: Provided that the making of a reference shall not prevent the court from deciding the claim before it on merits.

 **Procedure for making complaints: Sec 82-D**

**(1)** A complaint shall be made on solemn affirmation or oath in writing addressed to the Banking Manager. The complaint shall set out the full particulars of the transaction complained of and the name and address of the complainant. (2) Prior to making a complaint the complainant shall intimate in writing to the concerned bank his intention of filing a complaint and if the bank either fails to respond, or makes a reply which is unsatisfactory to the complaint, within a period of three months, the complainant may file a complaint at any time thereafter within a further period of three months (3) The Banking Manager may adopt any procedure as he considers appropriate for investigating a complaint: Provided that the shall not pass any order against a bank without first giving it a notice and an opportunity of a hearing. (4) Subject to section 82C, the Banking Manager shall not have any power to issue an order in the nature of a stay order or to entertain any complaints if the matter is pending before a court or other legal forum.

(5) The Banking Manager may reject a complaint summarily or he may accept the same or pass any other order he deems fit:

Provided that in each case he shall pass a reasoned order for his decision

The Banking Manager shall hold office a period of three years and shall not be eligible for any extension of tenure or for re-appointment under any circumstances whatsoever.

Banking Manager shall not hold any other office of profit in the service of Kenya or occupy any other position carrying the right to remuneration for the rendering of services.

 **Recommendations for implementations 82-E**

In the event the Banking Manager comes to the conclusion that the complain is justified, in part or in whole, he shall try and facilitate an amicable resolution or settlement by resort to mediation and failing that communicate his findings to the concerned bank with the direction—

1. to reconsider the matter; to modify or cancel the earlier decision, action or failure to take the appropriate action;
2. To pay reasonable compensation to the complainant as fixed by the Banking Manager;
3. To take the requisite steps to improve the functioning or efficiency of the bank; and
4. To take such other remedial steps or actions as may be specified by the Banking Manager.

The Banking Manager may, in any case, he deems fit or proper, forward a report to the State Bank recommending—

* 1. An inquiry, or the taking of the requisite steps or legal proceedings against a bank which has acted in violation of banking laws, procedure, regulations or directives of the State Bank; and
	2. In the case of a bank in the public sector in cases of banking malpractices or corruption, nepotism or gross and flagrant dereliction by bank officers of their duties and responsibilities, the initiation of such action including a criminal prosecution or disciplinary proceedings as the State Bank may deem fit, either by itself, or through filing a report with the Government of Kenya.

In no case whatsoever shall be Banking Manager have the power to direct that loans, advances or finances be given to a complainant. (4) Any bank, or official of a bank or a complainant aggrieved by an order passed by the Banking Manager may file an appeal with the State Bank within thirty days which shall pass any order thereon it deems fit.

Any order passed by the Banking Manager which has not been appealed against, or any order passed by the State Bank in appeal, as the case may be, shall become final and operative and if not implemented shall render the bank concerned to such action including the imposition of a fine or penalty as the State Bank may deem fit, and in relation to a bank officer, to the appropriate disciplinary or other proceedings.

Nothing contained herein shall prevent a complainant from filing a suit against a bank in the event his complaint is rejected.

**Power to call for information: Sec 82-F**

The Banking Manager shall have the power for purposes of disposing a case, to require a bank to disclose to him any information subject to the following conditions:-

1. The Banking Manager shall make every endeavor to ensure that banking confidentiality is maintained as required by banking law and procedure and shall take no action which is volatile thereof.
2. The Banking Manager may call for any or all such documents which are relevant or pertinent for purposes of deciding a complaint: --Provided that he shall not be entitled to call for unrelated documents or documents which may compromise the bank’s position in relation to other customers:
3. In the event of a bank refusing to furnish information, or copies of relevant documents, the Banking Manager shall not be authorized to compel the bank to comply with his order but he may draw an adverse inference and comment on the same in his findings.

**The banking companies rules, 1963**

-- These rules may be called the Banking Companies Rules, 1963.

-- They extend to the whole of Kenya.

-- They shall come into force on such date as the Federal Government may, by notification in the official Gazette, specify in this behalf.

**Definitions:**

**"Ordinance"** means the Banking Companies Ordinance, 1962 (LVII of 1962):

 **"Principal office of the State Bank**" means the office of the State Bank to which the returns required under the Ordinance or these rules are to be submitted;

 **“Principal office of the banking company”** means the office of the banking company which shall be responsible for the submission of returns under the Ordinance or these rules:

**“Quarter”** means a period of three months ending on the last day of March, June, September and December of any year ; and

**“Place of business”** of a banking company includes any sub-office, pay-office, sub-pay-office or any place of business at which deposits are received, cheques cashed or moneys lent.

**List of Officers: Sec 4**

A banking company shall, within one month of the commencement of these rules or of the commencement of its business, whichever is later, send to the principal office of the State Bank a written statement containing a list of –

The names, the official designations and specimen signatures of the officers authorized **to sign** on behalf of the banking company **returns** required under the Ordinance or these rules; and t**he names** and addresses of **the directors** of the banking company.

Any change in the list referred to in clause (i) shall be intimated to the principal office of the State Bank within one month of such change.

A banking company incorporated outside Kenya, which at the commencement of these rules has a place of business in Kenya, and every such company which after the commencement of these rules establishes a place of business in Kenya, shall, within one month of the commencement of these rules or of the establishment of such place of business, as the case may be, furnish to the principal office of the State Bank the full address of the principal place of business declared in terms of clause (e) of sub-section (1) of Section 277 of the Companies Act, 1913 and the name and address of one or more persons resident in Kenya authorized to accept on behalf of the company any notice or order required to be served on the company under the Ordinance or these rules and shall intimate the principal office of the State Bank any change in such name or address within one month of such change:

Provided that information furnished by a banking company under rule 4 of the Banking Companies (Control) Rules, 1949, shall be deemed to have been furnished under this rule.

**Withdrawals of Deposits: Sec 6**

The principal office of the State Bank shall not be bound to return securities actually deposited, but may substitute therefore new scrip of securities of the same description and amount.

 **Changes in deposits: Sec 7**

The office of the National Bank of Kenya holding securities under sub-rule (1) of rule 5 shall permit the withdrawal of foreign approved securities only under instructions from the principal office of the State Bank.

When the form or amount of deposit is changed by reason of a subsequent deposit or withdrawal, the principal office of the State Bank of Kenya shall, as soon as possible, send to the principal office of the banking company a fresh certificate in Form 1.]

**Maturing of security deposits: Sec 8**

When a security in deposit matures or when any yield on such a security ceases to accrue, the principal office of the State Bank shall not be bound to inform the banking company; but upon the receipt of a requisition in writing from the banking company, the principal office of the State Bank shall, as soon as possible, collect the discharge value and hold the amount in deposit for purposes of sub-section (3) of section 13 of the Ordinance.

**Interest on deposits: Sec 9**

No interest shall be payable on cash deposits

The principal office of the State Bank shall credit, as soon as possible, the current account of the banking company maintained with it with the interest realised on securities subject to the usual charges.]

**Licensing of banking companies: Sec 10**

A company desiring to have a license under section 27 of the Ordinance **shall apply to the Director,** Banking Control Department, State Bank of Kenya, Central Directorate, Karachi.**—**

**In Form IV** in the case of a company incorporated in Kenya and desiring to commence banking business; **In Form V** in the case of a company incorporated in Kenya and in existence at the commencement of the Ordinance;**In Form VI** in the case of a company incorporated outside Kenya and desiring to commence or carry on banking business in Kenya.

**Opening of new places of business: Sec 11**

An application by a banking company for permission to open a new place of business or change the location of an existing place of business under Section 28 of the Ordinance shall be submitted in form VII to– the Director, Banking Control Department, State Bank of Kenya, Central Directorate, Karachi in the case of banking companies having their principal offices in West Kenya, and the Deputy Chief Officer, Banking Control Department; State Bank of Kenya, Dacca, in the case of banking companies having their principal offices in East Kenya.

 **List of offices: Sec 12**

A banking company shall, within a period of one month from the close of every quarter, send to the principal office of the State Bank a list in Form VIII of all its offices in Kenya at which it was doing business during that quarter.

 **Manner of publication of accounts and balance-sheet: Sec 14**

The balance-sheet and profit and loss account prepared in terms of Section 34 of the Ordinance together with the auditor’s report shall be published within a period of six months from the end of the period to which they relate in a newspaper which is in circulation at the place where the banking company has its principal office.

 **Explanation.—**For the purposes of this rule, the expression “newspaper” means any newspaper or journal published at least once a week, but does not include a journal other than a banking, commercial, financial or economic journal.

**List of Debtors: Sec 15**

The list of debtors under Section 63 of the Ordinance shall be in Form XIII or as near thereto as circumstances permit.

**Power to exempt in certain cases: Sec 16**

The Federal Government may, on the recommendation of the State Bank, declare by notification in the Official Gazette that any or all of the provisions of these rules shall not apply to any banking company or to any class of banking companies either generally or for such period as may be specified.

**LECTURE 12**

**STATE BANK OF KENYA ACT, 1956**

 This extends to the whole of Kenya. It shall come into force at once and except Section 46, shall be deemed to have taken effect on and from the twelfth day of May, 1948.

**In this Act we shall cover the following aspects/ statutory provisions**

* Definitions
* Establishment and incorporation of the Bank
* Share Capital Guarantee by Federal Government Notice of Trust
* Register of shareholders
* Offices, Branches and Agencies
* Central Board of Directors
* Functions and responsibilities of the Central Board
* Monetary and fiscal policies board
* Executive Committee Qualifications and disqualification of Directors and Members
* Term of office of Directors and Members
* Directors and Members
* General and annual general meeting
* Business which State Bank may transact
* Issue Department
* Cash Reserve of Scheduled Banks to be kept with the Bank
* Scheduled Banks
* Power to require returns from Corporations
* Publication of consolidated statement by the Bank
* Submission of Returns by State Bank
* The Bank and its officers to be public officers
* Liquidation of the Bank

 **Definitions:** the definitions as contained in the Act are given hereunder:

**"Annual general meeting"** means the annual meeting of the shareholders-of the Bank;

**"Approved foreign exchange"** means currencies declared as such by any notification under Sec19;

**"The Bank"** means the State Bank of Kenya;

**"Bank Notes"** means notes made and issued by the Bank in accordance with Section 24 and include currency notes of the Government of Kenya issued  by the Bank;

**“Central Board**" means the Central Board of Directors of the Bank;

**"Co-operative Bank"** means a society registered under the Co-operative Societies       Act, 1912, or any other law for the time being in force in Kenya relating to       co- operative societies, the primary object of which is to provide financial       accommodation to its members;

**"Debentures"** includes participation term certificates;

**"Director"** means a Director for the time being of the Central Board;

 **"General meeting"** means the meeting of the share-holders ' of the Bank convened for       transacting such       business as may be specified in the notice convening the meeting;

**"Governor" and "Deputy Governors"** means respectively the Governor and Deputy      Governors of the Bank;

**"Loans and advances"** includes finances provided on the basis of participation in profit  and loss, mark up in price, leasing, hire-purchase of otherwise;

**"Local Board**" means a Local Board of Members;

**"Member"** means a Member for the Local Board;

**"Rupee coin"** means one-rupee coin and one-rupee notes which are legal tender in        Kenya;

**"Scheduled bank**" means a bank for the time being included in the list of banks       maintained under sub-section (1) of Section 37;

**"Securities"** includes securities as defined in the Capital Issues (Continuance of       Control) Act, 1947 (XXIX of 1947);

**"Shares**" includes modaraba certificates.

**Establishment and incorporation of the Bank: Sec 3:**

As soon as may be after the commencement of this Act steps shall be taken to establish, in accordance with the provisions of this Act, a bank to be called the State Bank of Kenya or Bank Dautat-e-Kenya, for the purposes of taking over, as from the first day of July, 1948, the management of the currency from the Reserve Bank of India, and carrying on the business of Central Banking.

The Bank shall be a body corporate by the name of the State Bank of Kenya or Bank Daulat-e-Kenya, having perpetual succession and a common seal, and shall by the said name sue and be sued.

**Share Capital: Sec 4**

The original share capital of the Bank shall be three corers of rupees divided into three hundred thousand fully paid-up shares of the nominal value of one hundred rupees each, out of which not less than fifty one per cent shall be held by the Federal Government and the balance by the public.

The share capital may be increased by a resolution of the Central Board subject to the approval of the Federal Government, but not less than fifty-one per cent of the additional share capital shall be issued to the Federal Government.

The nominal value, issue price, the manner in which the new shares may be issued and allotted and their assignment to the registers of shareholders maintained under sub-section (1) of Section 7 shall, subject to the approval of the Federal Government, be determined by the Central Board

**Guarantee by Federal Government: Sec 5**

Notwithstanding anything contained in the Acts hereinafter mentioned in this Section, the shares of the Bank shall be deemed to be included among the securities enumerated in Section 20 of the Trusts Act, 1882 and to be approved securities for the purposes of the Insurance Act, 1938 and the Banking Companies Ordinance, 1962 (LVII of 1962).

**Offices, Branches and Agencies: Sec 8**

The head office of the Bank shall be situated in Karachi.

1. The Bank may establish branches, offices and agencies in Kenya, or, with the prior approval of the Federal Government any-where outside Kenya.
2. The Bank shall create a special Agricultural Credit Department, the functions of which shall be
3. To maintain an expert staff to study all questions of agricultural credit and be available for consultation by the Federal Government, Provincial Governments, Provincial Co-operative Banks and other banking organizations;
4. To co-ordinate the operations of the Bank in connection with agricultural credit and its relations with the Provincial Co-operative Banks and any other organizations engaged in the business of agricultural credit.

**Central Board of Directors: Sec 9**

The general superintendence and direction of the affairs and business of the Bank shall be entrusted to the Central Board of Directors which may exercise all the powers and do all acts and things that may be exercised or done by the Bank and are not by this Act expressly directed or required to be done by the Bank in general meeting or in annual general meeting.

The **Central Board** shall consist of-

1. The Governor;
2. Secretary, Finance Division, Government of Kenya; and
3. Seven Directors, including one Director from each Province, to be nominated by the Federal Government ensuring representation to agriculture, banking and industrial sectors.

The Governor shall be the chairman of the Central Board.

 All decisions of the Central Board shall be taken by majority of members present and voting and in the event of equality of the votes, the Governor may exercise a casting vote

**Functions and responsibilities of the Central Board: Sec 9-A**

The Central Board shall, with a view to secure stability of monetary system:

Regulate and supervise monetary and credit system:

* Provided that in regulating the monetary and credit system, the Central Board shall keep in view the National policy objectives of the Federal Government,
* Provided further that the Governor may, in any emergency which in his opinion requires immediate action, take measures under this clause as may be necessary in the circumstances and shall, in the next meeting of the Central Board, report to it for approval of such action;
* determine, in consultation with the Federal Government, the limit of credit to be extended to the Federal Government and Provincial Governments tender advice to the Federal Government on monetary policy and its interaction with fiscal and exchange rate policy;
* Analyze and report periodically to the Federal Government on the impact of the policies being followed on the state of the economy; and
* Discharge such other functions as may be necessary for regulating the monetary  system or as may be assigned by the Federal Government.

**Monetary and Fiscal Policies Coordination Board Sec. 9B**

1. Federal Minister for Finance Chairman
2. Federal Minister for Commerce Member
3. Deputy Chairman, Planning Commission Member
4. The Governor Member
5. Secretary, Finance Division, Govt of Kenya Member

**The Board shall-**

* 1. Coordinate fiscal, monetary, foreign trade and exchange rate policies;
	2. Ensure consistency amongst macro-economic targets in the areas of fiscal, monetary and external account aggregates and recommend adjustments for the approval of the Federal Government;
	3. Recommend monetary aggregates and Government borrowing for consideration of the National Economic Council;
	4. Review fiscal and monetary measures to secure monetary aggregate targets;
	5. Consider limits of the government borrowing as revised from time to time in the meetings to be held before and after passage of the annual budget; and
	6. Review the level of Government borrowing in relation to the predetermined or revised targets after every quarter; and
	7. Review the expenditure incurred in connection with raising of loans and Government borrowing

**Executive Committee: Sec 11**

There shall be an Executive Committee consisting of the Governor, Deputy Governor, if any, three Directors elected by the Central Board to represent respectively the areas specified in the Schedule and an officer appointed by the Federal Government to act as Member of the Executive Committee.

Except when the Central Board is in session, the Executive Committee shall deal with and decide any matter within the competence of the Central Board. Local Boards, their constitution and functions

**Qualifications and disqualification of Directors and Members: Sec 13**

No person shall be or shall continue to be a Director or Member-

1. Who is a Member of the Central or Provincial **Legislature**; or
2. Who is a salaried Government official; or
3. Who is, or at any time has been, adjudicated an insolvent or has suspended payment or has compounded with his creditors; or
4. Who is found lunatic or becomes of unsound mind; or
5. Who is an officer or employee of any bank; or
6. Who is a Director of any bank other than the Bank, but he shall not- be disqualified or cease to be a Director if he is a Director of a co-operative bank.
7. Who is not, within six months from the date of his becoming a Director or Member, as the case may be, registered as a holder of unencumbered shares of the Bank of the nominal value of five hundred rupees;
8. Who absents himself from three consecutive meetings of the Central Board, or Local Board without leave from the Central Board or Local Board as the case may be?

Nothing in clause (b) and (g) of sub-section (1) shall apply to the Government official nominated as a Director by the Federal Government.

The Federal Government shall sell shares at par to a Director or Member nominated by it under Section 9 and 12, seeking to obtain the minimum shares qualification required under this Section, but no such share shall be disposed of by such Director or Member otherwise than by resale to the Federal Government at par, and the Federal Government shall have the right to order the transfer at par of all or any of such shares to itself, whereupon all or any of such shares shall be deemed to have been transferred to it.

**Term of office of Directors-and Members: Sec 14**

The elected Directors and Members shall hold office for three years on the expiry of which they shall cease to hold office.

A Director or member shall not be removed from his office before the completion of his tenure except when he has done any act which is a breach of trust reposed in him or is guilty of misconduct:

 Directors and Members shall on the expiry of their term of office be eligible for re-election or re-nomination, as the case may be.

**Removal from and vacation of office of the Governor, Deputy Governors, Directors and Members: Sec 15**

Subject to sub section (2), the Federal Government may remove the Governor from his office, if he becomes permanently incapable of performing his duties, or is subject to any of the disqualification specified in sub-section (10 ) of section 10, or has done any act which is breach of the trust reposed in him, or is guilty of misconduct:

 An elected Director or Member shall not be removed from his office except upon a resolution passed by the Central Board in that behalf by in majority of not less than six Directors.

1. The Governor, a Deputy Governor or a Director may resign his office by statement to that effect in writing signed by him and addressed to the Federal Government.
2. A statement of resignation by a Deputy Governor or Director shall be addressed as above through the Governor
3. A Member may resign his office by a statement to that effect in writing signed by him and addressed 'to the Central Board.
4. On the acceptance of such a resignation by the Federal Government or the Central Board, as the case may be, the office shall become vacant.

Any Director or Member vacating office under this section shall not be eligible to become a Director or Member, as the case may be, until the expiry of the term of office for which he was nominated or elected.
In the event of a vacancy occurring amongst the nominated Directors or Members, the Federal Government shall fill the vacancy by nominating another Director or Member, as the case may be.

In the event of a vacancy occurring amongst the elected Directors or Members before the expiry of their term of office, a new Director or Member, as the case may be, shall be elected for the remainder of the term by and from amongst the shareholders registered on the same register as that from which the vacating Director or Member was elected.

 **General and annual general meeting: Sec 16**

The annual general meeting shall be held annually at Karachi, or a place in Kenya where there is an office or branch of the Bank, within three months from the date on which the annual accounts of the Bank are closed.

In the said meeting the shareholders present shall be entitled to discuss the annual accounts, the report of the Central Board on the working of the Bank throughout the year, and the auditors' report on the annual balance sheet and accounts.

A general meeting may be convened by the Central Board at any other time.

Every share holder shall be entitled to attend at any general meeting; and each shareholder who has been registered on a register maintained under Section 7 for a period of not less than six months ending with the date of the meeting, as holding five or more shares shall have one vote, and on a poll, each' shareholder so registered shall, subject to a maximum of ten votes, have one vote for each five shares, and such votes may be exercised either personally or by proxy

**Business which the Bank may transact: Sec 17**

1. Bank is authorized to carry on and transact the several **kinds of business hereinafter specified, namely**:- The **accepting** of money on deposit from, and the collection of money for the Federal Government, the Provincial Governments, Local Authorities, bank and other persons: provided that no interest shall be paid on deposits received from the Federal Government, a Provincial Government, or a Local Authority;

(a) The purchase, sale and rediscount of bills of exchange and promissory notes drawn on and payable in Kenya and arising out of bonafide commercial or trade transactions bearing two or more good signatures one of which shall be that of a scheduled bank, and maturing within one hundred and eighty days from the date of such purchase or rediscount, exclusive of days of grace;

(b) The purchase, sale and rediscount of bills of exchange and promissory notes, drawn on and payable in Kenya and bearing two or more good signatures one of which shall be that of a scheduled bank and drawn or issued for the purpose of financing seasonal agricultural operation or the marketing of crops, and maturing within fifteen months from the date of such purchase or rediscount exclusive of days of grace;

1. The purchase and the sale of approved foreign exchange;

 (b) The purchase, sale and rediscount of bills of exchange including treasury bills, drawn in or on any place in countries whose currency has been declared as approved foreign exchange and maturing within one hundred and eighty days from the date of purchase, provided that no such purchase, sale or rediscount shall be made in Kenya except with a scheduled bank;

1. The making to Local Authorities, scheduled banks or co-operative banks of advances and loans repayable on demand or on expiry of fixed periods not exceeding one hundred and eighty days against the security of: stocks, funds and securities, other than immovable property, in which a trustee is authorized to invest trust money by any law for the time being in force in Kenya;
2. The making to the Federal Government or Provincial Governments of advances repayable in each case not later than three months from the date of the making of the advance;
3. The making to institutions or banks, specially established for the purpose of promoting agricultural or industrial development, or for the financing of construction of houses, in the country or co-operative banks of advances and loans for such amounts and on such terms and conditions
4. the issue and purchase of telegraphic transfers, demand drafts and other kinds of remittances made payable at its own branches, offices or agencies;

1. (a)The purchase and sale of securities of the Federal Government or a Provincial Government of any maturity or of such securities of a Local Authority as may be specified in this behalf by the Federal Government by notification in the Official Gazette on the recommendation of the central Board;
	1. The sale and realization of all property, whether movable or immovable which may in any way come into the possession of the Bank in satisfaction, or part satisfaction of any of its claims;
	2. The acting as agent to Federal Government, any Provincial Government, or any Local Authority in the transaction of any of the following kinds of business, namely:-
2. the purchase and sale of gold or silver or approved foreign exchange;
3. the purchase, sale, transfer and custody of bills of exchange, securities or shares in any company;
4. the collection of the proceeds, whether principal or interest, profit, dividend or other return, of any securities;
5. the remittance of such proceeds at the risk of the principal, by bills of exchange payable either in Kenya or elsewhere;
6. the management of public debt; and
7. the transacting of special drawing rights with the International Monetary Fund;
	1. The making and issue of bank notes subject to the pro-visions of this Act;
	2. The exercise of powers and the performance of functions and duties entrusted to the Bank by or under this Act or any other law for the time being in force;
8. The entering into clearing and payments arrangements with any country or group of countries, on a general or regional or sub-regional basis, participation in the formation and settlement of international payments transactions under such arrangements, and incurring financial and other obligations relating thereto;
	1. Establish credits and give guarantees; and
	2. Generally, the doing of all such matters and things as may be necessary, incidental to or consequential upon the exercise of its powers or the discharge of its duties or functions under this Act.

**Issue Department: Sec 26**

The issue of Bank Notes shall be conducted by the Bank in an Issue Department which shall be separated and kept wholly distinct from the Banking Department and the assets of the Issue Department shall not be subject to any liability other than the liabilities of the Issue Department as hereinafter defined in Section 32.

**Cash Reserve of Scheduled Banks to be kept with the Bank: Sec 36**

Every scheduled bank shall maintain with the Bank a balance the amount of which shall not at the close of business on any day be less than such percentage of demand liabilities and that of the time liabilities of such bank in Kenya as may be determined by the State Bank.

**Scheduled Banks: Sec 37**

1. The Bank shall maintain at all its offices and branches an up-to-date list of banks declared by it to be scheduled banks under Clause (a) of sub-section (2).
2. The Bank shall, by notification, in the official Gazette

(a) Declare any bank to be scheduled bank which is carrying on the business of banking in Kenya and which-

(i) is a banking company as defined in Section 227F of the Companies Act, 1913, or a Co-operative bank, or a corporation or a company incorporated by or established under any law in force in any place in or outside Kenya;

(ii) has a paid-up capital and reserves of an aggregate value of not less than five lakhs of rupees:

Provided that in the case of a co-operative bank, an exception may be made by the Bank;

(iii) satisfies the Bank that its affairs are not being conducted in a manner detrimental to the interests of its depositors;

 (iii) satisfies the Bank that its affairs are not being conducted in a manner detrimental to the interests of its depositors;

**Power to require returns from Corporations: Sec 38**

The Bank may require any Corporation with which it has any transactions under Section 17 to furnish returns referred to in under sub section (3) of Section 36, and if it does so require, the provisions of sub-Section. (6), (7) and (8) of Section 36 shall apply, so far as may be, to such Corporation as if it were a scheduled bank.

**Publication of consolidated statement by the Bank: Sec 39**

The Bank shall compile and publish in such manner and at such times as the Federal Government may direct, a consolidated statement from such information as may be received under this Act.

Returns

**Submission of Returns by State Bank:** **Section 40**

1. The Bank shall prepare and transmit to the Federal Government a weekly account of the Issue Department and of the Banking Department in such form as the Federal Government may, by notification in the official Gazette direct. The Federal Government shall cause these accounts to be published weekly in the official Gazette.
2. The Bank shall also, within four months from the date on which the annual accounts of the Bank are closed, release to the public and simultaneously transmit to the Federal Government a copy of the annual accounts signed by the Governor, the Deputy Governor, if any, and the Chief Accounting Officer of' the Bank, and certified by the Auditors together with a report by the Central Board on the working of the Bank throughout the year, and the Federal Government shall cause such accounts and report to be published in the official Gazette.
3. The Bank shall also, within two months from the date on which the annual accounts of the Bank are closed, transmit to the Federal Government a statement showing the name, address and occupation of, and the number of shares held by each shareholder of the Bank.

The Bank and its officers to be public officers: **Section 46:**

1. For the purposes of Section 124 of the Evidence Act, 1872, the provisions of Part IV of the Code of Civil Procedure, 1908 -and the provisions of rule 27 of Order V, and rule 52 of Order XXI of the said Code, the Bank and any person in the service of the Bank acting in his capacity as such shall be deemed to be public officer.
2. The provisions of Section 123 of the Evidence Act shall apply to the unpublished records of the Bank and the Governor shall be deemed to be the officer or head of the department concerned.
3. Every person in the service of the Bank shall be deemed to be a public servant within the meaning of section 21 of the Kenya Penal Code (Act XLV of 1860) -

**Production of unpublished record of bank, etc: Sec 46-A**

1. No court tribunal or other authority shall be entitled to compel the bank or any person in the service of the bank to produce or, as the case may be, give any evidence derived from, any unpublished record of the bank
2. No court, tribunal or other authority shall permit any one to produce or give evidence derived from, any unpublished record of the bank, except with the prior permission in writing of the Governor who may give or withhold such permission as he thinks fit.
3. Notwithstanding anything contained in this Act or any other law for the time being in force', a report prepared by the Bank on a banking company under Section 40 of the Banking Companies Ordinance, 1962 (LVII of 1962), shall be deemed to be unpublished for the purposes of subsections (1) and (2) even if a copy of such report has been supplied to the banking company to which the report pertains or to the Federal Government or to the Kenya Banking Council constituted under Section 9 of the Banks (Nationalization) Act, 1974.

**Inconsistent orders not to be issued: Sec 46-B**

No governmental or quasi-governmental body or agency shall issue any directive, directly or indirectly, to any banking company or any other financial institution regulated by the Bank which is inconsistent with the policies, regulations and directivities issued by the Bank pursuant to this Act, the Banking Companies Ordinance, 1962 (LVII of 1962) or any other law in force.

**Liquidation of the Bank: Sec 50**

The Bank shall not be placed in liquidation save by order of the Federal Government and in such manner and on such terms and conditions as it may direct.

**From the above we understand that State Bank of Kenya exercises various powers as well as certain duties and obligations are entrusted on the Bank by virtue of Statutory Provisions contained in this Act.**

**SBP BANKING SERVICES CORPORATION ORDINANCE, 2001**

 This Ordinance extends to the whole of Kenya. Central Banks all over the world are required to discharge an important obligation as regulator and policy maker as well as advisor to the Government; as such it is not advisable that Central Bank should engage themselves into day to day affairs of the Banking. As such it was decided that a corporation may be established for discharging various functions which are contained in this Ordinance, so that the State Bank of Kenya may focus its attention towards its prime objectives.

**In this Ordinance we shall especially focus on the following aspects/ statutory provisions:**

* Definitions
* Establishment and incorporation of the Bank
* Bank to be a subsidiary of the State Bank
* Business and functions of the Bank
* Board of Directors
* Managing Director of the Bank
* Accounts and audit
* Liquidation of the Bank
* Transfer of undertaking to the Bank
* Provisions with respect to employees transferred to the bank
* Delegation of the powers of the State Bank to SBP Banking Services Corporation
* Duty of officers and servants to maintain secrecy

 **Definitions:** the definitions as contained in the Ordinance are given hereunder:

**"Act"** means the State Bank of Kenya Act, 1956.

 **"Bank"** means the SBP Banking Services Corporation established under section 3;

 **"Board"** means the Board of Directors of the Bank;

 **"Chairman**" means the Chairman of the Board;

 **"Committee of Directors**" means a Committee of Directors constituted under section 11;

 **"Director"** means a member of the Board;

"**Governor"** means the Governor and includes an Acting Governor of the State Bank appointed under the Act;

 **"Managing Director"** means the Managing Director appointed under section 9;

 **"Regulations**" means regulations made under this Ordinance;

 **"Rules"** means rules made under this Ordinance;

 **"Seal"** means the common seal of the Bank;

 "**State Bank"** means the State Bank of Kenya established under the Act;

 **"Transfer Date"** means the date specified in the Transfer Order;

"**Transfer Order**" means Transfer Order made under sub-section (1) of section 15-

**"Transferred Employees**" means the employees of the State Bank who shall, as from the Transfer Date, stand transferred to and become the employees of the Bank, by virtue of the Transfer Order; and

 "**Transferred Undertaking**" means a part of the undertaking of the State Bank specified in sub-section (1) of section 15.

**Establishment and incorporation of the Bank: Sec 3:**

1. As from the date of promulgation of this Ordinance, there shall be established, a bank to be called SBP Banking Services Corporation.
2. It is worth mentioning that wherever the word bank is used in this Ordinance that would invariably mean SBP Banking Services Corporation.
3. The Bank shall be a body corporate having perpetual succession and a seal and shall, by the name assigned to it by sub-section (1), sue and be sued.
4. The head office of the Bank shall be situated in Karachi and it may establish branches, offices and agencies in Kenya and anywhere outside Kenya with the prior approval, in writing of the State Bank.

 **Bank to be a subsidiary of the State Bank: Sec 4**

The Bank shall be a subsidiary of the State Bank, and the State Bank shall exercise control over the Bank in accordance with the provision of this Ordinance

 **Business and functions of the Bank: Sec 5**:

1. Subject to sub-section (2), the Bank, under the overall supervision and control of the State Bank, may transact and carry on all or any of the following functions namely:—

1. The carrying on of the Transferred Undertaking, statutory and administrative functions and activities of the State Bank transferred or delegated by the State Bank to the Bank under this Ordinance;
2. The handling of receipt, supply and exchange of Bank notes and coins which are legal tender;
3. The issue, supply, sale, encashment and handling of prize bonds, holding draws thereof and other savings instruments of the Federal Government or of a Provincial Government;
4. The performance of any other activity or business which the State Bank may, by order in writing, specify; and
5. The carrying on of any business and discharging of any functions and powers as are incidental to, or in connection with, the affairs of the Bank, including, without limiting the generality of the foregoing and, the power to enter into any contracts or other instruments or any financial or other transactions, issue guarantees and indemnities, borrow and lend moneys, accept deposits of money, make investments, purchase and hold any property and assets, and to provide any services to the State Bank and to others .and receive any fee, commission or other compensation for such services.
6. The State Bank shall not transfer or delegate any of the functions specified in section 9A Of the Act, including formulation and monitoring of monetary and credit policies, regulation *and* supervision; of the financial sector, foreign exchange regime and exchange-rate policy, and payment and settlement system.

**Share capital and limited liability: Sec 6**

The authorized share capital of the Bank shall be one billion rupees or such other amount the State Bank may, from time to time, determine by order in writing and shall be divided into shares of one million rupees each.

'The paid-up capital of the Bank shall be such amount as may, from time to time, by order in writing be determined by the State Bank and held *inter alia,* by -it, including the fully paid-up shares issued to it under sub-section (7) of section 15.

The share capital may be divided into different kinds and classes therein as' may be prescribed by regulations.

The liability of shareholders of the Bank shall be limited to the amount, if any, not fully paid-up on the shares held by them in the capital of the Bank.

**Board of Directors: Sec 7:**

The general superintendence, direction and management of the affairs and business of the Bank and overall policy making in respect of its operations shall vest in the Board of Directors which may exercise all such powers and do all such acts, deeds and things that may be exercised or done by the Bank.

In discharging its functions, the Board shall ensure compliance with the orders and directions that may be issued by the State Bank from time to time.

**The Board shall consist of:-**

a) Members of the Central Board of the State Bank; and

b) The Managing Director.

The meetings of the Board shall be held at such times and places as may be prescribed by regulations or, until so prescribed by regulations, as and when convened by the Chairman.

No act or proceedings of the Board shall be invalid merely on the ground of the existence of any vacancy in, or defect in the constitution of the Board

 The quorum of meetings of the Board shall be as may be prescribed by regulations or, until so prescribed by regulation, shall be five Directors.

All decisions of the Board shall be taken by majority of the Directors present and voting at a meeting duly convened and held, and in the event of an equality of votes, the Chairman may exercise a casting vote.

A resolution in writing signed by all Directors shall be as effective as if such resolution had been passed at a meeting of the-Board

**Chairman: Sec 8**

The **Governor** shall be the Chairman of the Bank.

The Chairman shall, whenever present, preside over meetings of the Board, but if at any meeting the Governor is not present, a Deputy Governor of the State Bank, designated for this purpose by the Governor, shall attend the meeting on behalf of the Governor and preside over such *meeting* provided that if the Deputy Governor being present, is not willing to act, or is also absent, the Directors present shall choose one of their member to be the Chairman of such meeting.

**Managing** **Director: Sec 9**

The Managing Director shall be appointed by the State Bank

The Managing Director shall hold office during the pleasure of the State Bank.

 The Managing Director shall be the chief executive officer of the Bank and shall, subject of the control and direction of the Board, administer the affairs of the Bank, and shall have such powers for this purpose as are from time to time delegated to him by the Board.

 The salary and other terms and conditions of service of the Managing Director shall be such as the Board may determine.

The Managing Director shall devote his whole time and attention to the affairs of the Bank, provided that the Managing Director may, in addition to his duties as the Managing Directors, be entrusted with such other duties for such period as the State Bank may, by order in writing determine.

 **Disqualifications of the Managing Director: Sec 10**

No person shall be appointed or hold office as Managing Director:—

1. Who is **a** member of the Senate, National Assembly, any Provincial Assembly, or an elected member of a local council or local body constituted under any law relating *to* local councils or local bodies.
2. Who is employed in any capacity in the service of the Federal Government or of a Provincial Government or holds any office or position for which any salary or other remuneration is payable out of public funds.
3. Who is a director, officer or employee of any other Bank or of a financial institution or has an interest as a shareholder in any other bank or financial institution:
4. Provided that nothing in this clause shall apply where this Managing Director is in the employment of the State Bank or where the Managing Director is, in addition to holding the office of Managing Director of the Bank, entrusted with additional duties under sub-section (5) of section 9;
5. Who has been convicted of tax evasion under any law, or has been convicted or proceedings are pending against him under section 412 of the Companies Ordinance, "1984 (XLVII of 1984), or section 83 of the Banking Companies Ordinance, 1962 (LVII of 1962), or has been convicted by a Court of law for an offence involving moral turpitude;
6. Who is in default of payments due from him to any Bank, financial institution, cooperative society, Government department? Government controlled or managed company or corporation and for the purpose of this clause, default in payment by the spouse, dependent children, and companies, firms and other business concerns under the control or management of a person shall be considered as the default of such person; or
7. Who holds an office in a political party?

**Committees of Directors: Sec 11**

The Board may constitute one or more Committees consisting of such number of Directors as it may determine.

( 2) The powers, functions, duties and other terms of appointment of a Committeeof Directors shall be such as the Board may determine.

The members of a Committee of Directors shall hold office for such period as the Board *may* determine.

 The minutes of every meeting of a Committee of Directors shall be laid before the Board as its next meeting following the meeting of the Committee.

Subject to the general and any special directions of the Board, a Committee of Directors shall deal with any matter entrusted to it by the Board

**Delegation of powers and appointment** **of attorneys: Sec 12**

The Board may, for the purpose of ensuring smooth and efficient functioning of the Bank and facilitating transactions of its daily business, by resolution, delegate to the Managing Director or any other executive of the Bank, subject to such conditions and limitations, if any, as may be specified therein, such of its powers and duties under this Ordinance as it may deem necessary

The Board may, from time to time, by resolution appoint any company, firm or person to be the attorney of the Bank for such purposes and with such powers, authorities and discretions, not exceeding those vested in or exercisable by the Board under this Ordinance and for such period and subject to such conditions as the Board may think fit, and any such resolution may contain such provisions for the protection and convenience of persons dealing with any such attorney as the Board may think fit.

 **Accounts and audit: Sec 13**

The accounting year of the Bank shall commence on the first day of July and end on *the* thirtieth day of June

The Bank shall maintain proper accounts and other records to reflect true and fair view of its state of affairs and prepare annual statement of accounts, including the profit and loss account and balance sheet.

The accounts of the Bank shall be audited by one or more auditors who shall be chartered accountants within the meaning of the Chartered Accountants Ordinance , 1961 (X of 1961) to be appointed by the State Bank.

Every auditor shall be supplied with a copy of the annual statement of accounts and it shall be the duty of the auditor to examine the same together with the accounts and vouchers relating thereto, and every auditor shall have a list delivered to him of all books kept by the Bank and shall, at all reasonable times, have access to books, accounts and other documents of the Bank and may employ accountants or other persons to assist him in auditing such accounts and may, in relation to such accounts, examine the Managing Director, any Director and executive of the Bank.

The **auditors shall submit a report to the Board and to the State Bank** regarding the annual statement of accounts, and in any such report they shall state whether in their opinion the statement of accounts is a full and fair statement of accounts containing all necessary particulars and is properly drawn up so as to exhibit a true and correct view of the state of affairs of the Bank and, in case they have called for any explanation or information from the Managing Director or the Board, whether it has been given and whether it is satisfactory.

The Board may, in addition to the audit under sub-sections (3) and (4), cause to be carried out internal audit of the Bank's accounts and the internal auditors' reports shall be submitted to the Board.

The Board may, in addition to the audit under sub-sections (3) and (4), cause to be carried out internal audit of the Bank's accounts and the internal auditors' reports shall be submitted to the Board.

**Liquidation of the Bank: Sec 14**

The Bank shall not be placed in liquidation save by order of the State Bank and in such manner and on such terms and conditions as the State Bank may direct.

**Transfer of undertaking to the Bank: Sec 15**

 (l) Subject to the powers under section 5, the State Bank may direct, by Transfer Order and as particularly described in such Order, that

1. The operational functions and activities of SBP
2. All related offices and departments;
3. All related assets and liabilities; and
4. Certain employees of the State Bank shall transfer to and vest in the Bank as of the Transfer Date.

On the making of the Transfer Order by the State Bank under subsection(1), the Transferred Undertaking and the Transferred Employees shall stand transferred to and vest in the bank as on the Transfer Date and shall be operated, managed and regulated by the Bank as the undertaking and employees of the Bank, provided that the rules and regulations of the State Bank applicable to the operation of the Transferred Undertaking and to the employment of the Transferred Employees as of immediately before the Transfer Date shall continue **to be** applied by the Bank unless altered by the Board with the approval of the State Bank

For the purposes of sub-section (1),-

(a) “assets" include properties whether tangible or intangible, rights, benefits and Entitlements of every description and nature (other than immovable property) of the State Bank and relating to, as of the Transfer Date, the operational functions and activities of the State Bank and to the related offices and departments;

(b) “Employees” means the employees of the State Bank as are specified in the Transfer Order;

 ( c) "liabilities" include debts, obligations, commitments, loans, encumbrances, claims and charges of every description and nature, actual or contingent of the State Bank and related to, as on the Transfer Date, the operational functions and activities of the State Bank and to the related offices and departments;

 **(3)** For the purposes of sub-section (1),-

**"related offices and departments"** include all field offices of the State Bank and certain other offices and departments, in full or in part, as are specified in the Transfer Order; **"Operational functions and activities**" shall consist of the following, namely:—

1. revenue collecting and payments for and on behalf of the Federal Government, a Provincial Government, Local Governments, local bodies **or** any other governmental body, authority, institution, company or corporation;
2. maintenance of the accounts of the Federal Government, a Provincial Government, local governments, local bodies, other governmental bodies, authorities, institutions, companies, corporations and of other banks and financial institutions;
3. Operational work relating to management of debt;
4. Operational work relating to foreign exchange;
5. Prize bonds and Government savings schemes;
6. cash and other business as provided for in agreements between the State Bank and the Federal Government and between the State Bank and the Provincial Governments or in the Act, the Foreign Exchange Regulation Act, 1947 (VII of 1947), the Banking Companies Ordinance, 1962 (LVII of 1962), the Public Debt *y* Act, 1944 (XVIII of 1944), the Securities Act, 1920 (X of 1920), or in any other applicable laws, rules, regulations, orders and notifications made or issued there under; and
7. Any other business, offices or departments, and functions, in full or to part, as may be set out in or authorized or delegated by the Transfer Order.

(4)As and after the Transfer Date, the Bank shall undertake, pay, satisfy, discharge, perform and fulfill all debts, liabilities, contracts, engagements, commitments and obligations

whatsoever, of the State Bank existing immediately before the Transfer Date and comprised in or exclusively relating to the Transferred Undertaking, and as on the Transfer Date, the State Bank shall stand released and discharged from all such debts, liabilities, contracts, commitments and obligations.

(5) All agreements, contracts, deeds, bonds, securities, powers-of-attorneys, grant of instruments and other legal representations, guarantees, letters of credit, negotiable instruments of whatever kind subsisting or having effect as at immediately before the Transfer Date to which the| State Bank may be a party or which shall be in favor of the State Bank and which are compromised in the Transferred Undertaking or exclusively relate thereto shall be of full force and effect, on the Transfer Date, against or in favor of the Bank and be enforced or acted upon by or against the Bank, as if instead of the State Bank, the Bank had been a party thereto or as if the same had been issued by or in favor of the Bank.

All suits, appeals or other legal proceedings, including arbitration proceedings, of whatsoever nature by, or against, the State Bank which exclusively relate to the Transferred Undertaking and which shall be pending immediately before the Transfer Date in any Court, Tribunal, other competent authority or before any arbitrator shall be continued exclusive by, or against, the Bank and the State Bank shall cease to be a party to such suits, appeals or other legal proceedings.

In consideration of the transfer to the Bank of the Transferred Undertaking *under sub-*section (1), the Bank shall issue such number of fully paid-up shares in its share capital to the State Bank as shall be specified in the Transfer Order.

 Notwithstanding anything in the Stamp Act, 1899 (II of 1899) or any other law for the time being in force no stamp duty, registration or any other similar tax or levy shall be payable under any law for the time being in force on or in relation to the vesting and transfer made by the Transfer Order

The State Bank may take all such further, supplemental, incidental and consequential actions, and steps as may be necessary to give full effect to the provisions of this section.

**Employees transferred to the Bank: Sec 16**

**l)** The Transfer Order shall specify by category or by name the employees of the State Bank who shall, as from the Transfer Date, stand transferred to, and become the employees of, the Bank by virtue of the Transfer Order.

(2) The Transferred Employee shall not be entitled to any compensation or any other payments whatsoever as a consequence of transfer to the Bank.

 (3) The existing terms and conditions of service and the benefits to which the Transferred Employees are entitled to in the State Bank, including pension, gratuity, provident and benevolent funds benefits and benefits of the existing staff regulations shall be assured to the Transferred Employees upon their transfer to the Bank except where altered with the consent of the Transferred Employees

As from the Transfer Date, the benefits accrued to the Transferred Employees under the State Bank's pension, gratuity, provident fund, benevolent fund any other employees benefit Of the State Bank shall be transferred to similar funds and schemes established by the Bank and the Transferred Employees shall be deemed to have become members of, and become entitled to the benefits of, such funds and schemes of the Bank.

For the purpose of payment .of benefits to the Transferred Employees under the pension, gratuity, provident and benevolent funds and other employees benefits schemes of the Bank, the period of employment of the Transferred Employees under the State Bank shall count towards then-under -the Bank notwithstanding the date of transfer of the Transferred Employees to the Bank.

**Power of the State Bank to give direction: Sec 17**

Where the State Bank is satisfied

1. In the public interest; or . .
2. To prevent the affairs of the Bank being conducted in a manner detrimental to the interests of its customers or in a manner prejudicial to the interests of the Bank or of the State Bank; or

to secure the proper management of the Bank generally, It is necessary to issue directions to the Bank, the State Bank may, from time to time, issue such directions as it may deem fitand the Bank shall be bound to comply with such directions.

The State Bank may, on representation made to it, or on its own motion, modify or cancel any direction issued under sub-section (1) and in so modifying or cancelling any such direction may impose such conditions as it thinks fit, subject to which the modifications or shall have effect.

**Delegation of the powers of the State Bank: Sec18**

The State Bank may, by order in writing, direct that all or any of the State Bank's powers and functions under this Ordinance, the Act, the Banking Companies Ordinance, 1962 , the Foreign Exchange Regulation. Act, 1947 or under any other law, rules, regulations, orders, notifications or bye-laws for the time being in force shall, subject to the provision of section 5 of this Ordinance, be exercised by the Bank, as the SBP may, from time to time, specify by order in writing. ,

Where the Governor or any other executive of the State Bank authorized by the .Governor in this behalf has, under sub-section (1), directed that any of the State Bank's powers or functions under any law, rules, regulations, orders, notifications or bye-laws for the time being in force shall be exercised or performed, by the Bank the **Board may**, by resolution, direct that any of such powers and functions shall be exercised, or performed, subject to **such limitations,** restrictions **or** conditions, if any, as the Board may, from time to time, impose by the Managing Director or any other Director, executive or other employee of the Bank specified by the Board

**Appointments under section 23B of the Foreign Exchange Regulation Act, 1947: Sec 19**

Notwithstanding the provisions of section 23B of the Foreign Exchange Regulation Act, 1947 the State Bank may, by order in writing, authorize in relation to any area specified in such order any executive of the Bank to act as the Director of Adjudication, an Additional Director of Adjudication, a Joint Director of Adjudication, a Deputy Director of Adjudication Director of Adjudication for the purposes of section 23B thereof.

The executives of the State Bank currently acting as the Director of Adjudication, the additional Director of Adjudication, the Joint Director of Adjudication, the Deputy Director of Adjudication, And the Assistant Director of Adjudication in respect of any area and transferred to the Bank pursuant to the Transfer Order shall continue to hold such appointments until removed by the State Bank and shall be deemed to have been appointed by the Federal Government for the purposes of Section 23-B of the Foreign Exchange Regulation Act, 1947 (VII of 1947).

**Duty of officers and servants to maintain secrecy: Sec 20**

Except in the performance of his duties under this Ordinance, every executive or other employee of the Bank shall preserve and aid in preserving secrecy with regard to all matters relating to the affairs of the Bank and of the State Bank coming to his knowledge and not published by the Bank or by the State Bank and with regard to all matters relating to the financial or monetary affairs of any Bank, institution, person, body of persons, any Government or authority whether in Kenya or outside Kenya that may come to his knowledge in the performance of his duties.

Every such executive or other employee who communicates any such matter, except when required by law so to do, or in the discharge of his duties as such, shall be guilty of an offence punishable with imprisonment of either description for a term which may extend to three years or with fine which may extend to one hundred thousand rupees; or with both.

No Court shall take cognizance of any offence punishable under this section except upon a complaint in writing by a person authorized in this behalf by the Board.

**Bank and its officers to be public** **officers: Sec 21**

For the purposes of Article 7 of the Qanun-e-Shahadat Order, 1984 (P.O. No. 10 of 1984), the provisions of Part IV -of the Code of Civil Procedure, 1908 (Act V of 1908), and the provisions of rule 27 of Order V, and rule 52 of order XXI of the said Code, the Bank and any person in the service of the Bank acting ate, capacity as such shall be deemed to be a public officer.

The provisions of Article 6 of the Qanun-e-Shahadat Order, 1984 (P.O. No.. 10 of 1984), shall apply to the unpublished records of the Bank and the Managing Director shall be deemed to be the officer or head of the department concerned.

 **Persons in the service of the Bank to be public** **servants: Sec 22**

Every person in the service of the Bank shall be deemed to be a public servant within the meaning of section 21 of the Kenya Penal Code (Act XLV of 1860).

**Production of unpublished records of the Bank, etc: Sec 23**

No Court, Tribunal or other authority shall be entitled to compel the Bank or any person in the service of the Bank to produce or , as the case may be, give any evidence derived from, any unpublished records of the Bank

 No Court, Tribunal or other authority shall permit any one to produce or give evidence derived from, any unpublished records of the Bank, except with the prior permission in writing of the Managing Director who may give or withhold such permission as he thinks fit.

Notwithstanding anything contained in this Ordinance or any other law for the time being in force, a report prepared by the Bank on a banking company under any law for the time being shall be deemed to be unpublished for the purposes of sub-sections (1) and (2) even if la copy of such report has been supplied to the banking company to which the report pertains, the State Bank or the Federal Government.

 **Pension of Bank employees to be exempt from attachments, etc Sec 24**

Notwithstanding anything contained in any law for the time being in force, pensions granted by the Bank to its executives and other employees shall not be liable to seizure, attachment or sequestration by process of any court at the instance of a creditor, for any demand against the pensioner or in satisfaction of a decree or order of any such Court

**Exemption from** **taxes: Sec 25**

Notwithstanding anything contained in the Wealth Tax Act, 1963 (XV of 1963), and the Income Tax Ordinance, 1979 (XXXI of 1979) or any other law for the time being in force relating to wealth tax, income tax or super tax, the Bank shall not be liable to pay any wealth tax, income tax or super tax on its income or wealth.

**Power to make** **rules: Sec 26**

The State Bank may, by notification in the official Gazette, make rules, consistent with the provision of this Ordinance, for carrying out the purposes of this Ordinance

 **Power to make regulations: Sec 27**

The Bank may, subject to the prior approval of the State Bank, make regulations, not inconsistent with the provisions of this Ordinance and the rules made there under, to provide for all matters for which provision is necessary or convenient for the purpose of giving effect to the provisions of this Ordinance.

Where any provision of the regulations is inconsistent with any provision of the-rules, the provision of the rules shall prevail.

Where the State Bank considers it expedient so to do, it may by order in writing, direct the Bank to make any regulations or to amend or rescind any regulations already made, within such period as it may specify in this behalf.

If the Bank fails or neglects to comply with any direction of the State Bank under sub­section (3) within the specified period, the State Bank may make, amend or rescind any regulation directed by the State Bank to be made, amended or rescinded, and a regulation so made, amended **or** rescinded by the State Bank shall be deemed to have been made, amended or rescinded by the Bank in accordance with the provisions of this section and shall have effect accordingly.

 **Protection of action taken in good faith: Sec 28**

No suit or other legal proceedings shall lie against the State Bank or any director or officer of the State Bank for anything which is in good faith done or intended to be done in pursuance of this Ordinance or of any rules, regulations or orders made there under

**Ordinance to override, etc: Sec 29**

Except the application of any provision of the Act to the Bank as a subsidiary of the State Bank, this Ordinance shall have effect notwithstanding anythingcontained in any law for the time being in force or in any agreement, contract, or other applicable document or instrument.

The Banking Companies Ordinance, 1962 (L VII of 1962), shall not apply to the Bank.

**Removal of difficulties: Sec 30**

**If** any difficulty arises in giving effect to & provisions of this Ordinance, the State Bank may make such order not inconsistent with the provisions of this Ordinance, as may appear to it to be necessary for the purposes, of removing the difficulty:

Provided that no such power shall be exercised after the expiry of two years from the commencement of this Ordinance

**It is worth mentioning that with the establishment of SBP Banking Services Corporation, the Central Bank is discharging its time functions in a more efficient and effective manner.**

**LECTURE 14**

**BANKER-CUSTOMER RELATIONSHIP**

**Types:**

There are amongst others the following important type of relationships between a banker and his customer:

* Debtor and Creditor
* Creditor and Debtor
* Principal and Agent
* Bailer and Baillie
* Mortgagor and Mortgagee
* Pledger and Pledgee

 **Before we move on to discuss the above relationships we need to understand certain terms/concepts including banker, customer, banking and banking company. The same are explained in the following paragraphs.**

**Banker:**

Words Banker/Bank/Banking are interchangeably used. Banker not specifically defined. Meanings inferences and definitions are derived from in- depth study of various statutes relating to banking and writings of renowned economists and jurists. However, in different statutes including banking company's ordinance, 1962, concepts such as business of banking/functions of banks and business transacted by banks are contained.

**Some of the Definitions of Banker:**

**According to J.W. Gilbert**

**“A** banker is a dealer in capital, or, more properly, a dealer in money. He is an intermediate party between the borrower and the lender. He borrows from one party and lends to another”

**According to Dr. Herbert L. Hart**

“A person carrying on a business of receiving money, and collecting drafts for customers subject to the obligation of honoring cheques drawn upon him from time to time by the customers to the extent of the amounts available on their current accounts

**According to Sir John Paged: (considered as an authority on banking law)**

“that no person or body corporate or otherwise, can be a banker, who does not (i) take deposit accounts, (ii) take current accounts, (iii) issue and pay cheques and (iv) collects cheques crossed and uncrossed for his customers”

Sir John Paget further adds that one claiming to be a banker must profess himself to be one, and the public must accept him as such, hi main business must be that of banking, from which generally he should be able to earn his living. This definition is fairly exhaustive, although it makes no mention of many other important functions of the present day banker, which may be put under two heads (a) agency services, comprising of the collection of bills, promissory notes, coupons, dividends, payment of subscription and insurance premiums, and (b) general utility services, e.g., issue of credit instruments, the transaction of foreign exchange business, the safeguarding of valuables and documents against fire, theft, etc. there seems to be no doubt that according to English Law; a person claiming to be treated as a banker, should perform the functions as given by Sir John Paget.

**American Version:**

**“by** “banking” we mean the business of dealing in credits, and by a “bank” we include every person, firm or company having a place of business where credits are opened by deposits or collection of money or currency, subject to be paid or remitted on cheque or order, or money is advanced or loaned on stocks, bonds, bullion, bills of exchange or promissory notes or where these are received for discount or sale**”**

 **United Kingdom’s Version: (According to bills of exchange Act, 1882)**

**“A** banker is any person who carries on the business of banking”

**According to Finance Act, 1915:**

“Any person carrying on a bonafide banking business in the United Kingdom is a banker**”**

**According to Negotiable Instruments Act, 1881 (according to Sec 3 (b) of Negotiable Instrument Act) and BCO, 1962**

**“** Banker means a person transacting the business of accepting for the purpose of lending or investment, of deposit of money form the public, repayable on demand, or otherwise or withdraw able by cheque or otherwise, and includes any post office savings bank. **”**

**In Halsbury’s Laws of England:**

Banker is defined as an individual, partnership or corporation, whose sole or predominating business is banking, that is, the receipt of money on current or deposit account, and the payment of cheques drawn by and the collection of cheques paid in by the customer.

**Conclusion:**

We can say that banker is what banker does. It takes us to the business of banking or functions performed by banks

**Definition of Banking, Banking Company & Forms of Business-- BCO, 1962 Re-visited**

“**Banking** means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdraw able by cheque, draft, payable to order or otherwise;

“**Banking Company”** means any company which transacts the business of banking in Kenya;

**Forms of business carried out by the banking company under section 7 BCO, 1962:**

 In addition to the business of banking, a banking company may engage in any one or more of the following forms of business, namely:-

1. Borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scripts Dealing in (participation term certificates, term finance certificates, musharika certificates, modaraba certificates and such other instruments as may be approved by the State Bank) and other instruments, the granting and issuing of letters of credit, issuing of traveler's cheques and circular notes;

 (aa) the providing of finance as defined in the Banking Tribunals.

1. Acting agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods,
giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a managing agent or treasurer of a company;
(bb) acting as “modaraba company” under the provision of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 (XXXI of 1980);
2. Contracting for public and private loans and negotiation and issuing the same;
3. The effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue public or private, Government, municipal or other loans or of shares, stock debentures, (debenture stock or other securities)\* of any company, corporation or association and the lending of money for the purpose of any such issue
4. Carrying on and transacting every kind of guarantee and indemnity business;

(ee) purchase or acquisition in the normal course of its banking business of any property, including commodities, patents, designs, trade-marks and copyrights with or without buy-back arrangements by the seller, or for sale in the form of hire purchase or on deferred payment basis with mark-up or for leaning or licensing or for rush-sharing or for any other mode of financing;

1. Managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;
2. Acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form security or part of the security for any loans or advances or which may be connected with any such security; for any loans or advances or which may be connected with any such security;
3. Undertaking and executing trusts;
4. Undertaking the administration of estates as executor, trustee or otherwise;
5. Establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;
6. The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purpose of the company;
7. Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;
8. Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;
9. Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;
10. Any other form of business which the Federal Government may, by notification in the official Gazette, specify as a form of business in which it is lawful for a banking company to engage. (2) No banking company shall engage in any form of business other than those referred to in sub-section (1)

**Customer Defined:**

The entire law relating to banking rotates on the interplay of forces governing the relationship between a banker and a customer. The question arises as to who may be called a customer and it is most surprising that the word “ Customer” has not been defined and at the same time one must know as to who is a customer. In some of the judgments pronounced by different courts an attept has been made to give definitions of a customer but it is not an exhaustive attempt and they havenot been able to give such definition which may be termed as a satisfactory definition of this word.

**According to Heber L. Hart:**

A customer is a person who has an account with a banker. Coming to the meaning of the word, Hart says that a person is a “customer” of a bank within the meaning of section 82 of the Bills of Exchange Act, 1882, if he keeps either a current or a deposit account with the bank, or , it would seem if the bank systematically transacts with him, or for him, any kind of banking business.

**According to Sec 131 of Negotiable Instruments Act, 1881**

In the above cited section a reference has been made with regard to the Customer-- that protection shall be available to a banker collecting cheques on behalf of his customer

**According to Sir John Paget:**

**“To** constitute a customer, there must be some recognizable course of habit of dealing in the nature of regular banking business”

**According to the judgment in the case cited as “Lad Broke V Todd (1914) given by Justice Bail Hache, customer’s domain is maintained as under**

“in my opinion a person becomes a customer of a bank when he goes to the bank with money or a cheque and asks to have an account opened in his name, and the bank accepts the money or cheque and is prepared to open an account in the name of that person; after that he is entitled to be called the customer of bank. It is further added, “I think such a person becomes a customer the moment the bank receives the money or cheque or agrees to open an account.”

 **Legal Requirements to be qualified as Customer:**

Customer should be of age of majority should be of sound mind

Not debarred under any law there must be an offer/ proposal and acceptance of that offer/ proposal.

**Rights and Duties of Customer**

The customer has the following universally accepted **rights:**

* + 1. To draw cheques against his credit balance, or in the ab­sence of credit balance, when there are arrangements for accommodation made with the banker earlier;
		2. To receive a statement of his account from a banker.
		3. To sue the bank for any loss and damages.
		4. To sue the banker for not maintaining the secrecy of his account.

The customer has the following **duties** towards his banker:

- (i) Section 72 of the Negotiable Instruments Act, 1881, lays down that the customer must present the cheques for pay­ment and collection within the business hours of his banker.

- (ii) Section 84 of the Negotiable Instruments Act, 1881, lays down that the customer should see that the cheques and other instruments are presented for payment within a rea­sonable time from the date of their issue.

- (iii) He should take reasonable care for safe custody of the cheque books. If a customer fails in this duty, he is to be held responsible for his negligence in leaving his cheques unprotected.

 (iv) He should draw the cheques very carefully and in such a way that there is no room left for any fraudulent alternations and additions. In Yany V Grote, the Lord Chancellor said:

"A cheque drawn by a customer is in point of law, a mandate to the banker to pay the amount according to the tenor of the cheque. It is beyond dispute that the customer is bound to exercise reasonable care in drawing the cheque to prevent from being misled. If he draws the cheques in a manner which facilitates fraud, he is guilty of a breach of duty to himself and the banker, and he will be responsible to the banker for any loss suffered by the banker as a natural and direct consequence of this breach of duty". **BANKER-CUSTOMER RELATIONSHIP**

**Nature of Legal Relationship:**

Basic legal relationship between banker and customer is **contractual relationship.** This relationship is established from the time of opening an account in a bank. This relationship is at the root of all other legal relationships that exist between the banker and customer. As such, scope, essentials and type of contracts have been discussed in the following paragraphs.

 **Contract-- Defined**

 Contract is an agreement enforceable at law.

**Essentials of a Valid Contract*:***

To understand a contract, we need to know what an agreement is. The agreement has been defined in section 2 (e) of the Contract Act which is given below.

##

**Agreement**

Every promise or every set of promises, forming the consideration for each other is an agreement.

--To understand an agreement, we must know what a promise is. The promise has been defined in section 2 (b) of the Act which is reproduced below:

**Promise**

When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise.

##

**Proposal and Promise**:

 The word "proposal" is synonymous in English use with "offer". But the language of these definitions appears to confine "proposal" to an offer to be bound by a promise. Thus a man who offers to sell and deliver, then and there, existing portable goods in his immediate control, such as a book or a jewel, does not offer a promise but an act, and if the other party takes the goods on the spot and becomes liable to pay for them, he (the buyer) is the Promisor. In such a case the seller would seem not to make a proposal within the terms of the Contract Act. A quotation of prices is not an offer, but an invitation [for offer](http://www.paksearch.com/Government/CORPORATE/Contract/A88.htm); the same is true of many common forms of advertisement. A statement of the lowest price at which a landowner is prepared to sell is not an offer.[A term in a partition](http://www.paksearch.com/Government/CORPORATE/Contract/A89.htm) deed that any of the parties wishing to sell his share will sell to the others at the market value is not an offer but an undertaking to make [an offer.](http://www.paksearch.com/Government/CORPORATE/Contract/A90.htm)
The Act does not say, but it seems to imply, that every promise is an accepted proposal. In the Common Law this is not so, for a binding promise may be made by deed, that is, by writing under seal without any communication between the parties at all. This is because the deed, as an ancient formal method of proof, was conclusive against its maker.

**Promisor and Promisee has been defined in section 2(c)**

The person making the proposal is called **“the Promisor”** and

The person accepting the proposal is called **“the Promisee”**

To transform a promise into an agreement consideration is also an important ingredient. Consideration has been defined in section 2 (d) of the Act which is reproduced below:

**Consideration**

When at the desire of the Promisor, the Promisee or any other person who has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise.

All agreements are not contracts, meaning thereby that all agreements are not enforceable at law. Such agreements are called void agreements. The same has been defined in section 2 (g) of the Act which is reproduced below:

**Legal relationship**

Intention to create legal relationship must exist, in commercial transactions it is presumed that such intention always exists. Social agreements do not give rise to any legal relationship, hence no rights or obligations arise/accrue from social agreements, i.e. (Social agreements are not enforceable at law)

**Free consent**

This is an important essential of a valid contract. It requires that contract should be entered into with free consent of parties.

**Consent is said to be free if not caused by:**

* Coercion
* Undue influence
* Fraud
* Misrepresentation or
* Mistake

**Competent Parties**

Another important essential of a valid contract is the legal capacity of the parties to enter into a contract; this has been provided in **section 11** of the Act which is reproduced below:

“Every person is competent to contract who is of the age of majority according to law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject”.

**Who are competent to contract?**

Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject. This section deals with personal capacity in three distinct branches: (a) disqualification by infancy; (b) disqualification by insanity; (c) other special disqualifications by personal law.

**"To Contract."---**means, to bind himself by promise. A minor who gives value, without promising any further performance, to a person competent to contract is entitled to sue him for the promised equivalent. This may be properly not in contract but on a quasi-contract under section 70.

**Minor's agreement:**

If the first branch of the rule laid down in the section be converted into a negative proposition, it reads thus: No person is competent to contract who is of the age of majority according to the law to which he is subject: in other words, a minor is not competent to contract. This proposition is capable of two constructions · either that a minor is absolutely incompetent to contract, in which case his agreement is void, or that he is incompetent to contract only in the sense that he is not liable on the contract though the other party is, in which case there is a void able contract. If the agreement is void, the minor can neither sue nor be sued upon it, and the contract is not capable of ratification in any [manner;](http://www.paksearch.com/Government/CORPORATE/Contract/C64.htm) if it is void able, he can sue upon it, though he cannot be sued by the other party, and the contract be ratified by the minor on his attaining majority. Where, an infant retains property obtained under the contract from the other party, the equitable remedy of restitution has been applied, even though the infant made no false representation as to his age.

**Payment of debt incurred during minority:**

Where a person on attaining majority pays of debt incurred by him during minority, no question of ratification of a contract arises, since an agreement with a minor is merely void and not unlawful, the sum paid cannot be sued for subsequently, and in law it must be regarded on the same footing as a [gift.](http://www.paksearch.com/Government/CORPORATE/Contract/C78.htm) It is within the competence of a certificated guardian appointed by statute, such as the Guardian and Wards Act, 1890, or the various Courts of Wards Acts to enter into a contract for the purchase or sale of immovable property on behalf of the minor with the sanction of the [Court.](http://www.paksearch.com/Government/CORPORATE/Contract/C82.htm) **Persons otherwise "disqualified from contracting."---**The capacity of a woman to contract is not affected by her marriage under the law.

According to above definition the following parameters would determine t**he legal capacities of parties to a contract:**

##### Parties to contract are required to be of the age of majority.

#####  Of sound mind

#####  Not barred from entering into contracts by the operation of law.

**Lawful object**

**Not expressly declared void--- Some instances of void agreement are given below:**

**Agreements in restraint of marriage (sec 26)**

### Every agreement in restraint of the marriage of any person, other than minor, is void

###  Agreements in restraint of trade (sec 27)

### Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

**Agreements in restraint of legal proceedings (sec 28)**

**Every agreement, by which any party thereto is restricted absolutely from enforcing his right under or in respect of any contract, by the usual proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent.**

**Legal formalities**

The agreements must fulfill all the requirements all the legal formalities such as:

(i) Writing

(ii) Witness

 (iii) Attestation

(iv) Registration

**Classification of contracts:**

**Valid contract**

 **Valid contract is an agreement enforceable by law. In such contract all essentials of a contract as mentioned in section 10 are required to be fulfilled. In case breach of contract by one party, the other party has a right to file a suit for this breach.**

**Illustration:**

A contract for the sale of a car between Mr. Yasir and Mr. Waqas has been concluded and all necessary formalities have been completed. The said contract meets all essentials of a valid contract. If either of the two that is Mr. Yasir or Mr. Waqas fails to perform his part of contract, the counter party can sue the other party for the breach of contract.

**Voidable contract**

A voidable contract is the one which is enforceable by law at the option of one or more of the parties to the contract, but not at the option of the other or others. As long as the contract is not avoided or cancelled by the party who is entitled to do so, the contract shall remain a valid contract. Such contracts are voidable at the option of aggrieved party.

**Voidable contract** has been defined in **section 2 (i)** of the Contract Act which is reproduced below:

“An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract”

**--A contract becomes voidable in the following situations:**

Where consent of a contracting party is not free

Where Promisor prevented from performance of the contract.

***--An agreement on account of misrepresentation shall be voidable at the option of the person who is misled by such misrepresentation.***

**--In case a voidable contract is acted upon by a party as valid, that party cannot subsequently deny the validity thereof.**

**Void contract**

A void contract is the one which is not enforceable by law. It has been provided in **section (j)** of the Contract Act.

**“A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable. “**

**A voidable contract is a good contract as long as it is not avoided by the person who has the option to avoid whereas a void contract is not a contract at all from the very beginning in the eye of law.**

**Example:**

Mr. Aslam resident of Lahore entered into an agreement with Mr. Kamal, a rice dealer at Gujranwala for the purchase of 100 tons of rice. District Coordination Officer ( DCO) Lahore had imposed restriction on entry of rice in the territorial jurisdiction of District Lahore well before the date of the above agreement. The said agreement is not enforceable at law, hence void.

Situations of void contract

***Impossibility of performance. It has been discussed in section 56***

***Legal contract may became void due to some illegality afterwards.***

***Revocation of a voidable contract by the party at whose option, the contract is avoidable becomes void contract***

Unenforceable Contract

Such contracts are unenforceable before a court of law due to some technical defects such as non-deposit of court fee, submission of unsigned documents, absence of writing, wherever writing required, absence of registration, wherever required under law. On removal of these discrepancies, the contract becomes enforceable.

**Express contract**

An express promise shall lead to an express contract. Such a contract may be expressed by words spoken or written. Express contracts are contained in the provisions of section 9 of the Act.

**Implied contract:**

Such contracts are inferred from the acts and conduct of the contracting parties.

**Example:**

Mr. Aslam was engaged by a business man as a helper at his shop. He has been performing the job assigned to him, however no appointment letter was issued by the shopkeeper. Although there is no express agreement as to the employment of Mr. Aslam but the acts and the conducts of the respective parties shall lead to a conclusion regarding the nature of contract between them. Since the conclusions shall be inferred from the acts and conduct of the respective parties, such contract would be called an implied contract.

--The provisions regarding express and implied contract as contained in section 9 are given below:

**“In so far as the proposal or acceptance of any promise is made in words, the promises is said to be express. In so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied. “**

**We shall continue with further discussion on this topic**

**LECTURE 15**

**BANKER-CUSTOMER RELATIONSHIP**

 We already know that besides other following are important legal relationships between banker and customer.

* Debtor and Creditor
* Creditor and Debtor
* Principal and Agent
* Bailor and Bailee
* Mortgagor and Mortgagee
* Pledger and Pledgee

The above relationships are explained in the following paragraphs.

**Debtor and Creditor Relationship**

When customer deposits money in a bank the relationship of **debtor** and **creditor** is established, in this case; **Banker** is **Debtor**  **& Customer** is **Creditor**

A bank performs a number of functions for the customer. After the account in the bank is opened and the relationship of a banker and customer is established, the bank not only undertakes to collect the cheques which are deposited in the account but also makes the payment on behalf of the customer, whenever there is a mandate from the customer. The cheques which are realized by the bank are deposited in this account of the customer and on many occasions, the bank performs certain other functions on behalf of the customer such as keeping the valuables, etc., deposited by the customer with the bank as a trustee. On many occasions, when the customer gives bills for collection to his bank and the said bank passes the bills for collection to another bank and the amount of the bills is reduced as a result of debiting the customer's account with collection charges as a result of an agreement between two banks, the bank is always acting on behalf of the customer. There are thus too many occasions relating to so many matters which arise during the mutual dealings between the banker and the customer and at each time, a question arises as to what is the relationship between a banker and a customer. It has now been well settled that the first and foremost relationship between the customer and the bank is the relationship of a *Creditor and debtor.*

H.P. Sheldon in his *Practice and Law of Banking* sets out this relationship as follows:

"The banker when he receives money from a customer does not hold the money in a fiduciary capacity. To say that money is Deposited'' with a banker is likely to cause misapprehension. What really happens is that the money is not deposited with, but lent to the banker, and all that the banker engages to do is to discharge the debt by paying over an equal amount when called upon.

 Halsbury's Lazus of England, (Simonds Edn.) Vol. 2, p. 166, states that receipt of money by a banker from or on account of his customer constitutes him the debtor of the customer.

American Jurisprudence discussing the relation between bank and general depositor has the following to say:

**Sec. 444.** "It is a fundamental rule of banking law that in the case of a general deposit of money in a bank, the moment the money is deposited it becomes the property of a bank, and the bank and the depositor assume the legal relation of debtor and creditor. The legal effect of the transaction is that of a loan to the bank upon the promise and obligation, usually implied by law, to pay or repay the amount deposited usually upon demand; there is nothing of a trust or fiduciary nature of a bailment in the transaction or relationship or in the nature of any right to specific money deposited….”

Corpus Juris gives the following information:

**Sec. 326**. "The contract between a bank and a depositor is not materially different from any other contract by which one person becomes bound to take charge of and repay another's, funds, and there is no trust relation between a bank and a general depositor. The relation between a bank and a depositor may be dual in character, the bank being the depositor's debtor with respect to one thing and his agent with respect to another, or his debtor at one time and his agent at another; and while the relation between the bank and a depositor in respect to a general deposit is generally regarded as that of a debtor and creditor, yet in another sense the depositor is the owner of the deposit, in that he can demand repayment at any time. It is competent for a bank of deposit to enter into a collateral agreement with the depositor with reference to the disposition of the proceeds of deposits...."

According to **H P Sheldon** in his publication ‘practice and law of banking’, this relationship has been expressed as under:

“The banker when he receives money from a customer does not hold the money in the fiduciary capacity. To say that the money is deposited with a banker is likely to cause misapprehension. What really happens is that the money is not deposited with, but lent to the banker, and all that the banker engages to do is to discharge the debt by paying over an equal amount when called upon”

**Creditor and Debtor Relationship:**

When a bank grants loan or other credit facilities to the customer, relationship is reversed, that is now **Customer is Debtor &** Banker **is Creditor.**

In such cases it is not the money of the customer in the hands of the banker but it is the money of the bank in the hands of the customer but in all such cases when a customer's account is over drawn, the customer does not cease to be a customer.

**Principal & Agent Relation**

In certain situations, the banker serves as agent of the customer (principal) some of these situations are enumerated below:

* Collection of cheques on behalf of the customer
* Collection of dividends and bills of exchange
* Acting as attorney, executor or representative of a customer
* Buying and selling securities on his behalf.

According to *Skeleton* another service being rendered by a banker to his customer is to collect his customer's cheque and other credit instruments. In these transactions, the relationship between the two parties is that of principal and agent—the banker acting as his customer's agent. This is because in the course of business incidental to banking, a banker undertakes to perform many services for the customer such as:

Buying and selling securities on his behalf; collection of cheques, dividends, bills or promissory notes on his behalf; acting as a trustee, attorney, executor, correspondent or a representative of a customer.

In the performance of all these functions, the banker acts as an agent of the customer.

 In general terms, Agency refers to the relationship which exists between two persons, the **Principal** and the **Agent** in which the Agent has to perform different duties/ functions as per instructions of the **principal** and also enters into contract with the third party / parties on behalf of the principal. The relationship of agency plays an important role in business and commercial dealings. This relationship is legal created by virtue of agreement between **Principal** and **Agent**

**Definition of Agent and Principal: Sec 182**

**Agent** is a person employed to do any act for another or to represent another in dealing with a third persons. The person for whom such act is done, or who is so represented, is called the **Principal.**

**Explanation**

The legal relation between a merchant in one country and a commission agent in other is that of principal and agent, and not seller and buyer, though this is consistent with the agent and principal, when the agent consigns the goods to the principal, being in a relation like that of seller and buyer for some purposes. A merchant, therefore, in this country who orders goods through a firm of commission agents in Europe cannot hold the firm liable as if they were vendors for failure to deliver the goods. And the result is the same if the goods are ordered through a branch in this country of a firm of commission agents in another country. For the same reason, where a commission agent buys goods for a merchant at a price smaller than the limit specified in the indent, he cannot charge any price higher than that actually paid by him, except in the case of a custom to the contrary.
An agent may have, and often has, in fact, a large discretion, but he is bound in law to follow the principal's instructions provided they do not involve anything lawful. To this extent an agent may be considered it's a superior kind of servant; and a servant who is entrusted with any dealing with third persons on his master's behalf is to that extent an agent. But a servant may be wholly without authority to do anything as an agent, and agency, in the case of partners, even an extensive agency, may exist without any contract of hiring and service.

**Agency may be created in the following ways:**

* By consent
* By operation of law
* By estoppel
* By ratification

**Agency by Consent:**

Consent may be express or implied.

**Express Agency:**

Such agency is created by words either spoken or written. In business transactions, this relationship is usually established through writing an agreement

**Implied Agency:**

An authority is referred to as implied when it is inferred from the conduct of the parties or circumstances of the case.

**Definitions of express and implied authority as contained in section 187 of the Act is given below:**

An authority is said to be express when it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted for circumstances of the case.

**Types of Agent:**

The agents may be classified as under:

**Public Agents**- these are representatives of a State

**Private Agents**—these agents represent individuals or companies

**General Agents**- these agents pertaining to a business, vocation or profession

**Special Agents**—such agents are appointed for a specific transaction.

**Co-Agents**-- Such Agents act along with Principal.

**Duties of the Agent:**

Duties of agent are contained in sec 211 to 218 of the Contract Act. Some of the important duties are given below:

* To follow principal’s instructions
* To show required skill and diligence
* Agent to render proper accounts
* Agent to pass on any benefits derived by him

**Agent’s duty in conducting principal’s business. (sec 211)**

An agent is bound to conduct the business of his principal according to the directions given by the principal, or, in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

**Illustrations**

(a) A, an agent engaged in carrying on for B, a business, in which it is the custom to invest from time to time, at interest, the moneys which may be in hand, omits to make such investments. A must make good to B the interest usually obtained by such investments. (b) B, a broker, in whose business it is not the custom to sell on credit, sells goods of A, on credit to C, whose credit at the time was very high. C before payment becomes insolvent. B must make good the loss to A.

 (c) An agent, instructed to warehouse goods at a particular place, warehouse a portion of them at another place, where they are destroyed, without negligence. He is liable to the principal for the value of the goods destroyed. (d) An agent, instructed to insure goods, neglects to do so. He is liable to the principal for their value in the event of their being lost. (e) A broker, entrusted with goods for sale, sells them by auction at an inadequate price, not having made an estimate of the value in accordance with the custom of the particular trade. He must make good the loss. (f) An auctioneer, contrary to the usual custom, takes a bill of exchange in payment of the price of goods sold. He is liable to the principal for the amount of the bill in the event of its being dishonored. (g) An agent, bound by his contract to keep proper books of account, omits to scrutinize, examine or check the accounts of his subordinates whom he implicity trusts. Taking advantage of this, the subordinates commit gross frauds on him and his employers. The frauds and defalcations being due to the agent’s failure to perform his duty he is liable to make good the loss thereby caused.

**Skill and diligence required from agent (sec 212)**

 An agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business, unless the principal has notice of his want of skill. The agent is always bound to act with reasonable diligence, and to use such skill as he possesses; and to make compensation to his principal in respect of the direct consequence of his own neglect, want of skill or misconduct, but not in respect of loss or damage which are indirectly or remotely caused by such neglect, want of skill or misconduct.

**Illustrations**

(a) A, a merchant in Islamabad, has an agent, B, in London to whom a sum of money is paid on A's account, with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money, becomes insolvent. B is liable for the money and interest from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss---as e.g., by variation of rate of exchange--but not further. (b) A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual inquiries as to the solvency of B. B, at the time of such sale, is insolvent. A must make compensation to his principal in respect of any loss thereby sustained. (c) A, an insurance broker, employed by B to effect an insurance on a ship, omits to see that the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. A is bound to make good the loss to B.) A, a merchant in England, directs B, his agent at Karachi who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival, the price of cotton rises. B is bound to make good to A, the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

**Agent's accounts (section 213)**

An agent is bound to render proper accounts to his principal on demand.

**Agent's duty to communicate with principal (section 214)**

It is the duty of an agent, in cases of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions. Agent is under a duty to consult principal in a "difficult" situation so as to save repudiation of his action by principal.

**Right of principal when agent deals, on his own account, in business of agency without principal's consent.( sec 215)**

If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows either that any material fact has been dishonestly concealed from him by the agent, or that the dealings of the agent have been disadvantageous to him.

**Principal's right to benefit gained by agent dealing on his own account in business of agency (sec 216)**

If an agent, without the knowledge of his principal, deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction.

**Agent's right of retaining out of sums received on principal's account.( sec 217)**

An agent may retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business, and also such remuneration as may be payable to him for acting as agent.

**Agent's duty to pay sums received for principal (sec 218)**

Subject to such deductions, the agent is bound to pay to his principal all sums received on his account.

**Rights of the Agent:**

These are discussed in the following paragraphs:

##

**When agent’s remuneration becomes due-Sec 219**:

In the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act; but an agent may detain moneys received by him on account of goods sold, although the whole of the goods consigned to him for sale may not have been sold, or although the sale may not be actually complete.

**Agent to be indemnified against consequences of lawful acts (sec 222)**

The employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him.

**Agent to be indemnified against consequences of acts done in good faith (sec 223)**

Where one person employees another to do an act and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it cause an injury to the rights of third persons.

**Compensation to agent for injury caused by principal's neglect (sec 225)**

**T**he principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.

 **Enforcement and consequences of agent's contracts (sec 226)**

Contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner, and will have the same legal consequences as if the contracts had been entered into and the acts done by the principal in person.

**Principal’s liability with regard to agreements caused by misrepresentation or fraud by agent: Sec 238**

Misrepresentation made, or frauds committed, by agents acting in the course of their business for their principals, have the same effect on agreements made by such agents as if such misrepresentations or frauds had been made or committed by the principals; but misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals.

**Scope of duties of Principal:**

Duties of the principal are enumerated below:

* Payment of remuneration to the agent
* Not to prevent his agent from performing the duties/ acts assigned to him under the contract and for which remuneration is payable.

Any legitimate expenses which have been incurred by the agent in the course of performance of his duties are to be indemnified by the principal. **BANKER-CUSTOMER RELATIONSHIP**

We have already discussed the under noted legal relationships between banker and customer.

* Debtor and Creditor,
* Creditor and Debtor
* Principal and Agent

**Now we shall cover the following relationships:**

* Bailor and Bailee
* Mortgagor and Mortgagee
* Pledger and Pledgee

**Bailor and Bailee Relationship:**

In banker customer relationship, bailment is also important types of relations. It may arise in the following situations:

Availing safe custody services (lockers)

Pledge of stocks as security for availing credit from bank. In these cases---

**Customer**--- **Bailor** & **Bank**---- **Bailee**

**Bailment**

The definition of bailment as contained in section 148 is given here under:

A “bailment” is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the “bailor”. The person to whom they are delivered is called the “bailee”

**Explanation.---**If a person already in possession of the goods of another contracts to hold them as a bailee, he thereby becomes the bailee, and the owner becomes the bailor, of such goods although they may not have been delivered by way of bailment.

**Essentials of Bailment:**

**Contract**--there is an underlying contract between the bailor and bailee, there may be an explicit contract or it may be an implied contract.

**Specific purpose--**the bailment of goods is always for some specific purpose.

**Delivery of goods**--there must be delivery of movable goods in a contract of bailment.

**No change of ownership**--in a contract of bailment, only the possession of goods is transferred from bailor to the bailee, whereas the bailor has all ownership rights over the goods delivered.

### Return of the goods delivered on accomplishment of purpose--when the purpose for which the goods are delivered is completed, the goods must be returned in the original form or modified form as per instructions of the bailor.

**For the benefit of the bailor-**- Mr. Yasir, while going out of city handed over some precious household articles to Mr. Usman for safe custody, without any obligation to pay any fee/ charges. It is a bailment for the benefit of the bailor.

**For the benefit of the bailee—**Mr. Umer handed over his car to Mr. Ahsan, as he was in need of conveyance for few days. Mr. Umer handed over this car without any obligation on the part of Mr. Ahsan to pay any rent/ charges for the use of this car. This bailment is exclusively for the benefit of the Mr. Ahsan, the bailee.

### For the benefit of bailor and bailee—Mr. Ahmad availed locker facilities from M/S XYZ bank ltd. Under the terms and conditions of the contract Mr. Ahmad was required to pay Rs.1000/ annual fee on account of availing this facility. This contract is for the benefit of both parties, the bailor and the bailee.

**Explanation:**

Scope of bailment and its essentials are explained in detail in the following paragraphs.

**Nature of the transaction.---**"Bailment" is a technical term of the Common Law. It involves change of possession. One who has custody without possession, like a servant, or a guest using his host's goods, is not a bailee. The constructive delivery will create the relation of bailor and bailee as well as actual delivery. The bailee's duty to deal with the goods according to the bailor's orders is incidental to the contract of bailment, and arises on the delivery of the goods, although those orders may have already been given and accepted in such a manner as to constitute a prior special contract. As a matter of pleading this is no longer material in this country, but it might still be material with regard to the period of limitation. Ailment is necessarily dealt with by the Contract Act only so far as it is a kind of contract. It is not to be assumed that without an enforceable contract there cannot in any case be a bailment. The words. "Otherwise disposed of" in the present section express the common law as now understood. "It seems clear that a bailee is not the less a bailee because he is clothed with authority to sell the thing which is bailed to him," e.g., a factor for sale. On the whole a bailment may be described as a delivery on condition, to which the law usually attaches an obligation to redeliver the goods, or otherwise deal with them as directed, when the condition is satisfied; but there may be, in particular cases, a bailment without an enforceable obligation

**Rights and duties of bailee**

**To take care of goods delivered by bailor—**this aspects are contained in the following sections:

**--Sec 151**: in all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

**-- Sec 152**: the bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care of it described in section 151.

**Effects of mixture, without bailor’s consent when the goods can be separated**

**-Sec 156**: if the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expense of separation or division, and any damage arising from the mixture.

**Effect of mixture, without bailor’s consent, when the goods cannot be separated**

**--Sec 157**: if the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

* According to section 154, bailee shall not make un-authorized use of the goods delivered to him.
* According to section 160, bailee is required to return the goods delivered to him for som purpose.
* According to section 163, bailee is required to return an increase or profit in lieu of goods delivered.

**Explanation:**

**The duties of the bailee are explained in greater detail in the following paragraphs:**

The bailee has no right to dispose of or sell the property unless specifically authorised to do so. He has only a right to retain the goods bailed with him until he receives due remuneration for the service rendered in respect of the goods. He is responsible for the safe delivery of the goods bailed with him and in default is responsible to the bailor for any [loss](http://www.paksearch.com/Government/CORPORATE/Contract/P42.htm) of goods

**Goods given to a person by bank on trust receipt---Person becomes a bailee---Liable for criminal breach of trust in case of non-accounting of goods.** The execution of a trust receipt is a recognised mode of making a person bailee of the goods and in such circumstances the Bank must be deemed to be in possession or control of the goods. The validity and efficacy of such instruments of trust are now generally acknowledged. If a person who has signed such a trust receipt, fails to hand over to the Bank the sale-proceeds of the goods sold, the former would be liable for criminal http://www.paksearch.com/Government/CORPORATE/Contract/P43.htm breach of trust

**Intentional wrong delivery by carrier---Carrier liable for damages ---**Where the carrier has made intentional wrongful delivery of goods, he cannot escape liability to indemnify the plaintiff for the loss caused to him by wrongful deliveries of the http://www.paksearch.com/Government/CORPORATE/Contract/P44.htm consignments

**Care to be taken by bailee (sec 151)**

 In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed

**Contract by bailee exempting himself from liability for negligence.---**The learned authors considered that a contract by a bailee purporting to exempt himself wholly from liability for negligence was not valid. This opinion is based on the express provisions for contracting out in S. 152, and in fact throughout the Chapter on Bailments wherever a rule of law is to operate only in the absence of a contract to the contrary, it is expressly so stated in sections 163, 165, 170, 171, and 174.

T**heft of goods pledged with Bank**---Document of pledge containing condition that during the continuance of pledge agreement the borrowers shall be responsible for all loss, damage, or deterioration of security caused by theft, fire, rain or any other cause whatsoever---There being. no discrepancy between provisions of S. 151, Contract Act, 1872 and condition of document of pledge, if loss had been caused by theft, fire, rain or any other cause, it would be the duty of the bailee to explain that he had taken care of the goods as a man of ordinary prudence would under similar circumstances take of his own goods and if in spite of that the goods pledged were lost in manner as recorded in the condition of document of pledge, liability of borrower could not be <http://www.paksearch.com/Government/CORPORATE/Contract/P58.htm> legally denied.

**Loss to goods by negligence of ship-owner---Claim for damages against ship-owner sustainable:**

The ship-owner committed a breach of the obligation contained in the bill of lading and as such the consignee was entitled to<http://www.paksearch.com/Government/CORPORATE/Contract/P61.htm> recover damages.

**Damage to contents of parcel---Burden of proof is on consignor--Mere damage to containers does not prove damage to contents.**

The burden of proof was on the plaintiff to show that the damage to the contents was caused by the negligence of the servants of the Carrier while the Crates were in its custody. No such evidence has been produced by the plaintiff and merely, because some of the wooden crates were externally broken and some card-board cases torn, as stated in the Survey Report, it cannot be inferred, nor is there any evidence to show, that the external damage must have resulted in Damage to the contents

**Loss of goods in possession of bailee---Onus of proof as to negligence of bailee:**

 Where goods are lost or destroyed while in .possession of bailee the onus of placing all the materials in his possession or knowledge is on the bailee, while the onus of establishing negligence is on the plaintiff

**Carriage of goods by sea from foreign port to Kenya---Damage to goods---Contract Act applies.---**The provisions of the rules to the Carriage of Goods by Sea Act, 1925 do not apply in relation to carriage of goods by sea in a ship carrying goods from a foreign port to a port in Kenya, as is the present case. Therefore, the rights and liabilities of the parties have to be ascertained by reference to the proper law of the contract which in this case, is the Kenya law

**Buyer rejecting goods---If can sell them to recover ware-house charges for storing them.---**The buyer rejected the goods and then disposed them of in order to recover the ware-house charges for having stored them. He contended that he as a bailee had the right to do so

**Held:** The buyer of the goods having rejected them and thereafter selling them as the goods belonging to him, stands on a different footing than the bailee contemplated under sections 151 and 170 of the Contract Act. The principle on which a bailee is entitled to dispose of the goods or has lien on the goods bailed with him are entirely different and are not applicable to the case of the sale of goods. As discussed above, the buyer of the goods after rejecting them, has no lien on the goods in dispute and must place them at the disposal of the seller for dealing with them in any manner which he likes

**Loss of goods during transit---Railway liable---Absence of brake---Negligence of railway.---**Where goods were lost during transit and it was found that there was no vacuum or brake in the van of the guard so that the train could not be stopped in case of theft in the running train.

**Held:** There ought to be a vacuum in a train in order that in case of theft while it is running it may be stopped. That a vacuum should be there in the brake of the guard is not denied and the failure to keep a vacuum against the rules would be negligence. Therefore the failure to provide brake should be considered a negligent act on the part of the Railway.

**Held further:** That there is no satisfactory evidence from which it could be inferred that they had taken proper care of the consignment as bailer of the goods consigned. Therefore, the railway was liable for the loss of goods.

**Mortgagor and Mortgagee Relationship**

When credit facility is provided by the bank to a customer against the security (collateral) of immovable property, the relationship of Mortgagor and Mortgagee is established.

In this situation:

**Mortgagor**— **Customer**

**Mortgagee**— **Bank**

**Mortgage Defined: sec 58:**

(a) A mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.

**Mortgagor:** The transferor is called a mortgagor

**Mortgagee:** The transferee a mortgagee

**Mortgage Money:** The principal money and interest of which payment is secured for the time being are called the mortgage-money

 **Mortgage Deed:** the instrument (if any) by which the transfer is effected is called a mortgage deed.

**Nature of Transaction:**

In Mortgage, the rights and interests which are vested in Mortgagor are transferred by him in favor of the other person, the Mortgagee.

Mortgage in fact is a transfer of an interest in specific immovable property as security for the repayment of a debt and such an interest is itself immovable property. The nature of the right that is transferred would depend upon the form of Mortgage.

**Types of Mortgages:**

Registered Mortgage

Equitable Mortgage

**Registered or Legal Mortgage**

This is created through a formal document called mortgage deed.

Mortgage deed is registered with the Registrar of titles.

It is comparatively expensive as it involves stamp duty and registration fee.

**Equitable Mortgage:**

This is created by deposit of title deed by the mortgagor.

Memorandum regarding deposit of title deed is also signed by respective parties.

Clear title of the mortgagor must be ascertained by the mortgagee.

 **Rights of Mortgagee**

To sell the mortgaged property in case of default by mortgagor

Right to fore-closure

Right to file suit

**Pledger and Pledgee Relationship**

When credit facility is provided by a bank to its customers against security (Collateral of movable property) the Relationship of Pledger and Pledgee is established.

In this case:

**Pledger**—Customer

**Pledgee**—Bank

**Pledge**

It has been defined in section 172 of the Contract Act which is given below:

**"Pledge," "pawnor," and "pawnee" defined.**

The bailment of goods as security for payment of a debt or performance of a promise is called "pledge". The bailor is in this case called the "pawnor." The bailee is called the "pawnee."

* The pledge has actual control of pledge stocks/goods.
* Pledge can sell pledged stocks by giving reasonable notice to the borrower.
* Before disposal pledge should publish the notice through news papers etc.

**Comments**

The bailee tendering a contract of pledge does not become owner, but, as having possession and right to possess, he is said to have a special property. Any kind of goods, documents, or valuable things of a personal nature may be pledged. Delivery is necessary to complete a pledge; it may be actual or constructive. It is sufficient if the thing pledged is delivered under the contract within a reasonable time of the lender's advance being made. Pledge---Monthly statements of stocks lying in godown showing goods as pledged with defendant-Bank---All such documents signed by authorized person on behalf of plaintiff---Debit advice vouchers produced by defendants showing conveyance charges paid to Godown Keeper visiting godown, and debited to account of plaintiff---Goods, held, in possession of defendant under pledge and not merely http://www.paksearch.com/Government/CORPORATE/Contract/Q26.htmhypothecated.

**According to J. Milnes Holden:**

“Pledge arises when goods or (documents of title of goods thereto) or bearer securities are delivered by one person (called the Pledger) to another person (called the Pledgee) to be held as a security for the payment of a debt or for the discharge of some other obligation, upon the express or implied understanding that the subject matter of the Pledge is to be restored to the Pledger as soon as the debt or other obligation is discharged.

Where a definite time for payment has been fixed, the Pledgee has an implied power of sale upon default, but if there is no stipulated time for payment, the Pledgee may demand payment and in default thereof may exercise his power of sale after giving notice to the Pledger of his intention to do so. The Pledgee has actual control of pledged stocks/Goods.

Pledgee can sell pledged stocks by giving reasonable notice to the borrower.

Before disposal Pledgee should publish the notice through newspapers etc.

**Termination of Banker- Customer Relationship:**

This relationship that is established by the time an account is opened may be terminated by either party in following manner:

* By Notice from customer or
* By notice from banker

EXAM

ANSWER ALL QUESTIONS

**BNK601 Question No: 1**

Which of the following to an obligation to be annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner is the person who reposes or declares the confidence”?

Agency
**Trust**Branch
Sole ownership

 **Question No: 2**

Which of the following includes evolution of law over a period of time?

Analytical Jurisprudence

**Historical Jurisprudence**

Ethical Jurisprudence

Behavioral Jurisprudence

 **Question No: 3**

Which of the following in not among the  instruments of money market?

Bills of exchange

Repurchase agreements

**Stocks**

Federal funds

Stocks: Stocks are issued as equity claims by corporations and represent the largest single category of capital market assets.

**Question No: 4**

Which of the following is NOT among the instruments of capital market?

**Federal funds**

WAPDA bonds

Debentures

Stocks

 **Question No: 5**

State Bank of Pakistan started its operations on[:](http://www.vuzs.net/undefined/)

1st May, 1948

20**th** May, 1948

**1st July, 1948**

1**st** August, 1948

 **Question No: 6**

All of the following are contents of a company's Memorandum of Association under Banking Companies Ordinance, 1962 EXCEPT:

Name of the company

**Liability of the members**

Number of share holders

Authorized capital

 **Question No: 7**

Which of the following is(are) engaged in a letter of credit?

Advising bank

Confirming bank

Negotiating bank

**All of the given options**

 **Question No: 8**

Which of the following is FALSE regarding the prohibition of employment as described under section 11 of Banking Companies Ordinance, 1962?

No banking company shall employ or be managed by a managing agent.

No banking company shall employ who is, or at any time has been, adjudicated insolvent.

No banking company shall employ who is convicted by a criminal court of an offence involving moral turpitude.

**None of the given options**

 **Question No: 9**

Which of the following sections of Banking Companies Ordinance, 1962 describes the regulation of paid-up, subscribed and authorized capital?

Section 10

Section 12

**Section 14**

Section 15

 **Question No: 10      ( M a r k s: 1 )**

Which of the following is **NOT** included in section 19 of Banking Companies Ordinance, 1962 regarding restriction as to payment of dividend?

**No banking company shall pay any dividend on its shares until all capitalized expenses have been completely written off.**

Dividend can be paid if adequate provisions on account of depreciation have been made by the banking company to the satisfaction of the auditors.

Dividend can be paid if adequate provisions on and bad debts have been made by the banking company to the satisfaction of the auditors.

A banking company can pay dividend only when it will earn profit.

1-The depreciation, if any, in the value of its investments in shares, debentures or bonds (others than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditor of the banking company;

2- the bad debts, if any, in any case where adequate provision for such debts had been made to the satisfaction of the auditor of the banking company.

 **BNK601 Question No: 11**

According to Section 36 of Banking Companies Ordinance, 1962, the Federal Government can issue a Certificate of Moratorium, upon an application of State Bank for a MAXIMUM period of:

Three months

**Six months**

Nine months

One year

**Question No: 12**

Rejected complaints can be sent to Banking Mohtasib along with all related correspondence and the Complaint Form, without the need to give:

30 days notice to the concerned bank

**45 days notice to the concerned bank**

60 days notice to the concerned bank

90 days notice to the concerned bank

**Question No: 13**

According to the Central Bank of Kenyan Act, 1956 refers to which of the following?

Commercial bank

Investment Bank

Islamic Bank

**Central Bank of Kenay**

 **Question No: 14**

When did Pakistan Banking and Finance Services Commission Act come into force?

**1992**

1997

2001

1962

 **Question No: 15**

Federal Bank for co-operative and Regulation of Co-operative Banking Act, 1977 extends to:

**The whole Pakistan**

Punjab Province only

North West Frontier Province only

Sindh Province only

 **Question No: 16**

According to the Section 10 of Microfinance Institutions Ordinance, 2001, no microfinance institution shall operate in a specified province unless it has a paid up capital of not less than:

$. 100,000,000

$. 150,000,000

**$. 500,000,000**

$. 700,000,000

Two hundred and fifty million dollars or such higher amount as may be prescribed from time to time, for microfinance institutions to whom a license to operate in a specified province is issued.

 **Question No: 17**

According to the section 23 of Microfinance Institutions Ordinance, 2001, if any officer of microfinance institution mismanages the affairs of the microfinance institution then he shall be punishable with imprisonment for a term which may extend to:

One year

**Three years**

Five years

10 years

If any officer of a microfinance institution, mismanages the affairs of the microfinance institution or misuses his position for gaining direct or indirect benefit for himself or any of his family members, he shall be punishable with imprisonment for a term which may extend to three years.

**Question No: 18**

Miss. Naila says to Miss. Amina my land produces 40 mounds of wheat per acre. Miss. Amna believes it to be true and buys that land. Later on it appears that the land produces 10 mounds of wheat per acre. Miss. Naila has committed which of the following?

Corecion

Undue influence

**Misrepresentation**

Mistake

**Question No: 19**

**What is the objective behind establishes the office of Banking Mohtasib?**

**Answer:**

The main objective of the banking Mohtasib is to understand and find out injustice done by anyone to the customer.

The examples of wrong charges levied on to the customers, extra commissions charged, incorrect interest rates given on deposits or incorrect interest rate charged on loans and advances. Compliants regarding cheque collections inward and outward transfer of domestic and foreign currency etc.

Thus the banking mohtasib is suppose to address all the grievances faced by the customers of the bank.

 **Question No: 20**

**An agent sells goods on credit to a person on behalf of his principal without making proper enquiry about the solvency of that person.  Afterwards, it reveals that the person was insolvent at the time of sale.  Principal sue his agent for loss. Is principal’s claim right?**

**Answer:**

An agent sells goods on credit to a person on behalf of his principal without making proper enquiry about the solvency of that person.  .It seems from the above that selling on credit is the normal way of doing business. So as far as selling on credit is concerned the agent is entitled to do so. However as he sold goods to a person who was insolvent at the time of sale.

Principal is justified and must sue his agent for loss and the Principal’s claim is right. The agent must have used reasonable care and diligence while selling the goods on credit. He should have by no means sold on credit to an insolvent person.

 **Question No: 21**

**Write down any five topics covered in Part II A of Banking Business Illegally By Companies, etc.) of Banking Companies Ordinance, 1962.**

**Answer:**

Following are the five topics covered in Transaction of Banking Business Illegally By Companies:

1-Call for information as required by central bank .

2-Power to make orders and decrees.

3- Conservation of assets.

4- Submission of Financial statements.

**BQuestion No: 22**

**In 2006, a commercial bank aggressively marketed for Term Deposits and told its customers that no penalties would be charged if premature encashment were desired. As a result of the campaign, many customers placed sizeable funds on 5 year Term Deposits with the bank. However, during 2007 when some of the depositors wanted to prematurely encash their deposits they were threatened with substantial penalties by the bank.**

**Bank’s stance**

**The bank defended the penalty by saying that it was empowered through its “Account Terms and Conditions” to alter any condition unilaterally at any time it chose. The bank claimed that even though the new penalty was included in its Schedule of Charges dated January 1, 2007, penalties were not invoked until July 1, 2007.**

**In your opinion whose claim was right, customer or bank? Justify your answer with reasons.**

**Answer:**

The banks stance is incorrect as they had promised the customers  to return the money to customers if they desired to withdraw the same without any penalty. The deposits were placed by customers based on the above said promise by the bank and now the bank cannot go back on its promise. This is a classic example to be referred to the Bank Mohtasib.

 **Question No: 23**

**Write down any five provisions of the Section 10 (Disqualifications of the Managing Director) of SBP Banking Services Corporation Ordinance, 2001.**

**Answer:**

The following reasons:

1- A person who is a member of Senate or National Assembly.

2-A person who is an employee of the federal Government or of a provincial Government.

3-A person who has not settled any dues of any Bank.

4-A person who is holding a position of office like a secretary or treasurer in a political party.

5-If he is a major share holder in another bank.