

PARLIAMENT OF UGANDA

REPORT OF THE COMMITTEE ON FINANCE, PLANNING AND ECONOMIC DEVELOPMENT ON THE MICRO-FINANCE DEPOSIT-TAKING INSTITUTIONS (AMENDMENT) BILL, 2022

OFFICE OF THE CLERK TO PARLIAMENT

FEBRUARY, 2023

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# **Report of the Committee on Finance, Planning and Economic Development on the Micro Finance Deposit-taking Institutions (Amendment) Bill, 2022**

## **1. Introduction**

The Micro Finance Deposit-Taking Institutions (Amendment) Bill, 2023 was read for the first time by the Minister of Finance, Planning and Economic Development on the 22<sup>nd</sup> November, 2022. It was then referred to the Committee on Finance, Planning and Economic Development for consideration in accordance with Rule 128 of the Rules of Procedure of Parliament.

There are currently only 4 entities regulated under the Microfinance Deposit Taking Institutions Act, 2003 namely UGAFODE, Pride Micro Finance, FINCA and EFC Uganda

## **2. Methodology**

### **2.1 Meetings and Submissions**

The Committee held meetings and received submissions from:

- The Ministry of Finance, Planning and Economic Development;
- Bank of Uganda (Central Bank);
- The Uganda Bankers Association;
- FINCA UGANDA;
- UGAFODE;
- PRIDE Micro Finance Ltd;
- Deposit Protection Fund;
- Association of Microfinance Deposit Taking Institutions of Uganda (AMFIU);
- Uganda Microfinance Regulatory Authority (UMRA); and
- Uganda Co-operative Savings and Credit Union Limited (UCSCU)

### **2.2 Literature Review**

The Committee further made reference to the following literature;

- The Micro Finance Deposit-taking Institutions Act, 2003 (MDI Act)
- The Tier 4 Microfinance Institutions Act and Money Lenders Act, 2016
- The Financial Institutions Act, 2004 as amended
- The Cooperative Societies Act, Cap 112 (as amended)
- The Financial Institutions (Revision of Minimum Capital Requirements) Instrument, S.I No. 30 of 2022
- The Core Principles for Effective Banking Supervision (the Basel Principles);
- The International Financial Reporting Standards
- The International Accounting Standards
- The Bank of Uganda Consolidated Corporate Governance Guidelines

### 3. Background to the Bill

#### 3.1 Object of the Bill

The object of the Micro-Finance Deposit-taking Institutions (Amendment) Bill, 2022 is to amend the Micro Finance Deposit- Taking Institutions Act 2003 to provide for the use of the word "bank" by Microfinance Deposit Taking institutions; to provide for Islamic banking; to provide for bancassurance; to provide for agent banking, to provide for special access to the Credit Reference Bureau by other accredited credit providers and service providers; and for other related purposes.

#### 3.2 Justification for the Micro Finance Deposit-Taking Institutions (Amendment) Bill, 2022

The objective of the Micro Finance Deposit-Taking Institutions Act (MDI Act), 2003 was to provide for the licensing, regulation and supervision of micro-finance businesses in Uganda and to provide for related matters. At the time of the enactment of the MDI Act, 2003; it was considered adequate in ensuring that the micro finance business is better regulated than was the case prior to its enacting.

However, following the review of the Micro Finance Deposit-Taking Institutions Act, 2003, some provisions in the current legislation were found to be barriers to the new financial products development and innovations which are less costly and consumer driven. For instance, the Act does not permit for the conduct of Islamic banking which has become a popular form of micro-finance business especially because of its less reliance on interest. This is particularly significant for government which would benefit in terms of programme funding without having to incur huge fees.

Further, the Micro Finance Deposit-Taking Institutions Act, 2003 is lacking in terms of financial inclusion. The amendments contained in the Bill are intended to bring financial services closer to the people. For instance, the proposal to use micro finance institutions to sell insurance is a way of achieving financial inclusion for a large proportion of the population with less costs. Further, the Bill seeks to enable Micro finance institutions bring services closer to the people by the use of Agents who are not necessarily within the banking system.

### 4. Stakeholders' Views

#### 4.1. Amendment of Section 3 of the principal Act extending the application of the MDI Act to registered societies.

Section 3 of the principal Act states that the law applies to microfinance deposit taking institutions.

The Ministry of Finance seeks to extend the application of the MDI Act to registered societies (cooperative societies). The Ministry seeks to bring the SACCOs with institutional capital above Ushs. 500m and voluntary savings in excess of Ushs.1bn under the supervision of the Central Bank. The Ministry

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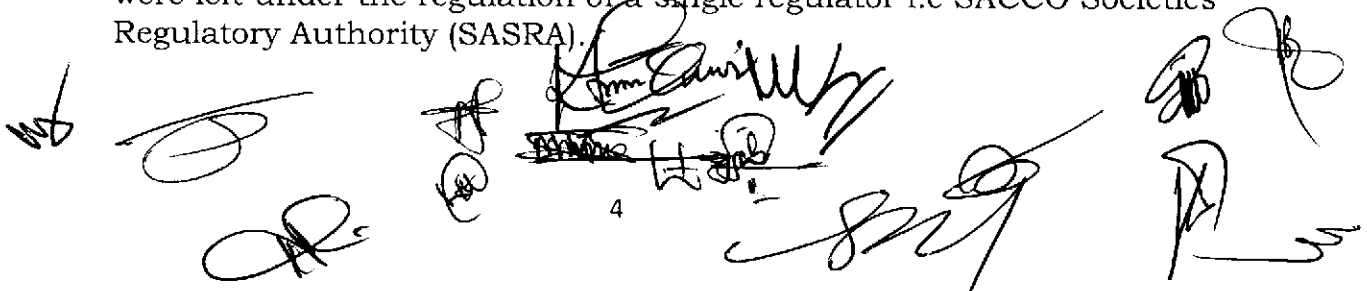


of Finance states that while SACCOs with a threshold of over 1Bn in savings and over 500m in institutional capital are practically under the supervision of the Central Bank, there is need to bring them under the ambit of the Central Bank through clear regulation.

The Ministry of Finance and the Central Bank are cognizant of the fact that the structures, modalities, operations and principles of SACCOs are different from those of the MDIs, however, they seek to bring the cooperative societies under the supervision of the Central Bank by including them in the MDI Act.

UCSCU presented the following arguments in their opposition of bringing SACCOs under the Microfinance Deposit Taking Institutions Act:

- 1) That if the SACCOs are brought under the supervision of the Central Bank through the MDI Amendment Bill, the provisions of the MDI Act would apply despite the fact that the 2 are set out on fundamentally different principles, that they seek to attain different goals and that their operations, structures, regulations and goals are not in tandem with those of the MDIs.
- 2) Secondly, the SACCOs were averse to being brought under the ambit of the central bank through the MDI Act because this is exacerbating the already existing challenges of having various legal regimes regulating, overseeing and supervising SACCOs. This only serves to create a retrogressive environment not just for the SACCOs but for all the players generally. The net effect of having multiple regulators with the Ministry of Trade, UMRA and now the Central Bank is leaving a disintegrated sub sector with no clear line of allegiance to a single regulator while at the same time creating a multiplicity of roles and reporting lines which will inevitably increase the cost of managing the SACCOs.
- 3) Thirdly, bundling up SACCOs with the MDIs will alter the SACCOs identity and values and at the worst, increase the cost of doing business which will essentially defeat the very fundamentals of SACCOs (what they stand for and who they serve). The representatives from the SACCOs' Union argued that the SACCOs are concerned with members' welfare and cooperation while the MDIs are more profit driven and speculative.
- 4) UCSCU noted the concerns raised by members of the Committee with regard to the oversight of the SACCOs especially safety of members' funds and the risks that the large SACCOs may present especially in the event of loss of members funds. They argued that similar concerns were raised in Kenya but all these were addressed and the SACCOs were left under the regulation of a single regulator i.e SACCO Societies Regulatory Authority (SASRA).



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- 5) Lastly, the SACCOs argued that pulling them under the MDI Act will not only detract them from their course but it will also create a gap between the large SACCOs and the small ones. The small ones may lose out on opportunities of mentorship and training from the large SACCOs since they will be bogged down with meeting the rigorous requirements of the Central Bank and will not have time to attend to the small SACCOs.

**4.2. Amendment of Section 5 of the principal Act permitting an MDI to use the word “Micro Finance Bank” after its name**

Section 5 of the MDI Act, 2003 and Section 7 of the Financial Institutions Act, 2004, restrict the use of the word “bank” to a bank licensed by the Central Bank to conduct banking business in Uganda.

The Financial Institutions Act defines a “bank” to mean any company licensed to carry on financial institution business as its principal business, as specified in the Second Schedule to the Act and includes all branches and offices of that company in Uganda. Financial institutions business is further defined in the Financial Institutions Act.

Clause 4 of the amendment Bill seeks to amend Section 5 of the Micro Finance Deposit Taking Institutions Act, 2003 and consequently Section 7 of the Financial Institutions Act to allow MDIs to use the word “bank” following their name. This will therefore allow MDI to be referred to as “Microfinance Bank”.

The Ministry of Finance, Planning and Economic Development argued that the word “Bank” is associated with safety and reliability. The MDIs stated that because they do not have the word “bank” they have lost their prospective and some existing customers who opt to deposit their money with the commercial banks that they perceive to be safer. These same customers, however, run back to the MDIs when borrowing or looking to raise funds for a project/business/meet quick pressure needs and all. This makes it hard for MDIs to mobilise deposits to match the borrowing demand.

This has in turn forced MDIs to borrow at very high interest rates from the commercial banks to be able to on lend to the customers. This has pushed the interest rates for the MDIs higher since they too have to cater for their mark up.

The MDIs argue that while they face rigorous regulation and have similar regulatory controls as the Tier 1 and Tier 2 financial institutions, their clients do not entrust them with the deposits but instead take them to Tier 1 and 2 banks.

They argue that allowing them to use the word bank will enable them to compete fairly with Tier 1 and 2 banks since they will be in a position to mobilise cheaper funds for onward lending at more affordable prices/rates.

They further stated that the public will be able to differentiate them from Tier 1 and 2 banks since they will be referred to as “Microfinance Banks”. This

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will further differentiate them from the Tier 4 Microfinance Institutions regulated under UMRA.

Bank of Uganda (BOU), while agreeing with the Ministry of Finance, noted that financial institutions in Tiers 1, 2 and 3 undergo similar regulatory controls under the Central Bank. The Bank determines their licensing, capital, corporate governance and equity requirements. They argued that their degree of regulatory compliance not only with the regulatory framework but with the international standards and Basel Principles is similar to that of Tier 1 and 2 banks.

The Association of Microfinance Institutions of Uganda (AMFIU), the umbrella organisation for MDIs, Uganda Bankers Association (UBA) and the Deposit Protection Fund noted that MDIs are disadvantaged without the word "bank" because their customers are sceptical about depositing their funds with them. The MDIs are confused with Tier 4 non-deposit taking financial institutions such as SACCOs and money lenders who are not under the stringent regulatory control of the Central Bank and have higher interest rates.

MDI's further argued that restricting the use of the word bank is a barrier to Uganda's savings culture. They informed the Committee that Uganda's savings culture is one of the lowest in Sub-Saharan Africa especially among the low income earners which is a serious impediment to further economic growth.

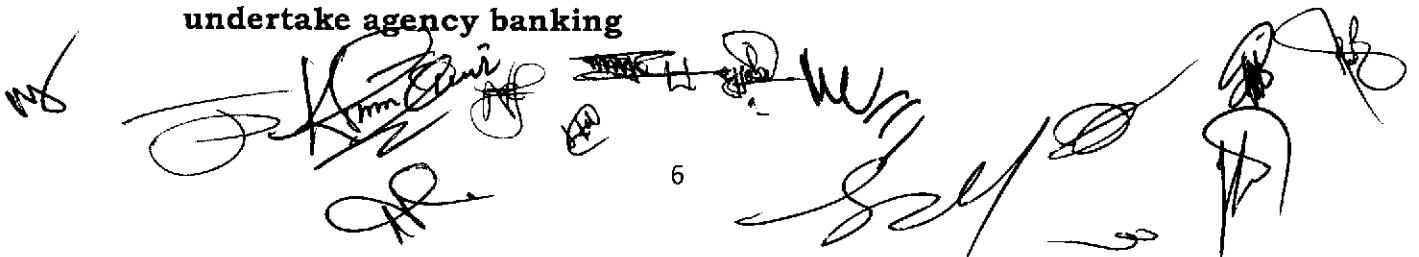
AMFIU informed the Committee that the barrier to savings among low-income earners has been their association of MDIs with limited regulation and governance compared to banks. However, no report or documentary evidence was provided to corroborate this.

MDIs also made the case that they provide banking services to customer segments that have been underbanked or typically excluded from conventional banking, and yet the absence of the word "bank" drives the urban, peri-urban and low-income earners away from the formal banking system into the informal systems to manage their money.

Lastly, BOU and MDIs further emphasized that other East African states use the word "bank" for their MDIs. Allowing the MDIs in Uganda to use the same will be in alignment with the rest of the East African States. The Central Bank cited examples of Kenya where they have Caritas Microfinance Bank Limited, Choice Microfinance Limited, Daraja Microfinance Limited and Kenya Women Micro finance Bank among others.

The MDIs, with the above arguments, prayed that the amendment to allow them to use the word "bank" which will foster public confidence in the MDIs and enable them deliver sustainable financial services to the lowly in society and aid in the alleviation of poverty.

#### **4.3. Amendment of the principal Act to authorise MDIs to undertake agency banking**



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The Ministry of Finance, Planning and Economic Development proposed the amendment of the principal Act to authorize MDIs to undertake agency banking.

The case advanced by the Ministry of Finance for agency banking was to bring financial services closer to the people and foster financial inclusion. While the benefits for agency banking have been enjoyed by the clients of Tier 1 and 2 banks with the 2016 amendment of the Financial Institutions Act, 2004, the same has not been experienced by the MDIs since the law has not been amended to allow them to have agents.

The Ministry noted that agency banking is akin to correspondent banking, where independent persons partner with a financial institution. With the introduction of agency banking there would be no need for MDIs to set up branches in order to reach customers. Instead, the agency banking allows as many financial institutions to plug into a singular network which allows them to reach as many customers as possible regardless of their locations. This in turn lowers the cost of doing business as it cuts down on the time for travel and the attendant costs and eventually eases doing business.

The implication of the amendment is that MDIs will be authorized to undertake agency banking. The Central Bank, in consultation with the Minister, shall make regulations in respect of agents and agent banking.

The Central Bank, in agreeing with the mover of the bill, informed the Committee that the amendment of the law to authorize MDIs to undertake agent banking will allow MDIs to serve hard to reach areas at a lower cost to institutions and customers.

MDIs informed the Committee that agent banking will present the following benefits;

- a) Reduce on the costs of business for small-scale farmers and rural businessmen. Agent banking will increase the number of brick-and-mortar branches or human touch distribution channels in rural areas.
- b) MDIs are unable to expand their outreach to the untapped customers in hard to reach areas. These customers will be easily accessible with the agent banking and will help remove bottlenecks of financial inclusion.

Without the agency banking, the Tier 1 and 2 banks have an unfair advantage over the Tier 3 MDIs. The Amendment therefore will not only expand the customer base for MDIs but it will also create a level playing field for the Tier 1, 2 and 3 institutions and create fair market competition.

#### **4.4. Amendment of the principal Act to authorize MDIs to undertake bancassurance**

The Ministry proposed the amendment allowing for provision of insurance services and products as well as empowering the Central Bank to review and

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approve any such services and products offered by MDIs, also referred to as bancassurance.

The Ministry added that MDIs have expressed interest in offering insurance products alongside their traditional products. However, the prevailing framework does not provide for the MDIs' desire to offer insurance products.

MDIs argued that the prohibition of bancassurance services is a barrier to uptake of insurance among low-income earners, and as such a hinderance to Government's financial inclusion efforts. Therefore, the Ministry prayed that the MDIs are allowed to offer bancassurance services and products which will enable penetration of insurance into hard to reach places.

#### **4.5. Amendment of the principal Act to authorize MDIs to undertake Islamic Banking**

The Ministry of Finance, Planning and Economic Development informed the Committee that the amendment of the principal Act to authorize MDIs to undertake Islamic Banking is to extend the opportunity accorded to the financial institutions under Tier 1 and 2 to offer Islamic banking.

The Central Bank emphasized the fact that the entities that opt to practice Islamic Banking will still be required to meet all the requirements set out in the laws and regulations under which they are set up and supervised/governed.

The Central Bank made the following submissions on Islamic banking to the Committee;

##### **a) Parameters of Islamic Banking**

In defining the parameters of Islamic Banking, Central Bank noted that Islamic banking is a system of banking which is consistent with Islamic faith morals and principles. These principles can be categorized into four; prohibition of interest on financial transactions, prohibition of speculation or gambling, mutual risk sharing between the bank and the customer, and prohibition of investment in businesses that contravene shari'ah law, such as alcohol.

##### **b) Deposit Mobilisation Structure of Shari'ah Financial Institutions**

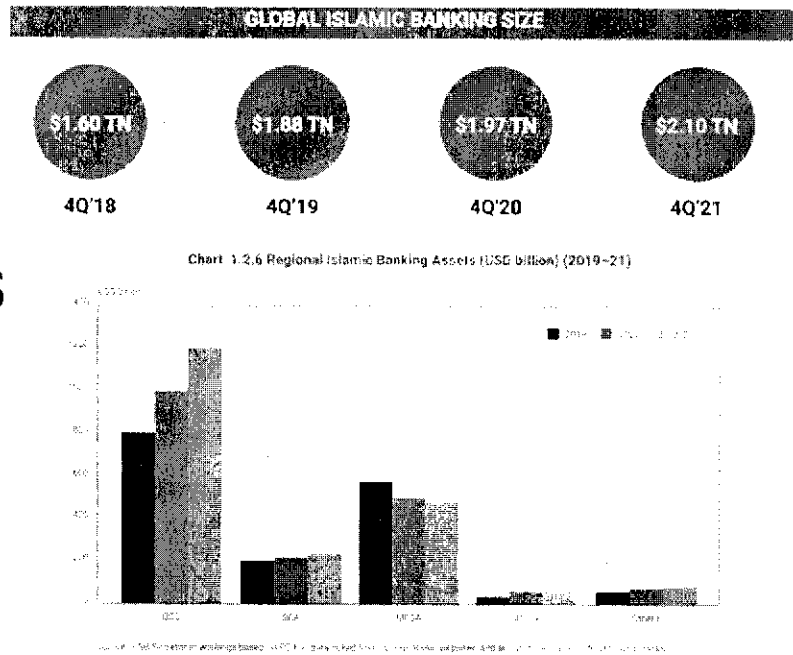
BOU elaborated on the deposit mobilisation structure of Islamic Banking, noting that there are three broad categories of bank accounts under Islamic Banking. These are; non-interest-bearing accounts, similar to current accounts in the conventional banking structure; profit-earning investment accounts, similar to savings accounts in conventional banking except that the depositor is paid profit not interest; and profit-sharing investment accounts, similar to fixed deposit accounts, wherein the depositor shares in the profits arising from projects financed by the Sharia Financial Institution and in the losses incurred.

##### **c) Global growth trends of Islamic banking**

The Central Bank further highlighted the global growth in Islamic Banking over the last four years from 2018 to 2022. Globally, Islamic banking has

grown from USD 1.6 Trillion in 2018 to USD 2.10 Trillion in 2021. Regionally, Kenya leads in Islamic Banking, with 1% of its total banking assets held through Islamic banking.

## GLOBAL STATISTICS



### d) Licensing of Shari'ah Financial Institutions

The Central Bank informed the Committee that through the amendment of the MDI Act, Islamic banking would be offered through fledged MDIs (granting licenses to new applicant) or via licensing existing MDIs to offer the service through a dedicated Islamic Banking window for MDIs that wish to offer both the conventional banking as well as Islamic banking.

### e) The regulatory framework for Islamic Banking under the Financial Institutions Act, 2004.

The Central Bank informed the Committee that the Financial Institutions (Amendment) Act, 2016 was passed in January 2016, paving the way for Islamic banking in Uganda. The new law amended Sections 37 and 38, and introduced Section 115 (A) and (B). Section 37, prohibiting financial institutions from engaging in trade and commerce, was amended to authorise banks to undertake the same through the Islamic banking window. Section 38, restricting acquisition of immovable property by financial institutions was amended to permit banks to acquire immovable property through the Islamic window, while Section 115 (A) and (B) was inserted into the Financial Institutions Act to empower the Central Bank to license Islamic Financial Institutions and to constitute a Sharia Advisory Board at the Central Bank. The section also for a Central Sharia Advisory Board under the Bank of Uganda to supervise SFI's and approve Islamic banking products on behalf of the Bank of Uganda.

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**f) Financing Arrangements under Islamic Banking**

There are four categories of financing arrangements under Islamic banking;

- i) **Partnership financing.** Under partnership financing, assets are owned by the Financial Institution and the customer. The Financial Institutions' portion is sold to the customer over the term or on conclusion of the contract.
- ii) **Equity-base financing.** Here, capital is provided by the Financial Institution and managed by the customer. The profits arising from such management of capital are shared between the Financial Institutions and the customer.
- iii) **Lease-based financing.** Assets are purchased by the Financial Institution and leased to the customer. These are akin to leases in conventional banking.
- iv) **Sale based financing.** Assets are purchased by the Financial Institution and sold to the customer at a mark-up. The customer thereafter pays for the asset in installments.

**g) Supervisory Approach for Islamic Banking.**

The Central Bank informed the Committee that its broader regulatory approach focuses on addressing the risks to the soundness of financial institutions since Islamic banks are exposed to the same risk as conventional banks except for Sharia compliance risk. Therefore, Financial Institutions conducting Islamic financial business will be expected to comply with the same rules and regulations as conventional financial institutions.

**h) The Shari'ah Advisory Board**

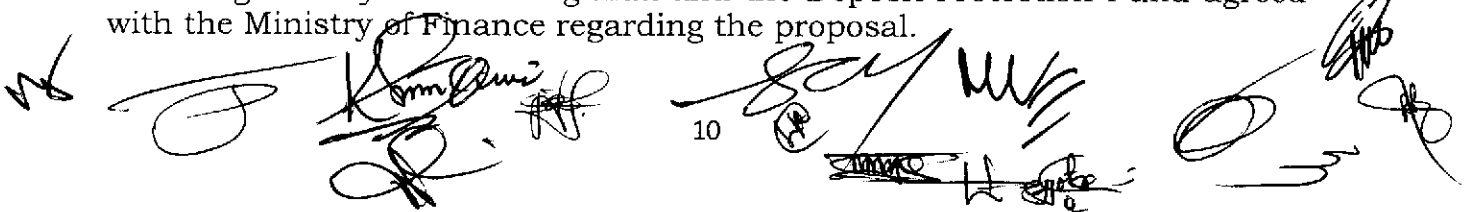
All financial institutions conducting Islamic Banking are required to appoint a Shari'ah advisory Board to assist the bank in ensuring compliance of its operations with Islamic principles.

In addition to the above, Uganda Bankers Association informed the Committee that since tier 1 institutions are allowed to provide Islamic banking, the unlevelled playing ground creates negative perceptions on microfinance institutions and their soundness and safety to provide a wide range of financial services.

**4.6. The Deposit Protection Fund as a separate legal entity**

The Ministry of Finance, Planning and Economic Development noted that the recognition of the Deposit Protection Fund (DPF) as a separate legal entity and merging MDI-DPF with Financial Institutions (FI)DPF follows the enactment of the Financial Institutions (Amendment) Act, 2016, incorporating provision requiring MDIs to contribute to the new entity, and the computation of premiums.

Therefore, the implication of this amendment is that it will address the conflicting sections of the MDI Act vis-à-vis the Financial Institutions (Amendment) Act 2016, by bringing Tier 3 institutions under the ambit of DPF as a single entity. Bank of Uganda and the Deposit Protection Fund agreed with the Ministry of Finance regarding the proposal.



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**4.7. Increase of the single borrower credit limit from 1% to 2% of core capital.**

The Ministry of Finance informed the Committee that the Bill seeks to increase the single borrower credit limit for a single borrower from 1% to 2% of the core capital. This increase is also a reflection of the growth that the MDIs have undergone.

The Ministry justified the proposal by noting that this will ensure that a borrower will be in position to access more funds from an MDI who will have more for lending to a single borrower given the increase in the core capital as well.

MDIs further informed the Committee that most of their core capital has increased since the enactment of the Micro Finance Deposit-taking Institutions Act in 2003. Therefore, the 1% increment is, as a proportion of their total asset base, large enough to have an impact on the amount of resources available for credit at their disposal. For example, Pride Microfinance Bank noted that their capital base is large enough for them to qualify for tier 2 licensing.

**4.8 Restrictions on significant shareholders participating in the day-to-day management of an MDI**

The Ministry proposes that significant shareholders should be barred from participating in the day-to-day management of MDIs. This is meant to promote international corporate governance principles, foster independence of the institutions from their owners, and to avoid coercion, undue influence and coercion in the decision making process of the institutions and finally to minimise conflict of interest situations.

**4.9 Amendment of Section 21 of the Principle Act to limit the amount of shareholding in an MDI from thirty percent to twenty-five percent**

The Ministry of Finance proposes to limit the amount of shareholding in an MDI for a single shareholder from thirty percent to twenty five percent.

The implication of this proposal is that any person or group of persons holding shares jointly in an MDI shall have to offload the excess of any shares beyond 25 percent, and any new shareholders shall not be authorised to hold more than twenty five percent of shares in an MDI.

The Ministry informed the Committee that this amendment is meant to align the law with international best practice and with the Basel Core Principle 6 relating to the transfer of significant ownership.

**4.10 Lowering the threshold for significant shareholding from 10 percent to 5 percent.**

In addition, the Ministry proposes that threshold for significant shareholders is lowered from 10 percent to 5 percent.

The implication of this proposal is that any person or group of persons holding more than 5 percent of shares in an MDI shall have to seek approval from Bank of Uganda prior to the purchase.

The Ministry, with endorsement from the Central Bank, informed the Committee that this proposal will align the law to international best practice.

**4.11 Limiting the tenure of office for a director to two terms**

The Ministry proposes that the tenure of office of a director of an MDI to two terms, with each term lasting five years. The implication of this proposal is that no Director will be Director in the same entity for more than 10 years.

**4.12 Prohibition from cross-directorship**

In addition, the Ministry seeks to prohibit directorship in more than one MDI. The implication of this proposal is that directors will not be able to belong to more than a single Board of Directors of MDIs; a fundamental pillar for good corporate governance.

**4.13 Amendment of Section 27 to explicitly provide for conflict of interest in governance of an institution**

The Bill further proposes to amend Section 27 to explicitly provide for conflict of interest in governance of an institution.

## 5) Observations and Recommendations of the Committee

### Issue 1:

#### **Amendment of Section 3 of principal Act to extend application of the Microfinance Deposit Taking Institutions Act to registered societies (cooperative Societies)**

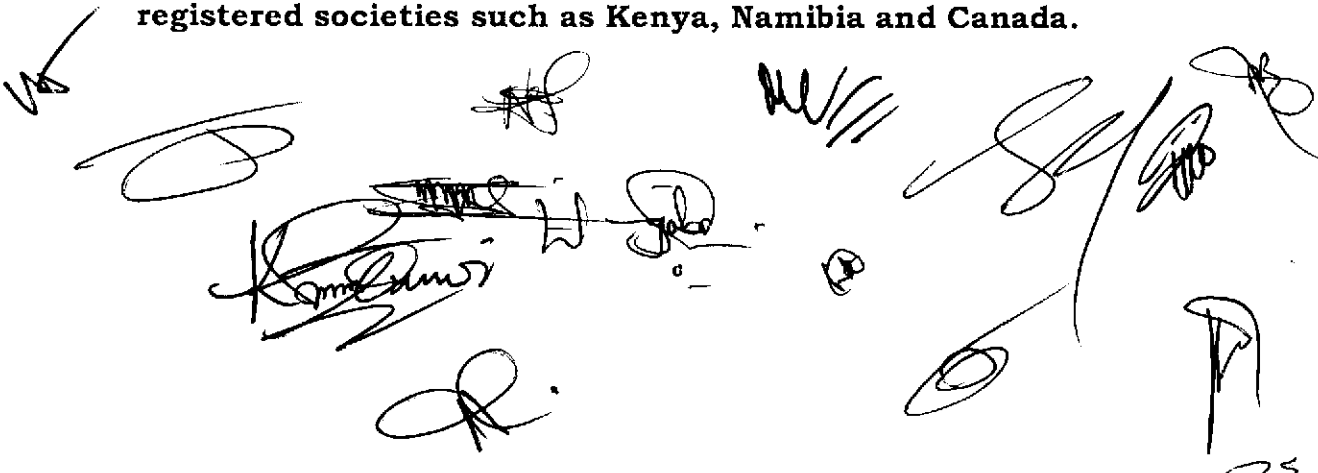
The Committee observed that while the movers of the Bill sought to bring the registered societies, which have been defined as cooperative societies under this Act, they were cognisant of the fact the registered societies and the MDIs were fundamentally different right from their structures, operations, goals and general regulatory framework.

The Committee agreed with Ministry of Finance, the Central Bank and UCSCU that the principles, structures and mode of operation for the SACCOs were fundamentally different from those of the MDIs. The Committee further observed that in fact it was erroneous for the registered societies to be brought under this Act given the cited differences.

While the committee was cognisant of the need to have rigorous supervision and oversight especially for the large SACCOs, they observed that bringing them under the MDI Act was not the ideal situation. The Committee proposes that particular attention should be paid to SACCOs especially the large ones given the risks they may face or they may pose. The Committee advised that the either a more rigorous regulatory regime be set out for the SACCOs or have the oversight role shifted to the Central Bank but under a different law not the MDI Act. The Committee noted that there is need for further benchmarking especially with Kenya to appreciate how the SACCOs have been handled to cover all the possible loopholes noted with their governance and supervision.

### **Recommendations**

- 1) **The Committee recommends that Clause 2 amending Section 3 of the principal Act is amended by deleting registered societies.**
- 2) **That the Committee carries out a study visit to countries with robust registered societies to appreciate the regulation of registered societies such as Kenya, Namibia and Canada.**



**Issue 2:**

**Amendment of Clause 5 of principal Act permitting an MDI to use the word "Micro Finance Bank" after its name**

The following issues and proposals were raised by Members in regard to the use of the word "bank" by MDIs;

- a) Whether or not the MDIs apply the same degree of rigour as Commercial banks in conforming with international banking standards including the Basel I, Basel II, Basel III and International accounting standards as to permit the use of the word "bank" in their names.**

The Committee observed that commercial banks have higher capital and equity requirements for licensing as to justify the use of the word "bank", as compared to MDIs. The Financial Institutions (Revision of Minimum Capital Requirements) Instrument, S.I No. 30 of 2022 set the minimum capital requirements for financial institutions at Shs150bn and for the MDIs at Shs10bn.

The Committee raised concern that the difference in capital requirements may imply more rigour in the requirements for establishing and operating a tier 1 financial institution, as compared to an MDI, and that referring to both as "banks" may be misleading on that front.

However, the Uganda Bankers' Association, Bank of Uganda, MDIs, UMRA and the Ministry of Finance assured the Committee that other than paid up capital requirements, MDIs face the same degree of rigour and scrutiny from Bank of Uganda and follow the same local and international standards of operation before they are licensed.

MDIs further differentiated between "bank" as applied to Tier1 Institutions, and "microfinance bank" as proposed in Clause 4 (b) (2) of the Bill. The MDIs stated that since the Banks are tiered, they will be able to differentiate between Tier 1, 2 and 3 since the Microfinance deposit taking institutions will be referred to as "Microfinance Banks".

- b) Whether adding the word bank to MDIs will have an effect on the interest rates**

The Committee observed that the MDIs were emphatic on using the word bank because this will enable them to mobilise deposits. With the increase in deposits, the MDIs will not have to borrow from commercial banks, which has been the practice, but rather mobilise the same deposit for onward lending. With the mobilization of deposits for onward lending, the MDIs will be able to lend at lower interest rates. This will not only boost access to capital for the low income savers and earners but will encourage financial inclusion and further spur economic growth.

- c) Whether using the word "bank" shall not be misleading to the average Ugandan**

The Committee expressed concern that when MDIs use the word "bank" they may mislead customers who will assume that interest rates and stringent requirements that apply to banks will apply to MDIs too.

However, this was rebutted by the Uganda Bankers Association and MDIs, who argued that to the contrary, this will help customers to differentiate MDIs regulated by the Central Bank from those regulated under Tier 4 by the Uganda Microfinance Regulatory Authority.

The MDIs felt strongly about differentiating them from the Tier 4 microfinance institutions. While being called Microfinance Banks will differentiate the Tier 1 and 2 from the Tier 3, it will also help differentiate them from Tier 4 microfinance.

The MDIs claim that the Tier 4 entities have exorbitant interest rates and that their regulation is not as rigorous as the Tier 3 Microfinance institutions, with the perception from the "public" that the banks boost confidence for the public thus the need to be differentiated but be allowed to use the word "bank".

**d) Whether or not existing MDIs as regulated by the Central bank cannot be upgraded to Tier 1, while prohibiting new applicants for Tier 4 financial institutions from using the word "bank".**

There was a proposal by the Committee to upgrade existing MDIs to Tier 1 institutions, as opposed to permitting all MDIs to use the word "micro finance bank" in their name. However, the Ministry of Finance and Bank of Uganda pointed out that this would be more complex as it would require them to raise their paid up capital, or reduce the paid up capital of all tier 1 institutions. That while they may be regulated with the same rigour, the MDIs do not have the capacity to upgrade and meet the minimum capital requirements of the Tier 1 banks (commercial banks).

**e) Whether products/financial services proposed to be availed to MDIs by the Bill including agency banking and bancassurance cannot be offered without the inclusion of the word "bank" in their names.**

The products proposed by the Bill to be extended to MDIs including agent banking, bancassurance and Islamic banking can be offered without the use of the word "bank".

MDIs and the Uganda Bankers Association explained to the Committee that the use of the word "bank" is not only to allow MDIs to offer the above-mentioned financial products and services, but also to change the perception of the public that regulated MDIs cannot offer the same degree of safety and reliability as Tier1 financial institutions.

**f) Whether the words "banking-affiliated institutions" cannot be applied to the MDIs, as opposed to using the word "bank".**

The Committee suggested the use of the word "banking-affiliated institutions" for MDI, as opposed to "bank". This too, according to MDIs, would defeat the

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objective of using the word “microfinance bank”, which is to build confidence in the safety and reliability of MDIs.

**Recommendation**

**The Committee recommends that Clause 4 amending Section 5 of the principal Act be maintained in the Bill.**

**Issue 3**

**Amendment of the principal Act to authorise MDIs to undertake agency banking**

The Committee observed that MDIs offering agent banking is a welcome proposal as it would come with the following benefits;

- a) Reduce on the costs of businesses for small-scale farmers and rural businessmen. Agent banking will increase the number of brick-and-mortar branches or human touch distribution channels in rural areas. For example, in Pakwach District, Centenary Bank, a famously rural-oriented bank has no presence, and as such, small-scale business people have to travel to distant districts to deposit their incomes, which increases the overall cost of business.
- b) The agency banking will help to bring services closer to the people. The Committee further noted that without agent banking, MDIs are unable to expand their outreach to the untapped customers in hard-to-reach areas, who would otherwise have been accessed by agents. This creates a bottleneck for financial inclusion efforts by Government.
- c) There is also a likelihood of creation of linkages between the agents and the beneficiaries of government programmes such as Parish Development Model (PDM). With the agents for microfinance, the beneficiaries of PDM will be able to access and deposit funds which will make deployment of funds easier.
- d) Further, the agency banking will assist with immediate deposit and withdraw of funds which will assist in reduction of insecurity which may arise due to individuals keeping money in their houses.
- e) The access to agents will also reduce on diversion of funds since there will be an easier avenue of accessing or depositing money.

**Recommendation**

**The Committee recommends that the principal Act be amended to authorise Microfinance Deposit Taking Institutions to undertake Agent Banking.**

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**Issue 4:**

**Amendment of the principal Act to authorise MDIs to undertake bancassurance**

The Committee observed that the Bill seeks to amend the principal Act to authorise MDIs to undertake bancassurance.

The expansion of insurance services to MDIs shall promote an uptake in micro insurance among low-income earners. Recommendation 7.5.3 of the Country diagnostic report on market and regulations of micro-insurance in Uganda undertaken by Bank of Uganda's Financial System Development Programme in November 2013, proposed that Government should engage with the Central Bank concerning the use by the Bank of its existing powers under the Micro Finance Deposit-Taking Institutions Act to permit Tier 3 financial institutions to sell micro-insurance.

With the current insurance penetration levels in the country at a measly 2%, permitting MDIs to offer bancassurance services shall ensure its growth. The net benefit of authorising bancassurance by MDIs, according to the country diagnostic report, is to enable affordable and accessible premiums for low-income earners.

The legal and regulatory framework has not been sufficient to permit MDIs to sell micro-insurance to low-income earners. The MDI Bill seeks to authorise MDIs to undertake bancassurance in a manner prescribed by the Central Bank and the Insurance Regulatory Authority.

**Recommendation**

**The Committee recommends that the principal Act be amended to authorise Micro Finance Deposit-taking Institutions to undertake bancassurance.**

**Issue 5:**

**Amendment of the principal Act to authorise MDIs to undertake Islamic Banking**

The Committee observed that Islamic Banking as an alternative to traditional banking has its intended benefits that low-income and rural savers and borrowers are currently excluded from accessing.

The key benefit of Islamic Banking over conventional banking is that while conventional banking treats money as a commodity and lends it against interest and compensation, Islamic Banking products are usually asset-backed, and as such involve trading of assets, renting of assets, and participation of parties on a strictly profit and loss basis.

The Committee noted that Islamic Banking therefore shall implicitly require MDIs to undertake financial literacy programmes with their customers if they are to remain relevant in the Islamic banking space, or risk suffering the same losses as their customers.

Islamic banking will further propel asset-based micro-economic growth among rural and peri-urban savers, whose assets will be the only way to access interest-free financing from MDIs engaged in Islamic banking.

The Committee however raised concern about the availability of sharia experts to sit on the Sharia Advisory Boards of all MDI's in the country, especially as micro-finance continues to expand and take root in the grassroots.

Authorities from Uganda Bankers Association gave an example of Nigeria, where micro-finance has expanded to the extent that some MDIs hold larger assets than Tier 1 institutions, and the number of MDIs continues to expand more than Tier 1 institutions. Though such a scenario of increased presence of MDIs is welcome, there would consequently be a scramble for the few sharia experts that are present to sit on the sharia advisory boards of MDIs. This is likely to stifle the growth of Islamic banking in the country.

The Committee therefore advised the Central bank to identify and promote Islamic sharia experts in the country

**Recommendation**

**The Committee recommends that the principal Act be amended to authorise Micro Finance Deposit-taking Institutions to carry out licensed Islamic Banking.**

**Issue 6:**

**Regulation and Supervision of Registered Societies (Cooperative Societies) by the Central Bank**

The Committee observed that Section 110 (c) of the Micro Finance Institutions and Money Lenders Act 2016 amended the Financial Institutions Act 2003, requiring registered societies in which the voluntary savings of the registered

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society are in excess of one billion five hundred million shillings; or the institutional capital of the registered society is above five hundred million shillings, to apply to the Central Bank for a license to operate.

The Committee observed that this was adequately addressed issue 1 and that consequently this amendment is rejected due to the deletion of registered societies from the application provision/ section.

### **Recommendation**

**The Committee recommends that the proposed clause on the application of the Cooperatives Act be rejected.**

### **Issue 7:**

#### **Application of the Cooperatives Act 2020**

The Committee observed that there is a proposal to introduce a new section in the MDI Act 2003 setting the extent to which the Cooperatives Act 2020 can apply to Registered Societies.

The new section as proposed by the Ministry is supposed to ensure that the Cooperatives Act 2020 only applies to the following aspects of a Registered Society/SACCO regulated under the MDI, Act;

- a) Governance of a SACCO;
- b) Investment of funds in a SACCO;
- c) Issuance of dividends or bonuses of a SACCO;
- d) Operation of a reserve fund of a SACCO;
- e) Operation of a share transfer fund of a SACCO;
- f) Contribution to the Education Fund.

Further, the new proposed section stipulates that any act required to be undertaken by the registrar under the Cooperatives Act 2020 for a SACCO regulated under by the MDI Act shall be undertaken by the Central Bank.

The Committee observed that this was adequately addressed issue 1 and that consequently this amendment is rejected due to the deletion of registered societies from the application provision/ section.

### **Recommendation**

**i) The Committee recommends that the proposed clause on the application of the Cooperatives Societies Act be rejected.**

### **Issue 8:**

#### **Reduction in number of shares owned by a single shareholder in an MDI**

The Committee observed that there is need to limit the amount of shares owned by a single shareholder to 25% from the current 30% prescribed in the principal Act.

The Committee noted that concentrated shareholding among MDI's poses a higher risk to customers. It is therefore best international practice and aligns

with Basel core principle 6 relating to significant ownership, to limit the number of shares owned by the largest shareholder in an MDI to 25%.

The Committee was however cognizant of the challenges current shareholders who own more than 25% of shares may face in offloading the excess shares on the local and global markets, especially since the global economy is urgently experiencing a slowdown.

Therefore, caution must be exercised by Government to ensure that the provision is applied in a phased manner, permitting a time-period within which any existing shareholder owning more than 25% may off-load the excess shares on the market.

### **Recommendation**

**The Committee recommends that Section 21 of the principal Act be amended limiting the number of shares a person or group or related persons can own in a Micro Finance Deposit-taking Institution, from 30% to 25%.**

### **Issue 9**

#### **Constitution of the Board Audit Committee**

The Committee observed the need to include a new subsection, under Section 22 of the MDI Act, 2003, requiring MDIs to constitute a Board Audit Committee among its members.

The Board Audit Committee shall consist of not less than two persons to perform such functions as the Board of Directors may specify.

The Committee further noted that all directors employed by the financial institutions in any other position except that of director, should be disqualified from serving on the committee on audit.

The Committee noted that this proposed amendment shall legitimize the Consolidated Corporate Governance Guidelines as issued by the Bank of Uganda in October 2022 whose aim is to reinforce sound corporate governance principles among financial institutions under its supervision, including MDIs.

### **Recommendation**

**The Committee recommends that Section 22 of the MDI Act, 2003 be amended to include a new section requiring MDIs to constitute a Board Audit Committee among its members.**

### **5. Conclusion**

**The Committee recommends that the Micro Finance Deposit-taking Institutions (Amendment) Bill, 2022 be passed with necessary amendments as reflected in the Report.**

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**PROPOSED AMENDMENTS TO THE MICRO FINANCE DEPOSIT-TAKING INSTITUTIONS (AMENDMENT) BILL, 2022**

**Clause 1: Amendment of Act 5 of 2003**

Clause 1 is amended in paragraph (j) by deleting the definition of “registered society”

**Justification**

Consequential amendment to the deletion of “registered societies” from the application of the Microfinance Deposit Taking Institutions Act, 2003.

**Clause 2: Amendment of section 3 of principal Act**

Clause 2 is amended by deleting the words “and registered societies”.

**Justification:**

To restrict the application of the Microfinance Deposit Taking Institution Act, 2003 to only Tier 3 MDIs.

**Amendment of section 80 of principal Act**

The principal Act is amended by substituting for section 80 the following-

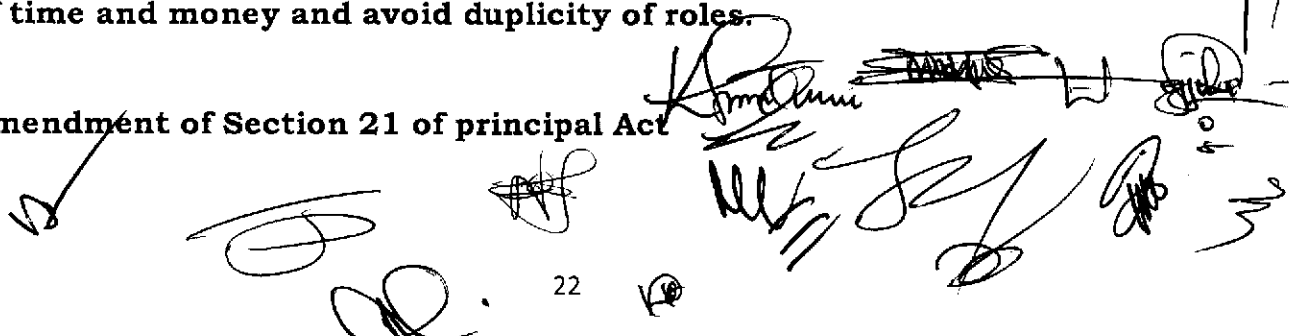
- (1) All Microfinance deposit taking institutions shall contribute to the Fund established under Part XII – The Deposit Protection Fund of the Financial Institutions Act, 2016
- (2) The object of the Deposit Protection Fund shall be to compensate depositors for losses incurred by them in the event of the insolvency of an institution.

The DPF of the MDI is merged with that of the FIA to minimize the cost of establishing a new one and avoid duplicity of roles by having a single entity.

**JUSTIFICATION**

**Align with the Deposit Protection Fund established under the Financial Institutions (Amendment) Act, 2016 and the Financial Institutions Deposit Protection Fund Regulations S.I No. 96 of 2019. This will leverage on the existing systems and staff and minimize costs in terms of time and money and avoid duplicity of roles.**

**Amendment of Section 21 of principal Act**



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Section 21 of the principal Act is amended-

(a) in sub section (1), by substituting for the word “thirty” the words “twenty – five”;

(b) by inserting immediately after sub section (1) the following-

“(1a) A person or group of related persons who before the commencement of this Act holds more than 25% of shares in an institution shall within three years from the date of commencement of this Act reduce their shareholding in the institution or controlling company to the percentage prescribed in sub section (1)”.

(c) repealing sub section 2.

### **Justification**

To align the percentage ownership of shares in an institution with international best practices and the Basel Core Principles relating to significant ownership.

### **Insertion of new clause**

**Immediately after section 22 of the principal Act, insert the following-**

#### **“22A. Audit Committee**

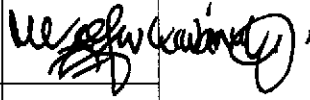
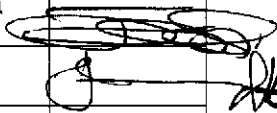
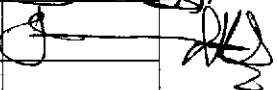


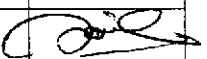
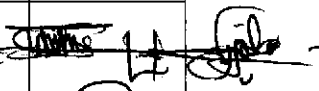
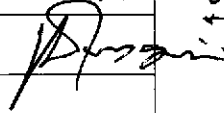
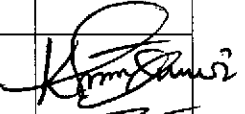




(1) There is established a board audit committee comprised of three independent non-executive directors, the Executive Director and a non-executive director who are persons of integrity.

(2) The audit committee shall serve for a term of three years, renewable once.

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**COMMITTEE ON FINANCE, PLANNING AND ECONOMIC DEVELOPMENT ;  
REPORT ON THE MICROFINNACE DEPOSIT-TAKING INSTITUTIONS  
(AMENDMENT) BILL, 2022**

NO	NAME	CONSTITUENCY	SIGNATURE
1	<b>Dr. Keefa Kiwanuka C/P</b>	<b>Kiboga East County</b>	
2	<b>Hon. Avur Jane Pacuto D/CP</b>	<b>DWR Pakwach</b>	
3	Hon. Wamakuyu Ignatious Mudimi	Elgon County	
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7	Hon. Asimwe K Enosi	Kabula County	
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10	Hon. Tayebwa Herbert Musasizi	Kashongi County	
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14	Hon. Nangoli Gerald	Elgon North County	
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17	Hon. Opolot Patrick Isiagi	Kachumbala County	
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23	Hon. Nandala Mafabi	Budadiri West County	
24	Hon. Kalule Flavia Nabagabe		
25	Hon. Akol Anthony	Kilak North	
26	Hon. Luttaguzi Semakula P.K	Nakaseke South	<i>SA</i>
27	Hon. Ocan Patrick	Apac Municipality	<i>Andrew</i>
28	Hon. Omara Paul	Otuke County	
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30	Hon. Aciro Paska Menya	DWR Pader	
31	Hon. Masaba Karim	Mbale, Industrial Division	