St. Mary's University Collage
Faculty of Law

LB Thesis

The Law and The Practice Relating To The Competency of National Bank of Ethiopia in the Context of Banks Supervision.

By Mengistu Eshete

ID No RLD0123/98

Addis Ababa, Ethiopia

July, 2009

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Submitted in Partial fulfillment of the Requirements for the Bachelors of Law (LLB) at the Faculty of Law, St. Mary's University College

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July, 2009

I here by declare that this paper is my original work and I take full responsibility for any failure to observe the conventional rules of citation.

Name ______Mengistu Eshete______

Signature ________________________

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Background of the Study

The formation of financial institutions are much more related with the different business activities which were conducted in the early 11th century in the northern Italian cities of Genoa, Florence and Venice. Money changing , money lending and deposit taking businesses were some of the roots of current banking system lie. These business activities which the then financial institution like Monte Vecchio, the oldest bank founded in Venice in 1156, were discharging their functions not in a well organized manner. The lending system which banks followed and the supervision which they conducted at that time had problems. For instance, bank predominantly grant credit to the government. This had negative impact on the economy. In addition to this, supervision was conducted by individual like Fredrick the Great of Prussia. This and other related problems necessitated for the establishment of Central bank. As the Banking business needs pertinent laws and supervision in order to benefit the economy of a country. For this reason central banks can play a great role to benefit the economy in many ways if we create good conditions that enable banks to undertake their duties.

When we turn to Ethiopia, private banks are flourishing rapidly in the past few years. The government giving due regard to this growing industry amended the National Bank of Ethiopia's establishment proclamation no 591/2008. The objective of this paper is to examine the competency of NBE in relation to its powers and duties stated in article 5 of proc. no 591/2008 specifically supervising the different activities of banks, the measure it takes to ensure healthy financial system.

Statement of the Problem

To begin with, there is no literature (commentary) that duly explains the law on the competency of the National Bank of Ethiopia. Many scholars, professional bankers ,borrowers(investors)etc complain(allege)that the National Bank of Ethiopia issues directives regulate matters beyond its jurisdiction and which falls under the competency of the Federal Legislative organ of Ethiopia. They further argue that some of the directives of the National Bank of Ethiopia are not only tightly regulate the financial sector but unduly chain banks not to undertake their business properly. The laws or the directives relating to the banking business negatively affect the share holders, the directors and the employees of banks and also borrowers of banks and the banks themselves. Hence, the legal and practical problems surrounding the competency of National Bank of Ethiopia call for a thorough legal research.

Objectives of the Study

The general objective of the study is to evaluate the legal and practical aspect of the competency of the National Bank of Ethiopia (NBE) in supervising banks of the country.

General Objectives

The general objective of this paper is to explain how the National Bank of Ethiopia supervises banks, excluding developmental bank in Ethiopia, and the legal and practical problems related with the competency of NBE to supervise Banks.

The specific objectives

- To assess the competency of National Bank of Ethiopia
- To evaluate how effective NBE is in undertaking its functions
- To show the variance between the law and the practice.
- To propose a solution that do support the endeavor of the nation Bank

Significance of the Study

For Ethiopia to meet its developmental needs catch up with middle income economy, mobilizing its financial resources at full level is imperative. To this effect however, there should be a strong financial system with practically applicable legal framework. The sole right and responsibility of monitoring financial institution of the country is rested up on National Bank of Ethiopia (NBE). The Bank has a supervisory role over the financial institution apart from providing them with licenses. By taking into account the prime objectives of financial institution it is also expected to be equitable and reliable from legal view point. At this juncture however, a question like “Is NBE competent enough to work according to the law?” may bear in to ones mind. Though it is crucial to make independent analysis by raising questions like little has been done showing that there is a gap in literature. This research with therefore help to fill these gaps. It can also serve as a good start to initiate other researchers to come up with more researches.

Scope of Study

National Bank of Ethiopia , is the highest financial institution to perform supervisory role over other financial institutions of the country. Taking this into account, it is crucial to examine the competency and effectiveness of NBE from legal point of view. The scope of this research is the competency of NBE.

Methodology and Data Source

The researcher will use the law and its interpretation as the main source in this research. Other sources also will be employed in this research such as books, newspapers, internet websites and some other things to search in depth. In general, the major sources are both published and unpublished materials.

Organization of the Study

This paper is organized in for chapters. Chapter one describes all the issues related to the research background of the study, statement of the problem, the objective of the research that is both the general and the specific, significance of the study, scope of the study, methodology and data source, organization of the study etc . Chapter two describes the organization, management, functions, relations of the NBE with the government, banks, insurance companies, and other financial institutions. Chapter three is devoted to the discussion with regard to the competency of the National bank in relation to issuing of directives and to what extent that the NBE issues directives and how much the existing laws of Banking business proclamation and the directives provides favorable conditions to share holders, the directors and employees of banks, borrowers of banks and the bank themselves. The last chapter, chapter four, makes a concluding remark based on the discussion.

Cost of the Research

Budget	In Birr
-Total amount of expenditure	2500.00
-Computer access and binding	1000.00
-Photocopy	1000.00
-Expenditure during interview and different cost	200.00
-Internet expense	300.00

Request for Approval

I sincerely request you to approve for any comment.

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Preliminary Bibliography

-Wernhard Moschel,Commercial Transactions and Institution.

-Dimitri B. Papadimitriou, Modernizing Financial Systems, Macmillan Press LTD.

-Supervision and Surveillance, The Powers of the Financial Services.

National Bank of Ethiopia Directives

-Financial Market Regulation

Request for Approval

I sincerely request you to approve for any comment.

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Powers Accorded to National Bank Ethiopia

Art. 4 of proclamation no 991/2008, a proclamation to amend the National Bank of Ethiopia establishment percolamtion, states the purpose of the National Bank of Ethiopia. It says, "(….) to maintain stable rate of price and exchange, to foster a healthy financial system and to undertake such other related activities as are conducive to rapid economic development of Ethiopia." Art. 4 In order to fulfill such purpose of the bank the proclamation which is stated hereinabove granted powers and duties to the national Bank of Ethiopia. The focus of this paper under this topic is to see powers which are accorded to the national bank of Ethiopia

It is good to see powers accorded to the National Bank in line with the core principles for effective banking supervision which are adopted by the basel committee. This is because the core principles and its methodology have shown significant changes in countries which apply it. In addition to this "the core principles have also been used by the IMF and the world bank in the context of the financial sector assessment program to assess countries banking supervision systems and practices." Pl For this reason, the basel committee continuously revise the principles in consulation with international standard setting bodies and finally with national supervisory authorities, central banks, international trade associations, academia and other interested parties.

Enacting national banking law in accordance with the core principles create suitable environment to the banking industry. Based on this truth the power which is given to the National bank of Ethiopia is go wide. One of my interviewee, Ato Getnet agree with the above idea. He justify that the man power which the bank has and their quality are not sufficient enough to perform its powers and duties. He added that, since the national Bank of Ethiopia is accountable to the prime minister of the federal democratic republic of Ethiopia the bank is exposed to the executive organ. When uses more money to perform its objectives.

The executive organ naturally uses large amount of money The shortage of money may forced the executive organ to intervene on matters given exclusively to the national Bank of Ethiopia excessive powers given to the Bank.

Power, which is excessive, given to the National Bank does not bring change in the banking industry rather it could be a yoke for the industry. So that systematic means has to be placed on the banking industry.

BANKING SUPERVISION

Banking supervision plays a significant role in the development of the economy. The development depends up on the quality of the system of supervision which the supervisory bank employee it. The National Bank of Ethiopia, which is the supervisory bank, has surrounded by many problems. The first is the problem of approach. The National Bank of Ethiopia through banking supervision Department supervise the Banking activities of all banks. It uses the CAMEL approach the word CAMEL is an abbreviation the word represents capital adequacy, is represents asset quality in represent management represent earnings and represents liquidity.

The CAMEL approach which consists the capital adequacy mainly focus on the overall financial condition of the bank, the ability of management to address emerging reeds for additional capital, the nature, trend an volume of problem asset, and the adequacy of allowances for loan an advances and other valuation reserves" p.4 "The asset quality reflects the quantity of existing and potential credit risk associated with the loan and investment pror folios, other real estate loan an investment port folios, other real estate owned, and other assets, as well as off-balance sheet transactions" p.4 "The management is the capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of a banks activities and to ensure a bank's safe, gound, and efficient operation in compliance with applicable laws and regulations is reflected in this rating" "Earnings reflects not only the quantity and trend of earnings, but also factors that may affect the sustainability or quality of earnings." Liquidity focuses on how much cash the bank has and the sources of liquidity that the bank has as compared to funding reeds as well as the sufficiency of funds management practice relative to bank's size, complexity, and risk profile.

This approach which the national bank of ehtiopia currently using is older approach than the risk based supervision which most foreign central banks are using gince banking business is a global business and fastly growing business of needs a better system to supervise banks show their exact positions. the National Bank of Ethiopia luckg this.

The other problem as Ato Getnet gaid, one of my interview of the problem of instability banks (NBE) employees. The National Bank of Ethiopia afford different courses for its employees that helps to their day to day activities. But the problem is that after taking these courses, which reaches five to six, the employees of the national Bank of Ethiopia do not want to remain in the bank. They resign from their office. This may affect the bank not to go with the current situation in the and there in also insufficient man power in the bank as compared to the member of existing banks in the country.

Means and Methods of Supervision

Conducting banking supervision is not an easy task. In order to have effective banking supervision banks should use different methods of supervision to supervise the affairs of the bank in order to determine whether it is a sound condition or not. On site supervision, off-sight supervision, regular contact with bank's management and secret super vision are incorporated in the proclamation. secret supervision can be conducted, where an application, accompanied with supporting evidence, is made to the National bank by one fifth of the total number of depositors or by any number of depositors holding not less than one-third of the deposits of a bank, the National Bank shall examine, or cause to be examined (…)Art 28 and 29 of proc. No 992/08 except for secret supervision, others are in line with principle 21 of the based core principles on banking supervision. In addition to these the national bank also uses minutes of banks as a means of supervision. In addition to these the national bank also uses minutes of banks as a means of supervision.

Mandatory Approval of Appointment

Directors of a bank may be appointed by either by the memorandum or article of association Art. 350(1) subsequent director shall be appointed by the general meeting art. 390(2)

Board of Directors of a bank shall appoint a chief executive officer. Art. 348(3) auditors, who are the third administrative organ in Share Company, are appointed by the meeting of subscribers. 369 (2)

Unless banks got written approval for their appointment from the national bank of Ethiopia directors, chief executive officers and auditors of a bank can not engage these persons.

Directors

The first directors of a share company are appointed by the memorandum of association or article of association Art. 350 Their numbers are must not be less than three and greater than twelve. Art. 347(3) This has to be specified in the memorandum of association. 313(10) if director who are appointed by memorandum of association lucks confirmation from the subscribers meeting side, then the subscribers meeting shall appoint other directors. 350(1) In the same manner, subsequent directors of a bank can be appointed by the general meeting 350(2). In addition to this, the general meeting shall decide the remuneration that directors received. But offer the enactment of proclamation no 99212008, a proclamation to provide for banking business, the power to appoint directors of a bank is left to the bank itself. one thing which is new in this proclamation is that the bank which appoint directors has to submit the appointment for approval purpose. The power to approve or confirm is taken from the general neeting. Ar. 14(2).

The proclamation has given responsibility to banks to take due consideration concerning his honest, integrity, diligence and good reputation to satisfaction of the national bank of Ethiopia Art. 14(1) this is in line with principle of the Basel core principles. It says (…) The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, …" p3 principle 3 appointment of directors in line with the requirement stated under art. 14(1) of proc no 9921/2008 is mandatory for banks, according to w/ro liya the justification for the seed for approval for the first directors and the s……… directors is that the share holders may not properly know the background of persons who are going to be directors of the company bank. But the national bank of Ethiopia in the supervisory capacity has a wider potential and possibility to investigate the hidden background of a person that could hinder for the business.

But another interviewee who has a different opinion that the above says that, it is a matter of reconciling the two different ideas. The first is that banking business in not like an ordinary business. It has high impact to the economy. So that sound financial system should exist. The economy needs this. The other point is that unless the business of a person contravene the low, he has right to engage freely in economic activity (…) art 41(1) of the FDRE constitution.

So that the proclamation fails to reconcile these two opposing ideas. It is against the constitutional right of a person.

Moreover it is not also in accordance with foreign experience, since banking business is a global business which can affect the economy very much. For instance in England lot only directors trut also other responsible officers must be fit and proper person to conduct the business in t prudent manner supervision and surveillance p.35

Even the law, which in paragraph 2 of schedule 3 of bank of England art. 1989 provide all criteria in order to determine whether a director is a fit an proper person. It read.

> *In determining whether a person is fit and proper person to hold my particular position, regard shall be had to his probity, to his competence and soundness of judgment for fulfilling the responsibilities of that position, to the diligence with which he is fulfilling or likely to fulfill those responsibilities and to whether the interests of depositors or potential depositors of the institution are, or are likely to be, in any way threatened try his holding that position. Supervision and sur. P36.*

Besides this there are also judicial guidelines which the English courts have developed to interpret some of the expressions which is gated in the above paragraph supervision p. 36.

Auditors (appointment)

Auditors is one of the three important organ is bank. In banking business three are two types of auditors. One is internal auditor and the other is external auditor both are appointed by meeting of until the first annual general meeting. *art 369(2) where the bank fails to appoint external auditors the national bank shall fill the post.*Art-24(4) of proc.992/08 but if the bank appoint auditors, their appointment is subject to approval of the National Bank of Ethiopia. *Art-24(1) of proc.992

Auditors play a decisive role in the bank. It is organs which pronounce or proclaim whether the bank has ground management or not. It has also power to call a general meeting where directors fail to call in accordance with the memorandum of association.*377(1) this may give a chance to shareholders to know the position of the bank and can also pass a resolution against the directors of a bank. And they also prepare an agenda for the meeting.*Art 377(4) on the contrary, if auditors fail to discharge their duties or knowingly do wrongful act to the detrimental to the bank then they will be liable.*Art 380(1) in general auditors can stop any wrongful banking practices conducted by board of directors or senior management of the bank. So that they are considered to be watch dog for the good practice of a bank.

But the law a proclamation to provide for banking business, did not gave much attention to the minimum professional experience and knowledge required of internal auditors. But it provide for external auditors. Since internal auditors play a decisive role in the bank much attention has to be given to them to have safe and sound banking and as the same time the industry is a fasting growing industry and world wide connection auditors should have in-depth knowledge.

Removal

C.E.O

In banking business chief executive official plays an imp0rtant role. They are appointed by board of directors of a bank, which is the body ultimately responsible and accountable for the safe, sound and proper operation of the bank, to render different banking activates.*Art proc.no 992/2008 they are deposable for implementing policies, procedures and banking practice that brought the board of directors goals in to reality. Proc.no992/2008 has granted responsibility to banks to take due consideration of the past history of the person and his professional experience and the ability to pass sound judgment skill integrity and any other requirements which are stated under dervitves no SBB/39/2006 issued … the national bank of Ethiopia

Art 17(1) of proc.no.992/2008, a proclamation to provide for banking business, grants power to the national bank of Ethiopia to remove chief executive officer from their position before the expiry of office. According to Ato Yeneakal who is a manager of legal department of Awash International Bank, says it may affect the constitutional right of the chief executive official. He says that, the national bank of Ethiopian is not the employer of the officer, it is the company which hired the officer go that how can a third party, who has No involvement in the contract of employment, except for approval purpose, terminate the contract that that was concluded between the company and the officer?

This implies that it is considering the board of directors which appoint him as non existing today.

This is not in-accordance with foreign experience. The basel core priciples, principle 17(4) says that {the supervisor has the powers to require changes in the composition of the Board and senior management to address any prudential cocerng related to the satisfaction of these criteria.*Art.17(4) the principle doesn't allow supervisory bank to remove directorys by their own power or supervisory capacity rather it requires the bank to take the necessary measure that can curb the problem in the Bank.

On the other hand, the measure which the National Bank exercises over the chief executive officer, removal from their office, violate the institutional freedom of the bank. The bank through its ordinary general meeting can exercise this power.

Concerning refusal of C.E.O the National Bank has right to refuse the appointment of chief executive officer during the license process of the bank and the subsequent appointment if the C.E.O does not fit to the satisfaction of the National Bank. The problem is that the law which is directive no SBB/39/2006 did not provide an exception for chief executive officers who has positive history in the management to the bank but fails.To fulfill the ten years working experience as a chief executive officer in the banking. *Pir-SBB/39/2006

Reporting Duty and permanent stream of contact.

The National Bank of Ethiopia has set different ways of collecting financial statements from banks. The reports which the national Bank of Ethiopia receives from banks are daily, weekly, monthly and quarterly. The daily report shows the amount of foreign currency which banks sold or bought. The law, limitation on open foreign currency position of banks, directive no.SBB/23/97, has set the amount of foreign currency position which does not exceed 15% of its total capital.* this is because the fluctuation of foreign currency, particularly the redaction of exchange rate in the world market may affects banks, if they collect in excess of the legal limit excepts for USD as one of my interviews Ato Getente Adame said. In addition to this there has to be fair distribution of foreign currency among bans By doing this the market would not be disturbed. Finally the report has to show the asset and liability of the bank.

The other or the second type of report which the national bank of Ethiopia receives from banks is that a report concerning reserve and liquidity. Liquidity includes cash payment and settlement account, Treasury bill and others. This report enables the National Bank of Ethiopia to identify whether banks have placed 15% as a reserve of the total money which they collect. On other hand banks are expected to hold 25% of liquidity from the total capital. Based on such report the National Bank of Ethiopia can control banks

Whether they hold both reserve and liquidity in accordance with the limit which the National Bank of Ethiopia set.

The third type of report which banks expected t submit to the National Bank of Ethiopia is a report concerning single borrower shall at no time exceed 25% of the total capital of the bank.* Art 4 of Directive no SBB/29 2002 As the same time the same directive also impose obligations on bank. * Art 6 of dir.no SBB/29/2002 and on the other hand the #The aggregate sum of loans extended or permitted to be outstanding directly or indirectly to one related party at any one time shall not exceed 15% of the total capital of the bank.$*Art 4-2 of dir.no. SBB/30/2002 The aggregate sum of loans extended or permitted to be outstanding directly or indirectly to all related parties at one time shall not exceed 32% of the total capital of the bank. *Art 4.3 of Dir.No-SBB/30/2002

The aim of collecting such kinds of report in the monthly basis is to reduce the credit risk and it also enables the National Bank to identify borrowers who took loans more than the legal limit.

The fourth type of report

Chapter two

2.1 Banking Business

The practice of banking business is as far back as the early existence of trading activities. Banking activities came after the development of international trade. In order to transact different transactions traders need to change their coins by those used in the place where the transaction is taken place. Carrying a large amount of money and travel may create danger and one may lose his capital or potentiasl to transact and get profit. For this and other reasons the need for further advancement of the trading and the banking business necessitated. Such kind of practice developed through time and coming being institutionalized that banking operation and banks as a financial institution attain their present future and status.

Bank is the main instrument of the economy of the country. Bank gives variety of functions to the public as well as to the economy. Banking implies borrowing and lending of money. The bank borrows money from some people and lends it to the general public. Banks a borrower in the sense that it accepts deposits from people so that depositors are its creditors.Banking also implies lending deposits received in various forms in to for productive uses in the form of loans, advances and cash credits against approved securities. When the bank apply this it has to take high care whether the money has to be return back or not. Agency services is another banking business which banks provide to the public. Among the agency services sale and purchase of securities, Remittance of funds, being trustees, executors and collector and payer of promissory notes, bills, cheques and some others payment instrument or receipts. There are also other functions as well which banks perform as part of their banking business such as issuing of letters of credit, bank draft, travelers cheques sale and purchase of

TN Hajela, Money Banking and international Trade (7th revised edition) p-196 foreign exchange. Creation of credit is a very important banking activity for any economy "When the bank gives loan to its customers it retains with it some portion of the deposits received from its other customers and gives the remaining by way of loan. Thus, it only lends out a certain portion of the deposits received. Again it does not pay the amount of loan in cash but only by opening an account in the same of the borrower. Thus, while giving a loan, it also creates a deposit or a loan against itself. And since the deposits of the bank are treated like money, the creation of such deposits leads to an increase in the total money supply of the economy.[2] Through such activities which are stated here in above banking business can play a great role in influencing the economy positively. So that banking business has to be regulated highly because public interest is there.

2.1.1 Nature of Banking Business

Banks mainly act financial intermediary in the monetary system. Financial intermediaries are link between the borrowing individuals and firms. The lenders or surplus income units possess assets in the form of bank deposit, insurance deposits, insurance policies, pensions etc. The financial intermediaries transfer the saving of surplus income units to the spending units by purchasing primary securities. If collects the savings of the surplus simply as a middleman. So that they are intermediaries. They bring borrowers and lender together. By doing such activities they promote savings and investment habits amount the ordinary people by putting surplus funds to profitable and productive use and by providing credit loans to the consumer. They also encourage the growth of the business sector by providing facilities for investment in plant, equipment, etc... through loans, mortgages, purchase of bonds, shares etc.[4] In general they play a very important role in the modern financial system.

The other point to be focused is that a bank is also a dealer in the debts of financial obligations. In order to show this it is good to explain what is stated in the balance sheet. A balance sheet is a statement of financial activities of a business organization which shows the assets and liabilities of the banks of one year activity. On the asset side of its balance sheet there are different kinds of obligations which have been issued by other. But on the liabilities side there are obligations which it has incurred of its own. There are different claims stated on the balance sheet of a bank. These are deposits and advances and loans. Deposits represent the claims of the customers against the bank whereas advances and loan represent the claims of the bank against borrowers. What make similar for both claims are both appear in the balance sheet of the two parties, but they are stated opposite side. In general, almost all the assets and liabilities of a bank are financial obligations of a bank.

2.1.2 Historical Development

The institution of Banking in the present form has developed in a very long time. The reasons were different from one state to another state. For instance, the Babylonians had developed a banking system in 2000 B.C and the people believed their gods and deposited their money and valuables with the gods. The Romans and Mohammedans think charging of interest of money as sinful and immoral. As a result of this banking business was not developed as compared to other places.

The historical development of banking business in England in a bit different from the above banking history. As we know bank of England is the model for many central Banks. Since bank of England is the model for many banks it is good to see the historical development of Banking business in England. In England, people had faith in the king and the royal family had been considered as money depositor institution.[5] The people used to deposit their cash and bullion at the royal mint. In the reign of Edward III foreign trade had increased and because of this reason the Royal mint had served as an exchanging place for diverse foreign coins to travelers. But later on after the coming of Charles I, he catched a large sum of 130.000 pound bullion kept for safe custody with the royal unit.

For this reason the people lost faith in the Royal mint and they deposit their money in the hands of the cashiers but the cashiers embezzled the money so that the merchants were forced to keep their money and valuables with the Goldsmiths who keep the money and valuables of their own in to their strong rooms. [6] In order to have confidence between the depositors and the goldsmiths, the goldsmiths were issuing receipts which were known as goldsmith's note. [7] This goldsmith's Note at that time had served as a bank not and it had got a chance to circulate in the market. Until the establishment of bank of England, banking business was mainly conducted by goldsmith, lenders and brokers. At that time there was no regulatory bodies that supervise and control the day to day activities of the private banking businesses which the goldsmiths, lenders and brokers were performing. The absence of such regulatory bodies gave a way to private businessmen to act as they like and this situation has made the development of banking business slow. In addition to this, there was no rule that these private businessmen have to be followed. After some years passed the goldsmiths were disputed each other and the business community had contend for the necessity for public institutions. As a result of the two things, the dispute among the goldsmiths and the idea of institutionalization resolved when the bank of England was established by public subscription in 1694 for the express purpose of advancing money to the government, in return for the privilege of note issue conferred under a charter granted to it in an act of parliament.

After its establishment the form of its activities was very much limited to resolve the financial difficulties that surrounded the government and the private financial market. For the former activity the preamble of bank of England act 1694 shows what enforced the legislator to enact the Act. This is the preamble of the bank of England act 1694.

An act for granting to their majesties several rates and duties up on Tunnage of ships and vessels and up on Beere Ale and other liquors for securing certaine recompenses and *advantages in the said act mentioned to such persons as shall voluntarily advance the sume of fifteene hundred thousand pounds towards the carrying on the war against france*[8].

On the other hand, though the bank of England activity was limited to overcoming the financial difficulty of the government in the form of loans, the bank acquired the privilege of note issue a partial monopoly of note issue in England. There were some rules relating to issue of money in that only banking firms and partnership of not more than six persons were allowed to issue notes[7]. Beside issue of money the bank was authorize to open branches in other parts of England in 1826. This can be taken as a development in the banking industry of England.

The next development was that the bank came to accept the position of being the lender of last resort. The activity of private banks, particularly these gold smiths and brokers laid unforgettable mark in the minds of the business community, but the bank and the business community did not raise the question of developing by form of regulations to control the money market. Such condition had created on the bank to luck its recognition within the country. As a result of this, the situation created a way to accept the bank as a national intuition with the authority to regulate the money market, to develop international trade progressively and for handling national debt and restructuring the economy[9]. This situation gave the bank to have both the private and public role. It is this personality that distinguishes the bank of England from any other central bank in the world.

2.1.3. General overview of Banking business in Ethiopia

It was in 1905, under the reign of menelik II, banking business was started in Ethiopia. This bank was named Bank of Abyssinia which was established by an agreement made between emperor Menelik II and a representative of central Bank of Egypt. This bank was engaged in issuing notes granting loans, collecting deposits, but its clients were mostly foreign businessmen and wealthy Ethiopians. While the bank was performing its duties emperor Haile sillassie recognize that the behavior of the bank predominantly devoted to the profit making for their own benefit rather than promoting economic development in the country. As a result of this, emperor Haile sillassie proposed and supported for the establishment of a wholly Ethiopian Bank. And it retained management, staff and clients of the old bank. In addition to this the bank had the power to print and issue bank notes but it did not apply its legal power to stop the circulation of Maria Theresa, which was the legal tender of the country.

The Italian occupation in 1936 gave a chance to foreign banks, especially the Italian and the G. Britian, to open their banks in some parts of the country. And they used their currency until the Ethiopian Bank established in a new form. The bank which was established at that time was performing both the commercial bank and central bank duties simultaneously. But later on in 1963 the bank, which was established in 1942 disintegrated in to two different banks forming the NBE and the CBE.

Through times, more domestic and foreign banks were established. Among these banks Banco di Roma, Banca Nazionale del lavoro and Banco di Napoli were belong to the foreign banks but Agricultural bank belongs to the domestic bank.

2.2 Central Banking

There has been a great diversity of opinion with regard to central banking definition. So that to define a central bank is a problematic issue. The writer of this paper has no intention to define central banking rather explaining about central banking in general. The concept of central bank is an evolutionary one. It has grown with years. For instance countries of Europe had a central bank but except few countries of East, such as Japan, Java and Egypt and the new world there were no central banks in 1900. Even in the united states the Federal Reserve was created in

1913.But the vast expansion of monetary, fiscal and trade activities particularly after the WWII and after the establishment of international monetary fund fastened the development central bank in the world.

Central bank has unique nature as compared to other banks. There are three main principles that govern the operations of a central bank. The first principle is that central bank is always motivated by the spirit of national welfare. This has to be always done by increasing the interest of the people or the nation not by increasing the profits as most commercial banks do it. Central banks perform their duties placing profit not in the first place. In order to achieve its objective the best interest of the public has to come first then profit earnings comes next. The second principle, is that the central bank's operations should aims at maintaining the monetary and financial stability in the economy. This principle give wide powers to central banks for controlling the monetary and banking structure of a country to achieve its objective. Though central bank has been established by state to increase the benefit of the welfare of the people and maintain the monetary and financial stability in the economy every activities of the central bank have to be free from any political influences. What ever political ideology the state follows the policy which the central bank draws should not be interrelate with the ideology rather the economic conditions of the country that should get foremost recognition. This is the third principles that govern the operation of a central bank.

Finally, a central bank should not perform what commercial banks perform such as accepting deposits from the general public etc. In relation to this, de kock has pointed out that *"such operations might come in to direct conflict with its functions as a bankers' Bank, the lender of last resort and the controller of credit. It has, for example, come to be recognized over a wide range of countries that the success of a central bank depends largely up on the whole hearted support and co-operation of the commercial banks, and that such cooperation can be effectively obtained only if it refrains from competing directly with them in their* *ordinary banking business, except with compelled to do so in the national economic interest."*[9]

2.2.1 Historical Background

The concept of central banking has been no intelligibly explained until the beginning of the twentieth century. A continuous development had been taking place in different countries over a long period of years, but the process had not always been a responsive one. There was no systematized and constant approach developed and devised. Because of such reason banks managements were conducted on the discretion of individual managements, so that the individual managements had played the main part in the decisions and operations of the bank which had become the centre of the monetary and banking system in each of many countries.[10]

In many countries, one bank progressively came to assume more and more the position of a central bank. This is predominantly be happen due to its enjoying the principal right of note issue and also acting as the government's banker and agent. These banks which they mainly issue not and government banker and agent were not at the beginning called central banks, but they were known as banks of issue.

Concerning their functions mostly they were devoted to note issue and converting the notes in to gold or silver or both. Besides the functions the bank had got powers and duties to exercise issues which has relation with banking business until the term central bank came to be officially used and to have a standardized meaning.

Regarding the scope of central banking objective, it was very limited to certain issues. But through times its objective has, however, been considerably broadened in more recent statutes. Regulation of money market, promotion of the best interest of the economic life of the society, monetary policy, and economic stability are some of the objectives that form a wide range of objectives.

Among the existing central banks the Riks bank of Sweden is the oldest and it was also the first to be established. Though, the Riks bank is the oldest, it was the Bank of England the has laid the fundamental of art of central banking [11]. The history of bank of England can be taken as an example for illustrating the development of central banking principles and technique.

2.2.2 The need for central Bank

The formation of central bank is very much different from the formation of the banks, especially commercial banks which are governmental and non governmental. Banks which are not central banks are established by both government, like commercial bank of Ethiopia in our context, and private banks, central bank is mostly established and owned by government apart from the united states which they call it Federal Reserve.

The existence of this bank (central bank) in a nation is significant in the economic development of the country. Central bank role is more on the administration and control of the banking business and the financial system of the country. Their aim is at the stabilization of the monetary system with the growth of the country's economy. It acts as a monetary policy maker to determine the exchange rate which one country's currency can be changed for another nation and it also controls the amount of credit and money available in circulation by buying or selling government debt instruments such as bonds, and treasury bill. Since interest rates are usually related to how much money and credits are available in the economy central bank determines the level of interest rates. On the other hand, central bank can act as government's banker. It acts as the bank or depository for government revenue and it can also act as a lender to the commercial banks in times of need or economic crisis. And that is why, the central bank has been called as a lender of last resort. And Fiscal agent and financial advisor to the government. And it also serves as banker for the country's banks to deposit for bank reserves and central bank can supervise and control the financial system of the country. By doing such activates which are mentioned here in above the central bank can bring the rapid economic development, stable price in the market and the financial system will be stable.

2.2.3 Characteristics of Central Bank

The question as to which functions more particularly characterize central bank of a certain nation (country) had challenged the minds of economists during the inter war period when the surge of new central banks began to manifest themselves across the world. The first person to deal with this question is Howtrey, regarded banks in general as the lender of the last resort. According to him, central bank has the power to issue note which gave it an advantage in facing the responsibilities of the lender of last resort[12]. Another economist, who forwarded about central bank is Vera smith. According to #him the primary definition of central banking is a banking system in which a single bank has either a complete or a residuary monopoly in the note issue$ and that it was out of monopolies in the note issue that were derived the secondary functions and characteristics of our modern central banks[14].

In addition to the above definition or characteristics propounded by the two economists, the statutes of the bank for international settlement that the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country[15].

According to the understanding of many central banks authorities they named their banks reserve banks, for instance Federal Reserve banks of the united states can be good example for this. This is because the custody of bank reserves was the characteristic function of a central bank.

When we come to the practice or the day to day activities of the central bank, it is difficult to point out any particular function as the characteristic of one or name all functions in the order of their importance, since they are interrelated[16]. For instance, a specific loan operation of central bank that is in its capacity as a bank of rediscount might have been caused by a commercial bank requiring more note currency involving the central bank as the custodian of the nations reserves, or having to refill its cash reserves and clearing balances involving the central bank as the custodian of the nations reserves, or having to refill its cash reserves clearing balances involving the central bank as the custodian of the cash reserves of the commercial banks and the bank of central clearance which could not obtain from any other source owing to general monetary stringency involving the central bank as a lender of last resort, and before effecting the rediscount, the central bank might have raised its discount rate or imposed certain conditions in its capacity as the controller of credit[17].

There is no doubt that every nations need a central bank to perform certain activities to benefit both the economy and the businessmen. So that central banks should have a guiding principles whatever functions or different types of functions if performs any time so that it should act only in the public interest and it should also act with out considering to make profit as a prime goals.

2.2.4 National Bank of Ethiopia

The history of central bank, as we name it now national Bank of Ethiopia, in the earlier time has some similarity with the history of banking business (commercial banking) in Ethiopia. It was in 1897 E.C the Bank of Habesha officially started banking business in the country. The bank was a foreign bank established by both the Egyptian National bank and Ethiopian bank in an agreement that remain for 50 years, but the bank did to continued its activity for the specified period which was mentioned in the agreement for the reason that the bank particularly the foreigner were more devoted to profit making rather than expanding banking service to the country. As a result of this emperor Haile Sillassie ordered for the establishment of a wholly Ethiopian bank. It was after such situations that the new bank, bank of Ethiopia came to exist.

Bank of Ethiopia was the first National bank established in 1923. The bank was not only the first bank in Ethiopian but also in Africa. The bank started its activities by printing paper money and coin and it had branches in some parts of the country. Because of the occupation of the Italian, the bank did not continued its activity and lastly in 1929 officially closed.

State bank of Ethiopia established after the Italian left the country replacing the former Bank of Ethiopia. This bank, state bank of Ethiopia, established by the government order placing the former bank. Though it started in 1934 e.c the bank started its activity after two years. The bank had many employees the Indians, Europeans, Armenian, Egyptian and others were in the high post. It has been acted as a representative of ministry of finance and had power to issue paper money and coins as the bank of Ethiopia had. In 1937 the bank for the first time drew a directive concerning money circulation. Later on in 1941 the bank became the sole controller of exchange. In addition to the above activities the bank also involved in commercial bank activities. After one year the bank had drew an exchange regulation system. In order to create favorable conditions for the expansion of banking, proc. No 207/1999 has disintegrated the state Bank of Ethiopia in to two different banks forming National Bank of Ethiopia as supervisory bank and commercial bank of Ethiopia to engage commercial activities. After this banking proclamation made state bank of Ethiopia ceased its function as a bank.

National Bank of Ethiopia (NBE) was established by an order no 30/1955 but for the reasons which are stated under the preamble of proc. No 591/2008 it says … for the rapid economic development of

- Proc No. 591/2008, the National Bank of Ethiopian establishment proclamation.

Ethiopia stable price and foreign exchange rate and healthy financial system are being necessary, whereas it is necessary for the National Bank of Ethiopia to undertake such other activities as are conforming to the proportional economic growth of Ethiopia… the establishing proclamation of national bank of Ethiopia, that order no 30/1955 amended and repealed by proc. No 591/2008.

2.3 The need for banking regulation

Any type of economic activity requires sufficient amount of financial resources. In modern economy, however, a balance between investment needs and the required invest able financial resource (Savings) by the same economic unit will not be achieved at the same time. There might be some economic units with excess investment plan over saving will others save more than what they actually want to invest in real terms. The more diverse the pattern of desired investment activities and savings among different economic units the greater the need for efficient and more reliable financial institution (banking system) to generate and channel excess savings to ultimate users in an economy. Since they play an intermediary role, they channel funds from those whose current savings exceeds over their current investment activity to those whose investment activities in real term exceeds over their savings.

Efficient financial systems (Banking system) are essential to assure adequate capital formation and economic growth in a modern economy. To this effect, however, there should be conducive working environment and legal framework. In essence, banks particularly private banks, have their own prime objective apart from assisting the national economy by meeting the needs of borrowers and savers at the least possible cost with the least inconvenience. Their existence and effectiveness primary depend mainly on the existing institutional and legal framework. Which should take in to account not only the prime objectives of the banks but also the overall economic situation of an economy at large.

Chapter Four

Legislative Powers (Jurisdiction) of The National Bank Of Ethiopia and Its Competency

4.1 Legislative powers (Jurisdiction)

An inherent jurisdiction which the law making organ possess to enact laws is the main characteristic that distinguish it from the other two government organs, the executive and the judiciary. This organ has superior power to enact laws which is important for regulating the society in general. Despite the fact that it is the House of Peoples' Representative , which is competent to issue laws that normally fell within the jurisdiction of the Federal Government.[1] It is the National Bank of Ethiopia that is empowered to issue directive to expound regulation and proclamation regulating the financial industry.[2] Nevertheless since the promulgation the recent banking proclamation, the National Bank Ethiopia is unduly charge with the power to issue directives having the characteristics of a proclamation. That is to say the National Bank of Ethiopia has been empowered to issue directives to regulate matter which ought to have been regulated by a proclamation issued by the House of Peoples' Representatives.

4.1.1 Delegation

There are different reasons for power delegation to administrative agencies. State of emergency, state of emergency, flexibility, technicality of subject matter, experimentation, and pressure up on parliament and complexities of modern administration are some of the reasons for delegation of legislative power to administrative agencies.[3]

The legislator enact, only general guidelines and it then delegates rulemaking power to agencies to enact lows within the required

1. Art. 99(1) of

specifications.[4] The reason is that it is not possible for the legislator to enact detailed laws that govern every aspect of life of the society.[5] The other reason justifying delegation is that some legislation may need consultation with experts and interested parties before being enacted.[6] In this respect, it is believed that administrative agencies are better suited for the facilitating of such consultation.[7] The law making organ, however, has no legitimate power to delegate powers which is originally belongs to it.

4.1.2 SCOPE

It is not the intention of the writer of this paper to explain about the necessity of delegation under this topic rather it focuses on the scope of delegation of power. In the first place the law making organ has to know its jurisdiction to enact laws. In Ethiopia context the constitution exhaustively lists down all areas of laws which the house of peoples representatives may enact.[8] And secondly the law making organ or the legislature has to identify Powers which may be delegable to the subordinate bodies and powers which may not be delegable to the subordinate bodies.[9]

Some times the law making organ delegates powers to administrative organs in order they issue regulations or directives to expound a proclamation which has general nature. However, the National Bank of Ethiopia is empowered to issue directives to regulate matters that ought to have been regulated by a proclamation issued by House of Peoples' Representatives. Thus some of the powers which are given to the National Bank of Ethiopia are not in line with art.55 of the FDRE constitution. As a result of this the National Bank of Ethiopia, which is the financial advisor and agent of the government in the financial matters, issue directive beyond its jurisdiction. This may give a way to the executive organ to do what ever it wants to do.

4.2 Legislative Competency

Legislation is an important task which the legislature should conducts in a prudent manner. This is because the legislature may impose or influence the life of the society by enacting a law which are not in line with the socio-economic and cultural life of the society. The law could be primary legislation or subordinate legislation. Both require the same skill and care. The primary legislation is more general than the subordinate legislation. The latter is procedural in character. Drafting both kind of law is undertake under certain constraints.[10]

As I have mentioned earlier drafting the primary legislation is made in a defiled situation. So that, subordinate legislation faces additional constraint because of the relationship between the subordinate legislation and the empowering act. Because of this subordinate legislation can be more difficult than the primary legislation[11]

If subordinate legislation is more difficult than primary legislation then drafter of subordinate legislation should acquire the necessary knowledge and skill. The drafter of subordinate legislation not only acquires the way to draft but also should know and understand the empowering law in order to comply with it.[12]If this is the fact, evaluating the legislative competency of the National Bank of Ethiopia in line with the above Point is imperative. In order to evaluate the legislate competency of the National Bank it is good to see the directives issued by the bank.

According to Ato Yeneakal, the bank had issued directives in certain areas which directives must be enacted either in the form of regulation or in the form of proclamation. He added that, some of the directives are of in line with the reality. It doesn’t give transition period to banks before the directives are implemented. On the other hand the profile of both the legal department of the bank and the supervision department has created some kind of gap in the issuance of directives .

On the other hand the inspector of supervision deportment have no legal knowledge. This situation may give a way for problem in the issuance.

4.2.1 Staff profile

Man power is the main factor for the success of an institution to fulfill its goals. In addition to the number of man power which the institution has the quality of the staff also matters. Since the National Bank is the supervisory Bank it is responsible for the safe and sound banking and for stability of the banking system. Thusthe bank should have competent man power. The NBE provides training for its workers in three ways. Firstly the Bank has contact with foreign central banks and gives training through these banks. Secondly the National Bank itself gives training for its workers. And thirdly the national bank has its own training institute for bankers.[14] Bank of Ethiopia which supervises banks, insurance companies and microfinance According to Ato Nigusse supervision department is one of the departments which supervise the activities of all bank in the country. This department has twenty four staff. Among them there is Directorate at the top, Though presently the National Bank has no Directorate and it is the Manager that has filled both positions. Next to the top position, there is an acting Banking inspector. There are also three Bank inspectors which are under level 13, there are three senior inspectors under level 15 and one principal inspector under level 17 and lastly 12 Junior inspectors.

Due to absence of full information banking supervision Department the writer of this paper could not show the number of inspectors for each team who are assigned under Banking supervision Department. According to the figure stated by Ato Nigusee most of inspectors are found at the level of junior inspector. It is know that junior inspectors have not enough experience since banking supervision needs better qualified professionals.

According to the NBE website, since 2000e.c BPR study is undertakes in order to bring about the fundamental changes in its activities. And different committees are set up for the process.[16] This may avoid the problem of the bank if properly implemented. The governor of the bank also believed that the bank has faced brain drain, regulatory power limitation, ineffectiveness of regulatory policies and law so that the BPR need to aim avoiding such problems of the bank.[17]

4.2.2 Requisites of Rule Making

As has been discussed earlier the legislator only enacts general guide lines. The nature of the power of the legislator to enact laws doesn't allow to go beyond the limit. In addition to this the technicality of the subject matter, pressure up on parliament, state of emergency and some other legitimate issue enabled the legislator to delegates rule making power to subordinate bodies to enact laws within the required specifications.

Since banking business is a fastly growing business it needs frequent amendment in order to go with the current situation of the market. In order to do this a person who is acquainted in the area needed very much. If the rule making organ adhere to such principles of delegation it can make rule according to its periodic need and hence may not harm participants in the finical market.

CHAPTER FIVE

CONCLUSION AND RECOMMANDATION

5.1 CONCLUSION

As I have tried to show in the body of this paper, almost all countries central banks, share the same responsibilities in relation to benefiting the economy of the country. They also create suitable environment for the expansion of financial sectors in the country. And supervision of financial sectors also rested up on such banks. So that central bands play a great role in the economy. As briefly discussed under chapter three of this paper the national bank of Ethiopia has got wider power both in the banking business of the country and on other issues which are stated under art 5 of proc. 591/2008.According to art. 14 of proclamation no 592/2008 the National Bank has power to approve the appointment of directors, chief executive officers and senior officer of banks. And it has also power to approve the appointment o f external auditors. The National Bank not only as power to approve their appointment it has also power to appoint directors, Chief executive officers senior executive officers and external auditors of banks if the supervised fail to do. In addition to this the National Bank has also power to refuse the appointment of director, chief executive officers, and senior executive officers of banks if the National Bank not satisfied with their appointment . It has also power to remove from their position before the expiry of their office. This practice is completely out of free market economic principle. In free market economy private financial Sectors have right to appoint managers & directors who lead the business in the prudent manner.

5.2 Recommendation

The working environment is one possible reason for persons, to leave their work so that the national bank of Ethiopia has to create suitable environment to its employee the problem could be salary, interference and the absence of staff regulation to be issued by the council of ministers pursuant to art 24 of proclamation no-591/2008 has to be enacted.

-Provisions for mandatory approval of appointment for directors C.E.O & junior executive officer need some kind of amendment in order to go with the free market economy principle

- Since CAMEL approach is an old approach for supervision the supervision department has to use risk based supervision rather than CAMEL approach.

-Since Banking supervision department drafts and issued laws without law background they need to be familiar with laws particularly legal drafting

-The powers accorded to NBE is not in accordance with its competency. It is so wide so that power which must not be to the NBE have to be taken from it.

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