Study Session 5

Study Session Outline

i. Regulatory frameworks of rotating savings and credit associations and loans
ii. Regulatory frameworks of Banking
iii. Negotiable Instruments
iv. Regulatory frameworks of Insurance
v. Nature of the contract of insurance
vi. Elements of Insurance

Study Session Duration

This Study unit requires a 2 hours of formal study time.

Financial Laws and business

Introduction

This session mainly deals with the regulatory frameworks of the savings and credits associations, banks and negotiable instruments. More over this session also tries o cover the fundamentals of law of insurance. In doing so it tries to link the issues with the context of the partner countries.

Learning Outcomes of Study Session 5

After attending this session students will be able to:

- *Explain financial law*
- *Discuss antitrust, bankruptcy, and securities laws of specific member countries*
- *Describe regulatory frameworks of banking*

Unit 5- Financial Laws and business

Financing is essential to the survival of young, especially those who would like to get engaged in businesses. In the absence of funding, businesses cannot expand and succeed. Similarly, finance

enables established large organizations to achieve strategic objectives such as growth, mergers and acquisitions, "coming public," restructuring, or "going private." Thus we can say that corporate finance is essential to a business's long-term strategic plans. That means access to finance may make or break a business.

5.1 The Economic Significance of Financial Institutions; banks

Robust and competent financial sector is essential for a country's economic growth that the financial sector is robust and competent. Individuals who do not require money immediately can deposit the money with banks, which are then loaned to individuals who do require money for the purpose of investment. Consequently, banks serve as a vital source of capital for investment, which is essential for increasing the country's production, exports, employment, and foreign exchange earnings.

In a similar manner, bank lending to clients who necessitate funds for various purposes such as consummation, the procurement of several products and services, construction, and health and education generates demand for such goods and services, inspiring service providers and producers to intensify their enterprises and enhance their production levels. More over the financial access that is obtained from banks is necessary to employ more people as a result of expansion and increased production. This leads to the raise in the number of jobs available, as well as an increase in the number of producers and suppliers. (*Demirgüç-Kunt, Feyen, & Levine, 2013*).

The other significance of banks is that they contribute to saving. One of the mechanisms to increase saving is payment of interest. In addition to that saving can be encouraged by providing sense of security on the bank client. Saving is also extremely important as a means of future investment which improves the lives of societies.

The authority to decide the interest rate of banks mostly rests on central banks. This also has a direct implication on the investment and saving decisions of clients. Obviously satisfactory rate of interest on deposits encourages clients to save rather than spend their money. However, such interest should not be used to convert them into rent seekers (this means potential investors may choose to hold their money in order to receive interest). When banks lower interest rates on money they lend to borrowers, it encourages, production, investment, job creation and export. Because service givers and traders prefer not to deposit the money in banks because of the poor interest rate.

The existence of a countrywide network of banks that assists commercial transactions by making payments easier, safer, and more economical is a significant gain. Furthermore, using a bank to make a payment minimizes the possibility of money being lost or stolen (*Demirguc-Kunt, Feyen, & Levine, 2012)*.

Overview of the National Bank of Ethiopia (NBE)

This autonomous institution is established by banking Proclamation No 83/1994. The bank's primary goal is to foster monetary stability in the financial system, as well as other credit and exchange conditions that are beneficial to Ethiopia's economy growing in a balanced manner. As mentioned under article 6 of proclamation no. 83/1994. The other goal of the NBE is to encourage economic growth of the nation in a balanced manner. (*Kebede, 2014*)

In order to help it in fulfilling its objective, the bank is given the following powers and responsibilities: /Article 7 of Proclamation No 83/1994. /

I. '*'Mint legal tender money, print it, and distribute it''*.

II. ‘’*Control the availability and supply of money, limit interest rates, regulates loan and credit for banks and other financial institutions*. (*Art 7 and Art 30 of the proclamation No. 83/1994*).

III. Manage and administer Ethiopia's international reserve fund, which includes executing exchange rate policy, allocating foreign exchange, and maintaining and administering the country's international reserve fund. In addition to gold and silver, foreign exchange and securities are held in this reserve fund. These assets are used to support imports into the country as well as to pay foreign international loans and other obligations (Art 50 of the proclamation No. 83/1994). (*Mauri, 2010*)

Generally, the NBE is mandated to oversee and regulate financial in Ethiopia. Moreover, the NBE Puts limitations on how much gold and foreign currency can be held in deposits by commercial banks institutions pf similar function which are allowed to transact in foreign currency. (Art 39, proclamation No.93/1994)

Finance law: Laws in financial transactions, refer to any set of rules governing the raising of funds by a party through various modalities of investing. For example, Antitrust, bankruptcy, rules of loan, stock exchange etc. Apart from that, the provisions of these acts may have influence on bankruptcy procedures, especially in the case of corporate debtors.

Banking Laws Banking rules can impact finance law through regulating lending restrictions, the types of investments that banks may make, and the reporting requirements related with these investments.

Bankruptcy Laws -Bankruptcy is a legal process that enables individuals and businesses to obtain a financial fresh start by eliminating or resolving unsustainable debt. Additionally, it can be used to help businesses wind down and liquidate assets in an orderly fashion. Bankruptcy provides a way out of this dilemma while still taking the creditors' collection efforts into account. While

bankruptcy will remain on your credit report for prolonged period of time, it is sometimes the best choice for financial revival. Hence, bankruptcy law regulates how funded obligations are safeguarded or discharged during bankruptcy procedures.

Insolvency Law in Ethiopia

Insolvency law, which completes the Commercial Code, is relatively unknown in commercial practice and courts in Ethiopian business litigations. There are numerous reasons for this, the most credible being unfamiliarity with the benefits of a collective bankruptcy procedure and the fear with which insolvent businesses often approach bankruptcy. Even members of the legal profession don't dare to consider bankruptcy when their clients experience a cessation of debt payments. Instead they prefer the lengthy and complex procedures of individual civil litigation to enforce obligations against defaulting debtors. Consequently, many civil lawsuits against a single defaulting debtor have been instituted, as well as lengthy court litigation including multiple court orders and injunctions against judgment execution. Moreover, stay of executions are all usual occurrences in a large number of individual civil and/or commercial court proceedings concerning debts. Relaying on other alternative debt collection procedures are also considered. For example, Banks, as professional creditors dealing with debt default, have traditionally avoided collective bankruptcy proceedings, relying instead on foreclosure rules that empowered banks to unilaterally foreclose on the collateral of defaulting borrowers (*Mauri, 2010).* This has resulted in a situation where banks employ foreclosure laws to resolve insolvencies, frequently to the expense of all other creditors of an insolvent business.

5.2 Regulatory frameworks of **rotating savings and credit associations and loans**

Through recurrent contributions and withdrawals to and from a shared fund, rotating savings as well as credit associations serve as an informal institution of finance. Rotating Credit and saving associations are particularly prevalent in emerging economies and among immigrant communities in established economies. This is because official institutions are difficult to reach due to their unavailability or inability to deliver the right service. The modus operandi of those Rotating Credit and Savings Associations should be regulated by legal frame works. For example, in Ethiopia the National bank of Ethiopia enacts regulations for the credit associations functioning in the country. In *Somalia, Sudan and South Sudan* also it is expected that Credit Associations as emerging financial institutions have to be regulated in order to achieve the prime objectives by which they were established and provide proper services for their clients.

Can you discuss the laws and regulations of Credit Associates in your respective counties?

5.3 Regulatory frameworks of Banking

5.6.1 Negotiable Instruments

Negotiable instruments include documents such as cheque, bills of exchange, promissory notes, and stock warrants, etc. Those documents serve as means of transaction and may represent the function that money can serve. Anyone who possesses a negotiable instrument may bring legal action even if he has not given consideration if the prior holder did.

5.4 Regulatory frameworks of Insurance

Insurance is a critical component of modern living. Individuals and organizations purchase insurance to protect themselves against financial loss caused by property damage or death.

Nature of the contract of insurance

Insurance contract is a type of contract in which the insurer agrees to compensate the insured in the case of an occurrence. Insurance contracts, like all other types of contracts, are regulated by the general rules of contracts, one of which is the law of privity of contract.

When the proposer's offer is approved by the insurer, an insurance contract is formed. The proposal is completed by the proposer to the insurer and this is the formal way by which offer is made under insurance contract. After completing all the requirements of the form, the proposer signs a declaration stating that the responses represent the basis of the contract between the proposer and the insurer. This declaration is referred to as the "Contract Basis Clause." The proposer's formal offer is made when the proposal form is submitted to the insurer. The insurer doesn’t have outright obligations to accept the proposal. He may, however, as a result of his risk assessment, extend temporal cover to the proposer.

5.4.1 Insurance Policies and their Components

1. The **parties to the contract**: Contracting parties in insurance agreements are the insurer and the insured.

2. Premium: This is the amount of money that is periodically transferred from the beneficiary of the insurance/insured to the insurer in order to support implementation of the contract (*Mauri, 2010*).

3. Risk is the possibility or chance of suffering a loss; it is defined as the probability of experiencing a result that is contrary to what is expected. Insurance is a method of risk management. Unlike insurance contracts, where risk exists in advance of the contract, in a risking contract, the risk happens by a party who enters into the deal. (*Robertson v. Hamilton*)

When it comes to insurance, there must be doubt if the event will ever occur, and if that happens, there should be uncertainty as to when it will occur, as was determined in the case of *Revenue Commission Vs Prudential Assurance Company* in the United Kingdom.

4. Insurable Interest: Is the pecuniary or monetary interest of a person in a subject matter that he or she is likely to lose if the risk occurs. The interest can be either authorized or equitable in nature.

5. Control: The insurable incidence need to be out of either party's control in order to be covered. Accidents and the consequences of negligence: Insurance is only financially viable in situations where damage is expected to be accidental or owing to someone's carelessness.

Self-assessment questions

- *What are Negotiable Instruments*
- *In insurance, what are the content of the proposal form.*
- *What are the elements of insurance?*
- *Explain the nature of the contract of insurance*
- *List down the role of small and microfinance e institutions in supporting development plans?*
- *How are microfinance institutions regulated?*