“The closure of Crane Bank and bank failures in other Jurisdictions”

The closure of Crane Bank by Bank of Uganda has generated mixed reactions on both sides of the divide. Some have argued that the closure of Crane Bank could have been prevented since it was it was preceded by failures of other banks in Uganda, for example, the Greenland Bank 1999 and many others in Europe and USA. This school of thought suggests that when there is a precedence on certain behavioural aspect, it is easy to predict and prevent similar behavioural occurrences in future. I do not wholly agree with this school of thought because there are many judicial precedence on theft, for example R v Gosh (1983) name them but this has not prevented criminal elements from breaking into someone’s house or car to help themselves on whatever they can get their hands on. In another school (where I tend to lean), is that however robust bank supervision is, it cannot singlehandedly prevent bank failure or failure of any other corporation for that matter.

In 1990s, several banks were closed by Bank of Uganda for failure to institute robust measures to protect depositors’ money and millions of shareholders equity. There was a culture among top bank executives to ignore prudential regulatory guidelines, extending credit to borrowers on strength of a hand written chit (the flying chits’ culture), ideally treating customer’s money as personal property. The board had been either complicit to fraud or auditors compromised to perform their functions to those failed banks properly. Is this not what seems to have happened at Crane Bank considering the loans extended to Mr Sudhir Ruparelia associates often in disregard of prudential regulatory guidelines by BOU? Crane Bank is alleged to have extended huge loans to Mr Ruparelia close associates and his other company—Meera investments Ltd. Its financial health became frail and fell below the required minimum capital threshold for a bank to operate effectively. A financial institution is required at all times to maintain a core capital of not less than 8% and a total capital of not less than 12% of the total risk adjusted assets plus risk adjusted off balance sheet items as set out in the Quarterly Computation for Capital Adequacy. The Financial Institutions (Revision of Minimum Capital Requirements) Instrument No. 43 of 2010 in accordance with section 26(5) of the Financial Institutions Act 2004, revised the Minimum Capital requirements of Banks to One million, two hundred and fifty thousand currency points (25,000,000,000/=. Crane Bank capital reserves was found to have fallen far below the required minimum capital threshold to sustain a healthy financial institution. This left BOU with very few options but to close its operations. In a statement issued by the Governor of BOU—Professor Tumusiime Mutebile, Crane Bank was taken over to safeguard depositors money and maintain public confidence in the financial sector.

There is no doubt that banking supervision is a crucial component for the success of banks, nevertheless, it cannot singlehandedly prevent bank failure. Recent experiences of bank failures in other jurisdictions suggest that a well supervised bank can also fail especially where failure is a result of extraneous factors the individual bank cannot control. Here cases abound, for instance, the Lehman Brothers Ltd (a highly leveraged of broker dealers) which collapsed due to factors beyond its control, the Northern Rock and Royal Bank of Scotland in the UK which were nationalised by the British Government. In

United States, there was Merrill Lynch which was taken over by Bank of America and the New York Fed having an oversight responsibility. Goldman Sachs was rescued by Warren Buffett and the list goes on and on. While there was failure of regulatory oversight to curtail a risk appetite culture in these banks, their fate was not sealed solely by supervisory failure but they were also victims of circumstances beyond their control. So, what does bank supervision entail? "Bank supervision is a practice carried through a number of mutually self-supporting processes, generally based on regular returns, meetings, regular or *adhoc* visits, reports and investigations in individual banks."

The supervision of banks in Uganda is the responsibility of Bank of Uganda. Its supervisory mandate is to ensure not least a safe and sound financial system for protection of depositors' funds to foster an effective environment for macro-economic stability. So why was the supervision of Crane Bank by BOU slack and failed to reveal underlying problems, leading to its closure and eventual take over by DFCU Bank. One can infer that some of the supervisory processes by BOU could either have been overlooked or not well carried out or something the public is yet to know about happened. In both instances, the closure of Crane Bank can be examined in the context of failures of other banks in other parts of the globe such as Bank of Credit and Commerce International (BCCI) under the supervision of the Bank of England in 1991. Though the case of the BCCI has been superseded by recent bank failures, the circumstances in which it happened are similar to the collapse of Crane Bank in Uganda. Both banks were able to hoodwink supervisory authorities, which persisted for a long time undetected. What makes the case of Crane Bank unique or different is that it did not operate a complicated segmented structure like BCCI where corporate records were spread worldwide with fragmentation of regulation across different jurisdictions. Crane bank was supervised by a single regulator (the BOU) based in a single jurisdiction having consolidated access to all the bank's records at least as far as what has been revealed in investigations show.

There is an adage that "crime follows opportunity" and thus because banks deal in financial products, they are seen as fertile for vast opportunities to exploit. They will therefore always be targeted by criminals. The collapse of Crane Bank has demonstrated that lapses in supervision of banks by regulators will always open apertures for criminal exploitation. The earlier potential apertures are identified and isolated before they become multi-layered and complicated beyond regulators remit, very much the better. Poorly supervised bank establishments can easily be infiltrated by criminals to advance their criminal agenda. The BCCI (1991) was a case in point, of an institution that fundamentally operated without clear regulatory oversight and criminals were able to infiltrate it for criminal expediency. The BCCI also underscored how criminally minded bankers could outwit regulators and accountants with national remits. The BCCI, with its Luxembourg registration, London Headquarters, Middle Eastern shareholders and worldwide operations was regulated by everyone but no-one. The structure of the bank made it very difficult for regulators to provide the expected oversight from Bank of England.

In a situation where depositors' money or shareholders equity is being treated as personal property, for example, money lent out to close associates without following

prescribed prudential guidelines, I call this a syndrome many executives suffer from, of seeing themselves as bigger than corporations—their employer. There must be a clear divide executives MUST never cross—to know that their companies are bigger than them. There will be manipulations or defalcations which may go on undetected for a long time but eventually the truth will bubble to the surface. One can go as far as saying that "the truth will set you free" and lack of it will do the exact opposite. Since we have alluded to the adage that "crime follows opportunity" banks will always be targeted either from within or from without to exploit opportunities in the banks—there is no two way about it. This is precisely why BOU as a regulator cannot afford to take its foot off the gas (literally speaking), as this opens potential opportunities for criminal exploitation. I also propose that the regulatory function of BOU such as the regular visits to banks, meetings, checking the robustness of internal measures to counter-undesired behaviour such as KYCs, SARs CDDs ECDDs within banks, except for licencing should be outsourced to specialist financial consultancy firms**.** This will encourage public-private partnership in management of public finances. These three interest groups—BOU, Banks, and the private sector have a stake in the way financial institutions are regulated. Bank of Uganda is the regulator, the Bank is a business and the private sector is there for members of the public who will pick the pieces when things go wrong.

The author is a financial Law Consultant and a University Lecturer. He can be reached at garadi.ltd@gmail.com