











## LIST OF ACRONYMS

APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investment Commission
BCBS	Basel Committee on Banking Supervision
BOU	Bank of Uganda
CMA	Capital Markets Authority (Uganda)
FCA	Financial Conduct Authority (UK)
FIA	Financial Intelligence Authority (Uganda)
FPC	Financial Policy Committee (UK)
FSA	Financial Services Authority (UK)
FSB	Financial Services Board (South Africa)
GIZ	Deutsche Gesellschaft fuer Internationale Zusammenarbeit/ (German-Ugandan Development Cooperation)
IMF	International Monetary Fund
IRA	Insurance Regulatory Authority (Uganda)
MDI	Micro finance deposit-taking institutions
MFI	Micro finance institutions
NGO	Non-governmental organisation
NSSF	National Social Security Fund
PRA	Prudential Regulation Authority (UK)
SACCOs	Savings and credit cooperative organisations
UK	United Kingdom
ULRC	Uganda Law Reform Commission
URBRA	Uganda Retirement Benefits Regulatory Authority
USA	United States of America
USE	Uganda Securities Exchange

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# CHAPTER 1

## INTRODUCTION AND BACKGROUND

### 1.1. INTRODUCTION

The financial services sector in Uganda is relatively small and made up of both formal and semi-formal institutions. The formal institutions are regulated through a defined regulatory and supervisory framework while the semi-formal institutions are either regulated through ad hoc systems or not regulated at all.<sup>1</sup> Regulation refers to the establishment of rules relating to a particular industry and the monitoring and enforcement of such rules.<sup>2</sup> Financial regulation is formulation of rules to govern the financial sector. The objectives of regulation are categorised as being; consumer and investor protection, to ensure the solvency and soundness of financial institutions, to promote fairness, efficiency and transparency in the securities market and to promote a stable financial system.<sup>3</sup> It is believed that where market abuses are controlled consumer and investor confidences in the financial sector are high.<sup>4</sup> Financial regulations are premised on three perspectives; the philosophy perspective which is determined by the norms of the financial community in a country, the objective of regulation which is usually to achieve a higher degree of economic efficiency and guarantee consumer protection and the regulation theory.<sup>5</sup> All these perspectives are relied on to determine the choice of a regulatory framework.<sup>6</sup>

Different regulatory frameworks are adopted by different countries. The various regulatory frameworks that have been adopted by different jurisdictions include the functional model of regulation, the institutional model also known as the silos model of regulation, the unified regulator and the twin peaks model.<sup>7</sup> A functional model of regulation works on the basis of different departments being established in a financial sector to conduct specific functions at

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<sup>1</sup> ABC Capital Bank 'The Financial Sector In Uganda' available at <http://www.abccapitalbank.co.ug/index.php/financial-literacy/the-financial-sector-in-uganda> (accessed 14 February 2015).

<sup>2</sup> Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) 10 (11) *International Business and Economics Research Journal* 27.

<sup>3</sup> Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) 10 (11) *International Business and Economics Research Journal* 27.

<sup>4</sup> Mwenda KK *Legal Aspects of Financial regulation and the concept of a unified regulator* (2006) 3.

<sup>5</sup> Falkena H, Bamber R, Llewellyn D *et al Financial regulation in South Africa* 2 ed (2001) 1-3

<sup>6</sup> Falkena H, Bamber R, Llewellyn D *et al Financial regulation in South Africa* 2 ed (2001) 1-3.

<sup>7</sup> Llewellyn DT 'Institutional Structure of Financial Regulation and Supervision: Three Basic Issues' (2006) A paper presented at a World Bank Seminar *Aligning Supervisory Structures with Country needs* Washington DC, 6 & 7 June 2006 16-17 & 19.

non-sectoral level, such as licensing, legal accounting and others.<sup>8</sup> The institutional model is where each financial service is regulated by a different regulator.<sup>9</sup> It is also known as the silos model of regulation.<sup>10</sup> The unified regulator is where one authority is established to supervise and regulate all aspects of financial services in that country. On the other hand, the twin peaks model is where two distinct authorities are established one being for prudential regulation and the other being in charge of market conduct regulation in the financial sector.<sup>11</sup> The choice of a regulatory framework may be determined by country specific factors which include historical development of the financial sector, size of the sector and public policy priorities among others.<sup>12</sup> There is therefore no one - size fits all choice of a regulatory framework.

In the recent years, financial consumer protection has become a determinant for the choice of a regulatory framework. Consumer protection refers to measures streamlined by the state to protect consumers against fraudulent and deceptive sales practices.<sup>13</sup> A world federation of consumer groups, Consumers International, advises that it is good practice for a framework to successfully integrate financial consumer protection into the legal, regulatory and supervisory frameworks and to protect consumers against financial fraud, abuse and error.<sup>14</sup> Financial regulation protects customers and investors through business conduct rules especially those rules which mandate fair treatment and high standards of business conduct.<sup>15</sup> Jurisdictions such as Australia, the United States of America and the United Kingdom have adopted regulatory frameworks that seek to achieve more financial consumer protection. Other

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<sup>8</sup> Mwenda KK *Legal Aspects of Financial regulation and the concept of a unified regulator* (2006) 11.

<sup>9</sup> Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice In South Africa' (2011) 10 (11) *International Business and Economics Research Journal* 30.

<sup>10</sup> Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice In South Africa' (2011) 10 (11) *International Business and Economics Research Journal* 30.

<sup>11</sup> Llewellyn D T 'Institutional Structure of Financial Regulation and Supervision: Three Basic Issues' (2006) A paper presented at a World Bank seminar *Aligning Supervisory Structures with Country Needs* Washington DC, 6 & 7 June 2006 3.

<sup>12</sup> Mwenda KK *Legal Aspects of Financial regulation and the concept of a unified regulator* (2006) 11.

<sup>13</sup> Jeffries DJ 'Protection for consumers against unfair and deceptive business practices in Wisconsin' (1974) 57(4) *Marquette Law Review* 559-560.

<sup>14</sup> Consumers International 'In search of good practices in financial consumer protection' (2013) Available at

<http://www.consumersinternational.org/media/1135359/in%20search%20of%20good%20practices%20in%20financial%20consumer%20protection.pdf> (accessed 17 September 2015).

<sup>15</sup> Group of thirty Working Group on Financial supervision 'The structure of financial supervision; Approaches and challenges in a global market place' (2008) available at <http://www.group30.org/images/PDF/The%20Structure%20of%20Financial%20Supervision.pdf> (accessed 21 September 2015) 23.

countries such as South Africa are also in the process of changing their financial regulatory regimes to meet the consumer protection objective.<sup>16</sup>

As already stated above, the financial sector in Uganda is made up of formal and semi-formal institutions. The formal financial sector in Uganda is made up of banks, micro finance deposit-taking institutions, pension funds, insurance companies and the capital market whereas the semi-formal sector is made up of savings and credit cooperatives organisations (SACCOs and money lenders).<sup>17</sup>

The banking industry which takes up the biggest part of the formal financial sector in Uganda can be traced as far back as before independence. Uganda attained its independence in 1962 and at that time the government-owned institutions dominated most banking activities in Uganda.<sup>18</sup> There was however no central bank until 1966 when the Bank of Uganda was established to deal with currency control and foreign exchange reserves.<sup>19</sup> During that year (1966) Uganda also adopted the Uganda Shilling as the currency.<sup>20</sup> The banking sector seemed to be thriving but was later affected by the political upheavals prevailing in the country between the 1970's and 1980's causing the number of commercial bank branches to drop from 290 (two hundred ninety) to 84 (eighty four).<sup>21</sup> Intervention by the World Bank and International Monetary Fund (IMF) through imposing development conditions on the banking sector eventually stabilised the banking industry.<sup>22</sup> An extended moratorium was

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<sup>16</sup> FSB Focus 'Twin Peaks near its final stages' available at <https://www.fsb.co.za/Departments/twinpeaks/Documents/Twin%20Peaks%20FAQ%27s.pdf> (accessed 25 January 2016).

<sup>17</sup> Iwumbwe SK 'Overview of the Financial Sector in Uganda' (2015) available at <http://www.comcec.org/UserFiles/File/WorkingGroups/Financial4/presentations/Uganda.pdf> (accessed 22 June 2015).

<sup>18</sup> Uganda Bankers Association 'History of Banks' available at <http://ugandabankers.org/history-of-banks/> (accessed on 27 January, 2016)

<sup>19</sup> Mutibwa PM 'Birth of Bank of Uganda through a twisty road of thorns and roses' available at <http://www.independent.co.ug/supplement/117-supplement/7389-birth-of-bank-of-uganda-through-a-twisty-road-of-thorns-and-roses> (accessed 17 February 2015).

<sup>20</sup> Mutibwa PM 'Birth of Bank of Uganda through a twisty road of thorns and roses' available at <http://www.independent.co.ug/supplement/117-supplement/7389-birth-of-bank-of-uganda-through-a-twisty-road-of-thorns-and-rose> (accessed 17 February 2015).

<sup>21</sup> Bategeka L & Okumu LJ 'Banking sector Liberalisation in Uganda; Process, Results and Policy Options- (2010) Research report 10 available at [http://somo.nl/publications-en/Publication\\_3646/at\\_download/fullfile](http://somo.nl/publications-en/Publication_3646/at_download/fullfile) (accessed 17 February 2015).

<sup>22</sup> Bategeka L & Okumu LJ 'Banking sector Liberalisation in Uganda; Process, Results and Policy Options (2010) Research report 11.

imposed on services in Uganda between 1996 and 2008 to allow for implementation of new reforms for the supervision and regulation of the sector.<sup>23</sup> The banking sector currently consists of the Central bank, commercial banks, credit institutions, micro-finance deposit-taking institutions and development banks.<sup>24</sup> The Bank of Uganda (BOU), the country's central bank, supervises and regulates banking businesses and other non-banking businesses such as Micro Finance deposit-taking institutions and Forex Bureaus.<sup>25</sup>

The pension funds sector in Uganda is still under developed compared to the other countries in East Africa.<sup>26</sup> Uganda originally had two retirement fund streams; one for public service employees regulated by the pensions department at the ministry of public service<sup>27</sup> and the other for private employees handled by the National Social Security Fund (NSSF).<sup>28</sup> The pensions fund sector in Uganda is as of 2011 regulated and supervised by the Uganda Retirement Benefits Regulatory Authority (URBRA) which was established when Parliament passed the Uganda Retirement Benefits Act.<sup>29</sup>

The insurance sector in Uganda is regulated and supervised by the Insurance Regulatory Authority (IRA) which has overall authority to supervise and licence insurance activities in Uganda.<sup>30</sup> The Uganda Securities Exchange is regulated by the Capital Markets Authority (CMA) and other semi-formal financial institutions such as the money lenders and SACCOs are regulated by Acts of Parliament.

Uganda's financial sector regulatory framework can therefore be argued to be a 'silos model of regulation'. A silos model is a system of regulation where multiple agencies are set as

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<sup>23</sup> Cihak M & Podpiera R 'Bank Behaviour in Developing Countries: Evidence from East Africa' (2005) *IMF Working Paper* 6-7.

<sup>24</sup> Bategeka L & Okumu LJ 'Banking sector Liberalisation in Uganda; Process, Results and Policy Options (2010) *Research report* 11.

<sup>25</sup> Kigenyi C 'Banking and Finance in small states: issues and policies-Uganda's Case' (2009) Malta: Commonwealth 3<sup>rd</sup> Country Training Program.

<sup>26</sup> Kasente D *et al* 'Social Security Systems in Uganda' (2002) *Journal of social developments in Africa* 17(2) 157.

<sup>27</sup> Nyakundi BD 'A description of the pension System in Uganda: Need for Reform' (2009) *Social Science Research Network* available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1508364](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1508364) (accessed 22 June 2015).

<sup>28</sup> Rwakakamba M 'Uganda Pension Liberalisation: Will workers money be safe' (2014) *Public Policy Issue paper* 1.

<sup>29</sup> Uganda Retirement Benefits Regulatory Authority (URBRA) available at <http://www.urbra.go.ug/> (accessed 14 February 2015).

<sup>30</sup> IRA 'Insurance Regulatory Authority of Uganda' available at <http://www.ira.go.ug/index.html> (accessed 14 February 2015).

regulators for different institutions basing on objectives intended to be met by the regulator, functions of the regulator or institutions to be regulated.<sup>31</sup> A silos model of regulation presumes that there is clear demarcation between the industries and that each industry runs independently of another such that regulation of each industry can also be conducted independently of the other industries.<sup>32</sup> It is expected therefore that each regulator in the industry will conduct both prudential and market conduct regulation which aims to promote consumer protection.

Consumer protection refers to policies and laws put in place by a state to protect its consumers against abusive and deceptive business practices.<sup>33</sup> The state therefore has to balance the interests of the consumers and those of the suppliers or sellers of goods and services through either interventionist policies or non-interventionist policies.<sup>34</sup> The Ugandan Government does not have a consumer protection law in force. The Consumer Protection Bill has been shelved in Parliament since 2007 but has never been passed into law.<sup>35</sup> The lack of a general consumer protection regime places the duty to protect consumers on individual sectors. In the case of the financial sector, each regulator is expected to guarantee financial consumer protection in its service delivery.

The term financial consumer protection has been defined as the fair treatment, by financial services providers, of their customers and potential customers.<sup>36</sup> The 2007-2009 global financial crisis highlighted financial consumer protection as an important issue if global financial stability was to be attained.<sup>37</sup> The steady increase in the number of financial consumers over the years has also made it imperative to increase financial regulation and to educate consumers such that they are empowered to make informed decisions.<sup>38</sup> There are currently debates in legislatures and central banks of countries worldwide highlighting the

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<sup>31</sup> Mwenda KK *Legal Aspects of Financial regulation and the concept of a unified regulator* (2006) 8.

<sup>32</sup> The Group of Thirty *The structure of financial supervision: Approaches and challenges in a global market place* (2008) 24.

<sup>33</sup> Jeffries DJ 'Protection for consumers against unfair and deceptive business' (1974) 57(4) *Marquette Law Review* 559-560.

<sup>34</sup> Akinbami F 'Financial services and consumer protection after the crisis' (2011) 29(2) *International Journal of Banking Marketing* 134-135.

<sup>35</sup> Murina E 'Minister to table Consumer Protection Bill' (2013) *New Vision paper* available at <http://www.newvision.co.ug/news/645550-minister-to-table-consumer-protection-bill.html> (accessed 20 February 2015).

<sup>36</sup> Bank of Uganda and Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ) *Towards an Effective Framework for Financial Literacy and Financial Consumer Protection in Uganda* (2011).

<sup>37</sup> The World Bank *Good practices for financial consumer protection* (2012) 1.

<sup>38</sup> The World Bank *Good practices for financial consumer protection* (2012) 1.

link between protecting financial consumers and stable efficient markets.<sup>39</sup> The World Bank has formulated good practices of consumer financial protection which it is assisting all countries to implement in order to ensure that; consumers receive relevant information and make informed decisions, are protected for unfair and deceptive practices and have mechanisms of recourse in the event of disputes.<sup>40</sup> Financial consumer protection in many countries is implemented through law, codes of conduct and voluntary standards aimed at market regulation.<sup>41</sup>

It is only the BOU which has consumer protection guidelines in force at the moment, meaning that only consumers of banking services are assured of protection.<sup>42</sup> The absence of a consumer protection law leaves so much power in the hands of too many regulators who may either manipulate it or not prioritise protection of financial consumers. Many consumers have fallen victim to the consequences that come with the absence of a streamlined financial consumer protection regime. In the semi-formal sector, money lenders have made away with unsuspecting clients' property.<sup>43</sup> The retirement benefits sector has had pension payments being made to ghost workers in the public service while the legitimate public servants wait for years before having their payments processed<sup>44</sup> and the country loses billions of shillings to bank fraud every year because of weak security controls in the financial sector.<sup>45</sup> It is submitted that a change in regulatory framework from the silos model which causes disintegrated regulation as seen in the case of Uganda to the Twin Peaks model would guarantee financial consumer protection.

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<sup>39</sup> Brix L & Mckee C 'Consumer Protection Regulation in Low-Access Environments: Opportunities to promote Responsible Finance' (2010) *CGAP Issue No. 60*.

<sup>40</sup> The World Bank *Good practices for financial consumer protection* (2012) 1-2.

<sup>41</sup> Consumers International *In search of good practices in financial consumer protection* (2013) 2.

<sup>42</sup> Bank of Uganda 'Bank of Uganda Financial Consumer Protection Guidelines' available at [https://www.bou.or.ug/bou/media/from\\_the\\_bank/Financial\\_Consumer\\_Protection\\_Guidelines.html](https://www.bou.or.ug/bou/media/from_the_bank/Financial_Consumer_Protection_Guidelines.html) (accessed 20 February 2015).

<sup>43</sup> Tugume I 'Exposed: Tricks money lenders use to grab people's property' *The Red Pepper News Paper* 10 February 2013 available at <http://www.redpepper.co.ug/exposed-tricks-money-lenders-use-to-grab-peoples-property/> (accessed 6 August 2015).

<sup>44</sup> Candia S & Masaba S 'Shillings 165 billion paid to ghost pensioners' *The NewVision Newspaper* 10 January 2013 available at <http://www.newvision.co.ug/news/638782-sh165b-paid-to-ghost-pensioners.html> (accessed 22 July 2015).

<sup>45</sup> Kulabako F 'Uganda loses about 25b to bank fraud annually-report' *The Daily Monitor Newspaper* 7 March 2014 available at <http://www.monitor.co.ug/Business/Uganda-loses-about-Shs25b-to-bank-fraud-annually---report/-/688322/2233710/-/q8dsr3z/-/index.html> (accessed 2 September 2015).

If a comparison were to be made with United Kingdom (UK), one would realise that UK moved towards the twin peaks model in 2013 after the Financial Services Authority failed to successfully regulate the banks especially in the wake of the 2008 financial crisis.<sup>46</sup> The move towards two regulators, a prudential regulator and a financial conduct regulator was not only intended to stabilise the economy but also to guarantee protection of consumers in the Financial Sector.<sup>47</sup> The Twin Peaks model is considered to be the reason why Australia fared much better than most other countries in the 2008 global financial crisis.<sup>48</sup> Even closer to home, one of the reasons for South Africa's implementation of the Twin Peaks model according to the country's Financial Stability Board is to elevate the importance of market conduct regulation.<sup>49</sup> The Twin Peaks model of regulation is normally based on functions intended to be conducted by the regulator and occurs where two independent and autonomous authorities a set up one charged with prudential regulation and the other with market conduct regulation.<sup>50</sup>

Market conduct regulation and consumer protection seem to be an important aspect of most countries regulatory framework but Uganda has made minimal progress on this.



## 1.2. PROBLEM STATEMENT

Uganda has relied on the Silos regulatory framework for a number of years now. Each sector in the financial industry has its own distinct regulatory authority but there is no ultimate body or authority to oversee compliance in all the sectors. Whereas the Parliament of the Republic of Uganda is vested with power by Law to inspect the activities of each regulatory authority, it only intervenes after problems have arisen. For example, the Public Accounts Committee

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<sup>46</sup> Treanor J 'Farewell to FSA- and the bleak legacy of the light touch regulator' *The guardian* available at <http://www.theguardian.com/business/2013/mar/24/farewell-fsa-bleak-legacy-light-touch-regulator> (accessed 20 February 2015).

<sup>47</sup> Kitamura M 'UK replaces failed FSA with prudential Regulatory Authority' available at <http://www.bloomberq.com/news/articles/2013-04-01/u-k-replaces-failed-fsa-with-prudential-regulatory-authority> (accessed 20 February 2015).

<sup>48</sup> Jones E 'Australia and the GFC- why did we fare so well' available at <http://sydney.edu.au/news/law/436.html?newsstoryid=12677> (accessed 20 February 2015).

<sup>49</sup> 'Twin Peaks model to boost South Africa's financial stability' available at <http://www.sanews.gov.za/business/twin-peaks-model-boost-sa%E2%80%99s-financial-system> (accessed 20 February 2015).

<sup>50</sup> Mwenda KK *Legal Aspects of Financial regulation and the concept of a unified regulator* (2006) 9.

only inquired into the activities of the NSSF after they had used public funds to purchase land without authorisation.<sup>51</sup>

In the last twenty years many banks have either been liquidated or taken over by the BOU for various reasons ranging from low liquidity levels to mismanagement.<sup>52</sup> The retirement benefits' sector has been tarnished by corruption on several occasions the most scandalous being procedural impropriety and misallocation of funds during purchase of assets.<sup>53</sup> Several unsuspecting consumers have lost their property to the fraud orchestrated by money lenders who have not been adequately regulated.<sup>54</sup>

The BOU issued guidelines in 2011 to ensure consumer protection however these only apply to institutions that are regulated by the central bank.<sup>55</sup> This leaves the rest of financial sector without protection for the consumers. The parliament of Uganda has for years failed to pass into law statutes intended to protect consumers of financial services. The fact that there is underlying fraud in the financial system which has caused the consumers to lose a lot of money and property begs the question whether the silos model is the most appropriate model for Uganda to ensure consumer protection.

This study therefore seeks to examine the suitability of the Silos model in guaranteeing consumer protection for the financial sector in Uganda and to recommend the adoption of the Twin Peaks model as a financial consumer protection mechanism.

### **1.3. OBJECTIVES OF THE STUDY**

The main objective of the study is to analyse the possibility of adopting the Twin Peaks model as a mechanism for ensuring protection to the consumers of financial services in Uganda.

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<sup>51</sup> 'NSSF: MP's move on jamwa and kagonyera' available at <http://www.observer.ug/news-headlines/8073-nssf-mps-move-on-jamwa-kagonyera> (accessed 24 February 2015).

<sup>52</sup> Bategeka L & Okumu LJ 'Banking sector Liberalisation in Uganda; Process, Results and Policy Options- Research report ' (2010) 11 available at [http://somo.nl/publications-en/Publication\\_3646/at\\_download/fullfile](http://somo.nl/publications-en/Publication_3646/at_download/fullfile) (accessed 17 February 2015).

<sup>53</sup> Rwakakamba M 'Uganda Pension Liberalisation: Will workers money be safe' (2014) *Public Policy Issue paper 1*.

<sup>54</sup> Etukuri C 'Money lenders strip hundreds of property' *The New Vision* 17 June 2013 available at <http://www.newvision.co.ug/news/644039-money-lenders-strip-hundreds-of-property.html> (accessed 24 February 2015).

<sup>55</sup> Section 2 of the Bank of Uganda Financial Consumer Protection Guidelines 2011.

In-order to answer this question, this paper shall:

1. Critically analyse the utilisation of a silos model in Uganda and its sufficiency in guaranteeing consumer protection
2. Analyse the possibility of Uganda adopting a Twin Peaks model to elevate consumer protection in the financial sector

#### **1.4. SIGNIFICANCE OF THE STUDY**

Uganda's financial sector has suffered impediments to growth and this can largely be attributed to the regulatory framework but also due to the absence in streamlined financial consumer protection. The Parliament of Uganda has failed to pass into law legislation required to protect consumers generally let alone financial consumers. The gaping hole created by lack of legislation puts consumers of financial services at risk of loss.

This research paper shall give insight into the possibility of the financial sector adopting a new regulatory framework with inbuilt mechanisms for consumer protection. This research paper will also be a legal resource for literature pertaining to the correlation between a financial regulatory system and financial consumer protection.

#### **1.5. RESEARCH METHODOLOGY**

The researcher will rely entirely on materials available from various primary sources including national legislation, textbooks, and secondary sources such as journal articles, reports, newspaper articles and internet sources. A comparison will be made between Uganda and other countries such as UK, Australia and South Africa that have to a larger extent implemented financial consumer protection through adopting the Twin Peaks Regulatory Framework. UK implemented the Twin peaks model following the global financial crisis to promote quick recovery and stability in the financial sector.<sup>56</sup>

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<sup>56</sup> 'The new Twin Peaks Model; a report on the financial services industry's view on upcoming regulatory issues' available at [http://information.dla.com/information/published/Twin\\_peaks.pdf](http://information.dla.com/information/published/Twin_peaks.pdf) (accessed 11 March 2015).

According to the chairperson of the Twin Peaks Implementation Board, South Africa's decision to implement the Twin Peaks model of regulation is influenced by the need to strengthen its approach to consumer protection and market conduct.<sup>57</sup>

Australia has had the Twin Peaks model in operation for much longer than the UK and it is argued that this model played a big role in protecting Australia's financial sector from the credit crunch which badly affected most other developing and developed countries.<sup>58</sup> These countries have been selected by the researcher because they all changed their regulatory frameworks to the Twin Peaks model specifically to improve consumer protection. The researcher's comparison to these countries will therefore be in respect to how the Twin Peaks Model has promoted consumer protection in these countries and how Uganda can refer to them to implement the same.

## **1.6. STRUCTURE**

### **Chapter one**

This is an introductory chapter which provided an overview of the background to the study, the problem statement, the significance of the study and the methodology.

### **Chapter two**

This Chapter will analyse critically the current silos regulatory framework in Uganda and the status of the financial consumer protection regime. It shall also examine the efficiency of the silos model in ensuring financial consumer protection.

### **Chapter three**

This chapter will study the possibility of Uganda adopting a Twin Peaks model to elevate consumer protection and regulate market conduct in the financial sector. Comparison in this chapter shall be made to the United Kingdom, South Africa and Australia which have all adopted the Twin Peaks model

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<sup>57</sup> FSB Focus 'Twin Peaks near its final stages' available at <https://www.fsb.co.za/Departments/twinpeaks/Documents/Twin%20Peaks%20FAQ%27s.pdf> (accessed 9 March 2015).

<sup>58</sup> Jones E 'Australia and GFC –why did we fare so well' available at <http://sydney.edu.au/news/law/436.html?newsstoryid=12677> (accessed 20 February 2015).

## **Chapter four**

This chapter will contain and summary of all the previous chapters together with recommendations and conclusions on the possibility of adopting a Twin Peaks model.



## **CHAPTER 2**

### **THE SCOPE OF FINANCIAL REGULATION AND CONSUMER FINANCIAL PROTECTION IN UGANDA**

#### **2.1. INTRODUCTION**

Uganda's financial sector is made up of various industries each regulated by a different authority established by different statutes of parliament. The different laws that regulate the financial sector in Uganda are the following. The Bank of Uganda Act 2000 which establishes the Bank of Uganda (BOU) as the regulator and supervisor for commercial banks, microfinance deposit-taking institutions and foreign currency exchange bureaus. Other statutes which regulate the banking industry are the Financial Institutions Act 2004, the Micro Finance Deposit-Taking Institutions Act 2003 and Foreign Exchange Act 2003. The Insurance Act establishes the Uganda Insurance Regulatory Authority as the regulator for the insurance sector,<sup>59</sup> the Capital Markets Act establishes the CMA as the regulator for the stock markets and the Retirement Benefits Regulation Act, 2011 establishes the Uganda Retirement Benefits Regulatory Authority (URBRA) as the pension's sector regulator.<sup>60</sup> The retirement benefits sector is also regulated through the Pensions Act Cap 286. Semi-formal sectors such as money lenders are regulated by the Money Lenders Act Cap 273 but no specific authority has been established to regulate them. Each of the industries in Uganda's financial sector is regulated independently from the other industries.

This chapter examines the scope and nature of regulation in Uganda's financial sector and analyses the extent to which the regulatory framework is equipped to guarantee protection to the consumers of these services. The first section is a brief introduction giving an overview of Uganda's financial sector. The second section analyses the financial industries in Uganda specifically highlighting the regulatory framework in place. Section three is an analysis of the consumer protection framework in Uganda.

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<sup>59</sup> 'The Insurance Regulatory Authority' available at <http://ira.go.ug/index.html> (accessed 31 August 2015).

<sup>60</sup> 'The Uganda Retirement Benefits Regulatory Authority' available at <http://www.urbra.go.ug/rbs-act.html> (accessed 31 August 2015).

## 2.2. UGANDA'S FINANCIAL SECTOR

Uganda has various financial services within its financial sector and each service is regulated by a different body. This has already been referred to in chapter one as a silos model of regulation. According to Botha, the silos model is the traditional model which appropriates the financial regulation in terms of its financial lines being; banking, insurance, securities and others.<sup>61</sup> Some authors have noted that the classic silos model worked well in financial industries where there was a clear demarcation between banking, security markets and insurance companies and other financial industries.<sup>62</sup> This sort of clear cut demarcation in the financial sector is no longer easy to find. This could be due to the fact that the financial sector has evolved and become more integrated such that there is an increase in the risk of financial contagion during crises.<sup>63</sup> Moreover it is also argued that a silo-based approach to financial sector regulation with each industry being governed by a separate and distinct piece of legislation leads to fragmented supervision and regulatory arbitrage.<sup>64</sup> This is a viable argument because of the linkages that have over time developed between industries in the financial sector making it difficult to ascertain the boundaries of one industry from another.

Uganda's financial sector has formal frameworks and semi-formal frameworks but some sectors are not being regulated at all. The formal regulatory frameworks are those where effective mechanisms are put in place for the supervision and enforcement of standards in a particular industry.<sup>65</sup> The industries regulated through formal frameworks include the banks and micro finance deposit-taking institutions, micro finance institutions, foreign currency exchange bureaus, the capital markets industry, the insurance industry and the retirement benefits industry.<sup>66</sup>

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<sup>61</sup> Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) 27-30.

<sup>62</sup> Masciandaro D & Quintyn M 'Reforming financial supervision and the role of central banks: A review of global trends causes and effects' (2009) *Centre for Economic Policy Research Policy Insight* No.30 3.

<sup>63</sup> Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) 27.

<sup>64</sup> Department of South Africa National Treasury 'Treating customers fairly: A draft market conduct policy framework for South Africa' (2014) *Discussion paper* available at <http://www.treasury.gov.za/public%20comments/FSR2014/Treating%20Customers%20Fairly%20in%20the%20Financial%20Sector%20Draft%20MCP%20Framework%20Amended%20Jan2015%20WithAp6.pdf> (accessed 13 August 2015).

<sup>65</sup> Falkena H, Bamber R and Llewellyn D *et al Financial Regulation in South Africa* (2001) v.

<sup>66</sup> Abc Capital Bank 'The Financial sector in Uganda' available at <http://www.abccapitalbank.co.ug/index.php/financial-literacy/the-financial-sector-in-uganda> accessed 15 June 2015.

### 2.2.1. Banking industry

The banking industry in Uganda can be traced as far back as before Uganda attained her independence when the industry was mainly dominated by foreign commercial banks.<sup>67</sup> The country had no central Bank therefore currency was issued by the East African Currency Board.<sup>68</sup> In 1966 the Parliament passed a statute creating the BOU and granted it powers to regulate and supervise banking services in Uganda.<sup>69</sup> Regulation of banking services was however not exclusively conducted by the central bank since it was done in partnership with the Ministry of Finance until the early 1990's when new bank reforms were issued.<sup>70</sup> With assistance from the World Bank, reforms were made to banking regulation ranging from legislative reforms to prudential regulation reforms.<sup>71</sup> The parallel licensing and regulatory system was phased away such that the central bank now has exclusive regulatory and licensing authority over the banking sector in Uganda.<sup>72</sup>

New legislation pertaining to regulation of the banking sector was enacted by Parliament among which were the Bank of Uganda Act<sup>73</sup> and the Financial Institutions Act.<sup>74</sup> The Bank of Uganda Act indicates that its purpose is 'regulating the issuing of legal tender, maintaining external reserves and for promoting the stability of the currency and a sound financial structure conducive to a balanced and sustained rate of growth of the economy' among others.<sup>75</sup> The Financial Institutions Act places regulatory and supervisory power of financial institutions in the hands of the central bank (BOU) and gives it power to licence, supervise

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<sup>67</sup> Mugume A 'Market Structure and performance in Uganda's Banking Industry' available at <http://www.africametrics.org/documents/conference07/Day%202/Session%206/Muqume%20market%20strucure.pdf> (accessed 18 June 2015) 8.

<sup>68</sup> Mutibwa PM 'Birth of Bank of Uganda through a twisty road of thorns and roses' available at <http://www.independent.co.ug/supplement/117-supplement/7389-birth-of-bank-of-uganda-through-a-twisty-road-of-thorns-and-roses> (accessed 17 February 2015).

<sup>69</sup> Bategeka L & Okumu L J (Economic Policy Research Centre Uganda) 'Banking Sector Liberalisation in Uganda: Process, Results and Policy Options' (2010) *Research Report* 10.

<sup>70</sup> Mutibwa PM 'Birth of Bank of Uganda through a twisty road of thorns and roses' available at <http://www.independent.co.ug/supplement/117-supplement/7389-birth-of-bank-of-uganda-through-a-twisty-road-of-thorns-and-roses> (accessed 17 February 2015).

<sup>71</sup> Brownbridge M 'Financial repression and financial reform in Uganda' in Brownbridge M & Hervey C *Banking in Africa the impact of financial sector reform since independence* (1998) 121,128.

<sup>72</sup> Kasekende L 'Plenary Session on Financial Services and Economic Development in Africa: Uganda's Experience with Financial Sector Reforms and Lessons for Africa' (2007) 16 *Journal for African Economics* 58.

<sup>73</sup> The Bank of Uganda Act Cap 51 (All legislation enacted in Uganda before the year 2000 was compiled into a compendium of laws known as the Laws of Uganda, 2000 and is therefore cited as a chapter (Cap) of the laws of Uganda compendium. All laws enacted after the year 2000 are cited by the year of enactment)

<sup>74</sup> The Financial Institutions Act 2004.

<sup>75</sup> The Bank of Uganda Act Cap 51.

and inspect all financial institutions.<sup>76</sup> The Financial Institutions Act defines financial institutions to include commercial banks, merchant banks, mortgage banks, the post office savings bank, credit institutions, a building society, an acceptance house, a discount house and a finance house among others.<sup>77</sup> The Act also extends the BOU's powers to regulation of businesses engaged in foreign currency exchange services.<sup>78</sup>

The financial reforms passed in the 1990s introduced the four tier financial regulatory system in Uganda.<sup>79</sup> The four tier regulatory system places financial institutions into categories listing those that are supervised by the BOU and those that are left outside the BOU's regulation. Tier one comprises of commercial banks, tier two comprises of credit institutions and tier three comprises of micro finance credit taking institutions which are governed by the micro deposit-taking institutions Act.<sup>80</sup> All institutions categorised as tier one to tier three are governed by different statutes but regulated by the BOU however tier four institutions which are non- deposit-taking institutions are not regulated by the BOU.<sup>81</sup> The main objectives of the BOU's regulation are to promote existence of efficient and fair banking and financial services markets, to supervise licensees and determine whether they are in sound financial condition and to maintain an appropriate level of protection for the depositors.<sup>82</sup> In doing this, regulations have been issued that set minimum capital requirements, liquidity requirements and credit exposure limits that are to be met before a financial institution can be licensed.<sup>83</sup> The requirements for licensing a bank to commence operations are prudential requirements. It appears as long as the bank proves that it is financially sound, such a bank will be authorised to operate.

The focus of the BOU's regulation is prudential regulation which aims to protect the stability of the financial system and protect deposits thus maintaining the safety and soundness of the banking system.<sup>84</sup> However the BOU, in an attempt to expand the scope of its regulation to

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<sup>76</sup> Sections 4, 38,39,40,79 & 82 of the Financial Institutions Act 2 of 2004.

<sup>77</sup> Section 3 of the Financial Institutions Act 2 of 2004.

<sup>78</sup> Section 40 of the Financial Institutions Act 2 of 2004.

<sup>79</sup> Kalyango DL 'Uganda's experience with tiered Banking regulation' available at [www.finmark.org.za/wp-content/.../Paper\\_Kalyango\\_tiered\\_04.pdf](http://www.finmark.org.za/wp-content/.../Paper_Kalyango_tiered_04.pdf) (accessed 18 June 2015).

<sup>80</sup> Micro Finance Deposit Taking Institutions Act 2003.

<sup>81</sup> Kalyango DL 'Uganda's experience with tiered Banking regulation' available at [www.finmark.org.za/wp-content/.../Paper\\_Kalyango\\_tiered\\_04.pdf](http://www.finmark.org.za/wp-content/.../Paper_Kalyango_tiered_04.pdf) (accessed 18 June 2015).

<sup>82</sup> Section 5(3) of the Financial Institutions Act of 2008.

<sup>83</sup> Section 9 (1)-(3) of the Financial Institutions Act of 2008.

<sup>84</sup> Browbridge M Kirkpatrick C & Maimbo MS 'Prudential Regulation' (2002) *Finance and development*

financial consumer protection, has recently issued consumer protection guidelines for all institutions under its supervision. The basic principles upon which the BOU Consumer Protection Guidelines operate are fairness, transparency and reliability.<sup>85</sup> They instruct financial services providers to act reasonably when dealing with consumers, to provide them with sufficient well explained information such that they can make informed decisions and to give advice to consumers relating to financial products after taking into consideration their individual circumstances.<sup>86</sup> The BOU is implementing a consumer protection mechanism however its main focus has remained prudential regulation which it has given more priority while less attention is given to consumer protection.

### 2.2.2. Insurance industry

Insurance services in Uganda have over the years been regulated by a multitude of statutes starting with the 1961 Insurance Ordinance to the present day Insurance Act, 2000 as amended by the Insurance Amendment Act of 2011.<sup>87</sup> The Insurance Act<sup>88</sup> established the Insurance Commission and this was later replaced by the Insurance Regulatory Authority (IRA) to ensure effective administration, supervision, regulation and control of Insurance business in Uganda.<sup>89</sup> The IRA is charged with the duty to licence insurance services in Uganda and only issues licences to companies that have complied with set conditions for the operation of insurance business.<sup>90</sup> Its regulatory system is mainly prudential to the extent that IRA's main objective is to ensure that insurance companies remain solvent and in order to achieve this, it sets out capital requirements intended to guarantee this<sup>91</sup> The insurance regulations which are issued under the Insurance Act set a minimum paid up capital and lays out conditions upon which a company will be authorised to operate insurance business and these are that the company must possess a professional indemnity policy, must make a

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*briefing papers 1.*

<sup>85</sup> Section 5 of the Bank of Uganda Consumer protection guidelines of 2011.

<sup>86</sup> Section 6 (1) (2) of the Bank of Uganda Consumer Protection guidelines of 2011.

<sup>87</sup> Insurance Regulatory Authority 'Insurance Regulation in Uganda' available at <http://ira.go.ug/a%20presentation%20on%20regulations%20of%20insurance%20at%20ldc.pdf> (accessed 20 June 2015).

<sup>88</sup> The Insurance Act Cap 213 as amended.

<sup>89</sup> Insurance Regulatory Authority 'Insurance Regulation in Uganda' available at <http://ira.go.ug/a%20presentation%20on%20regulations%20of%20insurance%20at%20ldc.pdf> (accessed 20 June 2015).

<sup>90</sup> Section 14, 15 of the Insurance Act Cap 213.

<sup>91</sup> Section 6 of the Insurance Act Cap 213; Insurance Regulatory Authority 'Insurance Regulation in Uganda' available at <http://ira.go.ug/a%20presentation%20on%20regulations%20of%20insurance%20at%20ldc.pdf> (accessed 20 June 2015).

security deposit of ten percent of its paid up capital to IRA and must have in place a capital structure that supports its future earnings prospects among others.<sup>92</sup> These however are all prudential requirements and do not relate to market conduct regulation.

The IRA in trying to improve insurance regulation in Uganda overhauled the insurance laws to bring them up to international standards by catering for corporate governance and risk management which is not covered by the Insurance Act originally.<sup>93</sup> The IRA also set up an Insurance Bureau to handle complaints from the public against insurers.<sup>94</sup> The 2013 annual insurance report indicates that the bureau has so far received 113 complaints from the public. It shows that the majority of the complaints arose from the fact that there were differences between benefits promised by insurers and those stated in the policies and the fact that there were delays in payments of claims among others.<sup>95</sup> These complaints arise not out of a failure of prudential regulation but because of lack of adequate market conduct regulation. The IRA in the annual report also noted that there was increasing unethical conduct in service delivery in the Insurance industry yet its onsite and offsite inspections still focus on liquidity of insurance companies and payment of premiums but do not give as much attention to market conduct.<sup>96</sup> The IRA in its consumer education focuses on increasing awareness to the public about the benefits of insurance<sup>97</sup> as opposed to equipping them with necessary knowledge to make informed decisions. The IRA is biased and seems to concentrate on financial success of the insurance industry at the expense of consumer protection. It can be argued therefore that the IRA is less concerned about the protection of its consumers than it is about the success of the insurance industry.

### 2.2.3. The pensions industry

The pensions industry in Uganda is regulated by the Pensions Act which aims to regulate pensions, gratuities and other allowances for public service officers.<sup>98</sup> Pensions for public

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<sup>92</sup> Insurance Regulatory Authority 'Regulation of Insurance in Uganda' available at <http://ira.go.ug/a%20presentation%20on%20regulations%20of%20insurance%20at%20ldc.pdf> (accessed 7 September 2015).

<sup>93</sup> Insurance Regulatory Authority of Uganda 'Insurance Act set for overhaul' available at <http://www.ira.go.ug/leadstory2.html> (accessed 20 June 2015).

<sup>94</sup> Insurance Regulatory Authority of Uganda available at <http://ira.go.ug/> (last accessed on 10<sup>th</sup> February, 2016)

<sup>95</sup> Insurance Regulatory Authority Uganda 'Annual Insurance Market Report' (2013) 9.

<sup>96</sup> Insurance Regulatory Authority Uganda 'Annual Insurance Market Report' (2013) 9.

<sup>97</sup> Insurance Regulatory Authority Uganda 'Annual Insurance Market Report' (2013) 9.

<sup>98</sup> The Pensions Act Cap 286.

servants are handled by the pensions department and the Ministry of Public Service.<sup>99</sup> Private employees are not governed by the Pensions Act but get social protection through the National Social Security Fund (NSSF) Act which applies generally to all private employees.<sup>100</sup> The NSSF Act establishes the NSSF as a mandatory scheme for all formal employees to cater for their social benefits on termination of services either due to death, invalidity of employment old age and emigration.<sup>101</sup> The two different laws applying to public and private employees seemed to create two parallel regulatory frameworks in the pensions sector in Uganda which may have allowed a lot of scamming and fraud to go unchecked. In 2011, Parliament passed the Uganda Retirement Benefits Act which established the URBRA and charged it with the duty to regulate the establishment, management and operation of retirement benefit schemes in Uganda whether private or public.

Regulations have been issued under the Retirement Benefits Act that relate to licensing a retirement benefits scheme, licensing custodians, trustees, administrators and fund managers.<sup>102</sup> There are no regulations that have been issued to govern protection of beneficiaries or that relate to how and when complaints can be lodged by beneficiaries of this service. Instead, the URBRA established a complaints desk and formulated a form through which complaints can be lodged.<sup>103</sup> However, many aggrieved people may not be in position to use the complaints desk if there is no platform for them to understand the basis upon which they can complain. For example, a report by the Auditor General's office revealed that on average it takes over 23 months for retired individuals to get onto the government's pension pay roll.<sup>104</sup> This period is too long but because there are no regulations to protect consumers, they are forced to endure long waits before they get onto the pay roll and even longer before

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<sup>99</sup> Nyakundi BD 'A description of the pension System in Uganda: Need for Reform' (2009) *Social Science Research Network* available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1508364](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1508364) (accessed 22 June 2015).

<sup>100</sup> The National Social Security Act Cap 222.

<sup>101</sup> Nyakundi BD 'A description of the pension System in Uganda: Need for Reform' (2009) *Social Science Research Network* available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1508364](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1508364) (accessed 22 June 2015).

<sup>102</sup> 'Uganda Retirement Benefits Regulatory Authority' available at <http://www.urbra.go.ug/rbs-regulations.html> (accessed 10 September 2015).

<sup>103</sup> 'Uganda Retirement Benefits Regulatory Authority' available at <http://www.urbra.go.ug/complaints-form.html> (accessed 31 August 2015).

<sup>104</sup> Office of the Auditor General 'Value for money audit report on pension processing by the department of compensation, Ministry of Public Service' (2010) available at [https://afrosai-e.org.za/sites/afrosai-e.org.za/files/reports/1273680351PENSION\\_REPORT.pdf](https://afrosai-e.org.za/sites/afrosai-e.org.za/files/reports/1273680351PENSION_REPORT.pdf) (accessed 31 August 2015).

they get paid. Moreover, there is no sufficient information being availed to consumers about the purpose of the complaints desk so it is unlikely that most aggrieved people will know how to use it. The URBRA for all intents and purposes concentrates on soundness of retirement benefits schemes but less emphasis is placed on protection of consumers of this product.

#### 2.2.4. Capital markets industry

The capital markets industry is regulated by the Capital Markets Act<sup>105</sup> which established the CMA as a semi- autonomous body charged with promoting and regulating capital markets in Uganda.<sup>106</sup> The Uganda Securities Exchange (USE) is licenced by the CMA as a stock market through which companies that have met the conditions set by the CMA list their shares to be purchased by the public.<sup>107</sup> The Capital Markets Act together with USE listing rules lay out mainly capital requirements and corporate governance conditions that a corporate body has to meet before it can be listed on the USE.<sup>108</sup> The CMA emphasises transparency and insists that all corporate bodies make relevant disclosures about their business operations before such companies are allowed to list on the stock exchange.<sup>109</sup> The CMA also appreciates the need for financial consumer literacy to empower consumers in making informed decisions.<sup>110</sup> Japheth Katto, the chief executive officer of the CMA pointed out that the CMA is taking initiative to increase customer literacy because it is necessary to improve customers' financial wellbeing.<sup>111</sup> In spite of the fact that the CMA insists on transparency and has taken initiatives to increase consumer literacy, its main objective is to promote development of capital markets.<sup>112</sup> This is because Uganda's capital market industry, similar to most of those in other parts of Africa except for South Africa, is small and lacks

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<sup>105</sup> The Capital Markets Act Cap 84.

<sup>106</sup> CMA 'Capital Markets Authority' available at [http://cmauganda.co.ug/about\\_cma](http://cmauganda.co.ug/about_cma) (accessed 22 June 2015); Section 5 & Cap 84 of the Capital Markets Act.

<sup>107</sup> Section 24 of the Capital Markets Act Cap 84.

<sup>108</sup> Bohnstedt A, Hannig A & Odendall PR 'Capital Market development in Uganda; Private Sector Opinions on Listing' (2000) *Financial Systems Development Project* Series No. 2 19-20.

<sup>109</sup> Nsamba C 'Approval to list shares cannot be compromised-CMA' *The New vision Newspaper* 3 April 2015 available at <http://www.newvision.co.ug/news/666632-approval-to-list-shares-cannot-be-compromised-cma.html> (accessed 11September 2015).

<sup>110</sup> Capital Markets Authority Uganda 'Consumer Education: A National Necessity or an Unnecessary Irritation; the role of the regulator' (2011) 36<sup>th</sup> Annual International Organization of Securities Commissions (IOSCO) Conference 18-21 April 2011 Cape Town, South Africa.

<sup>111</sup> Capital Markets Authority Uganda 'Consumer Education: A National Necessity or an Unnecessary Irritation; the role of the regulator' (2011) 36<sup>th</sup> Annual International Organization of Securities Commissions (IOSCO) Conference 18-21 April 2011 Cape Town, South Africa.

<sup>112</sup> Section 5(1) of the Capital Markets Authority Act Cap 84.

liquidity.<sup>113</sup> The CMA therefore focuses more on prudential regulation than it does on market conduct.

### 2.2.5. The semi-formal financial sector

In Uganda the supply of financial services to rural areas is still done by semi-formal and informal systems because most main stream formal financial services are not available there.<sup>114</sup> The institutions which provide financial services to the rural areas are referred to as tier four institutions and they are not regulated by the BOU.<sup>115</sup> These institutions include savings and credit co-operative organisations (SACCOs), non-government organisations (NGOs) and money lenders. The form of regulation for these institutions is semi-formal though discussions are being conducted to bring them under the ambit of formal regulation through the BOU's financial inclusion drive.<sup>116</sup>

SACCOs are regulated by the Cooperative Societies Act and regulations enacted there under.<sup>117</sup> The licencing, regulation and supervision of SACCOs is conducted by the Registrar of cooperatives in the Ministry of Trade Tourism and Industry.<sup>118</sup> The Cabinet and Parliament of Uganda are both in consultations to bring the regulation of SACCOs under the Micro Finance Deposit-Taking Institutions Act to guarantee stricter regulation of such organisations in a bid to protect consumers.<sup>119</sup>

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<sup>113</sup> Bohnstedt A, Hannig A & Odendall P R 'Capital Market development in Uganda; Private Sector Opinions on Listing' (2000) *Financial Systems Development Project* Series No. 2-5.

<sup>114</sup> Iwumbwe SK 'Overview of the Financial Sector in Uganda' (2015) available at <http://www.comcec.org/UserFiles/File/WorkingGroups/Financial4/presentations/Uganda.pdf> (accessed 22 June 2015).

<sup>115</sup> Association of Micro finance Institutions in Uganda 'A survey on Regulation of micro finance Companies and NGOs' (2009) available at <http://www.microfinancegateway.org/sites/default/files/mfg-en-paper-a-survey-on-regulation-of-microfinance-companies-and-ngos-jan-2009.pdf> (accessed 22 June 2015).

<sup>116</sup> Kalyango DL 'Uganda's experience with tiered Banking regulation' available at [www.finmark.org.za/wp-content/.../Paper\\_Kalyango\\_tiered\\_04.pdf](http://www.finmark.org.za/wp-content/.../Paper_Kalyango_tiered_04.pdf) (accessed 18 June 2015); BOU 'Financial inclusion' available at [https://www.bou.or.ug/bou/supervision/Financial\\_Inclusion/Financial\\_Inclusion\\_Overview.html](https://www.bou.or.ug/bou/supervision/Financial_Inclusion/Financial_Inclusion_Overview.html) (accessed 22 June 2015).

<sup>117</sup> The Cooperative Societies Act Cap 112.

<sup>118</sup> Association of Micro finance Institutions in Uganda 'A survey on Regulation of micro finance Companies and NGOs' (2009) available at <http://www.microfinancegateway.org/sites/default/files/mfg-en-paper-a-survey-on-regulation-of-microfinance-companies-and-ngos-jan-2009.pdf> (accessed 22 June 2015).

<sup>119</sup> Wesonga N 'SACCOs to face tighter regulation in new law' *The Daily Monitor* January 30, 2015.

Money lenders are regulated by the Money Lenders Act<sup>120</sup> which gives licencing authority for such businesses to magistrates in each jurisdiction in which the money lender wishes to operate.<sup>121</sup> There is a high rise on money lending business in Uganda because they fill the gap in provision of financial services to people who cannot access funding from micro finance institutions.<sup>122</sup> There is however almost no regulation of these financial services because magistrates who are responsible for the regulation of money lenders are not professionally empowered to regulate these services.<sup>123</sup> Magistrates are judicial officers who stop at issuing certificates permitting the money lenders to operate but do not inspect the businesses thereafter to guarantee that consumers are protected.<sup>124</sup>

As shown in this section, Uganda's financial sector is regulated through a silo based approached which allows each institution or industry to be regulated independently from the others. Whether or not such a system of regulation takes into consideration need to protect consumers of such services is yet to be examined.

### **2.3. THE CONSUMER PROTECTION REGIME IN UGANDA'S FINANCIAL SECTOR**

Uganda currently has no consumer protection law in force whether for the financial sector or any other sector. The Uganda Law Reform Commission (ULRC) is taking steps to put in place a law to protect consumers in all sectors.<sup>125</sup> The objective of the ULRC is to put in place a law that will equip consumers with sufficient knowledge to help them make informed decisions when acquiring services in the market and to protect them from unfair trade practices.<sup>126</sup> This law, once passed will regulate consumer protection at a national level in all sectors however the focus of this paper is financial consumer protection only.

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<sup>120</sup> The Money Lenders Act Cap 273.

<sup>121</sup> Section 3(3) of the Money Lenders Act Cap 273.

<sup>122</sup> Byaruhanga J 'Money lenders: The need to regulate Uganda's money lenders' *The Daily Monitor News Paper* 22 June 2010.

<sup>123</sup> Byaruhanga J 'Money lenders: The need to regulate Uganda's money lenders' *The Daily Monitor News Paper* 22 June 2010.

<sup>124</sup> Section 3(1) of the Money Lenders Act Cap 273

<sup>125</sup> Uganda Law Reform Commission 'A study report on selected trade laws- Consumer protection law' (2004) *Law Commission Publication* No.27 of 2004.

<sup>126</sup> Uganda Law Reform Commission publication (2004).

As already stated in chapter one, the term financial consumer protection refers to the fair treatment, by financial services providers, of their customers and potential customers.<sup>127</sup> Since there is no general consumer protection law in Uganda, the different regulatory authorities in Uganda's financial sector are expected to put in place measures intended to protect the consumers of their services. Banking regulation in Uganda focuses mainly on prudential regulation and little thought was initially given to market conduct.<sup>128</sup> The BOU in an attempt to implement financial consumer protection issued the Financial Consumer Protection Guidelines<sup>129</sup> to apply to all services regulated by the BOU. The objectives of these guidelines are to; promote fair and equitable financial services practices by setting minimum standards for financial services providers in dealing with consumers, increase transparency in order to inform and empower consumers of financial services, foster confidence in the financial services sector, and to provide efficient and effective mechanisms for handling consumer complaints relating to the provision of financial products and services.<sup>130</sup> The BOU has partnered with financial institutions to ensure implementation of and compliance with the consumer protection guidelines.<sup>131</sup> Further assistance in form of training and harmonisation of consumer protection requirements has been offered by the BOU to all financial services under its regulation to achieve this goal.<sup>132</sup>

The formal financial sector in Uganda comprises of institutions regulated by the BOU and these, as noted above, are categorised as tier one, tier two and tier three financial institutions.<sup>133</sup> Tier four institutions are semi-formal institutions which are not regulated by Bank of Uganda.<sup>134</sup> Industries such as the Insurance industry, the Retirement benefits industry and the Capital Markets industry are regulated by different authorities and are outside the ambit of the BOU consumer protection guidelines.

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<sup>127</sup> Bank of Uganda and Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ) 'Towards an Effective Framework for Financial Literacy and Financial Consumer Protection in Uganda' (2011) *Financial System Development Program* 22.

<sup>128</sup> Bank of Uganda and Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ) (2011) 22.

<sup>129</sup> The Bank of Uganda Financial Consumer protection guidelines 2011.

<sup>130</sup> Section 4 of the Bank of Uganda Financial Consumer protection guidelines 2011.

<sup>131</sup> Uganda Bankers Association available at <http://ugandabankers.org/consumer-protection/> (accessed on 10 February 2016)

<sup>132</sup> Bank of Uganda 'Financial Inclusion: Financial Consumer protection (pillar 2)' available at [https://www.bou.or.ug/bou/supervision/Financial\\_Inclusion/Financial\\_Consumer\\_Protection.html](https://www.bou.or.ug/bou/supervision/Financial_Inclusion/Financial_Consumer_Protection.html) (accessed 25 June 2015).

<sup>133</sup> Kalyango DL 'Uganda's experience with tiered Banking regulation' (2005) available at [www.finmark.org.za/wp-content/.../Paper\\_Kalyango\\_tiered\\_04.pdf](http://www.finmark.org.za/wp-content/.../Paper_Kalyango_tiered_04.pdf) (accessed 18 June 2015).

<sup>134</sup> Kalyango DL 'Uganda's experience with tiered Banking regulation' available at [www.finmark.org.za/wp-content/.../Paper\\_Kalyango\\_tiered\\_04.pdf](http://www.finmark.org.za/wp-content/.../Paper_Kalyango_tiered_04.pdf) (accessed 18 June 2015).

The CMA through the Capital Markets (Prospectus Requirement) Regulations<sup>135</sup> guarantees that corporate bodies wishing to list as public companies on the stock exchange provide relevant information to the public to enable consumers to make informed decisions.<sup>136</sup> The CMA though not regulated or supervised by the BOU is partnering with the BOU to implement financial consumer protection through its regulations.<sup>137</sup> The CMA further provides for extensive financial consumer protection through the Capital Markets (Conduct of Business) Regulations 1996 which protect consumers by directing that advertisements of stocks should be true and fair; that conflict of interest should not be adverse to consumers and that consumers should be made aware of all risks at hand before taking decisions.<sup>138</sup> The CMA as already mentioned above assisted the BOU to establish its consumer protection guidelines but has not done that for its own industry. It is submitted that regulations intended to protect consumers in the capital markets industry are not streamlined and can therefore not have sufficient force. Moreover, the CMA's main objective is to develop the capital markets industry which implies that it will mostly concentrate on achieving financial soundness in the industry as opposed to consumer protection.

The regulatory regime for the insurance industry concentrates on prudential regulation with just a few provisions in the Uganda Insurers Association Code of Conduct catering for consumer protection<sup>139</sup> It has been noted that a weak consumer protection regime in the insurance sector can have a negative effect on the further development of the sector and can also spell loss on pay outs for the clients.<sup>140</sup> Attempts have been made by the Insurance Regulatory Authority to overhaul the insurance laws to provide for consumer protection however in its current state the law does not adequately protect consumers.<sup>141</sup>

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<sup>135</sup> Capital Markets (Prospectus Requirement) Regulations 1996.

<sup>136</sup> Nsamba C 'Approval to list shares cannot be compromised-CMA' *The New vision Newspaper* 3 April 2015 available at <http://www.newvision.co.ug/news/666632-approval-to-list-shares-cannot-be-compromised-cma.html> (accessed 11 September 2015).

<sup>137</sup> Bank of Uganda and Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ) (2011) 23.

<sup>138</sup> The Capital Markets (Conduct of Business) Regulations 1996; Bank of Uganda and Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ) (2011) 23.

<sup>139</sup> Bank of Uganda and Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ) (2011) 22.

<sup>140</sup> Federal Ministry for Economic Cooperation and Development 'Consumer Protection in Microinsurance; An input to the consumer protection task force of the micro insurance Network' *Discussion Paper* available at [https://a2ii.org/fileadmin/data\\_storage/documents/internal\\_documents/Discussion\\_Paper\\_on\\_Consumer\\_Protection\\_in\\_Microinsurance.pdf](https://a2ii.org/fileadmin/data_storage/documents/internal_documents/Discussion_Paper_on_Consumer_Protection_in_Microinsurance.pdf) (accessed 29 June 2015).

<sup>141</sup> Insurance Regulatory Authority of Uganda 'Insurance Act set for overhaul' available at <http://www.ira.go.ug/leadstory2.html> (accessed 20 June 2015).

The retirement benefits industry only caters for about ten per cent of Uganda's working population even after adding the beneficiaries of the public service pension schemes, the NSSF scheme and the armed forces pension scheme.<sup>142</sup> It is arguable that the reason for this is because many Ugandans are ignorant about the need for retirement benefits and many more are sceptical about the safety of their money in a pension's scheme. The retirement benefits industry in Uganda has in the past only concentrated on prudential regulation but now with assistance from the World Bank, it has effected reforms to improve regulation and supervision in the pensions sector.<sup>143</sup> The URBRA is a result of reforms in the pensions sector following the NSSF land purchase deal in 2008 which cost workers a lot of money<sup>144</sup> and the public service pensions scam in 2012 in which 169 billion Shillings (USD \$ 48,915,360 ) intended for former railway workers was swindled.<sup>145</sup> The Uganda Retirement Benefits Regulatory Act attempts to promote consumer protection by mandating the URBRA with the duty to protect the interests of members and beneficiaries of retirement benefits schemes. This is done through the promotion of transparency and accountability;<sup>146</sup> however, there has been no regulation or directive issued URBRA specifically to implement consumer protection. As already noted above, a complaints desk has been set up to handle grievances from the public but it is submitted that giving the public a platform to complain without educating them on the quality of standards to expect from services providers is not sufficient consumer protection.

Financial consumer protection in the semi-formal and informal sector is very minimal and as such many customers have suffered great financial loss while using informal and semi-formal financial services.<sup>147</sup> In the case of money lending business there is almost no consumer protection mechanism in place. The law is mainly ignored and most money lenders operate

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<sup>142</sup> Kidimu G 'Workers to benefit from Pensions Reforms' *The New Vision Paper* 12 September 2013.

<sup>143</sup> World Bank Press Release 'Uganda gets support to strengthen Regulation of pensions sector, foster Access to Financial services' 20 June 2011 available at <http://www.worldbank.org/en/news/press-release/2011/06/30/uganda-gets-support-to-strengthen-regulation-of-pension-sector-foster-access-to-financial-services> (accessed 25 June 2015).

<sup>144</sup> Njoroge J 'Temangalo Scandal Consumes nation' *The Independent* 25 December 2008 available at <http://www.independent.co.ug/news/news-analysis/436-temangalo-scandal-consumes-nation> (accessed 25 June 2015).

<sup>145</sup> The New Vision 'Nine Scandals to look back at' available at <http://www.newvision.co.ug/mobile/Detail.aspx?NewsID=637209&CatID=1> (accessed 25 June 2015).

<sup>146</sup> Section 5(1) (e) of the Uganda Retirement Benefits Regulatory Act 15 of 2011.

<sup>147</sup> Kasekende L 'Opportunities and Challenges of Financial inclusion' (2011) Remarks at the National Micro Finance Conference available at <http://www.bis.org/review/r110510e.pdf> (accessed 26 June 2015).

without licences and charge higher interest than they are allowed to charge.<sup>148</sup> The Money Lenders Act forbids money lenders to ask for real property as security.<sup>149</sup> However it is argued that most money lenders ask their customers for land as security with the intention of taking over ownership of such property as soon as the customer fails to pay. Many people in Uganda have for this reason lost their property to money lenders.<sup>150</sup> In order to increase confidence in the semi-formal sector and to protect consumers more, the BOU is making steps towards financial inclusion to establish a regulatory framework that promotes financial literacy and consumer protection even among tier four financial institutions like SACCOs and money lending services.<sup>151</sup>

Uganda recently passed an anti-money laundering law to investigate financial crimes in Uganda's financial sector.<sup>152</sup> The Anti- Money Laundering Act<sup>153</sup> has established the Financial Intelligence Authority (FIA) as the body charged with conducting investigations into suspicious financial transactions and causing the crimes to be prosecuted.<sup>154</sup> The FIA will work in partnership with BOU, IRA, CMA, Uganda Revenue Authority, the Inspector General of Government (IGG) and the office of the Director of Public Prosecution.<sup>155</sup> The success of the FIA will depend on the different regulators in the financial sector being in position to detect and financial malpractice and notifying the FIA. It is therefore arguable that where the different regulators in the financial sector do not have mechanisms in place to detect malpractice, the FIA will not be able to investigate and report it. The FIA in its infancy

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<sup>148</sup> Kaffu E & Rippey P 'Lessons from Ugandan money lenders' available at [http://www.fsdu.or.ug/pdfs/Money\\_Lenders\\_Study.pdf](http://www.fsdu.or.ug/pdfs/Money_Lenders_Study.pdf) (accessed 26 June 2015).

<sup>149</sup> Section 21(1)(C) of the Money Lenders' Act Cap 273

<sup>150</sup> Etukuri C 'Money lenders strip hundreds of property' *The New Vision News Paper* 17 June 2013 available at <http://www.newvision.co.ug/news/644039-money-lenders-strip-hundreds-of-property.html> (accessed 26 June 2015).

<sup>151</sup> Mftransparency.org 'Promoting Transparent pricing in the Microfinance Industry' available at <http://www.mftransparency.org/wp-content/uploads/2012/05/MFT-RPT-107-EN-Country-Survey-Uganda.pdf> (accessed 26 June 2015).

<sup>152</sup> Karugaba P & Pacuto S 'Fighting Money Laundering In Uganda' (2014) available at <http://www.kwm.com/en/uk/knowledge/insights/fighting-money-laundering-in-uganda-20140723> (accessed 1 July 2015).

<sup>153</sup> Anti- Money Laundering Act 2013.

<sup>154</sup> Karugaba P & Pacuto S 'Fighting Money Laundering In Uganda' (2014) available at <http://www.kwm.com/en/uk/knowledge/insights/fighting-money-laundering-in-uganda-20140723> (accessed 1 July 2015).

<sup>155</sup> International Bar Association Anti- Money Laundering Legislation implementation World Group 'Uganda: Central reporting Authority' (2014) available at <http://www.anti-moneylaundering.org/africa/Uganda.aspx> (accessed 1 July 2015).

is already facing challenges because of the huge semi-formal and informal financial sector in Uganda whose dubious financial transactions cannot be easily detected.<sup>156</sup>

## 2.4. CONCLUSION

Uganda's financial sector operates through a silo- based approach to regulation under which each service in the sector has its own regulatory and supervisory authority. Since Uganda currently does not have a consumer protection law in force, the expectation is that each industry will put in place steps necessary to effect consumer protection. The BOU has issued and is in the process of implementing the financial consumer protection guidelines through all the financial institutions under its regulation. Semi-formal financial institutions outside the supervision of BOU have no viable consumer protection mechanism and because of this their consumers have suffered great financial loss. Other financial institutions such as the Capital Markets industry have attempted to implement financial consumer protection through their regulations but others such as the Insurance industry and the retirement benefits industry are yet to put in place regulations for consumer protection. Although some industries are in the process of over hauling their legal framework to cater for consumer protection the financial sector in Uganda generally does not have a viable financial consumer protection regime in place thus leaving consumers at risk of loss.

The financial regulatory framework in Uganda in its current form is not effectively protecting consumers if only institutions regulated by the BOU are protected while the rest are left unprotected. The Silos Regulatory Framework which does not put in place a centralised consumer protection mechanism has fallen short of guaranteeing financial consumer protection in Uganda. It is therefore important for Uganda to adopt a financial regulatory framework which prioritises consumer protection in the financial sector.

The next chapter will examine how the twin peaks model has assisted the jurisdictions which have implemented it to implement financial consumer protection and will also examine the possibility of Uganda adopting the twin peaks model as a financial consumer protection mechanism

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<sup>156</sup> The Uganda Institute of Banking and Financial Services (UIBFS) 'Anti-Money laundering law faces challenges' available at <http://www.uibfs.or.ug/index.php/media-room/news-highlights/218-anti-money-laundering-law-faces-challenges> (accessed 1 July 2015).



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### CHAPTER 3

## THE TWIN PEAKS REGULATORY FRAMEWORK AS A CONSUMER PROTECTION MECHANISM

### 3.1. INTRODUCTION

The objectives of financial regulation have been highlighted above as consumer and investor protection, ensuring the solvency and soundness of financial institutions, promoting fairness, efficiency and transparency in the securities market and promoting a stable financial system.<sup>157</sup> However regulation is also important because it offsets the inherent information imbalance between financial service providers and consumers.<sup>158</sup> The global financial crisis increased awareness that a regulatory framework which permits financial exploitation can cause problems for the economy.<sup>159</sup> It is therefore important for governments to adopt regulatory frameworks that will safeguard their economies against market abuse and exploitation. It has also been advised that the drafters of a regulatory framework should understand the size and structure of a particular industry and the role of the regulator in that country.<sup>160</sup>

After the global financial crisis, some jurisdictions adopted the Twin Peaks model of financial regulation as an answer to shortfalls in regulation that were brought about by over emphasis on prudential regulation at the expense of market conduct regulation.<sup>161</sup>

The United Kingdom in 2012 split its unified Financial Services Authority into the Financial Conduct Authority and the Prudential Regulatory Authority.<sup>162</sup> South Africa is expected to soon pass into law the Financial Sector Regulatory Bill to implement the Twin Peaks Model.<sup>163</sup> A study sanctioned by the BOU and conducted by the GIZ in Uganda

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<sup>157</sup> Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice In South Africa' (2011) 10 (11) *International Business and Economics Research Journal* 27.

<sup>158</sup> Brix L & Mckee C 'Consumer Protection Regulation in Low-Access Environments: Opportunities to promote Responsible Finance' (2010) *CGAP Issue No. 60* 2.

<sup>159</sup> National treasury South Africa 'Reviewing the Regulation of financial markets in South Africa' (2011) *Policy Paper* explaining the financial markets bill 2011 4.

<sup>160</sup> Mwenda K K *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator* (2006) 6.

<sup>161</sup> Huang RH & Shoenmaker D *Institutional structure of financial regulation: Theories and international experiences* (2015) 257.

<sup>162</sup> Huang RH & Shoenmaker D *Institutional structure of financial regulation: Theories and international experiences* (2015) 258.

<sup>163</sup> Jones G 'Revised financial regulation bill clarifies 'twin peaks'' *Business day live* 17 December 2014

recommended that a proportionate regulatory regime covering both prudential and financial consumer protection issues needs to be adopted in Uganda especially for the sake of tier four financial institutions.<sup>164</sup> Different types of financial regulatory frameworks have been mentioned above in section 2.2.

This chapter will study the possibility of Uganda adopting a Twin Peaks model to elevate consumer protection and regulate market conduct in the financial sector. The chapter will analyse the Twin Peaks model of regulation in detail taking examples from the countries which have adopted it as a regulatory regime. In a separate section the chapter will analyse consumer protection under the Twin Peaks model and examine how Uganda can benefit from adopting this regime. Comparison in this chapter shall be made to the United Kingdom, South Africa and Australia which have all adopted the Twin Peaks model.

### 3.2. THE TWIN PEAKS MODEL OF FINANCIAL REGULATION

The Twin Peaks model of financial regulation is defined as a form of regulation based on objectives in which there is a separation of regulatory functions between two regulators whereby one performs the safety and soundness supervision function while the other focuses on conduct of business regulation.<sup>165</sup> It is therefore a system of regulation which separates prudential regulation from market conduct regulation by setting up one authority for all prudential regulation and another for all market conduct.<sup>166</sup>

Prudential regulation relates to a range of legislations and regulations that ensure that financial institutions are financially sound.<sup>167</sup> Prudential regulation dictates that banks, for example, meet a certain minimum capital requirements, maintain set liquidity levels and

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available at <http://www.bdlive.co.za/business/financial/2014/12/17/revised-financial-regulation-bill-clarifies-twin-peaks> (accessed 25 September 2015).

<sup>164</sup> Bank of Uganda and Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ) Towards an Effective Framework for Financial Literacy and Financial Consumer Protection in Uganda (2011) *Financial System Development Program* 11.

<sup>165</sup> Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) *International Business & Economics Research Journal* 30.

<sup>166</sup> Llewellyn DT 'Institutional Structure of financial regulation and supervision: The Basic Issues' (2006) Paper presented at a World Bank Seminar *Aligning supervisory issues with country needs* 6<sup>th</sup> & 7<sup>th</sup> June 2006, Washington DC 16.

<sup>167</sup> Llewellyn DT 'Institutional Structure of financial regulation and supervision: The Basic Issues' (2006) Paper presented at a World Bank Seminar *Aligning supervisory issues with country needs* 6<sup>th</sup> & 7<sup>th</sup> June 2006, Washington DC 27.

invest prudently.<sup>168</sup> Prudential regulation may be conducted either as macro-prudential regulation which looks at factors that may affect the soundness of the whole financial sector or micro-prudential regulation which only focuses on soundness of specific institutions in the sector.<sup>169</sup> Essentially micro-prudential regulation concentrates on risks that originate from factors within the specific institutions in the financial sector but macro regulation concentrates on risks that arise outside/ externally to the different institutions and seeks to put in place systems that detect and avert these risks.<sup>170</sup> Micro- prudential regulation became more popular after the formation of the Basel Committee on Banking Supervision (BCBS) which was established to reduce cross border bank exposures.<sup>171</sup> Even though the scope of prudential regulation appears to have been expanded through the BCBS recommendation of micro-prudential regulation, the 2008 global crisis confirmed that prudential regulation alone is not sufficient to protect financial sectors and that there is a need for market conduct regulation.

Market conduct regulation under the Twin Peaks model ‘focuses on mandatory information disclosure, the honesty and integrity of firms and their employees, the level of competence of firms supplying financial services and products’.<sup>172</sup> Although market conduct regulation is difficult to define, some have described it as consumer protection. In more developed economies, consumer protection extends aspects such as ‘corporate governance and incentives, organisational systems, competition and anti-trust, ‘fit and proper’ requirements and professionalism and product governance’.<sup>173</sup> Market conduct regulation presumes that there is market imperfection arising from inadequate information being availed to consumers, asymmetrical informational flows and problems arising from conflict of interest between the consumers and the service providers.<sup>174</sup> Conduct regulation is intended to give a higher level of protection than ordinary consumer protection laws to boost the confidence of the

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<sup>168</sup> Helmann TF, Murdock CK & Stiglitz EJ ‘Liberalisation moral hazard in Banking and Prudential regulation. Are capital requirements enough?’ (2000) 90 (1) *The American Economic Review* 147-148.

<sup>169</sup> Brunnermeir, M Crocket, A Goodhart C *et al The fundamental principles of financial regulation* (2009) xiii.

<sup>170</sup> Brunnermeir, M Crocket A, Goodhart C *et al The fundamental principles of financial regulation* (2009) xiii.

<sup>171</sup> Caprio G ‘Financial regulation after the crisis: How did we get here and how do we get out?’ (2013) *LSE financial markets group special paper series, special paper 226* 8.

<sup>172</sup> Falkena H, Bamber R, Llewellyn D *et al Financial Regulation in South Africa* (2001) 12.

<sup>173</sup> Norton Rose Fulbright ‘Beyond law: Understanding the scope of conduct regulation’ (2014) available at <http://www.nortonrosefulbright.com/files/beyond-law-understanding-the-scope-of-conduct-regulation-115391.pdf> accessed (17 August 2015).

<sup>174</sup> Falkena H, Bamber R, Llewellyn D & Store T *Financial Regulation in South Africa* (2001) 1.

consumers in the financial services.<sup>175</sup> It is therefore argued that the two types of regulation are so different that they are best carried out by two separate authorities as seen under the Twin Peaks model.<sup>176</sup>

Australia was the first country to implement the twin peaks model of regulation after passing into law the Financial Services Reform Act to establish the Australian Prudential Regulation Authority (APRA) as the only prudential regulator in the country and the Australian Securities and Investment Commission (ASIC) as the regulator in charge of disclosures.<sup>177</sup> Australia implemented the Twin Peaks model at a time when there was no pressing financial need and it has been debated that the Twin Peaks model may have contributed to protecting Australia from the adverse effects of the global financial crisis that greatly impacted on the UK and the United States of America (USA).<sup>178</sup>

The UK, after the global financial crisis, rethought its regulatory model to adopt an objective based model which allowed it to establish separate agencies for prudential regulation and market conduct regulation.<sup>179</sup> Prior to this, the UK operated a unified regulatory Framework under the Financial Services Authority (FSA).<sup>180</sup> Under this framework all deposit-taking, insurance and investment business in UK was regulated by the FSA. The UK passed into law the Financial Services Act which replaced the FSA with the Twin Peaks Model. Through the Twin Peaks model, UK has replaced the FSA with two regulators one being the Prudential Regulation Authority (PRA) and the other being the Financial Conduct Authority (FCA) in charge of market conduct and consumer protection. It can be argued that UK's regulatory framework is not purely the Twin Peaks model because a third body, the Financial Policy Committee (FPC) sitting within the Bank of England also conducts macro-prudential

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<sup>175</sup> Jones G 'Revised Financial Regulation Bill clarifies Twin Peaks model' (2014) Business Day Live 17 December 2014 available at <http://www.bdlive.co.za/business/financial/2014/12/17/revised-financial-regulation-bill-clarifies-twin-peaks> (accessed 17 August 2015).

<sup>176</sup> Huang RH & Shoenmaker D *Institutional structure of financial regulation: Theories and international experiences* (2015) 254, 257.

<sup>177</sup> Bakir C 'The Governance of financial regulatory Reform: The Australian experience' (2009) *Public Administration* vol. 87(4) 910.

<sup>178</sup> Michael B 'Regulatory Model: The future of financial regulation?' (2014) *Banking Today* March-April 2014 Issue available at <http://www.law.hku.hk/aiifl/wp-content/uploads/2014/09/Twin-Peaks.pdf> (accessed 2 July 2015).

<sup>179</sup> Michael B, Hak Goo S & Dariusz W 'Does Objectives-Based Financial Regulation Imply a Rethink of Legislatively Mandated Economic Regulation? The Case of Hong Kong and Twin Peaks Financial Regulation' (2014) *Social Science Research Network Paper* 8.

<sup>180</sup> GIM3050 - Regulatory framework: The Financial Services and Markets Act 2000 (FSMA 2000) available at <http://www.hmrc.gov.uk/manuals/gimanual/gim3050.htm> (accessed on 15 February 2016)

regulation throughout the entire financial sector in UK.<sup>181</sup> The FPC achieves this through monitoring the financial sector for system risk and referring measures it has established to the PRA and FCA to implement them.<sup>182</sup> Whereas the PRA regulates the different financial institutions at a micro level, the FCA conducts macro- prudential monitoring and refers its findings to the PRA which implements them.<sup>183</sup>

South Africa is in the process of passing into law the Financial Sector Regulation Bill which will ultimately implement the Twin Peaks Model.<sup>184</sup> South Africa hopes that by strengthening its approach to consumer protection and market conduct in financial services it will create a more resilient and stable financial system.<sup>185</sup> South Africa will implement the Twin Peaks model by putting in place a prudential regulator under the South African Reserve Bank while the Financial Services Board will be the market conduct regulator.<sup>186</sup> South Africa's new Twin Peaks model will be different from the financial regulatory framework it has currently where the responsibility for prudential regulation and market conduct regulation is shared by the South African Reserve Bank; the Financial Services Board as well as the National Credit Regulator and the National Consumer Commission.<sup>187</sup> The current regulatory framework in South Africa presents so many market conduct challenges including opaque and complex fee structures which undermined product comparisons and competitiveness, there have been cases of incentives and inducements being given to customers to dissuade them from

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<sup>181</sup> Jennings-mares J, Green P & Lee L, *et al* 'The UK's Financial Services Act 2012: Some Key Features' (2013) News Bulletin April 15, 2013 1.

<sup>182</sup> Jennings-mares J, Green P & Lee L, *et al* 'The UK's Financial Services Act 2012: Some Key Features' (2013) News Bulletin April 15, 2013 2.

<sup>183</sup> Jennings-mares J, Green P & Lee L, *et al* 'The UK's Financial Services Act 2012: Some Key Features' (2013) News Bulletin April 15, 2013 2.

<sup>184</sup> Joffe H & Mittner M 'Reserve Bank bulks up for 'twin peaks' financial regulation' The Business Day Live 26 June 2014 available at <http://www.bdlive.co.za/economy/2014/06/26/reserve-bank-bulks-up-for-twin-peaks-financial-regulation> (accessed 17 September 2015); 10X Investments 'Update on Twin Peaks and Treating Customers fairly' (2015) available at <https://www.10x.co.za/publications/update-on-twin-peaks-and-treating-customers-fairly/> (accessed 17 September 2015).

<sup>185</sup> Dixon J (Chairman of Twin Peaks Implementation Committee) 'Twin Peaks Legislation near its final stages' (2014) *FSB Bulletin First Quarter 2014* 13.

<sup>186</sup> Financial Services Board 'Twin Peaks' available at <https://www.fsb.co.za/Departments/twinpeaks/Pages/What-is-Twin-Peaks.aspx> (accessed on 23 February 2016)

<sup>187</sup> KPMG financial services 'Regulation-has it gone too far?' available at <https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/KPMG%20Twin%20peaks.pdf> (accessed 23 September 2015).

scrutinizing core product features and to distort their decision making and there is a general lack of regulatory oversight for market conduct reforms.<sup>188</sup>

The Twin Peaks model is considered to be the best regulatory model because the traditional functional and institutional models have become too blurred to be good regulatory models and the unified regulatory model is sub-optimal owing to the pressures of one agency taking on such a huge diverse role.<sup>189</sup>

### 3.3. FINANCIAL CONSUMER PROTECTION

Consumer protection has already been defined in chapter one as measures streamlined by the state to protect consumers against fraudulent and deceptive sales practices.<sup>190</sup> A consumer has been defined by some as a person who purchases goods and services and has also been equated to a citizen.<sup>191</sup> Financial consumer protection therefore refers to measures that are put in place to protect the users of financial services against deceptive practices. It has been argued that although economists presume that there can be a perfect market (one in which relevant information is available to all parties involved in a commercial transaction), ideally it is not possible to have a perfect market because consumers will not be able to identify characteristics of a product until after they have purchased it.<sup>192</sup> Financial product characteristics are complex and difficult to understand and the information about these products is also too technical for consumers to understand.<sup>193</sup> Consumer protection is an important role for regulatory authorities in financial services because of the existence of asymmetric information flows.<sup>194</sup> In the provision of financial services it is more likely than not that relevant information will be in the hands of the service providers and customers may not easily have access to this information.<sup>195</sup> Consumers normally have fears that either the institutions which hold their funds will fail and become insolvent or that the institutions may

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<sup>188</sup> South Africa National Treasury 'Treating customers fairly in the financial sector: A draft market conduct policy framework for South Africa' (2014) *Discussion Paper* 11.

<sup>189</sup> Caprio G *Handbook of Safeguarding Global Financial Stability: Political Social, Cultural and Economic Theories* (2013) 476.

<sup>190</sup> Jeffries DJ 'Protection for consumers against unfair and deceptive business practices in Wisconsin' (1974) 57(4) *Marquette Law Review* 559-560.

<sup>191</sup> Cartwright P *Consumer Protection in Financial Services* (1999) 4.

<sup>192</sup> Cartwright P *Consumer Protection in Financial Services* (1999) 8.

<sup>193</sup> Cartwright P *Consumer Protection in Financial Services* (1999) 10.

<sup>194</sup> Falkena H Bamber R Llewellyn D & Store T *Financial Regulation in South Africa* (2001) 2.

<sup>195</sup> Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) 22.

not conduct the business in a way that is beneficial to them.<sup>196</sup> It is therefore argued that ‘the best regulatory systems are those that comprise regulations that have been drafted by expert regulators on financial, supervisory, and financial consumer protection issues’.<sup>197</sup> The ultimate rationale of consumer protection regulation is to correct market failures which compromise consumers’ welfare.<sup>198</sup> Due to the fact that management and directors of a company are prone to withholding bad news from the clients for their own benefits,<sup>199</sup> a regulatory framework which effectively controls market abuses such as unlawful disclosures, insider dealings and money laundering improves investor and consumer confidences.<sup>200</sup>

### 3.3.1. Consumer protection under the Twin Peaks Model

It is argued that the Twin Peaks model has become more popular recently because it focuses on consumer protection as an important aspect for financial stability. It makes consumer protection a specific objective of the financial regulatory framework distinguishable from financial stability.<sup>201</sup> As argued here in below, the UK and Australia which have already implemented the Twin peaks model are proof of increased consumer protection in the financial sector and South Africa which is in the process of implementing the Twin Peaks model hopes to achieve increased consumer protection.<sup>202</sup>

#### a) Consumer protection prospects in South Africa under the Twin Peaks model

South Africa’s current regulatory requirements focus on sub-sector rules rather than being focused on the entire financial sector which they hope to change through the Twin Peaks model.<sup>203</sup> A study of the current regulatory system revealed that financial institutions are subjected to ‘an incomplete and inconsistent legal framework for market conduct, creating opportunities for regulatory arbitrage, and meaning that the level of customer protection

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<sup>196</sup> Falkena H Bamber R Llewellyn D & Store T *Financial Regulation in South Africa* (2001) 11.

<sup>197</sup> ASBA & Multilateral Investment Fund ‘Best Practices and Recommendations on financial consumer protection’ (2012) available at <http://www.asbaweb.org/E-News/enews-32/INC%20FNAN/2%20INC%20FNAN.pdf> (accessed 9 July 2015).

<sup>198</sup> Falkena H Bamber R Llewellyn D & Store T *Financial Regulation in South Africa* (2001) 13.

<sup>199</sup> Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) 22.

<sup>200</sup> Mwenda KK *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator* (2006) 3.

<sup>201</sup> Gakeri JK ‘Financial Services Regulatory Modernization in East Africa: The Search for a new Paradigm for Kenya’ (2011) 1(16) *International Journal of Humanities and Social Science* 161 165.

<sup>202</sup> Financial Services Board ‘Twin Peaks’ available at <https://www.fsb.co.za/Departments/twinpeaks/Pages/What-is-Twin-Peaks.aspx> (accessed on 23 February 2016)

<sup>203</sup> South Africa National Treasury ‘Treating customers fairly in the financial sector: A draft market conduct policy framework for South Africa’ (2014) *Discussion Paper* 16.

depends on the industry and distribution channel'.<sup>204</sup> In the implementation of the Twin Peaks model, South Africa has crafted new legislation such as the Financial Sector Regulation Bill which aims to guarantee higher standards in consumer protection. The regulations will allow the FSB to inspect how financial institutions conduct their business, what products they sell and the disclosures they make about those products.<sup>205</sup> Customers lack the requisite knowledge to identify which product best suit their needs or even circumstances. Further to this, customers are unable to compare product value or to understand disclosures and product characteristics and customers do not know the channels through which to lodge complaints in case they are dissatisfied with a product or service.<sup>206</sup>

South Africa is therefore taking steps to incorporate new, amended and proposed regulations into its regulatory framework which will prevent institutions working in parallel and will cause them to realign their goals and objectives to reduce the duplication of roles.<sup>207</sup> The South African government also realizes that having consumer protection laws on paper without an enforcement mechanism would not be worthwhile.<sup>208</sup> It therefore intends to increase enforceability of laws relating to consumer protection through the establishment of a financial services tribunal to handle grievances by consumers of financial services.<sup>209</sup> South Africa currently is doing better than the other sub-Saharan countries in terms of financial literacy levels but it still has so many people who are illiterate about financial services and because of this many people are still making bad financial decisions.<sup>210</sup> The FSB as one of its

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<sup>204</sup> South Africa National Treasury 'Treating customers fairly in the financial sector: A draft market conduct policy framework for South Africa' (2014) *Discussion Paper* 16.

<sup>205</sup> Jones G 'Revised financial regulation bill clarifies Twin Peaks' Business Day Live 17 December 2014 available at <http://www.bdlive.co.za/business/financial/2014/12/17/revised-financial-regulation-bill-clarifies-twin-peaks> (accessed 15 July 2015).

<sup>206</sup> South Africa National Treasury 'Treating customers fairly in the financial sector: A draft market conduct policy framework for South Africa' (2014) *Discussion Paper* 16.

<sup>207</sup> KPMG 'Financial Services Twin Peaks' available <https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/KPMG%20Twin%20peaks.pdf> (accessed on 28 February 2016)

<sup>208</sup> Cartwright P *Consumer Protection in Financial Services* (1999) 15.

<sup>209</sup> Jones G 'Revised financial regulation bill clarifies Twin Peaks' Business Day Live 17 December 2014 available at <http://www.bdlive.co.za/business/financial/2014/12/17/revised-financial-regulation-bill-clarifies-twin-peaks> (accessed 15 July 2015).

<sup>210</sup> Roberts B Struwig J & Gordon S 'Financial Literacy in South Africa: Results from the 2013 South African Social Attitudes Survey (SASAS) round' (2014) Report Prepared for the Financial Services Board (FSB) by the Human Sciences Research Council (HSRC) Democracy, Governance & Service Delivery (DGSD) research programme 2; HR Future 'Lack of Financial Literacy in South Africa' available at <http://www.hrfuture.net/news/lack-of-financial-literacy-in-south-africa-4.php?Itemid=1336> (accessed 20 August 2015).

roles intends to increase financial literacy among South Africans to ensure consumers are not vulnerable or exploited.<sup>211</sup>

b) Consumer protection in Australia under the Twin Peaks model

Before Australia adopted the Twin Peaks model its regulatory system was complex, segmented and institutionally based with several federal and state regulators which had overlapping functions, specialised lines of business and products and increasingly blurred boundaries as a result of financial integration.<sup>212</sup> It is argued that by adopting the Twin Peaks model Australia created two independent regulatory bodies that each played a distinct function. Consumer protection in Australia is conducted at the sectoral level and also at industrial levels.<sup>213</sup> Generic consumer protection regulations are laid out in the ASIC Act 2001 and industry -specific consumer protection regulations are laid out in the Corporations Act, 2001 and the National Consumer Credit Protection Act, 2009 which includes the licensing, conduct and disclosure regimes.<sup>214</sup>

ASIC realises that financial consumer protection is also about empowerment of the consumers to guarantee their wellbeing. It has been noted that confident and knowledgeable consumers are an asset for well-functioning and efficient financial markets.<sup>215</sup> ASIC has also taken over the role of advancing financial literacy to consumers of financial services to guarantee that they are able to make informed decisions.<sup>216</sup> Financial literacy has been promoted through the National Financial Literacy Strategy which aims to guide and encourage the provision of financial literacy to all Australians.<sup>217</sup> ASIC set up the

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<sup>211</sup> KPMG 'Twin Peaks: Regulation- has it gone too far' available at <https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/KPMG%20Twin%20peaks.pdf> (accessed 20 August 2015).

<sup>212</sup> Hill GJ 'Why did Australia fare so well in the global financial crisis' (2012) *Sydney Law School Legal Research Paper 20*.

<sup>213</sup> Financial System Inquiry 'Consumer protection framework in financial services' available at <http://fsi.gov.au/publications/interim-report/06-consumer-outcomes/consumer-protection-framework-in-financial-services/> (accessed on 26 February 2016)

<sup>214</sup> Financial System Inquiry 'Consumer protection framework in financial services' available at <http://fsi.gov.au/publications/interim-report/06-consumer-outcomes/consumer-protection-framework-in-financial-services/> (accessed in 5 August 2015).

<sup>215</sup> Sandlant R 'Consumer financial protection: future direction' (2011) Paper presented at the 16th Melbourne money and finance conference in 2011 32

<sup>216</sup> Sandlant R 'Consumer financial protection: future direction' (2011) 33.

<sup>217</sup> ASIC 'The National Financial Literacy Strategy' available at <http://www.financialliteracy.gov.au/> (accessed 5 August 2015).

*moneysmart* website through which financial literacy is made accessible to schools as well as consumers and it is believed that this website is beneficial to over 400,000 Australians who access it gain knowledge on financial products and how to use their money.<sup>218</sup>

The Australian Government realizes that there is a lot of risk to the consumer and for this reason ASIC has cultivated the culture of compliance by enterprises and firms to regulatory requirements.<sup>219</sup> The Australian Government educates corporations on the benefits of compliance and strikes a balance between compliance and deterrence<sup>220</sup> however, where corporations fail to comply with market conduct rules, the ASIC takes legal steps to enforce the rules. An example of this is a case in which the ASIC brought proceedings against the ACM Group Limited for engaging in misleading and deceptive conduct when recovering money from debtors.<sup>221</sup> A study conducted on the banking sector after implementation of the Financial Services Reform Act in Australia concluded that systemic risk had reduced in the banks under ASIC because of the increased disclosure requirements.<sup>222</sup>

### c) Consumer protection in the UK under the Twin Peaks model

Before the global crisis the UK operated a tripartite regulatory framework under a single regulation of the Financial Services Authority (FSA) but this created a lot of tension between prudential health and devoting sufficient attention to the conduct of firms in retail markets.<sup>223</sup> It was for this reason that it adopted the Twin Peaks Model. The Financial Conduct Authority (FCA) as a market conduct regulator focuses on ensuring that services and products are designed to meet customers' needs and that firms put the interests of customers at the heart of how they run their business.<sup>224</sup> The FCA in achieving this conducts market surveys, for

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<sup>218</sup> Australian Securities & Investment Commission '14-185MR ASIC launches National financial literacy strategy' (2014) available at <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2014-releases/14-185mr-asic-launches-national-financial-literacy-strategy/> (accessed 21 September 2015).

<sup>219</sup> Pearson G 'Risk and the consumer in Australian financial reform' (2006) 28 (99) *Sydney Law Review* 111-112.

<sup>220</sup> Pearson G *Financial Services Law and Compliance in Australia* (2008) 18.

<sup>221</sup> Consumer Affairs Australia and New Zealand Implementation of the Australian Consumer Law (2012-2013) *Progress Report III* 24.

<sup>222</sup> Bollen B Skully M & Wei X 'The Financial Services Reform Act and Australian Bank Risk' (2010) 5(1) *Banks and Bank Systems* 58-63.

<sup>223</sup> Her Majesty's Treasury A new approach to financial regulation: Judgement, focus and stability (2010) 31

<sup>224</sup> KPMG 'Twin Peaks Regulation: Key changes and challenges' (2012) <https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/Twin%20Peaks%20Regulation%20Key%20Changes%20and%20Challenges%20-%2019%20Oct%2012.pdf> (accessed 5 August 2015).

example mystery shopping exercises to confirm whether the information being given to consumers is relevant and sufficient for them to make informed decisions on the products they acquire.<sup>225</sup> Enforcement of consumer protection regulations has increased under the FCA because the FCA monitors firms and individuals making sure that they meet the set standards before they are allowed to access the market. Even after the firms have penetrated the market, the FCA continues to monitor their operations to guarantee that they remain compliant and those which are found not to be compliant are either penalized or forced out of the sector.<sup>226</sup> Moreover, the FCA itself is not without supervision; The UK Parliament requires the FCA to submit regular reports through which the parliament vets its strength and weakness to ensure that it meets its objectives.<sup>227</sup> The FCA has also prioritised obtaining compensation for customers from firms that do operate negligently.<sup>228</sup> The FCA offers Financial Ombudsman Services as a free service through which consumers can complain about services they have found unsatisfactory.<sup>229</sup>

### 3.4. THE TWIN PEAKS MODEL FOR UGANDA

Different regulatory structures are adopted by different countries and these structures are usually based on different objectives.<sup>230</sup> The type of regulatory framework should be designed according to the size and structure of the economy however it has been noted historically that financial regulatory changes have been driven by financial crisis.<sup>231</sup> This has proved true both in the case of UK which replaced its unified regulatory model with the Twin Peaks model<sup>232</sup> and South Africa which also recently adopted the Twin Peaks to boost its

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<sup>205</sup> European Parliament Directorate General for Internal Policies 'Consumer Protection Aspects of Financial Services' (2014) available at [http://www.europarl.europa.eu/ReqData/etudes/etudes/join/2014/507463/IPOL-IMCO\\_ET\(2014\)507463\\_EN.pdf](http://www.europarl.europa.eu/ReqData/etudes/etudes/join/2014/507463/IPOL-IMCO_ET(2014)507463_EN.pdf) (accessed 20 August 2015).

<sup>226</sup> FCA 'Protecting Consumers' available at <http://www.fca.org.uk/about/what/protecting> (accessed 23 September 2015).

<sup>227</sup> FCA 'Who we report to' available at <http://www.fca.org.uk/about/operate/who> (accessed 23 September 2015).

<sup>228</sup> KPMG 'Twin Peaks Regulation: Key changes and challenges' (2012) <https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/Twin%20Peaks%20Regulation%20Key%20Changes%20and%20Challenges%20-%2019%20Oct%202012.pdf> 10.

<sup>229</sup> FCA 'How to complain' <http://www.fca.org.uk/consumers/complaints-and-compensation/how-to-complain> (accessed 5/08/2015).

<sup>230</sup> Mwenda KK *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator* (2006) 3.

<sup>231</sup> Gakeri JK 'Financial Services Regulatory Modernization in East Africa: The Search for a new Paradigm for Kenya' (2011) *International Journal of Humanities and Social Science* 1(16) 161.

<sup>232</sup> Michael B 'Regulatory Model: The future of financial regulation?' (2014) *Banking Today* March-April

financial stability in the wake of the 2007 – 2009 global financial crisis. The global financial crisis was attributed to inadequate regulatory systems, among other reasons.<sup>233</sup> A change in regulatory frameworks was therefore important to stabilise the economies. Australia's financial sector was not affected by the financial global crisis to the extent that the UK and the USA were affected and some have attributed this to the Twin Peaks model which was in force by then.<sup>234</sup>

It has been pointed out in chapter two that financial regulation in Uganda is mainly prudential and that there is minimal market conduct regulation. The banking industry is the biggest financial sector in Uganda with currently 25 commercial banks, three credit institutions, three micro finance deposit-taking institutions and 203 forex bureaus.<sup>235</sup> The banking sector is however dominated by foreign owned banks<sup>236</sup> which creates a challenge for prudential regulation since cross border banks operate on the security of balance sheets from the country of incorporation.<sup>237</sup> It is therefore difficult enough for the BOU to sufficiently conduct prudential regulation let alone also taking responsibility for market conduct regulation.

As already stated, Uganda does not have a general consumer protection framework in place and the financial sector relies on the different institutional regulators to put in place independent measures for financial consumer protection. The fact that the financial sector concentrates on prudential regulation means those regulators generally prioritise the financial institutions' profitability, through setting higher prices in the hopes of building a solid capital buffer, as opposed to caring about the needs of the customers.<sup>238</sup> The lack of a streamlined consumer protection mechanism has over the years allowed market abuses in the economy to go unchecked. Between 1998 and 1999 four commercial banks became insolvent and had to be closed by the BOU and in the case of two of these banks (Greenland Bank and

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2014 Issue 4 available at <http://www.law.hku.hk/aiifl/wp-content/uploads/2014/09/Twin-Peaks.pdf> (accessed 06 August 2015).

<sup>233</sup> Blundell-Wignall A Atkinson P & Lee S H 'The current financial crisis cause and policy issue' (2008) OECD Financial Market Trends 2.

<sup>234</sup> Jain A & Jordan C 'Diversity and Resilience: Lessons from the financial crisis' (2009) 32(2) *University of New South Africa* 416-432.

<sup>235</sup> Iwumbwe SK Bank of Uganda 'Overview of the financial Sector in Uganda' (2015) Paper presented at the 4<sup>th</sup> meeting of the financial cooperation working Group March 18-19 2015 5.

<sup>236</sup> African Business Magazine 'Uganda : foreign banks dominated' (2012) available at <http://africanbusinessmagazine.com/uncategorised/uganda-foreign-banks-dominate/> (accessed 29 July 2015).

<sup>237</sup> Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) 20.

<sup>238</sup> South Africa National Treasury 'Treating customers fairly in the financial sector: A draft market conduct policy framework for South Africa' (2014) *Discussion Paper* 19.

International Credit Bank) insider lending was found to be the cause of the insolvency.<sup>239</sup> In 2014 a few more commercial banks were closed down by the BOU and many others were on the brink of insolvency. It has been suggested that the greatest challenge to the financial services sector is rebuilding customer confidence which has been eroded by fears that banks do not care about customers' needs.<sup>240</sup>

The retirement benefits industry in Uganda has suffered numerous scandals over the years in which pensioners' money has been misallocated, misused or swindled such as the Temangalo land scandal of 2008 in which workers' savings were misused in a bogus land sale<sup>241</sup> and in 2013 when pensioners' money was misappropriated through payments by the public service ministry to ghost pensioners.<sup>242</sup> The government has sought to minimise financial impropriety in the pensions sector by establishing the URBRA as the overhead regulatory authority for all pension schemes<sup>243</sup> whether private or public but this authority focuses mainly on prudential regulation and little focus is given to market conduct.

The insurance sector in Uganda has remained very small and some of the challenges that have been pinpointed as inhibiting its growth are the fact that there is limited understanding of insurance and widespread mistrust of the insurance industry among the population and the fact that insurance offers poor value propositions to the clients.<sup>244</sup> It is suggested that mistrust among the customers arises from the low pay-out ratios on insurance claims and that the best way to expand the insurance industry in Uganda is to boost the confidence of the customers in the industry.<sup>245</sup> A more streamlined consumer protection regime would probably assist in boosting consumer confidence.

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<sup>239</sup> Brownbridge M 'Resolving Bank Failures in Uganda: Policy Lessons from Recent Bank Failures' (2002) 20(3) *Development Policy Review* 279-280.

Businge J 'Banks in turbulence' *The Independent* 25 August 2014 available at <http://www.independent.co.ug/business/business-news/9265-banks-in-turbulence> (accessed 29 July 2015).

<sup>241</sup> Njoroge J 'Temangalo Scandal consumes nation' *The Independent* 25 December 2008 available at <http://www.independent.co.ug/news/news-analysis/436-temangalo-scandal-consumes-nation> (accessed 22 July 2015).

<sup>242</sup> Candia S & Masaba S 'Shillings 165 billion paid to ghost pensioners' *The NewVision Newspaper* 10 January, 2013 available at <http://www.newvision.co.ug/news/638782-sh165b-paid-to-ghost-pensioners.html> (accessed 22 July 2015).

<sup>243</sup> URBRA 'regulatory framework' available at <http://www.urbra.go.ug/rbs-act.html> (accessed 25 September 2015).

<sup>244</sup> Hougaard, C Bester H & Chamberlain D 'The role of policy, regulation and supervision in making insurance markets work for the poor-Uganda' (2008) *Policy, Regulation and Supervision Focus Note* 7 6.

<sup>245</sup> GIZ 'Microinsurance in Uganda: Country diagnostic report on market regulations' (2013) available at

The informal and semi- formal financial sector has also been riddled with numerous scandals. Money lenders who are barely regulated have taken to seizing customers' land,<sup>246</sup> even if the Money Lenders Act forbids them from accepting land as security for such loans.<sup>247</sup> The Money Lenders Act also forbids money lenders from charging unconscionable interest rates.<sup>248</sup> It has been discovered that money lenders charge extremely high interest rates which their customers who are normally desperate are forced to bear.<sup>249</sup> This poor regulation in the semi-formal and informal sector creates a semblance of no regulation and because of this market imperfections and failures have been allowed to fester at the cost of the customer.<sup>250</sup> The trends in the financial regulatory framework in Uganda have diminished the confidence of the customers in the financial sector and this could easily be the reason why only 25 percent of the working population has registered for formal pension schemes<sup>251</sup> and why only four million Ugandan's in the entire population operate bank accounts.<sup>252</sup>

The OECD in its G20 high level principles on consumer protection pointed out that consumer protection is increasingly being seen as the other major objective of financial regulation apart from financial stability.<sup>253</sup> Moreover consumers rely on regulators to monitor the behaviour of financial institutions which they are unable to do themselves.<sup>254</sup> Financial regulation should not impose a cost on the consumers,<sup>255</sup> yet lack of a streamlined consumer

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[https://a2ii.org/sites/default/files/reports/microinsurance\\_in\\_uganda\\_country\\_diagnostic\\_report\\_on\\_market\\_and\\_regulations.pdf](https://a2ii.org/sites/default/files/reports/microinsurance_in_uganda_country_diagnostic_report_on_market_and_regulations.pdf) (accessed 7 August 2015) 1.

<sup>246</sup> Tugume I 'Exposed: Tricks money lenders use to grab people's property' *The Red Pepper News Paper* 10 February 2013 available at <http://www.redpepper.co.ug/exposed-tricks-money-lenders-use-to-grab-peoples-property/> (accessed 6 August 2015).

<sup>247</sup> section 21(1)(c) of the Money Lenders Act Cap 273

<sup>248</sup> section 12(1) of the Money Lenders Act Cap 273

<sup>249</sup> Tugume I 'Exposed: Tricks money lenders use to grab people's property' *The Red Pepper News Paper* 10 February 2013 available at <http://www.redpepper.co.ug/exposed-tricks-money-lenders-use-to-grab-peoples-property/> (accessed 6 August 2015).

<sup>250</sup> Falkena H Bamber R Llewellyn D & Store T *Financial Regulation in South Africa* (2001)12.

<sup>251</sup> The World Bank 'Uganda: About The Fourth Economic Update' available at <http://www.worldbank.org/content/dam/Worldbank/Feature%20Story/Africa/Uganda/ug-economic-update-fact-sheet.pdf> (accessed 03 August 2015).

<sup>252</sup> Asiimwe D 'Uganda: Only 21% Ugandans Have Bank Accounts - Problem or Opportunity?' available at <http://allafrica.com/stories/201006151241.html> (accessed 06 August 2015).

<sup>253</sup> OECD task force on financial consumer protection' G20 high level principles on financial consumer protection' (2011) 4.

<sup>254</sup> Falkena H, Bamber R, Llewellyn D & Store T *Financial Regulation in South Africa* (2001) 13.

<sup>255</sup> Falkena H, Bamber R, Llewellyn D & Store T *Financial Regulation in South Africa* (2001) 1.

protection mechanism exposes consumers to financial risk. Scholars have advised that regulation should be conducted in less costly ways.<sup>256</sup>

The Silos regulatory framework has been described as a regulatory model with gaps, duplication, overlaps, inconsistent regulations and cost ineffectiveness.<sup>257</sup> The failures in the regulatory framework have forced the country to establish the FIA to investigate financial crimes such as money laundering.<sup>258</sup> This Authority is going to be run at the tax payers' expense yet the various other regulatory authorities in Uganda such as the IRA, URBRA, BOU and CMA among others are already being funded at the tax payers' expense. This increases the cost of regulation – yet this could be avoided through adoption of the twin peaks model of financial regulation which incorporates consumer protection and prudential regulation. The GIZ has already recommended that Uganda ought to adopt a regulatory framework which consists of both prudential regulation and consumer protection<sup>259</sup> and the twin peaks model would achieve this.

The BOU is already taking steps through its financial inclusion drive to bring non-banking financial industries in the semi- formal and informal sector under the ambit of its regulation.<sup>260</sup> Similar to the Reserve Bank in South Africa, the BOU can retain prudential regulatory authority over all financial institutions to ensure stability and liquidity, while another authority would then be commissioned to take charge of market conduct regulation to guarantee consumer protection in the economy.<sup>261</sup> A framework which prioritises consumer protection and conducts itself with integrity would boost the confidence of the customers so that they are more willing to transact, or save or borrow.<sup>262</sup>

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<sup>256</sup> Falkena H, Bamber R, Llewellyn D & Store T *Financial Regulation in South Africa* (2001) 1.

<sup>257</sup> Schooner HM 'Regulating risk not function' (1988) 66 *University of CINCINNATI Law Review* 441-456.

<sup>258</sup> Candia S 'The Financial Intelligence Authority (FIA), a new body to combat money laundering has been formed' *The New Vision News Paper* 12 August 2014 available at <http://www.newvision.co.ug/news/658634-financial-intelligence-authority-formed.html> (accessed 3 August 2015).

<sup>259</sup> Bank of Uganda and Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ) Towards an Effective Framework for Financial Literacy and Financial Consumer Protection in Uganda (2011) *Financial System Development Program* 11.

<sup>260</sup> Care International 'Financial Inclusion in Uganda' (2014) policy brief 2 ; Bank of Uganda 'Financial Inclusion project' available at [https://www.bou.or.ug/bou/supervision/Financial\\_Inclusion/Financial\\_Inclusion\\_Project.html](https://www.bou.or.ug/bou/supervision/Financial_Inclusion/Financial_Inclusion_Project.html) (accessed 06 August 2015).

<sup>261</sup> KPMG 'Financial Services: Twin Peaks' available at <https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/KPMG%20Twin%20peaks.pdf> (accessed 03 August 2015).

<sup>262</sup> South Africa National Treasury 'Treating customers fairly in the financial sector: A draft market conduct

Uganda has also started a financial literacy programme to bring awareness of financial services and products to the people.<sup>263</sup> This is crucial for consumer protection because it reduces information asymmetries between financial institutions and ordinary customers and to improve their understanding of financial products, concepts, and to develop their skills and confidence such that they are more aware of financial risks and opportunities.<sup>264</sup> However in order for financial literacy to remain a priority, specific guidelines need to be issued under the market conduct authority laying out how financial literacy is to be achieved and these guidelines have to be strictly implemented by the conduct authority.

Financial literacy on its own will not be beneficial if there is no general financial consumer protection framework in place. A market conduct regulator, if Australia and UK are anything to go by, would put in place a complaints department to investigate and prosecute market offences and to give affected consumers remedies.

### 3.5. CONCLUSION

Uganda has no consumer protection law in place and yet the only semblance of financial consumer protection regime in place is the Bank of Uganda Consumer Protection guide lines that only govern institutions regulated by the BOU. The Silos Model of financial regulation currently in place dictates that each financial industry conducts its own regulation whether prudential or market conduct. However so many market failures and crimes have been allowed to fester under this regulatory framework. Banks have been closed or declared insolvent causing clients to lose their savings; Pension schemes have misallocated workers money and the semi-formal sector especially the money lenders have caused so many people to lose their property. A financial sector which does not operate with integrity causes loss of confidence among the customers. Lack of confidence in the financial sector is exemplified by the few people who operate bank accounts in Uganda, the small percentage of the working population which utilises pension schemes and the even fewer people who subscribe for insurance policies.

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policy framework for South Africa' (2014) *Discussion Paper* 19.

<sup>263</sup> Bank of Uganda 'Strategy for Financial Literacy in Uganda' (2013) 1 available at [https://www.bou.or.ug/opencms/bou/bou-downloads/Financial\\_Inclusion/Strategy-for-Financial-Literacy-in-Uganda\\_August-2013.pdf](https://www.bou.or.ug/opencms/bou/bou-downloads/Financial_Inclusion/Strategy-for-Financial-Literacy-in-Uganda_August-2013.pdf) (accessed on 28 February 2016)

<sup>264</sup> South Africa National Treasury 'Treating customers fairly in the financial sector: A draft market conduct policy framework for South Africa' (2014) 63.

Financial consumer protection is now recognised as one of the major objectives of financial regulation. Separating market conduct regulation from prudential regulation reduces problems resulting from asymmetrical information flows and allows regulators to focus on the needs of the consumers rather than on the profitability of the financial institutions. The need to prioritise market conduct regulation caused countries like Australia and UK to adopt the Twin Peaks model of regulation and for similar reasons South Africa is in its final stages of implementing the Twin Peaks model.

By adopting the Twin Peaks model, Uganda would have one regulator responsible for market conduct regulation such that with or without a consumer protection law, financial consumers would still be protected. The Twin Peaks regulatory system would foster financial inclusion because there would be no exclusion of certain financial institutions such as the semi-formal institutions from the ambit of regulation. In addition a market conduct regulator would also be responsible for increased financial literacy which would increase the ability of customers to make informed decisions.

The next chapter presents the conclusions from this research and makes recommendations pertinent to Uganda's financial regulatory system.



## **CHAPTER 4**

### **CONCLUSIONS AND RECOMMENDATIONS**

#### **4.1. INTRODUCTION**

This research aimed to analyse the possibility of Uganda adopting the Twin Peaks model of financial regulation as a financial consumer protection mechanism. The research showed that not only does Uganda lack a general consumer protection law, but it also lacks a financial consumer protection regime and because of this the consumers in the financial sector have suffered loss both monetary and proprietary at the hands of providers of financial services. This chapter will give the conclusion to the researcher's study and make recommendations for a change in Uganda's financial regulatory framework.

#### **4.2. CONCLUSION**

Uganda's financial sector is regulated through a silos model of financial regulation with each industry in the sector being regulated by a different authority. This research has shown that as a nation, Uganda has no consumer protection law and particularly, that the different regulators in the financial sector are each expected to provide financial consumer protection in their separate institutions.<sup>265</sup> Notwithstanding this, it is only the BOU which has streamlined financial consumer protection guidelines. All other institutions either have few market conduct rules scattered in their governing laws and regulations, or lack consumer protection guidelines completely. The regulatory framework in Uganda as shown in this research has encouraged prudential regulation at the expense of market conduct regulation. The absence of a general consumer protection law has not assisted the situation and because of this, the financial consumers have suffered loss at the hands of the financial services providers. While Uganda has paid little attention to market conduct regulation, the post global financial crisis era has made many jurisdictions realise that market conduct regulation and consumer protection should be a key objective of financial regulation, among others. This research has shown that jurisdictions such as Australia, the UK and South Africa took cognisance of the fact that it is important to separate market conduct regulation from

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<sup>265</sup> See section 2.4.

prudential regulation because the former seeks to protect the interests of the consumers while the latter only concentrates on financial soundness of the institutions yet a stable financial sector needs to strike a balance between both aspects. Market conduct regulation heightens consumer protection which increases consumer and investor confidence in the financial sector and consequently reduces the possibility of consumers succumbing to risk.<sup>266</sup>

This research examined jurisdictions that have prioritised financial consumer protection as an objective of financial regulation and therefore implemented regulatory frameworks that aim to strike a balance between the needs of the financial institutions and the needs of the consumers. Specifically, this research examined the Twin Peaks Model that has been implemented in Australia, the UK and is in the process of being implemented in South Africa.<sup>267</sup> The research shows that whereas the UK only implemented the Twin Peaks model after the 2007 global financial crisis, Australia had implemented the same long before and it has been said that the Twin Peaks model might be the reason why Australia fared better than the rest of the world during the global financial crisis.<sup>268</sup> An analysis of the Australian and UK financial sectors shows that the Twin Peaks story has been fairly successful. The Twin Peaks model capitalises on the separation of prudential regulation from market conduct regulation and gives each of them equal importance such that one is not prioritised at the expense of the other. Financial consumer literacy has been increased in these jurisdictions such that many of the consumers are able to make well informed decisions. Compliance with market conduct regulations is emphasised but where the financial services providers do not comply, the market conduct regulators in these jurisdictions have created a platform through which they enforce compliance through prosecution.<sup>269</sup>

The research shows that South Africa too is in the process of implementing the Twin Peaks model in the hopes of promoting consumer protection and increasing consumer and investor confidence in the financial sector.

The researcher submits that even where a country lacks a general consumer protection law, the financial sector can adopt a regulatory framework which caters for consumer protection. The Twin Peaks model dictates that one market conduct regulator is established separate

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<sup>266</sup> See section 2.2.0 & section 3.3.1(b)

<sup>267</sup> See section 3.2.

<sup>268</sup> See section 3.2.

<sup>269</sup> See section 3.3.1.

from the prudential regulator for the entire financial sector. The market conduct regulator is then mandated to put in place measures intended to protect consumers. The separation of these two authorities means that there will be a balance in the sector between the needs of the consumers and the desire to achieve financial soundness of the institutions. The challenge at this time is that the BOU sets the standards for compliance by the financial institutions, conducts inspection and supervision and is also in charge of implementation. This is a role too big for one authority to conduct. The adoption of the Twin Peaks model in Uganda would separate market conduct regulation from prudential regulation and the establishment of a market conduct regulator would promote consumer protection such that consumer and investor confidences in the financial sector are raised.

### **4.3. RECOMMENDATIONS**

#### **4.3.1. Twin Peaks model**

It is recommended that Uganda adopts the Twin Peaks model as its financial regulatory framework. The Twin Peaks model will allow Uganda to establish a prudential regulator mandated to maintain financial soundness in the financial sector and a separate market conduct regulator which shall be responsible for financial consumer protection.

#### **4.3.2. Proposal for a prudential regulator**

As already shown in this research, the BOU as the central bank of Uganda is the regulator of Uganda's banking industry which is the biggest industry in the financial sector. Furthermore, and as already shown in chapter three, the BOU has already commenced an inclusion drive to bring more institutions under its regulation. It has expertise in prudential regulation which makes it a viable choice as the prudential regulator of the whole financial sector. In the Jurisdictions which this research has studied (Australia, UK and South Africa), it has been shown that the prudential regulator is nested within the central bank. In the case of Australia, the APRA is housed in the Reserve Bank of Australia Just like in UK where the PRA is housed in the reserve bank of England and South Africa similarly intends to establish its prudential regulator within the South African Reserve bank. The BOU can therefore retain the mandate to conduct prudential regulation for the entire financial sector.

#### **4.3.3. Proposal for a market conduct regulator**

A separate market conduct regulator should be established outside the central bank and this regulator should be mandated to supervise and regulate the conduct of all financial institutions and their dealings with customers. The FIA in Uganda is mandated to investigate and prosecute financial crimes; it is therefore well placed to be transformed into the market conduct regulator for the financial sector. As a market conduct regulator, the FIA should be authorised to formulate consumer protection guidelines which will regulate conduct between providers of financial services and their customers.

In order to implement a market conductor regulator, a new law would have to be implemented specifying the roles and duties of the regulator.

There would be need to lobby to get the support of the government because such a venture would require financial support from the government.

The market conduct regulator should also be responsible for training both financial institutions and the consumers such that there is increased financial literacy. The FIA, if transformed into a market conduct regulator will be responsible for increasing the awareness of financial consumers about product characteristics and risks pertaining to the financial products to increase consumers' ability to make informed decisions.

The market conduct regulator should also be prepared to provide a platform through which customers can lodge complaints against providers of financial services who have failed to comply with consumer protection guidelines. The FCA has achieved this through establishing the office of the ombudsman who receives complaints from consumers and investigates financial crimes at no cost to the consumer.

The market conduct regulator should also carry out regular surveys and inspections to guarantee continuous compliance after financial institutions have been licenced to operate. Where institutions are found to have fallen short of expected standards, the FIA should be mandated to cause the institutions to compensate consumers for any loss arising from their failure to comply with consumer protection guidelines or to terminate their licenses. The FCA has achieved this through 'mystery shopping' surveys which allows it to keep inspecting the operations of licensed institutions to guarantee that they remain compliant.<sup>270</sup>

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<sup>270</sup> See section 3.3.1(c)

#### **4.3.4. Legislative amendments and enactments**

As already shown in this research, the jurisdictions which have implemented the Twin Peaks model have either had to amend their financial services regulations or to enact new legislation. A case in point is South Africa which is in the process of passing into law the Financial Sector Regulation Bill to implement the Twin Peaks model. Likewise, Uganda will either have to enact new laws or to amend its current laws to guide the implementation of the Twin Peaks model.

If these recommendations are adopted, it is submitted that the Twin Peaks model will be implemented as a financial regulatory framework thus separating prudential regulation from market conduct regulation. It is further submitted that the establishment of a market conduct regulator will improve consumer protection in the financial sector, increase consumer confidence and protect consumers against risk. The expected end result is that if the financial sector has a satisfactory financial consumer protection regime, investor confidence in the sector will be boosted thus attracting more investors.



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