Louis Kasekende: Bank of Uganda's role in monetary policy, regulation and financial sector development

Remarks by Dr Louis Kasekende, Deputy Governor of the Bank of Uganda, at the opening ceremony of the Colloquium of Judges and Magistrates on new laws and commercial products in the financial sector, Kampala, 20 October 2014.

* * *

My Lord, the Deputy Chief Justice

My Lords, the Honourable Judges

Your Worships, the Magistrates

The Chairman and Members of the Uganda Bankers Association (UBA)

Ladies and Gentlemen.

It is a pleasure and honour for me to have been invited to make a few remarks at this workshop for the judiciary and bankers. I would like to thank the organisers for once again inviting me to speak at such a distinguished forum.

This forum serves as a platform for your Lordships and Worships together with the bankers to discuss issues pertinent to the financial services industry and to enhance your understanding of them. As is the case around the world, the industry in Uganda is evolving very rapidly, with new products coming on the market.

Since its inauguration in 1981, the Uganda Bankers' Association has become the primary forum for sharing knowledge and articulating the interests of the banking industry in Uganda. The UBA has understood the importance of reaching out to all stakeholders in society, including the judiciary, government, parliamentarians, the business community and the general public.

In this address, I would like to share with you the strategy of the Bank of Uganda regarding the maintenance of financial stability. In particular, I will talk about the role of the central bank in the areas of monetary policy, regulation and financial sector development.

The global financial crisis that erupted in 2008 prompted a re-thinking by central banks around the globe of how they approach economic and financial stability. In particular, there has been a recognition in the advanced economies that "light touch regulation" allowed financial institutions too much leeway to take reckless risks. Central banks have also embraced the need for what is termed a macroprudential approach to analysing risks to the financial stability.

Prior to the financial crisis, the attainment of low and stable inflation was considered sufficient to ensure macroeconomic stability. It was thought that financial stability was the job of prudential regulation and that monetary policy should focus on inflation and output stabilization. However, it is now recognized that risks to financial stability can build up even when inflation is under control, for example risks which emanate from lending and asset price booms.

Over the last decade new entry and regional economic integration have combined to spur competition in the financial services industry in Uganda. Furthermore, banks are embracing information technology to offer innovative financial products, such as mobile money, as well as improve the efficiency of their operations. Several new banking products are on the market. Innovation and growth in the banking market are essential for meeting the needs of consumers and businesses for financial services, but they also generate new sources of risks.

Traditionally credit risk was the major type of risk facing banks in Uganda. The adoption of IT increases the importance of operational risk, while the increasing integration of the Uganda financial sector into global financial markets, through cross border banking and capital flows, also creates new sources of risk. The evolution of technology has made possible the issuance and innovation of many varied banking products including the VISA, MasterCard, online Banking, Mobile money and e-commerce. All these facilitate modern banking. IT is a key driver of new banking products like mobile money transfers. Today, IT innovations have influenced our ways of living in many fields including banking industry and we all benefit from the new technologies. However, the growth of IT investments and sophisticated products as well as advanced services in the banking industry comes with a concern on "security" and new risks which is the challenging key to propel the sustainability of such growth.

What is the role of the central bank in the financial sector? The primary responsibility of the BoU is to regulate the financial sector. Regulation has two objectives. The first is to protect the interests of depositors. We do this by imposing prudential requirements on banks, under the framework of the Financial Institutions Act (FIA), 2004 such as minimum capital requirements and liquidity requirements and restrictions on risk taking such as limits on large loan and foreign exchange exposures. We also intervene in distressed banks, again under the framework of the FIA, to ensure that banks do not collapse with insufficient funds to repay their deposits. The second objective of regulation is to preserve financial stability; to prevent financial crises.

This also involves ensuring that banks comply with the prudential regulations in the FIA. But we are also intending to introduce additional regulatory measures, which are informed by the macroprudential approach that I mentioned earlier, which are aimed specifically at mitigating systemic risks. Lessons learnt from the past crises have taught and reminded us not to ignore what adverse effects may come afterwards. Admittedly, BoU is just catching up with IT developments. For instance, mobile money agents are known to illegally hold money intended for money transfers. This introduces a new challenge for BoU to re-examine the concept and definition of a "deposit". Do mobile money agents take "deposits"? What must be done to ensure that they do not illegally take deposits? The advances in technology demand that BoU and other regulators world-wide re-examine financial regulations to facilitate the innovations in the banking industry. Central bankers should put the risks and "security" concerns as a key priority and align these concerns with standard setting to promote the advancement of banking services. In addition, BoU needs to work in close co-operation with other industry regulators like the Uganda Communications Commission who licence and regulate the telephone and mobile money companies.

The need to combat financial and economic crime is increasingly changing the role and mandate of the Central Bank which is required to honour various Freeze Order Lists and requests from International stakeholders like the US Embassy and local stakeholders like the Criminal Investigations Department (CIID) in Uganda.

I hope that this workshop will prove stimulating and valuable to all who are participating.

Thank you for your attention.