Explanatory Guide to the SADC Central Bank Model Law

2011

Abbreviations

AML	anti-money laundering
BIS	Bank for International Settlements
CCBG	Committee of Central Bank Governors [in the Southern African Development Community]
CEO	Chief Executive Officer
CFT	combating of the financing of terrorism
ECB	European Central Bank
ESCB	European System of Central Banks
EU	European Union
FIP	Finance and Investment Protocol
FSB	Financial Stability Board
FSF	Financial Stability Forum
G-20	Group of Twenty
IAS	International Accounting Standard
IFRSs	International Financial Reporting Standards
IMF	International Monetary Fund
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
MoU	Memorandum of Understanding
MPC	Monetary Policy Committee
RISDP	Regional Indicative Strategic Development Plan
SADC	Southern African Development Community
SC	Steering Committee
UK	United Kingdom
US	United States

Glossary

Bank	Bank of [*name of the country*]; Central Bank of [*name of the country*]; and Reserve Bank of [*name of the country*]
Board	Board of Directors
legal MoU	Harmonisation of Legal and Operational Frameworks of Central SADC Banks
Model Law	Southern African Development Community Central Bank Model Law
the Fed	United States Federal Reserve System
the Guide	*Explanatory Guide to the SADC Central Bank Model Law*

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Overview

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1. Introduction

This *Explanatory Guide to the SADC Central Bank Model Law* (the Guide) explains policy arguments for the options chosen by the Committee of Central Bank Governors (CCBG) to develop harmonised legislation for Southern African Development Community (SADC) central banks.

The Guide contains proposals and options for the Southern African Development Community Model Law (Model Law), and presents a comparative analysis of the contents of existing SADC central bank laws (as they were in 2002). The information in this Guide therefore explains the provisions in the Model Law.

The Guide starts with a brief review of existing central bank laws in the different SADC countries and the shortcomings of these laws. It then proposes themes or key principles for the development of the model legislation discussed in the subsequent chapters, together with an attempt to explain the motivation behind the proposals. The chapters in the Guide are aligned with the chapters of the Model Law.

2. Background

The CCBG is a SADC organ whose objectives, among other things, are to promote co-operation of Member States towards regional economic development and integration. The CCBG was established in August 1995 as a vehicle for co-operation specifically in monetary policy and central bank activities in the SADC region.

The Terms of Reference of the CCBG cover central banking issues that need to be reviewed to attain convergence in the SADC region. One of the requirements of the Terms of Reference is that the legal and operational frameworks of SADC central banks should be compared and analysed to achieve compatibility.

The Regional Indicative Strategic Development Plan (RISDP) lists the Memorandum of Understanding (MoU) on "Harmonisation of Legal and Operational Frameworks for SADC Central Banks" (legal MoU) and the development of the model central bank statute for the region as the two most important milestones towards a more coherent and convergent status to facilitate the harmonisation of monetary policy in the region.

The CCBG's view is that SADC central banks should develop a model law to guide the reform of individual central banking legislation. The desired approach is for the central banking legislation in the region to be revised and replaced with the principles contained in a model law on central banking developed through the participation of all SADC central banks. This is to provide for international best practice and promote the SADC integration process. It is against this backdrop that the CCBG has developed the Model Law for the SADC region.

Over the past 20 to 30 years, there has been a gradual shift in the way central banks conduct their business. This has been accompanied by an analysis of the proper role and powers of central banks by national institutions and international institutions such as the International Monetary Fund (IMF) and the Bank for International Settlements (BIS), and academics. The shift appears to have been precipitated partly by developments in Eastern and Central Europe, and in Central Asia whose economies were transforming from centrally controlled to market economies and were in need of new institutions, including central banks. Another factor was the developments in the European Union (EU) to introduce a unified currency and the attendant statute on the system of European central banks. In addition, several countries in the SADC region went through a process of democratisation and liberalisation in the early 1990s that required appropriate legal frameworks for their new dispensations.

More recently, the issue of "good governance" in central banks "as a means to provide macroeconomic stability, orderly economic growth and a stable regulatory environment"[1] has been under active discussion. These developments have created an opportunity for SADC central banks to review their laws to enable them to provide an appropriate framework for central banking in the twenty-first century.

1. F. Amtenbrink, "The Three Pillars of Central Bank Governance: Towards a Model Central Bank Law or a Code of Good Governance", presentation at the IMF LEG Workshop on Central Banking, March 2004.

3. Methodology of the Guide

The Guide was prepared by the CCBG Steering Committee on Legal and Operational Frameworks of SADC central banks, with the participation of legal and economic experts from all SADC central banks. Various inputs were received at different stages with comments from the BIS and the IMF, and drafting enhancements by a plain-language legal draftsman.

The process followed in the development of the Model Law and the Guide began with a study titled "Legal and Operational Frameworks of SADC Central Banks: A Comparative Study, 2002". The objective of the study was to summarise the legal and operational structures of all central banks in SADC, analyse the differences in these structures, determine, where possible, the reasons for the diverse situations, and to propose steps and avenues to reach more comparability and harmonisation among the central banks in the region.[2]

2. See "Legal and Operational Framework of SADC Central Banks: Proposed Study". Document 98/04/03 – 10.1 of the CCBG.

The preparation of the different chapters of the Guide, based on the proposed chapters contained in the Model Law, was assigned to different central banks. The draft reports were then discussed and adopted by legal experts and economists from all SADC central banks. This process, conducted through workshops, entailed thorough discussion and debate among SADC central bank officials.

The proposals advanced in the Model Law have taken cognisance of international trends in central bank governance and performance. However, the proposals put forward have also taken into account, where possible, the special conditions existing in certain SADC countries. It is, accordingly, recognised that an individual central bank may modify the legislation to provide for the particular needs of its own country.

4. Present state of central banking legislation in the SADC region

The SADC region is home to at least three distinct legal families, namely common law, civil law and Roman Dutch law. Therefore, despite sharing common functions, central banks within the SADC region have widely differing powers and different legal regimes.

SADC comprises 15 countries at varying stages of development. Each country has its own central bank with its own central bank statute. The nature of this legislation varies widely across different countries, especially in respect of the relationships between Government and central banks in the operation of monetary policy. These variations are a consequence of historical, political, social and economic circumstances in individual countries, and the balance of policy thinking at the time the legislation was enacted. The period when these statutes were enacted ranges from 1974 to 2005.

Most of the existing central bank statutes were enacted in the 1990s. However, contrary to expectations, these laws did not address the pertinent issues relating to modern central banking and, in particular, the trend towards central bank independence. Moreover, most of the current SADC central bank legislation provides for multiple objectives for the central banks, and lacks clarity on the powers and functions of a central bank. Some central bank legislation makes no express reference to objectives but merely provides a list of functions and duties.

Furthermore, despite the general movement towards central bank independence by modern central banks, much of the SADC central bank legislation provides for the Minister responsible for national financial matters to issue directives to the central banks. Central bank policy may also be subject to approval by the Prime Minister in some jurisdictions.

Some central bank statutes contain provisions that should not be functions of central banks, such as dealing with shares for development purposes. The existing legislation in some jurisdictions may even result in unrealised gains being paid out to Government, to the central bank's detriment.

The move towards greater independence has also brought with it a greater focus on transparency and accountability, and the need to provide for both by statute. It is increasingly obvious that SADC central banks need to review

their governance structures to ensure that they are appropriate to the task of twenty-first-century central banking. SADC central banks need to improve their governance systems, especially through legal reforms. There is also a need to modernise applicable laws and regulations to provide for an effective mandate.

5. Central banking policy and principles

The three intertwined pillars of central banking have been cited as (i) independence, (ii) accountability and (iii) transparency.[3]

3. F. Amtenbrink: "The Three Pillars of Central Bank Governance".

5.1 Independence

Central bank independence is premised on the need for longer-term certainty and confidence in monetary policy and for the distancing of this area from governments. The relationship between the central bank and Government is always controversial, and has constitutional, legal, economic, political and sociological implications. The central bank has a medium- to long-term objective to achieve low and stable inflation or price stability. Therefore, the central bank should be an entity independent of Government. The classic issue of "independence" is therefore independence from political power, and includes issues of appointment and tenure of service for the central bank governors, and the interaction between the fiscal authorities and the monetary authorities.

Central bank independence is arguably the most debated institutional feature of a central bank in both economic and legal literature.[4] There is now almost unanimity that a central bank charged with the responsibility of monetary policy must be independent from Government. According to Amtenbrink,

> The [basic] argument is that elected politicians face monetary temptations conflicting with an inflation averse monetary policy. The very nature of their position, being based on the mandate of the electorate, makes it impossible for politicians to be impartial to the short-term benefits of an expansive monetary policy.[5]

Similarly, Collier[6] has stated that central banks in developed countries have acquired far greater independence from Government, "most notably due to the time consistency problem". According to Collier, "governments came to realise that they would better be able to achieve their economic objectives by curtailing their own discretionary power", in other words, "limiting their power of decision enhanced their power to achieve their objectives". According to Poole, "central bank independence is the institutional design that promises to reconcile the different horizons of elected officials and the central bank".[7]

These reasons have been articulated within the SADC region. Making reference to central bank autonomy at an address to the Association of African Central Bank Governors, the former President of South Africa, Mr Thabo Mbeki stated that, "In our case this commitment is borne of the understanding that monetary policy should not be subjected to the vicissitudes that necessarily confront ruling parties."[8] This was with reference to the fact that "monetary policy decisions which impact on the economy with a lag and over an extended period of time, should be insulated from short-term pressures that accompany party politics and elections".[9]

4. Amtenbrink, p. 2, and L. Nyberg, "The Framework of Modern Central Banking", paper presented at a Conference on Reforming the State of Vietnam (Hanoi, 21 March 2006).

5. Ibid, p. 3.

6. P. Collier, "Central Bank Independence: Is it Bad for the Ministry of Finance", paper presented at the Bank of Zambia "Symposium on Central Bank Independence: Does it Hurt the Treasury" (Livingstone, Zambia, November 2007).

7. W. Poole, "Institutions for Stable Prices: How to Design an Optimal Central Bank Law", *Federal Reserve Bank of St Louis Review*, (September/ October 2003), p. 3.

8. T. Mbeki, "Address at the 25th Meeting of the Association of African Central Bank Governors" (Johannesburg, 2001).

9. T. T. Mboweni, "Challenges of Central Banking in Africa", Keynote Address at the Bank of Zambia Symposium: Facing the Challenges of the 21st Century (Lusaka, 2004).

The concept of independence in the context of monetary policy formulation and implementation can be classified as goal independence or instrument independence.

- *Goal independence* is also sometimes referred to as "political independence" and refers to a central bank with power to set the final goals of monetary policy independently of "political institutions and in particular, the executive Government".[10]

- *Instrument independence* refers to a central bank's ability to decide and freely choose the monetary policy instruments to be applied in order to reach its objectives without interference from external sources.[11] This is the form of independence proposed for the SADC region, since many of the member countries that have not adopted inflation targeting are working towards adopting an inflation-targeting monetary policy framework.

  Independence also includes different aspects that may be variously classified as institutional, personal, functional, organisational and financial independence. More specifically, institutional independence overlaps with functional independence and is an inherent feature of administrative law tradition; the central bank is to discharge its delegated mandate without fear or prejudice and with no censorship or mandatory consultation with any external body. It relates to the legal basis of the central bank as an entity that is separate from the executive and the legislature, with its own legal personality and whose independence is guaranteed by statute or the Constitution.

- *Personal independence* refers to appointment, term of office, grounds for removal of, issues of conflict of interest and dismissal procedures for, senior officers, including the Governors and the Board of Directors (Board). It is also sometimes referred to as "organisational independence".

- *Functional independence* is related to operational independence. There should be no prior approval from any source for central bank actions, nor should the central bank seek instructions from any source. Among its essential features, functional independence excludes any obligation to provide Government with credit.

- Financial independence includes the central bank having its own adequate income separate from the Government's budget, that is, a budget that is approved by the central bank Board and not subject to approval by Government, and its own independent auditors. These terminologies, however, tend to overlap.

10. F. Amtenbrink, *The Democratic Accountability of Central Banks* (Oxford: Hart Publishing, 1999), pp. 18 and H. K. Scheller, *The European Central Bank: History, Role and Functions* (Frankfurt: European Central Bank, 2004).

11. Amtenbrink, *The Democratic Accountability of Central Banks*.

5.2 Accountability

The trend towards independent central banks raises issues of democratic accountability. Generally, it is accepted from the legal perspective that an independent institution fulfilling executive functions needs to be "subject to some restraining mechanisms in order not to run contrary to fundamental democratic principles".[12] Indeed, it is feared that without accountability to democratically elected representatives, such as the legislature, central banks run the risk of becoming "too conservative",[13] which could result in the production of sub-optimal monetary policy that would not serve the

12. Amtenbrink, *The Democratic Accountability of Central Banks*, p. 26.

13. G. Debelle and S. Fischer, "How Independent Should a Central Bank Be?" CEPR Conference Paper no. 392, Stanford, 1994, p. 28.

public interest. Therefore, the current proposals seek to transform SADC central banks into institutions that are independent yet fully accountable.

'Accountability' has been defined as the possibility to assess the results of policy against pre-set objectives. Hence, it has to be contextualised with checks and balances in a democratically elected system. Parliament is the appropriate forum for central banks to account to, bearing in mind the doctrine of separation of powers in the three spheres of state organs.

Concern with democratic accountability relates to all functions that a central bank fulfils, although emphasis is placed on democratic accountability in relation to the performance of monetary policy. Therefore, central bank independence must be accompanied by a requirement to account. These proposals advance an accountability framework that will be mainly, but not limited to, reporting to, and appearance before, the legislature and will include accountability to the public. The detailed proposals are contained in Chapter IX of the Guide, which deals with accounts and reporting requirements.

5.3 Transparency

A central bank is expected to be transparent in the way in which it makes decisions and implements policy.[14] As the trend grows towards central bank independence, transparency is increasingly demanded of central banks as a feature of a democratic, accountable institution. Transparency is about openness, and relates to the provision of information and interaction with the public on monetary policy decisions by a central bank.

The "IMF Code of Good Practices on Transparency in Monetary and Financial Policies" has defined 'transparency' as referring to "an environment in which the objectives of policy, its legal, institutional and economic framework, policy decisions and their rationale, data and information related to [. . .] policies, and the terms of agencies accountability, are provided to the public on an understandable, accessible and timely basis".[15] The former Chairperson of the United States (US) Federal Reserve Board, reflecting on the case for transparency stated that "we should make available to the electorate what it is we think, why we are doing what we are doing and in a general way under what conditions we would behave differently".[16]

A good central bank design is expected to provide for central banks to make timely reports about policy actions, including the reasons for changes.[17] Essential aspects of transparency include prompt disclosure of policy decisions and the rationale for those decisions. This is considered necessary for markets to function efficiently.[18] Political accountability, which is an essential feature of an independent central bank, also requires transparency. In this regard, transparency functions as a prerequisite for accountability.[19]

14. W. Poole, "Institutions for Stable Prices: How to Design an Optimal Central Bank Law", *Federal Reserve Bank of St Louis Review,* September/ October 2003.

15. International Monetary Fund, *Code of Good Practices on Transparency in Monetary and Financial Policies*. (Washington DC: IMF, 1999), p. 2.

16. Tercentenary Symposium of the Bank of England, 1994.

17. Poole, "Institutions for Stable Prices".

18. Poole, "Institutions for Stable Prices".

19. F. Amtenbrink, *The Democratic Accountability of Central Banks*, p. 7.

6. Financial stability and the role of central banks

6.1 Problem statement

In most central bank legislation in the SADC region, the issue of financial system stability does not feature. It has been left to the discretion of each central bank to find ways of addressing financial system instability when it occurs. The prominence of financial system instability predates most of the central bank legislation in the SADC region.

6.2 Discussion

It is generally accepted that financial stability is a situation where the financial system operates with no serious failures or undesirable impact on the present and future development of the economy as a whole, while showing a high degree of resilience to shocks.

Financial stability may be disturbed both by processes inside the financial sector, leading to the emergence of weak spots and by strong shocks emanating from outside the financial sector. Such shocks may arise, among other things, from the external macroeconomic environment, domestic macroeconomic developments, the position of the main debtors and creditors of financial institutions, economic policies or changes in the institutional environment. In some cases, a prolonged period of low, stable inflation and interest rates may stoke and abate excessive risk taking, which may ultimately cause financial instability towards or after the peak of the business cycle. Any interaction between weak spots and shocks can result in the collapse of major financial institutions, and disruption of the functions of the financial system as regards financial intermediation and payments. In the extreme case, it may even lead to a financial crisis with adverse implications for the real economy.

The international financial market crisis that began in the summer of 2007 led to an extended period of financial turmoil caused by the losses in the US sub-prime mortgage market. Renowned economists such as Stiglitz and Krugman, the IMF, and other commentators labelled the financial crisis as the worst financial crisis since the Great Depression. In mid-September 2008 it erupted into a full-blown, global financial crisis, precipitated by the failure of the investment bank Lehman Brothers. The subsequent loss of confidence in the financial system provoked a liquidity crunch in the interbank market. Banks became extremely reluctant to lend to one another and liquidity dried up rapidly. By the first quarter of 2009, the global economy was in the midst of a deep downturn or recession. All major advanced economies were in recession, while activity in emerging and developing economies slowed abruptly.

The impact of the financial crisis on major advanced economies came through credit crunches and liquidity freezes. The eruption of the financial crisis and uncertainty that followed provoked an increase in precautionary saving and the associated reduction in investment and consumer demand. This, together with increased borrowing costs and tighter lending

standards, provoked a severe slowdown in global economic growth. The cutback in investment demand was widespread, and continued sharply or precipitously in the first quarter of 2009. It involved countries directly affected by the financial crisis, those with close links to affected commercial and investment banks, and those emerging and developing economies that suffered through the indirect channel of falling export demand prices.

Though it began in the major advanced countries, the global financial crisis has also hit emerging and developing countries severely through indirect channels. Several developing countries, notably those with vulnerable capital accounts and weak macroeconomic fundamentals experienced severe economic downturns. Developing country commodity exporters have suffered a decline in income resulting from falling export demand and lower commodity prices. However, lower food and energy prices have boosted the purchasing power of consumers in commodity-importing countries.

In response to the current global financial crisis, many central banks in industrialised and emerging-market economies started to change the scope of their actions from the focus on reducing inflation to one of stimulating growth. Central banks across the board launched a large co-ordinated attack on the widening global financial crisis, lowering their policy rates in unison in order to restore confidence in the financial system. This co-ordinated movement displayed that the concern of central banks is not so much on controlling inflation anymore, but rather on stimulating domestic demand, given the fears of a global recession. Even central banks such as the European Central Bank (ECB) whose sole mandate is to keep eurozone prices steady followed the co-ordinated move. Such co-ordination among key central banks included provisions of liquidity to ease financial strains and co-ordinated round interest rate cuts to unfreeze interbank lending markets.

In an attempt to safeguard the domestic financial markets from collapsing, a number of central banks, including the United States Federal Reserve System (the Fed) extended lender-of-last-resort facilities to strategically important non-bank financial institutions. The overriding objective of the lender-of-last-resort facility is to maintain a sound financial system. Consequently, the primary goal of the lender of last resort is to curtail potential systemic or contagion risk, while the secondary goal is to prevent illiquidity in a troubled banking institution from precipitating into insolvency, and a potential run on the banking institution and the banking system as a whole. In addition, collateral requirements were lowered, asset swaps took place, longer maturity refinancing operations came into being, and capital was injected into banks and other financial institutions. Considerable fiscal stimulus packages were also announced and banks in some countries were nationalised. These co-ordinated interest rate actions involving major central banks were a sign of the fear that the global financial crisis could cripple the global economy faster than anticipated. In order to ensure financial system stability, it is clear that central banks should be charged with the function of supervising commercial banks.

The Fed has been predominantly antagonistic about monetary policy easing because it has reduced its Fed funds rate by a cumulative 500 basis points since the beginning of the crisis to close to zero per cent. Other central banks such as the ECB, the Bank of England (BoE), the Bank of

Japan and the People's Bank of China also cut their rates although their cuts were less aggressive than the Fed's in the early stages of the crisis, but more recently they have also been cut by large percentages. However, the question remained whether the co-ordinated moves managed to diminish the risks of the crisis and, consequently, a global recession. Considering all the actions taken by these global central banks, it is worth noting that such actions might have had negative consequences for economies, because the moves could turn out to be inflationary in the long run. Central banks, including those in the SADC region, should clearly communicate to their stakeholders and the public that they intend to keep policy rates low until recovery in the economy takes place in order to manage expectations, hence, reducing deflationary risks.

According to the IMF's *World Economic Update July 2009*, the global economy has started to pull out of its worst recession since World War II. Unprecedented policy actions undertaken by central banks and governments worldwide succeeded in stabilising the financial condition of banks, reducing counterparty risk and preventing another systemic failure. Signs of a global economic recovery appeared in the second quarter of 2009 in the US, eurozone, Japan, and China. Financial conditions improved with reduced risk of systemic collapse and with resumed bank lending, albeit still slow. Volatility in financial markets abated and the appetite for risk returned.

In emerging and developing countries commodity prices recovered, portfolio inflows resumed and asset prices rose as investors moved into risk assets and away from traditionally safe havens. Furthermore, since March 2009, spreads on developing country bonds started to narrow, with the financial market distinguishing better between the risks posed by different countries. In addition, there were strong signs of renewed external appetite for emerging-market exposure or bonds, in particular, sub-Saharan African debt.

In support of the global economic recovery, the leaders of the Group of Twenty (G-20) met in London on 2 April 2009 to discuss the challenges to the world economy posed by the global crisis that had deepened since they had last met. The G-20 Finance Ministers and Central Bank Governors pledged to do whatever was necessary to

- restore confidence, growth and jobs;
- repair the financial system to restore lending;
- strengthen financial supervision and regulation;
- strengthen global financial institutions;
- resist protectionism, and promoting global trade and investment; and
- ensure a fair and sustainable recovery for all.

The G-20 also reached an agreement which, in principle, provided US$12 trillion to various programmes designed to improve international finance, credit, trade, and overall economic stability and recovery. The G-20 also issued a declaration: "Strengthening the Financial System". In the declaration the G-20 agreed to establish a new Financial Stability Board (FSB) with a strengthened mandate, as a successor to the Financial Stability Forum

(FSF). The FSB is a Basel-based body of regulators. A declaration on further steps to strengthen the financial system was issued, in which the G-20 agreed to stronger regulation and oversight for systemically important firms, including rapid progress on developing tougher prudential requirements to reflect the higher costs of failure.

6.3 Proposal

Central banks should be charged with the function of supervising commercial banks in order to strengthen financial system stability, and to prevent system failure and collapse. Financial instability may originate from financial and non-financial institutions. Financial instability may also originate from markets. Financial instability may come from internal or external political instability, and external sources of instability can be contingent on the completeness of the systemic channels of transmission mechanisms. It may therefore be logical that institutions closest to regulatory matters should be tasked with the mandate of maintaining financial stability.

7. The basis for new legislation

7.1 SADC Regional Indicative Strategic Development Plan (RSDP)

The SADC RISDP provides a road map with a broad framework for deepening integration across the various sectors in the SADC region within given timelines. The RISDP emphasises that good political, economic and corporate governance are prerequisites for sustainable socio-economic development.

Priority intervention areas in the trade or economic liberalisation and development sectoral co-operation and integration areas include macroeconomic convergence, the establishment of a SADC monetary union by 2016 and other financial indicators, such as a gradual interconnection of the payments and the clearing system in SADC by 2008, and central bank credit to Government being less than 10 per cent of the previous year's tax revenue by 2008 and less than 5 per cent by 2015.

7.2 Finance and Investment Protocol (FIP) and annexures

The preparation of an institutional, administrative and legal framework for establishing a SADC Central Bank by 2016 would require harmonisation of legal and operational frameworks for the central banks of the SADC Member States. Towards this end, the CCBG adopted various MoUs, including the legal MoU. The MoUs have been incorporated as annexures to the Finance and Investment Protocol (FIP). Other annexures pertinent to central banking are the "Macroeconomic Convergence; Co-operation and Co-ordination of Exchange Control Policies"; "Co-operation on Payment, Clearing and Settlement Systems, Co-operation in the Area of Information and Communications Technology Amongst Central Banks"; "Co-operation"; and "Co-ordination in the Area of Banking Regulatory and Supervisory Matters".

Note should be taken that the Model Law can only work during the initial stage towards harmonisation of legal and operational frameworks among central banks in the region. Further legal steps, such as the establishment

of a SADC monetary institute, the drafting of a SADC central bank statute and other consequential acts, will be needed to take the region to the level of a single-currency union level.

7.3 Annexure on "Harmonisation of Legal and Operational Frameworks of Central SADC Banks"

The legal MoU provides the broad principles intended to eliminate the risks and contradictions in the national and multilateral legal frameworks of central banks of Member States. The objectives of the Legal MoU are to

a. establish principles that will facilitate the creation of a coherent and convergent status in the legal and operational frameworks of SADC central banks;

b. promote the adoption of principles that will facilitate the operational independence of central banks;

c. create best practice in the legal and operational frameworks of central banks; and

d. provide a framework for the creation of a SADC model central bank statute, which will be considered and approved by the Ministers responsible for national financial matters.

In order to achieve the above objectives and to foster harmonisation of legal and operational frameworks of SADC central banks, the central banks have agreed to certain principles. These are (i) principles for convergent status; (ii) principles for operational independence; and (iii) principles for transparency and accountability.[20] The CCBG is endeavouring to translate the broad principles embedded in the MoU detail into the Model Law.

20. Article 4 of the "MoU of Central Banks of the Southern African Community Member States on Harmonisation of Legal and Operational Frameworks".

The MoU was approved by the Ministers responsible for national financial matters at their meeting held in Pretoria in August 2005 after a period of protracted consultation with the CCBG.[21] The MoU is, therefore, a product of compromise to accommodate some of the concerns raised by the Ministers responsible for national financial matters.

21. Committee of Central Bank Governors in SADC, *Preliminary Report of the Consultations Between the Chairperson of the CCBG, SADC Central Bank Governors and the SADC Ministers Responsible for Finance*, (June 2005).

It is trite that the determination of the general monetary policy framework vests in Government, while the responsibility for monetary policy formulation and implementation rests with central banks. The key concepts that form the basis of the legal framework for a central bank are independence, accountability and transparency.

Within the above realm, the following questions are among the conceptual premises guiding the discussion towards developing the Model Law:

a. How should the independence of the central bank be conceptualised?

b. What is the nature of the relationship between the central bank and the Ministry responsible for national financial matters?

c. What is the primary objective of the central bank? Is it price stability, price and financial stability, price and monetary stability or something else?

d. How is the Board of the central bank to be appointed?

e. What should be the powers of the Board?

f. How should the Governor and Deputy Governor(s) be appointed?

g. What should be the tenure of Governor and Deputy Governor(s)?

h. How should the Governor and Deputy Governor(s) be dismissed from office?

i. What should be the remuneration policy of the central banks? Should it be part or independent from the civil service?

j. What are the corporate governance issues as regards disclosure of remuneration?

k. What should be the principles guiding the institutional framework for monetary policy formulation and implementation?

l. What should be the relationship between the Monetary Policy Committee (MPC) and the Board?

m. Who should determine the exchange rate policy?

n. What should be the relationship between the central bank and commercial banks and other financial institutions?

o. How can the accountability of the central bank to its stakeholders be ensured?

8. Principal aspects of the proposed SADC Central Bank Model Law

The proposed Model Law is based on three main premises, namely (i) to provide for adequate powers and independence for central banks to fulfil their responsibilities; (ii) to provide adequate mechanisms for good governance; and (iii) to provide for accountability to Government, Parliament and the public.

More specifically, the proposals provide for the following:

a. An appropriate legal form and capacity.

b. A primary objective and secondary objectives.

c. Independence of the Bank

- The new legislation should provide for articulation of the principle of independence of the Bank at all practical levels, bearing in mind the fine balance between the three pillars of central bank governance, namely (a) independence, (b) accountability and (c) transparency. The legal status of central bank independence comprises the following elements
  - Institutional independence
  - Functional independence
  - Personal (professional) independence
  - Financial autonomy.

d. Clear functions and powers, including limits where relevant.

e. Robust institutional arrangements, which include

- The composition of the Board, its appointment and dismissal
- Appointment and dismissal of the Governor and Deputy Governors and other directors.

f. Transparent monetary policy formulation and implementation.

g. Issuance of notes and coin.

h. A sound relationship with Government on

- lending to Government; and
- resolution of policy disputes.

i. Relationship with banks and other financial institutions

- accommodation of banks; and
- lender of last resort.

j. Maintenance of international reserves and conduct of foreign-exchange operations, in particular who formulates exchange rate policy?

k. Payment, clearing and settlement systems.

l. Accounts and reporting requirements.

m. Accountability.

n. Profits and reserves.

o. Enforcement mechanisms and general provisions.

p. General harmonisation and modernisation of central bank law in the SADC region.

9. Conclusion

The Model Law was approved by the CCBG at the meeting held in Pretoria in April 2008. The Model Law is designed to assist SADC Member States with updating their central banking legislation to address existing disparities in SADC central bank laws. This legal framework offers an avenue towards more compatibility, comparability and harmonisation among the central banks in the SADC region. The long-term objective is to promote the principles of operational independence, transparency and accountability that will form the cornerstone of a future regional central bank in SADC. The historical, political, social and economic challenges in the region have been considered in developing this legal framework. The RISDP and the FIP provide guidelines.

The Model Law is a legislative text that forms a common basis for SADC Member States for incorporation into their national law. When reviewing national central bank laws, Members States are urged to align their drafting to the Model Law as closely as possible to ensure consistency, certainty and harmonisation within SADC.

The Guide clarifies the objectives for specific provisions in the Model Law. An attempt has been made to explain why specific provisions are necessary to achieve comparability and harmonisation of implementation of monetary policy in the SADC region. A key feature of the Guide is the chapter-by-chapter explanatory notes intended to ensure ease of reference and alignment with the Model Law.

The Model Law attempts to be as comprehensive as possible. However, as SADC central banks explore the road map towards Monetary Union, and in particular the regional central bank, more reforms may have to be considered. Furthermore, the current global financial crisis poses significant challenges to central banks, particularly the reconciliation of the primary objective of achievement and maintenance of price stability with the central bank's role in fostering general financial system stability.

10. Summary of the proposals

Table 1 contains a summary of the proposals outlined in the Overview to the Guide:

Table 1: Proposals contained in the Overview

	Issue	Proposal
6	In most SADC region central bank legislation, the issue of financial system stability does not feature.	Central banks should be charged with the function of supervising commercial banks in order to strengthen financial system stability, and to prevent system failure and collapse.

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Chapter I
Name, objectives and functions of the Bank

---------- Contents ----------

1. Introduction

This chapter looks at key principles in the development of the SADC model central bank legislation. These principles include operational independence, transparency and democratic accountability[22] aimed at improving efficiency. Attainment of these principles motivated most of the provisions in the chapter. The chapter also looks at the basic tenets of good corporate governance in a modern central bank and international best practice.[23]

22. F. Amtenbrink, "The Three Pillars of Central Bank Governance: Towards a Model Central Bank Law or Code of Good Governance", IMF Institute Seminar on Current Developments in Monetary and Financial Law, Washington DC, 2004

23. International best practice was arrived at by reviewing comments from the IMF and the BIS and from conducting comparative international research on trends in central banking, bearing in mind the peculiar regional needs.

2. Name of the Bank

2.1 Problem statement

Central banks in the region lack a common reference name to identify them immediately as the central bank. The lack of a common reference makes it difficult to identify that which is referred to as a central bank, especially when doing a comparative analysis of SADC countries.

2.2 Discussion

Central banks in the region are variously described as provided under the establishing statutes, such as Banco Naçional de [*name of the country*]; Bank of [*name of the country*]; Central Bank of [*name of the country*]; and Reserve Bank of [*name of the country*]'. It is not immediately apparent in some instances that reference is being made to the central bank. The term, 'national bank' is particularly problematic. The term 'national bank' should not be used as it poses a risk of confusion because of its use by commercial banks in some jurisdictions.[24]

24. See CCBG, *Legal and Operational Frameworks Comparative Study,* 2002. Note that the central bank legislation of Mauritius was changed in 2004 and that of Tanzania in 2005.

2.3 Proposal

The more widely accepted terms, namely 'central bank', 'reserve bank', or 'Bank of [*name of country*]' should be the prefix to SADC central banks. (Section 2 of the Model Law.)

3. Constitutional provision

3.1 Problem statement

Most countries in the SADC region do not have a provision in their Constitution on the establishment of the central bank.

3.2 Discussion

The central bank is a very important institution in the economy of a country. As such, constitutional provision for the establishment of a central bank, as is the case in some countries, is critical to cushion it from influence that may undermine the achievement of its objectives. However, only few jurisdictions in the SADC region have constitutional provisions for the establishment of a central bank.

3.3 Proposal

At the constitutional level there should be a broad or explicit delegation of authority by the sovereign state to the central bank to enhance the legal independence of SADC central banks. Reference to central bank independence should also be made in central banks' respective Acts.

4. Legal form and capacity of central banks

4.1 Problem statement

In all SADC countries the central bank is a distinct legal person. However, there are many different descriptions of the corporate nature of these institutions in the various countries' legislation that require harmonisation. Moreover, some countries use a generic phrase without articulating the specific legal form and capacity of the central bank.

4.2 Discussion

Some countries describe the central bank as a body corporate in public law with the legal form of a public sector company and do not explicitly confer specific powers in this regard. Other countries describe the central bank as a public law institution with full legal status. It is a legal entity entrusted, in particular, with the capacity to contract, testify in court, acquire assets, own assets or have assets at its disposal. Furthermore, some countries describe the corporate nature of the central bank as a public-sector company, while other countries simply deem their central banks to be juristic persons. Other countries describe their central banks as body corporates and confer upon them, subject to the enabling Acts, all powers of a body corporate.

There are six SADC central bank Acts that describe their central banks as body corporates with perpetual succession and a common seal. However, not all other attributes conferred on these central banks are uniform. The

full complement includes the power to enter into contracts, to sue and be sued in the corporate name, and to acquire, hold and dispose of movable or immovable property.

Simply describing the corporate nature of the central bank as a body corporate or a juristic person or other such description is most unsatisfactory in the SADC region as the region is home to at least three distinct legal families, namely (i) common law, (ii) civil law and (iii) Roman Dutch law. Some of the terms used to describe the nature of the central bank do not necessarily mean the same thing in the different legal systems. A better approach may be to specify the different attributes of this legal person for the sake of certainty and avoidance of doubt. Rather than using a generic term such as "juristic person" or "body corporate", the legal form and capacity of the central banks should be expressly provided for to include the power to enter into contracts and incur obligations; to sue and be sued in its own name; and to acquire, hold and dispose of property, whether movable or immovable.

4.3 Proposal

The corporate nature of the central bank and its capacities should be clearly articulated in the enabling Act. (Section 3 of the Model Law.)

5. Primary objective of central banks

5.1 Problem statement

Central banks in the SADC region have different primary objectives. In addition, some have several objectives, which may sometimes be conflicting in nature.

5.2 Discussion

There is a need to harmonise the objectives of central banks in the SADC region to possibly one primary objective. This is necessitated by the stated goal to attain economic and monetary union.

Half the central bank Acts in SADC have provisions for primary objectives. The rest have either a list of objectives or a list of functions. For the central banks with Acts providing for a single primary objective, the focus is either on preserving the value of the national currency for economic development or on maintaining price stability for balanced economic development. It is worth noting that both cases refer to the need to ensure price stability, which is essential for economic development.

This is also in line with recent developments in many countries where central banks have focused their attention on reducing inflation or maintaining stable prices. The maintenance of price stability in an economy is essential for the facilitation of economic growth and development.[25] This realisation has compelled many countries to scale down objectives to that of ensuring price stability. This enables the central bank to remain focused on its primary objective. Multiple objectives may result in either conflicting interests or failure by the central bank to achieve its objectives.

25. See further discussion of objectives in L. Frisell, K. Roszbach, and G. Spagnolo, *Governing the Governors*: *A Clinical Study of Central Banks* (Norway: Sveriges Riksbank, November 2004).

The law should clearly set out the central bank's objective(s). All central banks in the region should move towards adopting a single, primary objective – that of ensuring price stability. The primary objective should be separated from other, secondary objectives.

Secondary objectives, such as economic development, and the fight against poverty and unemployment should support or complement the furtherance of the primary objective of price stability. An emerging area resulting from the global financial crisis for central banks is contributing towards fostering financial stability.

5.3 Proposal

The law should set out clearly the central bank's primary objective that articulates the central bank's mandate and, therefore, what it should be assessed against. The objective needs to be unambiguous and achievable.[26] (Section 4 of the Model Law.)

26. P. Nicholl, "Central Bank Organizational Structures: Their Significance", paper presented at the Central Banking Publications Seminars.

6. Independence of the Bank

6.1 Problem statement

Independence of the central bank has become a condition sine quo non for the achievement of price stability. However, most central banks in the SADC region do not have the principle of independence clearly stated in the statute and/or national Constitution.

6.2 Discussion

There has been an evolution in the past 30 years from treasury-run central banks to independent ones.[27] The independence of the central bank is, therefore, a general theme interwoven throughout the Guide. There are certain areas of central banking operations where independence is required and needs to be spelt out explicitly, and other areas where it is implied in a subtle manner.

27. D. Bengt, "Central Banking in an Evolving Environment", paper presented in the MEFMI Governors' Forum, Basel (June).

It is a generally accepted principle that central banks need to be independent of Government (or any other body's) influence if they are to conduct their affairs in the most objective and professional manner. Research has also demonstrated that countries with independent central banks have a better record on inflation.

Apart from express provisions, there are certain provisions that can be contained in legislation that would determine the operational and institutional independence of a central bank, such as the manner of appointment, tenure and dismissal of the chief executive officer (CEO) and the Board. These provisions are discussed in greater depth in Chapter II.

It is, however, also possible specifically to enact provisions enjoining the central bank and members of its decision-making bodies from seeking or taking directions from Government or any other body; in other words, statutes can expressly provide for the independence of the central banks in their pursuit of the primary objective. Such provisions would be most appropriate in a country's Constitution, which is the highest law of the

land, and the central bank's own statute. However, within the SADC region, Malawi, Namibia and South Africa currently appear to be the only jurisdictions with such provisions in their national Constitution.

6.3 Proposal

The law should explicitly provide for the independence of the central bank (incorporating institutional, legal, functional and financial independence). All national constitutions in the SADC region and central bank statutes should expressly provide for the independence of central banks in their pursuit of the primary objective. Furthermore, the central bank legislation should clearly spell out that the independence of the central bank should be observed and that no person should seek to influence the Bank improperly in the discharge of its duties.[28] The independence of the central bank should be safeguarded by the provision of sanctions for its breach. It should also be noted that independence must be balanced against the other important corollary principles of accountability and transparency. (Section 5 of the Model Law.)

28. The independence of the central bank can be further enhanced by making provision for it in the offences and penalties in the SADC Central Bank Model Law.

7. Duties, powers and functions of the Bank

7.1 Problem statement

The duties, powers and functions of SADC central banks are variously provided for in their respective legislation with some countries providing for objectives, while others have only a list of functions and duties.

7.2 Discussion

There is a need to harmonise the presentation and the content of duties, powers and functions in central bank statutes in the SADC region. Specific supportive functions will vary among countries, because they will be influenced by the relevant circumstances in each country. Proper differentiation should be made between the primary objective, broad objectives, functions, and powers and duties in the legislation. The duties, powers and functions of the Bank must be clearly provided for in the statute and they should be presented in such a manner that the first section provides for the core functions, while the other parts provide for the activities or functions in which the Bank may engage. In addition, a "catch all" provision should be added to provide for other functions that may not be expressly provided for in the Model Law, as long as such other functions are consistent with the provisions of the Model Law, such as the primary objective.[29]

29. Detailed discussion of proposals related to the specific powers and functions are contained in subsequent chapters of the Guide.

7.3 Proposal

The duties, functions and powers of central banks should be clearly provided for in one section of SADC region central bank statutes. (Section 6 of the Model Law.)

8. Prohibited activities

8.1 Problem statement

The majority of central bank statutes contain prohibited activities. However, some countries do not have a list of prohibited activities.

8.2 Discussion

There is a need for prohibited activities to be clearly spelt out in the Model Law to help remove any doubt that the Bank may have in carrying out its activities. If prohibited activities are not listed, the Bank may find itself involved in activities that could negatively impact on its primary objective.

The Model Law should include a section spelling out prohibited activities such as engaging in trade, acquiring/purchasing the shares of corporations, accepting shares as security, acquiring immovable property other than in the course of ordinary business, making unsecured advances, entering into insurance risk contracts; and guaranteeing debts of the State and State-controlled institutions. Each Member State will, however, be at liberty to add onto the list other prohibitions depending on its peculiar circumstances, such as lending to Government.

8.3 Proposal

Prohibited activities should be clearly set out in a section of the central bank statute. (Section 7 of the Model Law.)

9. Ownership structure of the Bank

9.1 Problem statement

All SADC central banks, with the exception of the South African Reserve Bank, are 100 per cent government-owned. This ownership structure poses the potential threat of encroachment on central bank independence.

9.2 Discussion

There is very little divergence in the manner of ownership of central banks in the SADC region as all the central banks are a creation of statute and all but one are owned by their respective governments. Since the late 1930s and after World War II the trend has been to move away from privately owned to state-owned central banks[30] even in the Western world. For example, the BoE, which was set up as a private company in 1694, was nationalised in 1946. However, the nature of the ownership structure, both private and Government, has not interfered with the creation of an independent institutional structure.[31]

30. J. Rossouw, "A Brief on Nel and Lekalake: Monetary Transparency in South Africa", and H. Nel, "Monetary Policy Transparency in South Africa: A Reply to Rossouw", both in *South African Journal of Economics*, 72:5 (December 2004).

31. Apart from South Africa, there are other central banks with private ownership. Other countries include Austria, Belgium, Greece, Italy, Japan, Pakistan, Switzerland and the Fed.

9.3 Proposal

Since central banking is a function delegated by the state, the existing ownership structure pertaining in the SADC countries could remain (government or private) provided the institutional set-up does not compromise the central bank's autonomy. (Section 8 of the Model Law.)

10. Capital of the Bank

10.1 Problem statement

Some SADC central banks are currently undercapitalised due to lack of adequate statutory safeguards. Inadequate capital may negatively impact on the financial and institutional independence of a central bank in discharging its mandate.

10.2 Discussion

There is a growing volume of literature on the subject of central bank capital. One question that has been asked is whether central banks need capital and, if so, how much?[32] Whereas it is acknowledged that under certain circumstances a central bank can operate on zero capital, the adequacy of central bank capital has implications for financial independence, which is one of the key components of central bank independence.

32. P. Stella, "Do Central Banks Need Capital?" IMF Working Paper, (Washington DC, 1997).

Some preliminary econometric evidence suggests that there is a link between a central bank's financial strength and its policy performance: in other words, the level of capital has implications for a central bank's ability to execute its mandate effectively and efficiently. A large negative net worth would impair a central bank's ability to conduct monetary policy and would make it dependent on the treasury for support.[33] As was stressed by the European Monetary Institute (the precursor to the ECB) in 1998, "If a national central bank is fully independent from an institutional and functional point of view, but at the same time unable to avail itself autonomously of the appropriate economic means, to fulfil its mandate, its overall independence would nevertheless be undermined."[34]

33. Stella, "Do Central Banks Need Capital?" p.5.

34. The European Monetary Institute, "Convergence Report" 1998, p. 295, quoted in Stella, P. and A. Lonnberg, "Issues in Central Bank Finance and Independence", IMF Working Paper WP/08/37 (Washington DC, 2008).

Another area of debate is whether legislation should provide for automatic re-capitalisation of central bank capital or if this should be negotiated between the monetary authorities, fiscal authorities and the legislature. Views on the matter vary. One view is that central bank capitalisation requires a broad-based policy debate and should therefore not be automatic.[35] The converse is that automatic capitalisation dispenses with the tensions between central banks, the national treasuries and the legislature that often delay central bank capitalisation. The latter approach is preferred. It has been acknowledged that central bank capitalisation can trigger lengthy and sometimes acrimonious debates.[36]

35. A. Ize, "Capitalizing Central Banks, a Net Worth Approach", IMF Working Paper WP/05/15 (Washington DC: IMF, 2005).

36. Ize, "Capitalizing Central Banks, a Net Worth Approach", p.19.

All SADC central bank statutes provide for the authorised capital but it is not clear how this is determined in each jurisdiction. However, too many jurisdictions have failed to provide for what constitutes the real capital (when 'capital' is narrowly defined as the contribution directly invested by shareholders) – the minimum paid-up capital. Provision for minimum paid-up capital is one way of ensuring that central banks are not legally under-capitalised.

The amount of capital for a central bank may vary depending on the

a. size and level of development of the economy;

b. lending levels to Government and operational expenses;

c. level of intervention in money markets and development of the secondary money market;

d. lender of last resort to commercial banks and other financial institutions; and

e. the amount of capital requirement for commercial banks.

The factors listed above will determine, to a large extent, the amount of capital required for the given central bank. Lending levels and the associated risk, which can erode the capital base of the central bank, have to be taken into account when determining the Bank's capital. A central

bank should be adequately capitalised to ensure and maintain confidence in the banking and financial system. Adequate capitalisation will enable a central bank to implement its monetary policies effectively, as it will be able to generate resources. Such a bank will not be susceptible to manipulation by governments because it will be able to fend for itself without recourse to public subventions.

The capital for a central bank will vary from country to country depending on its level of operations and associated risk. Each country must determine the capital of its central bank in accordance with the factors listed above.

10.3 Proposals

a. All central bank Acts should provide for both the authorised and the minimum paid-up capital.

b. Each country should determine its authorised and paid-up capital in accordance with the prescribed criteria in the central bank Act.

c. A provision should be made for increasing the authorised and minimum paid-up capital with the approval of the appropriate authority.

d. Legislation should provide for automatic internal recapitalisation by central banks. (Section 8 of the Model Law.)

11. Summary of the proposals

Table 2 outlines the proposals contained in Chapter 1: Name, objectives and functions of the Bank:

Table 2: Proposals outlined in Chapter 1

	Problem statement	Proposal	Model Law Section
2	Central banks in region lack a common reference name to identify them immediately as the central bank.	The more widely accepted terms, namely 'central bank', 'reserve bank', or 'Bank of [*country*]' should be the prefix to SADC central banks.	2
3	Most countries in the SADC region do not have a provision in the Constitution on the establishment of the central bank.	A broad or explicit delegation of authority by the sovereign state to the central bank should exist at the constitutional level to enhance the legal independence of SADC central banks.	2
4	In all SADC countries, the central bank is a distinct legal person.	The corporate nature of the central bank and its capacities should be clearly articulated in enabling Act.	3
5	Central banks in the SADC region have different primary objectives. In addition, some have several objectives, which may sometimes be conflicting in nature.	The law should set out clearly the central bank's primary objective that articulates the central bank's mandate and, therefore, what it should be assessed against.	4

Table 2: Proposals outlined in Chapter 1			
	Problem statement	Proposal	Model Law Section
6	Independence of the central bank has become a necessary condition to achieve price stability.	The law should explicitly provide for the independence of the central bank (incorporating institutional, legal, functional and financial independence).	5
7	The duties, powers and functions of SADC central banks are variously provided for in their respective legislation with some countries providing for objectives, while others have only a list of functions and duties.	The duties, functions and powers of central banks should be clearly provided for in the sections of the central bank statutes in the SADC region.	6
8	The majority of central bank statutes contain prohibited activities. However, some countries do not have a list of prohibited activities at all.	Prohibited activities should be set out clearly in a section of the central bank statute.	7
9.1	All SADC central banks, with the exception of the South African Reserve Bank, are 100 per cent government-owned.	Since central banking is a function delegated by the state, the existing ownership structure pertaining in the SADC countries could remain provided the institutional set-up does not compromise the central bank's autonomy.	8
9.2	Some SADC central banks are currently undercapitalised due to lack of adequate statutory safeguards.	• All central bank Acts should provide for both authorised and minimum paid-up capital. • Each country should determine its authorised and paid-up capital in accordance with prescribed criteria in the Act. • A provision should be made for increasing the authorised and minimum paid-up capital with the approval of the appropriate authority. • Legislation should provide for automatic internal recapitalisation by central banks.	8

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CBG *see* Committee of Central Bank Governors.

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IMF *see* International Monetary Fund.

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Chapter II
Institutional arrangements

---------- Contents ----------

1. Introduction

This chapter discusses the institutional arrangements for a modern central bank as perceived by the SADC region. The chapter makes proposals in respect of a central bank's Board and the Board's functions and powers; the appointments of the central bank's Governor and Deputy Governors; the appointment, qualification, disqualification and terms of the Board, including the Governor and Deputy Governor; and the establishment and operations of Board committees. A constant theme in these proposals is the need to include provisions to promote the independence of the central bank. The proposals also seek to ensure the clarity of roles and responsibilities of the various key central bank players.

2. Board of Directors

2.1 Problem statement

Most central bank boards in SADC have an executive chairperson who is also Governor and CEO. In addition, most SADC central banks do not have institutional arrangements that guarantee their operational independence.

2.2 Discussion

Corporate governance principles advocate the presence of a Board for an institution with an independent non-executive Chairperson and majority non-executive directors. The rationale for having a non-executive Chairperson is to avoid conflicts of interest and to enhance accountability of the executive management towards the Board, as compared to if the Chairperson is an executive member.

While generally the fact that the position of Governor, who is also the CEO of the institution, as Chairperson of the Board is in conflict with corporate governance principles, central banks are unique institutions requiring different application of this particular corporate governance principle. It is quite appropriate to have a different Chairperson if the Board is primarily a monitoring or supervisory Board. Generally, a central bank Board is different from other institutions because of its various significant policy and institutional roles. A central bank Board deals with monetary policy formulation and implementation, which are of vital national significance.

Furthermore, the Governor is the chief policy-maker and bears the greatest responsibility for good and bad policy. What is needed is to put in place adequate safeguards to ensure that the Governor's dual roles do not permit a situation of conflict of interest.

In order to separate the important monitoring role of the Board, committees of the Board that the Governor cannot chair and comprising mostly non-executive directors, such as the Audit Committee and Remuneration Committee, can be set up. Furthermore, the fact that the Governor will report to the Board whose majority membership comprises non-executive members should provide the necessary checks and balances.

2.3 Proposal

The Model Law should establish a supervisory Board, consisting of a majority non-executive members but chaired by the Governor. In order to address principles of corporate governance, the Model Law should make the Governor responsible to the Board. In addition, the Governor should not be a member or chair of any oversight committees of the Board, such as the Audit Committee. (Section 9 of the Model Law.)

3. Functions and powers of the Board of Directors

3.1 Problem statement

In the legislation of some SADC central banks, the powers and functions of the Board are neither clear nor adequate. Some statutes have sections that provide exhaustive lists, others have powers and functions scattered throughout the text, while others have very few powers and functions in the statute.

3.2 Discussion

The boards of most central banks in the SADC region are largely advisory and monitoring. The powers and functions of the Board should be clear and

adequate to enable the Board to provide proper guidance to the institution for the successful execution of its mandate. Lack of specification might inadvertently weaken the performance of the central bank, particularly in times of crisis.

As creatures of statute, central banks should undertake operations as expressly intended by the legislature and not by implication or inference. Well-articulated powers and functions also protect the central bank against unfair political criticism and interference, and from public criticism when actions are consistent with powers and functions as set out in the statute. It is also important for the role of the Board to be clearly and expressly stated to avoid the interference of directors in the day-to-day operations of the Bank.

3.3 Proposal

The Model Law should confer on the Board the responsibility of determining the policies applicable to the administration and operation of the Bank, of determining the terms and conditions of service of the Governor and Deputy Governor(s) and of approving the Bank's budget, among other powers. However, the formulation of monetary policy should be left to a more technical MPC. The Board's role in this regard would be to oversee and monitor implementation of this policy. (Section 10 of the Model Law.)

4. Appointment of the Governor and Deputy Governor(s)

4.1 Problem statements

In most SADC central banks, Governors and Deputy Governors are appointed by the head of the executive arm of Government only. No other arm of Government is involved in the appointment of these highly significant officers of the central bank.

The tenure of office of the Governor and Deputy Governors is either short and/or not guaranteed in some SADC central bank legislation.

The powers and functions of the Governors and Deputy Governors are not clear and/or mixed up with those of the Board.

4.2 Discussion

Generally, chairpersons of boards and CEOs are elected or appointed through structures within the institutions. However, owing to the unique nature and significance of a central bank, the appointment of Governor and Deputy Governors is vested in the executive arm of Government.

It is now, however, being widely proposed that in the interests of the independence of the central bank, these appointments should not rest with a single arm of Government. There should be consultations between at least two organs of Government. It is advisable that parliamentary approval, ratification or the participation of another credible institution should be sought in the appointment. This would be a safeguard against the appointment of cronies and those not properly qualified for appointment.

Although the concept of having more than one arm of Government involved in the appointment of the Governor and Deputy Governor(s) appears to be generally accepted, ratification of the appointments by Parliament, however, is an issue on which SADC countries have varied views. Some consensus needs to be achieved.

A Governor's tenure of office should be specific, at least not be less than five years with security of tenure. This would permit a Governor to serve the nation and manage the Bank in that capacity without fear. Although there is merit in a good Governor being permitted to serve infinitely, it is preferable to have a finite term to avoid complacency.

4.3 Proposals

The law should provide for the appointment of the Governor and Deputy Governor(s) to involve at least two arms of Government. The Head of State or Government should appoint the Governor and Deputy Governor(s), and Parliament or some other credible body should be mandated to ratify the appointment. Where the legislature disapproves the appointment, the process should re-commence until ratification. The actual detail would be a matter for national law.

A relatively long tenure of six years with a cap of two terms is proposed for the Governor and Deputy Governors.

The Governor and Deputy Governor(s) should be given clear powers and functions, including the executive management and direction of business and direction of the affairs of the Bank, in compliance with policy and directions determined by the Board. (Section 11 of the Model Law.)

5. Appointment, qualifications and terms of the other directors

5.1 Problem statement

The qualifications and terms of service of other directors on the Board for some SADC central banks are not clear. In addition, the tenure of office is either too short or not specific.

5.2 Discussion

Directors of an institution are normally appointed by shareholders or stakeholders. They should possess the relevant qualifications and experience to enable them to direct the affairs of the institutions properly. The terms and conditions of the directors should also be such that they will help the directors in the effective guidance of the institution.

5.3 Proposal

The Model Law should provide that the directors, other than the Governor and Deputy Governors, be appointed by the Head of State on recommendation of the Minister responsible for national financial matters.[37] The directors should be fit and proper persons, with proven knowledge and experience

37. Where there is private shareholding, the law should provide for the election of other directors.

in central banking, economics, banking, finance, law, business, commercial and other relevant disciplines. The term of office of the directors should be guaranteed at three years, subject to renewal for not more than two other terms. There should be an option for them to be ratified by Parliament. (Section 14 of the Model Law.)

6. Disqualification for membership of Board of Directors

6.1 Problem statement

Some central bank laws do not contain grounds on which Board members may be disqualified.

6.2 Discussion

To enhance the operational independence of central banks, which is necessary for their effectiveness, factors that may lead to disqualification of Board directors should be specific. This will assist authorities in appointing the right people and will avoid any uncertainty should one of the disqualifying factors apply to a director.

6.3 Proposal

The legislation should provide that directorship on the Board of the central bank be disallowed for Cabinet Ministers, Members of Parliament, minors, convicts to imprisonment terms, directors, employees or shareholders of financial institutions, debarred or disqualified professionals, Government employees or politically active persons. Where necessary, the law should define these terms. (Section 17 of the Model Law.)

7. Active participation in politics

7.1 Problem statement

Political activism, if not checked, could interfere with the proper execution of central bank operations.

7.2 Discussion

The central bank has a key role to play in national economic and financial sector development. In order for the central bank to command respect and inspire confidence in its policies, it is important that it is seen to be completely impartial, without undue influence from any particular sector or stakeholder. In this regard, it must also be seen to rise above partisan politicking.

In view of the above, it is important that all key players and decision-makers remain objective and loyal only to the central bank's objectives. It is for these reasons that there must be no active political involvement on the part of the Governor, Deputy Governors and Board members because any perception of bias would endanger the credibility and integrity of the central bank. This is best practice espoused by both the IMF and BIS.

This stance does not, however, preclude the officers in question from exercising their constitutional right to become members or affiliates of political parties of their choice.

7.3 Proposal

Governors, Deputy Governors and Board members should not become politically active. Consequently, the law should prohibit them from taking an active role in politics, holding an elected political office of any nature or being appointed to any political office. This includes dressing in political regalia or displaying party logos on or off duty.

8. Committees of the Board of Directors

8.1 Problem statement

Most SADC central bank legislation does not make it obligatory for the Board to establish key committees such as the Audit and Remuneration committees.

8.2 Discussion

Good corporate governance advocates for the establishment of certain critical committees of the Board. The Board normally works through committees that assist in the effective exercise of its powers and functions. This is one reason for the need for a balance in the size of the Board. Too many or too few members are not recommended. A recent survey has shown that most boards of central banks have membership of between seven and nine members allocated to different committees. The most important and recommended committees for any Board are the Audit Committee, the Directors Affairs' Committee and the Appointments and Remuneration Committee due to the governance issues that they must address.

8.3 Proposal

The Model Law should make it a requirement for central banks to establish three main committees of the Board. The three proposed committees are (i) the Audit Committee, (ii) the Appointments and Remuneration Committee, and (iii) the Directors Affairs' Committee, with specific functions. The first two committees would mostly comprise non-executive directors and must be chaired by non-executive directors. They should play a supervisory role over management of the central bank in their area of competence (Section 19 of the Model Law). The MPC would be separate and have executive powers (Chapter III of the Model Law).

9. Removal of Governor, Deputy Governor(s) and non-executive directors from the Board of Directors

9.1 Problem statement

In the legislation of most SADC central banks, provisions for dismissal of the Governor, Deputy Governors or the other directors are either absent or unclear.

9.2 Discussion

Clearly stipulated provisions and procedure for the removal of a director of a central bank Board are necessary in the modern democratic dispensation. Dismissals should be effected in accordance with natural justice principles and due process. Thus, a due process is invoked any employee or officer of an institution is dismissed. Doing otherwise generally yields unnecessary legal wrangles and expenses.

It is acknowledged that the procedures involving the removal of the Governor, Deputy Governors and non-executive directors may differ in Member States.

9.3 Proposal

The Model Law should specify grounds for the removal of the directors, inclusive of the Governor and Deputy Governor(s), and provide that this would only be after due process and on recommendation of a tribunal or commission. (Section 22 of the Model Law.)

10. Qualification and experience of Governor and Deputy Governor(s)

10.1 Problem statement

There are no clear provisions on qualifications and disqualifications of persons who shall be appointed to the office of the Governor and Deputy Governor(s).

10.2 Discussion

In certain instances, central bank statutes in SADC countries provide for qualifications for persons who should be appointed to the office of the Governor or Deputy Governor(s). These laws also provide for events and instances which, if they occurred during the tenure of office of the appointee, would have been a disqualification had that incumbent been involved in them at the time of the appointment.

In some cases, however, legislation provides for qualifications without providing for disqualifications. Yet in other instances, an Act would provide for disqualifications only, leaving the appointing authority with unfettered discretion as to who should be appointed to these very important offices.

10.3 Proposals

The law or statute should provide for specific professional qualifications and experience of persons to be appointed to the office of the Governor and Deputy Governor(s).

Appointees to those offices should come from persons of recognised professional standing and experience in the fields of economics, banking, finance, law and other fields relevant to central banking. (Section 12 of the Model Law.)

11. Terms and conditions of service of Governor and Deputy Governor(s)

11.1 Problem statement

Most central bank statutes in SADC do not contain provisions for the terms and conditions of service for Governors and Deputy Governor(s).

11.2 Discussion

One of the pointers or determinants of central bank independence is the way in which the CEOs of the banks are remunerated and the guarantee of their security of tenure. In this regard, therefore, it is pertinent that the law establishing the central bank must spell out in very clear language how the Governor and the Deputy Governor(s) will be remunerated, and who will be responsible for determining the remuneration.

However, whatever method may be adopted, the terms and conditions of service for the Governor and Deputy Governor(s) should be fixed, commensurate with the importance of these offices to the economy of a nation. It is important that this power be vested in the Board rather than the Minister responsible for national financial matters as is the case in a good number of statutes at the moment. This is because the Board is more intimately informed about the central bank and its means, and comparators.

Furthermore, the Board also does not have a motivation to use unfavourable terms and conditions as a means to wield influence over the Governors. Moreover, the Board, being appointed from outside the public service, is unlikely to align the terms and conditions of service with those in the civil service. This is a critical issue if central banks are to retain highly qualified staff.

11.3 Proposals

The power to determine the terms and conditions of service of the Governor and Deputy Governor(s) should be vested in the Board of the central bank.

The terms and conditions of service for the Governor and Deputy Governor(s) should not be altered to their disadvantage during their term of service. (Section 13 of the Model Law.)

12. Conflict of interest of Governor and Deputy Governor(s), and non-executive directors

12.1 Problem statement

The existing legislation establishing central banks in SADC lacks clear provisions on conflict of interest for the Governor, Deputy Governors and non-executive directors.

12.2 Discussion

The nature of the duties and responsibilities delegated to the Governor and Deputy Governor(s) by law calls for their full attention to those duties

and responsibilities. Hence, the Governor and Deputy Governors are required to dedicate all their time to running and managing the business and affairs of the central bank. However, most statutes of SADC central banks do not contain specific provisions that prohibit the Governor and Deputy Governor(s) during their tenure of office or sometime thereafter, from engaging in any other business or professional duties or functions which would compromise their functions or duties as Governors or Deputy Governor(s).

This, however, should not be construed that they cannot be appointed to serve into various organs established by Government or organs in which Government has an interest. Such organs or organisations may be national or international. The executive may therefore be given authority by law, in exceptional circumstances, to appoint or approve their appointment to serve in such organisations either as directors, Governors, alternate Governors or any other post for similar functions. Nonetheless, this must be balanced against the Governor's or Deputy Governors' tasks at the central bank.

12.3 Proposals

The central bank legislation should incorporate provisions that cater for conflict of interest actions by the Governor or Deputy Governor(s).

The Governor and Deputy Governor(s) should be in full-time employment of the Bank. They should not engage in any other business or professional work other than their work at the Bank or any other employment, save that they

a. may act as member of any body or commission appointed by Government;

b. serve in any international monetary authority in which Government participates; or

c. serve as members of a board of a corporation organised by Government for purposes of insuring deposits in a financial institution. (Section 16 of the Model Law.)

13. Summary of the proposals

Table 3 summarises the proposals outlined in Chapter 2 – Institutional Arrangements.

Table 3: Proposals outlined in Chapter 2

	Problem statement	Proposal	Model Law Section
2	Most central bank Boards in SADC have an executive chairperson who is also Governor and CEO.	The Model Law should establish a supervisory Board, consisting of majority non-executive members but be chaired by the Governor, who is responsible to the Board and not a member or chair of any Board oversight committees.	9

Table 3: Proposals outlined in Chapter 2			
	Problem statement	Proposal	Model Law Section
3	In the legislation of some SADC central banks, the powers and functions of the Board are neither clear nor adequate.	The Model Law should confer on the Board the responsibility of determining the policies applicable to the administration and operation of the Bank, of determining the terms and conditions of service of the Governor and Deputy Governor(s), and approving the Bank's budget, among other powers.	10
4	• In most SADC central banks, Governors and Deputy Governors are appointed by the head of the executive arm of Government only. • The tenure of office of the Governor and Deputy Governors is either short and/ or not guaranteed in some SADC central bank legislation. • The powers and functions of the Governors and Deputy Governors are not clear and/ or mixed up with those of the Board.	• The law should provide for the appointment of the Governor and Deputy Governor(s) to involve at least two arms of Government. • The Head of State or Government should appoint the Governor and Deputy Governor(s), and Parliament or some other credible body should be mandated to ratify the appointment. • A relatively long tenure of six years with a cap of two terms is proposed for the Governor and Deputy Governors. • The Governor and Deputy Governor(s) should be given clear powers and functions, in compliance with policy and directions determined by the Board.	11
5	The qualifications and terms of service of other directors on the Board for some SADC central banks are not clear.	The Model Law should provide that the directors, other than the Governor and Deputy Governors, be appointed by the Head of State on recommendation of the Minister responsible for national financial matters.	14
6	Some central bank laws do not contain grounds on which Board members may be disqualified.	The legislation should provide that directorship on the central bank Board be disallowed for Cabinet Ministers, Members of Parliament, minors, convicts to imprisonment terms, directors, employees or shareholders of financial institutions, debarred or disqualified professionals, Government employees or politically active persons.	17
7	Political activism, if not checked, could interfere with the proper execution of central bank operations.	Governors, Deputy Governors and Board members should not become politically active.	17, 25

Table 3: Proposals outlined in Chapter 2			
	Problem statement	Proposal	Model Law Section
8	Most SADC central bank legislation does not make it obligatory for the Board to establish key committees such as the Audit and Remuneration committees.	The Model Law should make it a requirement for central banks to establish three main committees of the Board: (i) the Audit Committee, (ii) the Appointments and Remuneration Committee and the (iii) Directors Affairs' Committee, with specific functions. The MPC would be separate and have executive powers (Chapter III of the Model Law).	19
9	In the legislation of most SADC central banks, provisions for dismissal of the Governor, Deputy Governors or the other directors are either absent or unclear.	The Model Law should specify grounds for the removal of the directors, inclusive of the Governor and Deputy Governor(s), and provide that this would only be after due process and on the recommendation of a tribunal or commission.	22
10	There are no clear provisions on qualifications and disqualifications of persons who shall be appointed to the office of the Governor and Deputy Governor(s).	• The law or statute should provide for specific professional qualifications and experiences of persons to be appointed to the office of the Governor and Deputy Governor(s). • Appointees to those offices should come from persons of recognised professional standing and experience in the fields of economics, banking, finance, law and other fields relevant to central banking.	12
11	Most central bank statutes in SADC do not contain provisions for terms and conditions of service for Governors and Deputy Governor(s).	• The power to determine the terms and conditions of service of the Governor and Deputy Governor(s) should be vested in the Board of the central bank. • The terms and conditions of service for the Governor and Deputy Governor(s) should not be altered to their disadvantage during their term of service.	13

Table 3: Proposals outlined in Chapter 2			
	Problem statement	Proposal	Model Law Section
12	The existing legislation establishing central banks in SADC lacks clear provisions on conflict of interest for the Governor, Deputy Governors and non-executive directors.	Central bank legislation should cater for conflict of interest actions by the Governor or Deputy Governor(s). The Governor and Deputy Governor(s) should be in full-time employment of the Bank. They should not engage in any other business, professional work other than their work at the Bank or any other employment, save that they • may act as member of any body or commission appointed by Government; • serve in any international monetary authority to which Government participates; or • serve as members of a board of a corporation organised by Government for purposes of insuring deposits in a financial institution.	16

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Chapter III
Monetary Policy Committee

---------- Contents ----------

1. Introduction

Chapter III of the Model Law provides the legal framework for monetary policy co-operation, co-ordination and harmonisation in the SADC region. This proposed framework is consistent with the SADC RISDP and the FIP.

On the basis of the above objectives, this chapter looks at issues surrounding the establishment of the MPC, its composition, structure and functions. It also presents views on the issuance of monetary policy statements and publication of minutes of its meetings. Last but not least, the chapter highlights potential problems and provides proposals and key solutions to the main components of the MPC.

2. Establishment of the Monetary Policy Committee

2.1 Problem statement

Most SADC central banks do not have legal provisions to establish the MPC.

2.2 Discussion

Among the most notable, but generally least discussed, hallmarks of what has been described as the “quiet revolution” in central banking practice has been the movement towards the making of monetary policy decisions by a committee. Until about a decade ago, most central banks had a single Governor, who might or might not have been independent of the rest of Government. Since then, the United Kingdom (UK), Japan, Sweden, Norway, Switzerland and Brazil, to name just a few, have opted to establish MPCs. There is no known case in which a country replaced an MPC with a single decision-maker. In fact, a survey conducted by Poland (2004) found that 79 out of 88 central banks made monetary policy decisions through an MPC. Thus, the existence of a pronounced worldwide trend is clear.

Theories about why central banks might want decisions to be made by a committee are a relatively young intellectual industry – and still a small one. One of the reasons for the trend is institutional. In a number of countries, the movement towards committees went hand in glove with the spread of central bank operational independence. When the central bank was

merely following orders from Government, there were not many reasons to have a committee as an individual Governor sufficed. But as central bank independence was granted in a number of countries, the choice between an individual and a committee became apparent, both in theory and practice.

Several arguments have been advanced for, and against, the establishment of MPCs in SADC central banks. Some members of the Legal Steering Committee (SC) argued that it is preferable to have a committee making monetary policy decisions as opposed to the Governor alone and that the trend internationally is moving in this direction. Others argued that the MPC is not a panacea for maintenance of central bank independence or the only route possible in modern central banking for the formulation of monetary policy. Still others were of the view that group (committee) decision-making provided some insurance against the possibly extreme preference of an individual central banker. Other arguments in favour of the MPC included the pooling of knowledge in monetary policy decision-making and that a committee system may ensure transparency, greater accountability and credibility for monetary policy decisions. Therefore, notwithstanding that the legal MoU provides that the Governor shall ultimately be accountable and responsible for monetary policy, the preferred practice is that the MPC as a collective entity is responsible for its decisions.

It will also be prudent to become vigilant in the decision-making process not only in the MPC, but in other disciplines of central banking, such as the national payment system, currency management and exchange rate policy. The objective being to ensure holistic synchronisation of decision-making that does not compromise or encroach on the independence of the central bank in the long term.

2.3 Proposals

The Model Law should provide that each central bank in the SADC region sets up an independent MPC to formulate monetary policy.

In order to preserve the independence of the MPC, the MPC should put in place its own rules of procedures for its meetings including the quorum, the frequency of meetings and the voting powers.

The above proposals are critical for the establishment of an independent MPC and are recommended to form part of the relevant sections of the proposed Model Law. (Section 24 of the Model Law.)

3. Composition of the Monetary Policy Committee

3.1 Problem statement

In most central bank legislation in the SADC region, the composition of the MPC is not stipulated. In this respect, monetary policy formulation is left to the discretion of the Governor, who may or may not establish the MPC and decide on its composition.

3.2 Discussion

The general practice worldwide in terms of the composition and size of the MPC varies from central bank to central bank. In the UK, the MPC is composed of the Governor, two Deputy Governors, two members

with relevant executive responsibilities within the Bank appointed by the Governor and four external members appointed by the Chancellor of the Exchequer.

Similarly, in Japan and Australia the MPC consists of nine members, with seven members appointed from external organisations in the latter. In Norway, the Philippines, South Korea, Sweden and Thailand the MPCs are made up of seven members. In these countries, members from outside the central banks are four in South Korea and Thailand, whereas in the rest of the other countries no member is appointed from outside the Bank. In the US, however, the Federal Open Market Committee consists of twelve members from within the Federal Reserve Bank. In Canada and Switzerland the MPC is composed of six and three members, respectively from within the central banks. The decision-making process by the MPCs in all these countries is either by consensus or simple majority vote.

With regard to the composition of the MPC in central banks in the SADC region, several alternatives may be considered. Research was undertaken to find best practice in terms of the establishment of the MPC. This exercise revealed that the Bank of England Act was a useful example to which the Model Law could align its proposal for composition of the MPC, bearing in mind the problems experienced. In this regard, the Model Law should thus modify the composition of the BoE MPC to suit the situation in the SADC region by reducing the number of members to be appointed from outside the Bank. Among the issues looked at in this respect were cost considerations.

During the SC deliberations on the composition of the MPC, it was argued that the MPCs should include persons from outside the Bank who possessed knowledge and experience that were likely to be relevant to the functions of the MPC. Arguments advanced in support of the inclusion of these persons were to ensure greater transparency and enhance the credibility of monetary policy. It was argued that the presence of these members would also serve to provide the relevant expertise and, more importantly, to counter-balance the powers of the executive directors.

However, the MPC model is also fraught with potential problems that could threaten the operational independence of the Bank. Particular attention should be paid to the role of Government officials or Government appointees who may indirectly interfere in central bank operations. Issues of concern include whether or not they have voting powers. Although some support has been advanced in some quarters regarding the value of having some Government representatives on the MPC, although the current proposals do not include the participation of Government officials.

Arguments were advanced for the Governor to chair the MPC to give it the necessary institutional linkage and required authority in terms of the implementation of its decisions. Those who were against it being chaired the Governor, argued that the Governor was likely to dominate the MPC and direct it towards the Governor's preferred choices in the decision-making process.

3.3 Proposals

The MPC should consist of the following persons:

- the Governor, who will be the chairperson;
- the Deputy Governor(s);

- two persons (not civil servants or central bank employees) of renowned professional reputation in the fields relevant to central banking;
- two professionals from outside the Bank should be appointed by the Head of State or Government.
- two other senior staff members, one responsible for economic research and the other for monetary policy operations.

The Governor as CEO of the Bank should be accountable and responsible for the implementation of monetary policy. (Section 25 of the Model Law.)

4. Publication of statement of decisions

4.1 Problem statement

In most SADC central banks, public and key stakeholders are not adequately informed about the monetary policy stance. This could compromise transparency for members of the public and the financial market.

4.2 Discussion

It is generally accepted that the MPC issues a statement that accompanies the monetary policy decision and explains it. This practice has been recognised in most central banks the world over because it can enhance transparency. It is true that some MPCs disclose both decisions and voting records, including the Bank of Japan Policy Board and the BoE MPC. However, some committees, such as the ECB Governing Council, only announce their decisions, What should or should not be said in these statements is a matter of continuing controversy, and practices differ enormously across central banks.

However, in most central banks, the monetary policy statement contains important input into, and reasons for, the decision. These include forecasts of economic outlook, major factors relevant to the decision and models used to appraise policy effects. It is also fair to say that most central banks dislike revealing much in this domain, therefore, releasing a substantive statement that goes well beyond a mere summary is probably the most critical aspect of transparency. The principle is that, if necessary, a more detailed report can come later with further elaboration and clarification.

For the purposes of ensuring greater transparency and to disseminate the information to the public accurately, effectively and in a timely manner, the envisaged MPCs in SADC central banks should issue a statement of the monetary policy stance after each meeting. The reason for this is to disseminate information and to prevent speculation in the market. Arguments in favour of the publication of monetary policy statements were that the key principles of transparency relate to a central bank's openness in explaining the rationale behind its specific monetary policy decisions.

The central bank needs to explain the economic environment in which it expects its actions to be felt. It was further argued that publishing these statements in a transparent manner reduced market uncertainty and enhanced the predictability of monetary policy. It could also give central banks a stronger incentive to build a positive reputation. Arguments against greater transparency in the monetary policy stance were that it could

be detrimental, in particular, in the form of greater volatility caused by information disclosure.

Further points of view expressed were that publishing the statement had the potential to enhance the credibility of monetary policy and making long-run, private-sector inflation expectations more stable, which would allow the private sector to assess whether monetary policy actions and outcomes are consistent with monetary policy objectives. It was noted that the issuance of monetary policy reports by the MPC helped to ensure accountability in monetary policy decision-making by allowing the public to have access to these documents.

4.3 Proposals

The MPC should issue a statement of the monetary policy stance immediately after each meeting.

The MPC should be mandated to make public the reports on inflation and monetary policy review for the country at least once a year. (Section 26 of the Model Law.)

5. Publication of minutes

5.1 Problem statement

The majority of SADC central bank legislation does not adequately provide for the publication of MPC minutes.

5.2 Discussion

There is a wide variety of choices with regard to the publication of minutes and the practices are very diverse. The ECB does not publish minutes, whereas the Federal Open Market Committee at the Fed issues precise records that are released only after five years. The minutes are meant to provide more detailed explanations than the monetary policy statement on how the MPC arrived at a certain decision.

Voting at MPC meetings may or may not be reflected in the minutes. MPCs around the world vary greatly on whether they take an explicit vote on the interest rate decision, whether the results of the vote should be revealed in the minutes and whether, in doing so, they give names. The vote on monetary policy is an essential piece of forward-looking information when decisions are made by a committee. Therefore, such a committee always announces its vote in the minutes, probably giving names. This is not only important for individual accountability, but also for group accountability.

Issues may be taken into consideration with regard to the publication of minutes by the MPCs in central banks in the SADC region. Arguments advanced are that the release of the minutes of the monetary policy meetings could stimulate central banks to engage in a high-quality policy discussion. This could lead to better decision-making. It is argued that the publication of minutes should deepen and expand the rationale for a monetary policy decision that was already given in the statement released immediately after an MPC meeting.

It is further argued that minutes should indicate the existence and strength of contrary views. Some opinions are that this should be added to the minutes as additional information, whereas others contend that there is a risk that even such a marginal expansion of information in the minutes could receive more weight than warranted and may foster misperceptions about the possible course of monetary policy. Such misperceptions might result from a market misinterpretation of any element of the minutes. It was noted that the publication of minutes had certain disadvantages, one of which was that it may lead to the victimisation of MPC members because of the stand they took either for or against the decision during the meeting.

5.3 Proposals

MPCs should be allowed to decide whether to publish the minutes of their meetings and in the manner that they deem fit. (Section 27 of the Model Law.)

6. Summary of the proposals

Table 4 summarises the proposals outlined in Chapter 3: Monetary Policy Committee.

Table 4: Proposals outlined in Chapter 3

	Problem statement	Proposal	Model Law Section
2	Most SADC central banks do not have legal provisions to establish the MPC.	• The Model Law should provide that each central bank in the SADC region sets up an independent MPC to formulate monetary policy. • To preserve its independence, the MPC should put in place its own rules of procedure for its meetings, including the quorum, the frequency of meetings and the voting powers.	24
3	In most SADC central bank legislation, the composition of the MPC is not stipulated. In this respect, monetary policy formulation is left to the discretion of the Governor, who may or may not establish the MPC and decide on its composition.	• The MPC should consist of the Governor, who will be chairperson, the Deputy Governor(s) and two persons (not civil servants or central bank employees) of renowned professional reputation in fields relevant to central banking. • Two further professionals from outside the Bank should be appointed by the Head of State/Government. • Two other senior staff members, one responsible for economic research and the other for monetary policy operations should be members of the MPC. • The Governor as CEO of the Bank shall be accountable and responsible for the implementation of monetary policy.	25

Table 4: Proposals outlined in Chapter 3			
	Problem statement	Proposal	Model Law Section
4	In most SADC central banks, the public and key stakeholders are not adequately informed about the monetary policy stance.	• An MPC should issue a statement of the monetary policy stance immediately after each meeting. • MPC should be mandated to make public, at least once a year, the reports on inflation and monetary policy review for the country.	26
5	The majority of SADC central bank legislation does not adequately provide for the publication of MPC minutes.	MPCs should be allowed to decide whether to publish the minutes of their meetings and in the manner that they deem fit.	27

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Chapter IV
Monetary unit, and issuance of banknotes and coin

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1. Introduction

This chapter focuses on the privilege of issuing money, which is one of the recognised hallmarks in the gradual evolution of the concept "central bank".[38] The manner in which this task is provided for seems to vary from country to country in the SADC region.

The sole right to issue banknotes and coin as legal tender in a given country is a task often described as the first reason for being of a central bank.[39] There are essentially two schools of thought in this regard: (i) the currency school principle and (ii) the banking school principle. In the former, and more widely accepted, central banks have a monopoly on note issuing, with possible alternative scenarios that may allow commercial banks to issue notes but with seigniorage[40] still accruing entirely to the central bank.[41]

Under a free banking system, there are also various possible scenarios, with or without a central bank, but with the distinguishing feature of commercial banks competing in the provision of currency.[42] This raises major economic issues and complex problems that are beyond the scope of the Guide.

The issuance of currency in a country is a core function of every central bank that has implications for central bank independence. Therefore, it is normally accompanied by some institutional arrangements, relative to currency inventory and issue plan, accounting treatment of currency issued, bulk distribution and circulation, safekeeping, withdrawal and destruction of unfit currency. Lack of specification might inadvertently weaken the effectiveness of central banks, particularly in times of crisis. Banknote issuance has monetary policy implications and is, therefore, a core task of central banks.

Ancillary issues that arise in the execution of this function include the Bank's monitoring and control of incidences of counterfeit banknotes and coin. Research and development of measures to combat counterfeiting include a continued quest for enhanced security features, ongoing wide public communication campaigns and working closely with law enforcement agencies.

38. See Rosa Maria Lastra, *Central Banking and Banking Regulation*, the Financial Markets Group, 1996 on the "Evolution of the Functions of a Central Bank", p. 250.

39. Lastra, "Evolution of the Functions of a Central Bank". See also the South African Reserve Bank College, "Introduction to Central Banking" course material, updated April 2005.

40. Seigniorage is the profit that accrues to central banks from the monopoly of issuance of currency.

41. See Lastra, *Central Banking and Banking Regulation*, pp. 250–257.

42. See Lastra, *Central Banking and Banking Regulation*, p. 252.

Issues of reimbursement by the Bank for damaged and mutilated banknotes pose continuous challenges to central banks. There is an emerging concern related to dye-stained notes that is currently being researched.

Predictions that cash utilisation would diminish with time due to the impact of electronic payments have not materialised. Cash remains the major method of payment, particularly in the SADC region. Elsewhere, for instance in Europe, the central bank's role and responsibilities in the cash cycle are under review. The major ongoing challenge for central banks is maintenance of public confidence in the currency through its integrity and security, while ensuring efficient and effective cash management, thereby reducing the cost of currency production to the public.

2. Issuance of banknotes and coin

2.1 Problem statement

The *Comparative Study on SADC Central Banks Legislation, 2002*, revealed that there was no uniformity in the provision of the core function of issuing banknotes and coin by central banks in the region.

2.2 Discussion

The issuing of banknotes and coin is a key function of a central bank that needs to be protected in the Model Law to ensure the essential proper functioning of the economy and the preservation of value and confidence of the public in the currency.

2.3 Proposals

Minimum provisions regarding the issuance of banknotes and coin is advisable in the Model Law for SADC central banks as part of the harmonisation process of legal and operational frameworks.

The core function of issuance of banknotes and coin by central banks will invariably change and be further developed in future as part of the general move towards the monetary union within the SADC region. (Section 29 of the Model Law.)

3. Prescription of legal tender or currency

3.1 Problem statement

A survey of SADC central bank legislation found that only four out of fourteen[43] countries surveyed made provision in their central bank laws for prescription of a currency as legal tender.

43. At the time of the survey there were 14 member countries of SADC.

3.2 Discussion

It is important to prescribe in the Model Law that the banknotes issued by a central bank are lawful currency and legal tender in the country. This means that the currency so issued is a medium for payment for goods and services in that country. The issuance of coin in most jurisdictions remains the prerogative of the sovereign (i.e., through the Minister responsible

for national financial matters) and the central banks are merely logistical channels for supply and distribution.

The importance of the prescription of a currency as legal tender is that it essentially distinguishes the notes issued by the central bank from any other, for example, those issued by commercial banks. This distinguishes the monopoly that enables central banks to obtain seigniorage through the law.

Unofficial "dollarisation" or "euroisation" [44]

The SADC region is experiencing a high degree of unofficial or *de facto* "dollarisation" or "euroisation" due to a number of socio-economic and political factors. The costs/benefit analysis of unofficial dollarisation/ euroisation is beyond the scope of this Guide. Suffice to point out that the solutions are not through the use of legal measures, but through socio-economic and political measures. It is, however, important to provide in the law that the local currency is the only legal tender as a safeguard against encroachment by foreign currencies that tend to circulate in the economics of developing economies and over which the central bank has no monetary policy control.

44. Official "dollarisation" or "euroisation" is defined as the adoption of the US dollar or the euro by the authorities of a country outside the US and the euro area as legal tender and official currency, implying that the country chooses to abandon its own currency and the central bank foregoes implementing monetary policy. By implication, this negates the existence and role of a central bank in that country as the lender of last resort (the international banking system takes over). The results are loss of seiniorage and a reduction in the sovereign status of the local currency, besides other potentially negative economic impacts. See ECB, "Official Dollarisation/Euroisation: Motives, Features and Policy Implications of Current Cases", Occasional Paper Series No. 11/ (Frankfurt: ECB, February 2004).

3.3 Proposals

The Model Law should provide for banknotes and coin issued as legal tender by the Bank to be widely accepted as a medium of exchange for payment of goods and services in the country, and be enacted in the Model Law.

The currency should have security features and other features or symbols designed to bind the nation.

The currency features should be determined by the technical operational experts in the central bank, who have the worldwide benefit of ongoing research and development in the updating of security features in currency.

The Bank shall respect, as far as possible, existing practices and conventions regarding the issuance and design of banknotes in the industry. The Minister responsible for national financial matters should be consulted in the final determination of the currency features, to enable Government's input and incorporation of any national events or commemoration features or national symbols.

The central bank should also be granted powers to withdraw currency from circulation as part of its monetary policy where such currency is no longer fit for use (Section 30 of the Model Law).

4. Seigniorage

4.1 Problem statement

There is a lack of transparency and consistency in the SADC central bank laws in the accounting treatment of currency issued, which has a key influence on central bank balance sheets.

4.2 Discussion

The sole right of issuance of domestic currency gives the central bank a monopoly unlike commercial banks. The central bank's main liability on its balance sheet is traditionally the issuance of currency.

Control of central banks in the issuance of currency is part of monitoring undue credit expansion by the commercial banks.

Concentration of currency issuance in central banks give banknotes and coin a distinct prestige.

Seigniorage gives central banks a source of operational profit which, in view of the fact that governments have opted not to issue notes themselves, enables the central banks to share the profits with the governments.

Currency is produced at a low cost by the central bank (through statutory monopoly) and sold at face value to commercial banks. The selling price of the currency issued after the deduction of production cost is the central bank profit.

Therefore, it is important to establish common accounting treatment of currency issued by SADC central banks.

4.3 Proposals

Banknotes, coin issue and circulation should aim for uniformity in the region to lower the potential risk of money laundering.

There is a need for better regulation and control of the currency issued through central banks.

5. Currency features

5.1 Problem statement

There is a lack of clarity and uniformity in SADC central bank legislation on the process to determine the design and features of banknotes and coin.

5.2 Discussion

The establishment and maintenance of common approval processes in the design and security features in banknotes and coin production in the SADC region are critical towards common countermeasures against money laundering.

The critical role played by the central bank in the cash management strategy of a country cannot be over-emphasised. The preservation of confidentiality and secrecy regarding the affairs of the Bank generally enhances the entrenched position that currency production is best left with central banks.

5.3 Proposals

The central bank should determine the design and other features of banknotes and coin.

The Bank must, in the discharge of this responsibility, liaise closely with Government through the Minister responsible for national financial matters to enable the widest public confidence in the currency. (Section 31 of the Model Law.)

6. Cash management

6.1 Problem statement

SADC central bank legislation does not make consistent provisions for the management of cash.

6.2 Discussion

The cash management value chain ranges from production, bulk distribution, collecting, treasury storage, wholesale distribution, retail distribution, bulk processing to destruction. The stakeholders along the value chain begin with the central bank, commercial banks, the cash-in-transit industry, retailers and the public, and end with central bank yet again.

The central bank faces the continual challenge of ensuring that its cash management strategy keeps abreast of security threats and levels of service in the cash industry. Security considerations regarding operations, information, personnel and assets are critical. Cash management brings forth certain other challenges such as anti-money laundering (AML) issues and combating the financing of terrorism (CFT).

Dye-stained notes are becoming common and the issue is currently being researched.

6.3 Proposals

The central bank should, as part of servicing the issuance of currency, be responsible for distribution countrywide, be the custodian of undistributed currency, and withdraw and destroy unfit currency.

The Bank should assess and, where considered prudent, reimburse members of the public with the face value of any damaged, mutilated or contaminated banknote.

The Bank should contribute towards compliance with international AML and anti-terrorism measures, and assist the relevant authorities where necessary.

The Bank should work closely with law enforcement agencies to combat counterfeit banknotes and coin, including assisting with investigations in the prosecution of relevant cases. Staff of the Bank should collaborate and provide forensic expertise about counterfeiting methods for court cases. (Sections 34 and 35 of the Model Law.)

7. Summary of the proposals

Table 5 summarises the proposals outlined in Chapter 4: Monetary Unit, Issuance of banknotes and coin.

Table 5: Proposals outlined in Chapter 4			
	Problem statement	Proposal	Model Law Section
2	There is no uniformity in the provision of the core function of issuing banknotes and coin by central banks in the region.	Minimum provisions regarding the issuing of banknotes and coin is advisable in the Model Law for SADC central banks.	29
3	Only 4 out of 14 countries surveyed made provision in their central bank laws for prescription of a currency as legal tender.	• The Model Law should provide for banknotes and coin issued as legal tender by the Bank to be widely accepted as a medium of exchange for payment of goods and services in the country. • The Bank should respect existing practices and conventions regarding the issuance and design of banknotes in the industry where possible. • The currency should have security features and other features or symbols designed to bind the nation but determined by the technical operational experts in the central bank. • The Minister responsible for national financial matters should be consulted in the final determination of the currency features. • The central bank should be granted powers to withdraw currency from circulation as part of its monetary policy. (Section 30 of the Model Law.)	29 and 30
4	There is a lack of transparency and consistency in the SADC central bank laws in the accounting treatment of currency issued, which plays a key influence on central bank balance sheets.	Banknotes, coin issue and circulation should have a level of uniformity to lessen the potential risk of money laundering. There should be better regulation and control of the currency issued through central banks.	36
5	There is a lack of clarity and uniformity in SADC central bank legislation on the process to determine designs and features of banknotes and coin.	• The central bank should determine the designs and other features of banknotes and coin. • The Bank should liaise closely with Government through the Minister responsible for national financial matters to enable widest public confidence in the currency.	31

Table 5: Proposals outlined in Chapter 4			
	Problem statement	Proposal	Model Law Section
6	SADC central bank legislation does not make consistent provisions for the management of cash.	• The central bank should be responsible for distribution countrywide, be the custodian of undistributed currency and withdraw and destroy unfit currency. • The Bank should assess and, where prudent, reimburse members of the public with the face value of any damaged, mutilated or contaminated banknote. • The Bank should comply with international AML and anti-terrorism measures by assisting the relevant authorities. • The Bank should work closely with law-enforcement agencies to combat counterfeit banknotes and coin, including assisting with investigations in the prosecution of relevant cases.	34 and 35

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Chapter V
Relationship with Government

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1. Introduction

The relationship between the central bank and Government is always a subject of controversy. It is, therefore, important to appreciate the separate juridical personality of a central bank, ownership thereof, and dependence or independence (which revolves around control).

Legal convergence in preparation for regional monetary integration places emphasis on the achievement of the requirements for central bank independence. It is therefore, important to appreciate the respective roles of Government and the central bank to minimise potential conflict when the regional central bank is established.

Central bank independence has various features, namely those of an institutional, personal, functional and financial nature. Furthermore, the case for central bank independence is conceived as a means to achieve the goal of price stability. Thus, there are limits; it is not absolute independence.

The determination of the exchange rate policy framework is vested in Government, while the central bank has responsibility for monetary policy formulation and implementation. The degree of central bank independence enhances the credibility and effectiveness of monetary policy. While the central bank derives its mandate and power from the central banking statute, it is an incontrovertible fact that because of its role and accountability to Government (unless this close relationship with Government is managed adequately), the central bank may frequently be frustrated in the fulfilment of its monetary policy responsibilities.

This discussion, therefore, focuses on the critical aspects pertaining to this special relationship, with a view to ensuring the protection of the central

bank by limiting the extent to which Government may interfere with the central bank's ability to discharge its obligations under the Act. The major issues identified are as follows:

a. A review of the respective statutes of each SADC country reveals an extensive relationship between Government and the central bank. This is primarily due to the ownership of the central bank by Government, which is a function of the fact that in most countries the central bank is banker and adviser to Government, as well as fiscal agent or manager of Government securities. Although the South African Reserve Bank has private shareholding, its obligations under the law are essentially the same other central banks in the region.

b. In a number of countries, central bank policy may be subject to approval by the Minister responsible for national financial matters.

c. All central banks are accountable to Government for their objectives.

d. Some statutes contain exceptional provisions for dealing with shares for development purposes. There are indications that, at least in the case of one country, efforts are under way to delete this provision in recognition that this is not a central banking function.

e. It is desirable that the central bank be banker to, and fiscal agent of, Government, adviser to Government on monetary and exchange rate policy issues and depository for international financial institutions.

f. In all countries, lending to Government is restricted by the amount and repayment period. This is acceptable by international standards. In some countries the legislation allows lending to statutory bodies.

g. The uniqueness of the relationship between Government and the central bank requires extensive thought in balancing involvement, while enhancing the independence of the central bank.

The most contentious issues that need to be addressed in this part include

- lending to Government;
- acquisition by the central bank of securities issued or guaranteed by Government; and
- resolution of policy disputes with Government.

45. See Lastra, *Central Banking and Banking Regulation*, (1996), p. 10.

According to advocates of central bank independence, this is justifiable mainly in the conduct of monetary policy, leaving aside other central bank functions, such as the lender of last resort, banking supervision and regulation, oversight of the payment systems, management of official foreign reserves, and monopoly of note issuance.[45] The more holistic view recognises the interdependence of the other central bank functions from the conduct of monetary policy and would, therefore, recommend vigilance on the potential encroachment from all fronts.

Hence, the areas where consultation with Government (Minister responsible for national financial matters) is necessary need to be clearly articulated.

Central bank independence is not absolute. Thus, central banks, even though generally free to formulate and implement monetary policy,

remain constrained with the primary objective of price stability that is best incorporated in their statutes. Furthermore, the corollary principle of accountability in a democratic society makes it imperative to engage with other organs of state. Hence qualifications of "instrument independence", "operational independence" and so forth.

2. Adviser to Government

2.1 Problem statement

The nature of the relationship of the central bank as adviser to Government is not always as clear as it should be.

2.2 Discussion

Most of the central banking legislation provides for the central bank to perform the role of economic adviser to Government primarily relating to monetary policy issues, including that of exchange rate policy. However, not in every country is this considered or deemed desirable, such as where Government refuses to take heed of the central bank's economic advice. Thus, some flexibility should be built into the proposal. The provision should also be specific regarding the nature of the economic advice, namely in the area of the central bank's competence. This is important for the credibility of the central bank.

2.3 Proposal

Central banking legislation should contain provisions that permit the central bank to be economic adviser to Government. This responsibility should, however, not be mandatory. (Section 38 of the Model Law.)

3. Banker to Government

3.1 Problem statement

Government holdings of balances in commercial banks are not always reported to the central banks.

3.2 Discussion

It is an accepted principle of central banking that the central bank should perform the function of banker to Government on terms agreed between the central bank and Government. It is also accepted that Government may appoint any financial institution to serve as its agent in the execution of its banking services. To decongest the central bank, it is indeed desirable that the retail banking requirements of Government be conducted by commercial banks. In this regard, the central bank should also be empowered to delegate certain functions to commercial banks or other financial institutions.

However, there may be problems for the central bank's efficient execution of its mandate if it is not regularly apprised of Government cash balances outside the central bank. For example, in cases where the financial system has excess liquidity, the central bank requires this information to sterilise excess liquidity.

3.3 Proposal

Legislation should oblige Government to provide information on balances maintained by other institutions to the central bank. (Section 39 of the Model Law.)

4. Fiscal agent

4.1 Problem statement

The role of the central bank as a fiscal agent to Government is not always clearly stipulated.

4.2 Discussion

The role of the central bank as fiscal agent to Government is accepted with the proviso that it shall, under no circumstances, impose a responsibility on the part of the central bank to underwrite any Government debt. Permitting this would undermine the Bank's independence.

4.3 Proposal

Legislation should ensure that the central bank's role of fiscal agent must not include an obligation to underwrite in whole or in part, or to act as a residual buyer of, Government securities. (Section 40 of the Model Law.)

5. Lending to Government

5.1 Problem statement

Contrary to best practice, some central banks in the SADC region still extend credit to Government.

5.2 Discussion

The principles underlying central banking independence include prohibiting, or at the very minimum, strictly restricting direct lending to Government, while recognising that it may, in certain exceptional circumstances, be permitted. The prohibition or restriction of direct lending to Government is intended to obviate a potential problem that could undermine the ability of the central bank to pursue its objectives effectively.

International trends suggest that lending to Government should be prohibited. This approach has been embraced by the MoU between SADC central banks in paragraph 2(e), which states that "lending by central banks to Government, its agencies and political subdivisions shall be discouraged". Paragraph 2(g) takes it further and states that "overdue Government securities and other indebtedness of Government and its various agencies shall, at the end of each financial year, first be redeemed from any available surplus income before the transfer of the residue to Government". This position has also been carried forward in Article 4(2)(e) of Annexure 5 of the SADC Protocol on Finance and Investment, "Harmonisation of the Legal and Operational Frameworks".

SADC central banks fully embrace the principle enunciated in the previous paragraph. However, in recognition of the different levels of economic

development in the various Member States, it has been agreed that a phased and gradual approach to this matter be adopted as an alternative option by those members who may not be ready to prohibit lending altogether, provided that even in this instance the extent of lending should be phased out from the current 10 per cent of Government's annual average of its ordinary revenue for the three years immediately preceding the timing of the borrowing and for which accounts are available in 2008 to 5 per cent in 2015, consistent with the pronouncements in the RISDP.

5.3 Proposal

Lending to Government should be prohibited and, in the exceptional case where it is permitted, be severely limited, by statute, to a percentage of Government budget as provided in the RISDP and the repayment period limited to a period not exceeding 12 months. This is a key economic test of true independence of the central bank from Government that should be guarded jealously. (Section 41 of the Model Law.)

6. Acquisition of securities issued or guaranteed by Government

6.1 Problem statement

Most central banks in SADC currently purchase and sell securities issued or guaranteed by Government as part of a public issue.

6.2 Discussion

As a consequence of the prohibition on lending, purchases by the central bank of securities issued or guaranteed by Government for its account and for purposes other than monetary policy considerations or as part of the effort to assist in the development of the domestic capital markets are prohibited. The basis is that these purchases will be treated as indirect advances to Government. A truly economically independent central bank is able to withstand pressure from Government to finance Government deficits through central bank credit.

6.3 Proposal

Central banks should only deal in securities for monetary policy issues. (Section 42 of the Model Law.)

7. Management of public debt

7.1 Problem statement

Central banks in some SADC countries are responsible for managing the public debt of Government and this role needs to be clearly stipulated.

7.2 Discussion

Central banks are the primary institutions for recording, monitoring and assisting in the management of their countries' external debt, and for advising governments on the timing, and terms and conditions of borrowing

before the debt is contracted. As bankers to Government, they are also responsible for executing external payments on behalf of the central Government, including the repayment of debt. It is accepted that the Bank may act as agent for Government in the management of public debt on terms specifically agreed between the Minister responsible for national financial matters and the Bank. However, there are some jurisdictions in which this function resides in an independent agency.

7.3 Proposal

Central banks should continue to monitor public debt and play an advisory role with regard to borrowing. (Section 43 of the Model Law.)

8. Agent for administration of exchange controls

8.1 Problem statement

Agent(s) responsible for administering exchange controls and authorised dealers not always clearly specified.

8.2 Discussion

The central bank acts as an agent for Government in the administration of exchange controls and the central bank may, in turn, delegate some of its powers to banks or Authorised Dealers. The role, structure and/or composition of Authorised Dealers must be clearly defined. The administration of exchange controls by central banks further serves an additional purpose of collection and compilation of data for the estimation of balance-of-payments statistics.

8.3 Proposal

The central bank should perform such functions and exercise consequent powers as may be assigned upon it in terms of any exchange control legislation. (Section 53 of the Model Law.)

9. Consultation and exchange of information

9.1 Problem statement

While there is a clear division of responsibilities and accountabilities between the central bank and the Minister responsible for national financial matters or Government, there is often not sufficient information sharing, co-operation and co-ordination between the two institutions.

9.2 Discussion

In many countries central banks have the mandate to preserve price stability as their primary objective. While most central banks have the autonomy to conduct monetary policy without the interference of Government, they may still consult Government in the process of making such decisions. It is accepted that the central bank and the Minister responsible for national financial matters will exchange information likely to affect the Bank's achievement of its obligations or which the Bank may require for the purposes of discharging its functions under the Act. This principle also

imposes an obligation on the part of the Minister responsible for national financial matters and the central bank to consult on matters necessary to ensure the co-ordination and effectiveness of monetary and fiscal policies.

9.3 Proposal

A process that deals with consultation and exchange of information between the central bank and Government must be put in place and should be formalised. (Section 44 of the Model Law.)

10. Policy disputes with Government

10.1 Problem statement

It has been observed that the dispute-resolution mechanisms of SADC central bank statutes need to be strengthened. This stems from the need to promote an effective communication mechanism between the central bank and Government.

10.2 Discussion

The Model Law attempts to grant full target and instrument autonomy, it has been observed that this, it may make it difficult to adopt in some jurisdictions; hence it is necessary to provide a mechanism to resolve differences of opinion in the implementation of policy between the central bank and Government. This relates, in particular, to fundamental differences with regard to policies adopted by the central bank in the discharge of its functions in terms of the Act, in particular, monetary policy implementation. Empirical evidence suggests, that the more explicit the mechanisms of ensuring the effective performance of mandated tasks and achievement of legally stipulated objectives, the less likely the possibility for policy disputes.

In deciding an appropriate response, it is recognised first and foremost that the procedure must impose an obligation on the two parties to find an amicable solution to the problem to minimise the likely adverse consequences of a protracted stalemate. In the second instance, the mediation structure must be of integrity and inspire confidence.

Various options for dispute resolution were mooted: the Head of State as a possible mediator, and the courts and Parliament as alternatives. In this regard, the following should be noted:

a. The Head of State as mediator approach was discounted on the basis that it could, in certain circumstances, be difficult for that office to rise above political considerations and bias.

b. Involving Parliament would entail the publication of the dispute in the form of a minute or press release presented before Parliament. This would require both parties to explain their positions, whereupon Parliament would publicly consider and weigh the merits and demerits of each party's case and thereby limiting the scope for highhandedness on the part of Government.

c. The court option may result in undue delay and possible misdirection as a result of a failure by the judicial officers to fully appreciate the complexities of macroeconomic issues. It was noted that if the matter

were to be referred to the courts, it should be considered whether to limit the court's scope of review to ensure that the court does not replace the central bank's policy decision with its own. This would further guard against encroachments into the purview of the central bank's operational independence and freedom from pressure being brought to bear upon it by other authorities.

d. An alternative approach is what is referred to as Government's power to "overrule" the Bank on specific policy issues. A prerequisite for effective functioning of this system is that the procedure must be subject to full public and parliamentary oversight and that Government must accept responsibility, in writing, for the consequences of the action adopted. Clearly, this may tend to undermine the independence of the central bank and for this reason it is not advocated.

Having considered the different options, the committee resolved that none seemed to satisfy the requirements and that a new and innovative approach be crafted. In view of this, it was agreed that a more suitable approach would be the referral of policy disputes to a specialised tribunal appointed by the Chief Justice, in consultation with both the Bank and the Minister responsible for national financial matters. This process is, in essence, similar to arbitration outside the mainstream court process. Members of the tribunal would be fit and proper specialists with proven knowledge and experience in central banking, economics, banking, finance and related fields of relevance. The decision of the Tribunal would be final and binding and would have the effect of an order of the court.

10.3 Proposal

The policy dispute-resolution mechanism in the proposed legislation should be strengthened to minimise the incidence of crippling deadlocks between the central banks and Government. (Section 45 of the Model Law.)

11. Summary of the proposals

Table 6 summarises the proposals outlined in Chapter 5: Relationship with Government.

Table 6: Proposals outlined in Chapter 5

	Problem statement	Proposal	Model Law Section
2	The nature of the relationship of the central bank as adviser to Government should be clear.	Central banking legislation should contain provisions that permit the central bank to be economic adviser to Government. This responsibility should, however, not be mandatory.	38
3	Government holdings of balances in commercial banks need to be reported regularly to the central banks.	Legislation should oblige Government to provide information on balances maintained by other institutions to the central bank.	39

Table 6: Proposals outlined in Chapter 5			
	Problem statement	Proposal	Model Law Section
4	The role of the central bank as a fiscal agent to Government should be stipulated clearly.	Legislation must ensure that the central bank's role of fiscal agent must not include an obligation to underwrite, in whole or in part, or to act as a residual buyer of, Government securities.	40
5	Contrary to best practice, some central banks in the SADC region still extend credit to Government.	Lending to Government should be prohibited and, in the exceptional case where it is permitted, be severely limited, by statute to a percentage of Government budget as provided for in the RISDP; and the repayment period should be limited to a period not exceeding 12 months.	41
6	Most central banks in SADC currently purchase and sell securities issued or guaranteed by Government as part of a public issue.	Central banks should only deal in securities for monetary policy issues.	42
7	Central banks in some SADC countries are responsible for managing the public debt of Government, and this role needs to be clearly stipulated.	Central banks should continue to monitor public debt and play an advisory role with regard to borrowing.	43
8	The agent(s) responsible for administering exchange controls and the Authorised Dealers must be specified clearly.	The central bank may perform such functions and exercise consequent powers as may be assigned to it in terms of any exchange control legislation.	53
9	While there is a clear division of responsibilities and accountabilities between the central bank and the Minister responsible for national financial matters or Government, it is crucial to have information sharing, co-operation and co-ordination between the two institutions.	A process that deals with consultation and exchange of information between the central bank and Government must be put in place and should be formalised.	44
10	Dispute-resolution mechanisms of SADC central bank statutes are not sufficiently strong to promote an effective communication mechanism between the central bank and Government.	The policy dispute-resolution mechanism in the proposed legislation should be strengthened to minimise the incidence of crippling deadlocks between the central banks and Government.	45

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Chapter VI
Relationship with banks and other financial institutions

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1. Introduction

This chapter deals with the relationship between the central bank and commercial banks. Central banks are usually bankers to commercial banks and other financial institutions. In some instances, this relationship is statutory in that the central bank statute would direct that the commercial bank opens statutory accounts such as the Statutory Minimum Reserve Account. The nature of commercial banking, which includes clearing and settlements functions, would also necessitate commercial banks to open accounts for that purpose.

2. Banker to banks

2.1 Problem statement

The relationship between central banks and commercial banks contributes to financial stability in a country. Unless properly regulated by law, potential risks may arise.

2.2 Discussion

A central bank plays the role of banker to banks. It does this by, among other things, opening accounts for, and accepting deposits from, banks conducting business in the country. The purpose of this is for issues of liquidity reserve requirements and to enable other banks and financial institutions to clear and settle their funds with the central bank and other banks easily and freely. The account would also enable the central bank to debit the bank directly for funds due to the central bank on account of any prior accommodation made to the bank.

2.3 Proposal

The law should explicitly provide the nature and extent of the relationship with Government and other non-bank financial institutions. (Section 46 of the Model Law.)

3. Accommodation of banks

3.1 Problem statement

While all SADC central banks provide credit facilities to the banking sector, most of their legislation is unclear regarding circumstances in which banks can be financially accommodated by the central bank.

3.2 Discussion

As banker to banks, the central bank should be allowed to provide financial accommodation to banks. The central bank may, therefore, purchase from, sell to, discount or rediscount instruments for, banks or grant advances up to certain limits, and on such terms and conditions determined by the central bank. The central bank should also be permitted to grant emergency liquidity assistance to a bank in distress so long as ultimately such bank is solvent, able to repay the loan and the Minister responsible for national financial matters has consented in writing to the granting of the advance.

The lender-of-last resort function of the central bank should be exercised to support or preserve the stability of the financial system as a whole. However, the central bank should exercise judgement between the need to bail out a failing bank and the decision to let such a bank fail.

3.3 Proposal

The Model Law should include this function of providing short-term financial accommodation to solvent but illiquid banks. However, where the central bank decides to extend credit to a bank, the terms and conditions should be above market rates. Ministerial approval is required because if the bank still fails, Government is required to cover any loss by the central bank for the transaction.

4. Publication of the Bank's rates

4.1 Problem statement

Most SADC central bank legislation does not specifically require the Bank to publish its rates.

4.2 Discussion

The central bank should be required to publish its rates, just as banks are required to do so. This is necessary for purposes of transparency and accountability to banks and the general public.

4.3 Proposal

The Model Law should make publication of rates for the central bank mandatory. (Section 48 of the Model Law.)

5. Reserve requirements for banks

5.1 Problem statement

SADC central banks prescribe and implement reserve requirements for banks in diverse ways.

5.2 Discussion

The central bank should be permitted, if deemed necessary, to prescribe required reserves to be maintained by each bank whether through cash holdings by the bank or by deposits with the central bank, as part of monetary policy and prudential requirements for the banks. The central bank may prescribe liquidity reserve requirements and different reserve ratios for different classes of deposits.

5.3 Proposal

The Model Law should incorporate issues related to the central bank prescribing reserves for banks. (Section 49 of the Model Law.)

6. Disclosure by banks and other financial institutions

6.1 Problem statement

Most SADC legislation does not make it obligatory for central banks to demand disclosure of rates and other charges by banks and financial institutions.

6.2 Discussion

The central bank should be permitted to prescribe the mode of disclosure by banks to the public of the banks' effective annual interest rates for both lending and deposits. The basis of this is to have relatively uniform disclosure requirements for banks of similar nature. The central bank should also be permitted to consult with banks on matters of common interest relating to financial institutions and banks.

6.3 Proposal

The Model Law should contain requirements related to the central bank's ability to prescribe banks' disclosure requirements and to consult with banks on matters of common interest. (Section 50 of the Model Law.)

7. Licensing and supervision of banks

7.1 Problem statement

Some SADC central banks that are mandated to regulate and supervise banks do not have statutory powers of licensing and revocation of licences.

7.2 Discussion

Where a central bank is authorised to license and supervise banks, it should be mandatory for it to have exclusive responsibility for the licensing and

supervision of the licensed banks and to co-operate with foreign banking supervisory authorities.

There are points both in support of, and against, central bank supervision and regulation of banks. Those in support of the idea argue that the banking business presents certain characteristics that are potential sources of financial system instability requiring the central bank's regulatory and supervisory attention, lest bank runs and bank crises develop. Those against the idea indicate that banking supervision and regulation are not necessarily a central bank's exclusive responsibility. A separate regulatory body, public or private, could execute this responsibility. The major objective of the central bank is the implementation of monetary policy, not banking supervision.

7.3 Proposal

The Model Law should leave individual countries to decide whether their respective central banks should be responsible for supervision or regulation of banks. The Model Law should not make it mandatory for central banks to be supervisory and regulatory authorities for banks. However, where the law mandates the central bank to supervise banks and financial institutions, it should avoid a situation where the licensing and de-licensing or regulating authorities are different. The one who licenses should have the powers to regulate and revoke the licence. (Section 52 of the Model Law.)

8. Summary of the proposals

Table 7 summarises the proposals outlined in Chapter 6: Relationship with banks and other financial institutions.

Table 7: Proposals outlined in Chapter 6

	Problem statement	Proposal	Model Law Section
2	The relationship between central banks and commercial banks contributes to financial stability in a country.	The law should explicitly provide the nature and extent of the relationship with Government and other non-bank financial institutions.	46
3	While all SADC central banks provide credit facilities to the banking sector, most of their legislation is unclear regarding circumstances in which the central bank can financially accommodate banks.	• The Model Law should include this function of providing short-term financial accommodation to solvent but illiquid banks. • Where the central bank decides to extend credit to a bank, the terms and conditions should be above market rates. • Ministerial approval is required because if the bank still fails, Government is required to cover any loss by the central bank for the transaction.	47
4	Most SADC central bank legislation does not specifically require the Bank to publish its rates.	The Model Law should make publication of rates for the central bank mandatory.	48

Table 7: Proposals outlined in Chapter 6			
	Problem statement	Proposal	Model Law Section
5	SADC central banks prescribe and implement reserve requirements for banks in diverse ways.	The Model Law should incorporate issues relating to the central bank prescribing reserves for banks.	49
6	Most SADC legislation does not make it obligatory for central banks to demand disclosure of rates, and other charges by banks and financial institutions.	The Model Law should contain requirements relating to the central bank's ability to prescribe banks' disclosure requirements and to consult with banks on matters of common interest.	50
7	Some SADC central banks that are mandated to regulate and supervise banks do not have statutory powers of licensing and revocation of the licences.	• The Model Law should leave individual countries to decide whether their respective central banks should be responsible for supervision or regulation of banks. • The Model Law should not make it mandatory for central banks to be supervisory and regulatory authorities for banks. • Where the law mandates the central bank to supervise banks and financial institutions, The one who licenses should have the powers to regulate and revoke the licence.	52

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Chapter VII
International reserves and foreign-exchange operations

---------- Contents ----------

1. Introduction

This chapter deals with the central banks' need to maintain and hold the reserves of their respective countries. This phenomenon is closely linked with the need for countries to pursue independent national economic policies. In this regard, it is important to note that international reserves may be applied to cushion the national economy against external shocks such as a sudden rise in import prices (such as oil). Some countries have used the international reserves to insulate themselves from the rigours of the world economy.

2. Maintenance of international reserves

2.1 Problem statement

Maintenance of the required levels of international reserves is handled differently by central banks' legislation in SADC.

2.2 Discussion

Central banks, as fiscal agents of Government, usually hold the international reserves of their respective countries. International reserves are those external assets that are readily available to, and controlled by, central banks for direct financing of balance of payments, for indirectly regulating the magnitude of such balances through intervention in exchange markets to effect the currency exchange rates, and/or for other purposes.

Very often, central banks' holding of foreign reserves does not necessarily reflect the degree or size of the balance-of-payments concern to the economy, but may hold reserves for other motives, such as to maintain confidence in the currency and the economy to satisfy domestic legal requirements or to serve as a basis for foreign borrowing. International reserves would usually be reflected on the central bank's balance sheet. Failure to hold adequate reserves may lead the country into some economic

difficulties. If, for example, a country experiences drought, then it will have to depend on its international reserves for food imports, otherwise the country will have to rely on external assistance or aid, which may not necessarily be forthcoming.

Countries need to maintain adequate levels of foreign reserves to meet international payment obligations, and for the execution of monetary and exchange rate policies. When international reserves are low, countries face hardships in settling their international obligations.

2.3 Proposals

The law should provide for central banks to maintain international reserves.

Central banks should hold and manage international reserves to maintain those reserves at an adequate level to execute monetary and foreign-exchange policies, and for the prompt settlement of the country's international payment obligations. (Sections 54 and 55 of the Model Law.)

3. Exchange rate policy

3.1 Problem statement

In some SADC jurisdictions, the exchange rate policy is determined or formulated by the Minister responsible for national financial matters and implemented by the central bank, while in others the central bank formulates and implements the exchange rate policy.

3.2 Discussion

The application of exchange rate policies in SADC is quite diverse. In a number of countries, central bank laws give indirect authority to the central bank to apply exchange rate policies whereas in other instances there is no reference at all that the central bank is legally charged with such a duty. This state of affairs might in some cases weaken the effectiveness of a central bank in as far as exchange rate policies are concerned. Some Acts provide that the central bank has as one of its functions to formulate exchange rate policies. But this is not the same as saying the central bank is empowered to determine or fix the exchange rate. It, therefore, becomes unclear what is intended as the extent to which such formulation takes place is not defined, particularly due to the fact that exchange rate policy formulation is ordinarily associated with Government action.

Some central bank Acts contain provisions that enable governments to issue policy directives to the central banks. This has an impact on the manner in which central banks carry out their duties and functions, particularly the formulation and execution of monetary policy. In a few instances the exchange rate is left to float.

3.3 Proposals

Government, in consultation with the central bank, should formulate and execute exchange rate policy.

When carrying out this function, the central bank should do so in co-operation with other relevant agencies, but should not take instructions from any authority, institution or office. (Section 53 of the Model Law.)

4. Authorised transactions for central banks

4.1 Problem statement

The buying and selling of Treasury bills or other securities issued or guaranteed by foreign governments or international financial institutions is only referred to in a limited number of cases and, therefore, not widely practised by SADC central banks.

4.2 Discussion

In the majority of cases, central bank legislation in SADC provides for the trading in gold and other precious metals. However, the buying and selling of Treasury bills or other securities issued or guaranteed by foreign governments or international financial institutions is only referred to in a limited number of cases.

4.3 Proposals

The draft statute should authorise central banks, for purposes of the maintenance of international reserves and the conduct of foreign-exchange operations, to trade or deal in gold, other precious metals, foreign exchange, Treasury bills and foreign securities. (Section 56 of the Model Law.)

5. Treatment of unrealised gains and losses on certain assets and liabilities

5.1 Problem statement

A situation may occur where the central bank finds there are insufficient balances in the Revaluation Account to cover for losses at the end of the financial year.

5.2 Discussion

A central bank may experience unrealised gains or losses arising from changes in the valuation of its domestic and foreign assets or liabilities. Any net unrealised losses arising from such changes would be set off against any credit balance in the Revaluation Account at the end of the financial year. In SADC countries, almost all central bank legislation contains provisions for establishing special accounts through which the central bank may treat unrealised gains and losses arising from exchange rate changes in the valuation of its assets and liabilities.

Research into the accounting practices by central banks in the SADC region revealed that no uniform international best practice exists. In terms of International Financial Reporting Standards (IFRSs), all realised and unrealised profits or losses should be transferred to the central bank's profit-and-loss account. However, note should be taken that central bank accounting is not aligned with the IFRSs.

The ECB does not follow the IFRS in that realised profits and losses and unrealised losses are transferred to the profit and loss account annually.

Unrealised profits, however, are transferred to a stabilisation account on the central banks' balance sheet. Like the ECB, the Fed also employs non-standard accounting treatment for unrealised gains. Research conducted by Central Banking Publications, furthermore, revealed that several central banks outside the ECB system also employ some form of a hybrid approach between the IFRSs and the ECB methodology.

Therefore, there will always be challenges in terms of central banks' financial reporting conforming with the IFRSs. There is a school of thought that suggests that central banks should lobby the BIS to develop and recommend an appropriate international reporting standard designed for central banks.

5.3 Proposals

Unrealised net losses accruing to Government should be made good in the following year as these reserves are maintained, among other things, to execute monetary and exchange rate policies. In the event that net losses are incurred, such losses should be recognised during the following year so that they do not affect the operations of the Bank.

Unrealised net gains should be credited to the Revaluation Reserve Account to offset future unrealised losses. In this regard, central banks need to maintain the revaluation account.

Given the observations above, SADC central banks in their legislative provisions in this area should adopt a clear, high-level and flexible framework. This may be complemented by written agreements to address the operational details and structured communication channels that are agreed upon with Government. (Section 58 of the Model Law.)

6. Summary of the proposals

Table 8 summarises the proposals outlined in Chapter 7: International reserves and foreign-exchange operations.

Table 8: Proposals outlined in Chapter 7

	Problem statement	Proposal	Model Law Section
2	Maintenance of the required levels of international reserves is handled differently by central banks' legislation in SADC.	The law should provide for central banks to maintain international reserves. Central banks should hold and manage international reserves to maintain those reserves at an adequate level for the execution of monetary and foreign-exchange policies, and for the prompt settlement of the country's international payment obligations.	54 and 55

Table 8: Proposals outlined in Chapter 7			
	Problem statement	Proposal	Model Law Section
3	In some SADC jurisdictions, the exchange rate policy is determined or formulated by the Minister responsible for national financial matters and implemented by the central bank, while in others the central bank formulates and implements the exchange rate policy.	Government, in consultation with the central bank, should formulate and execute exchange rate policy. When carrying out this function, the central bank should do so in co-operation with other relevant agencies, but should not take instructions from any authority, institution or office.	53
4	The buying and selling of Treasury bills or other securities issued or guaranteed by foreign governments or international financial institutions is only referred to in a limited number of cases and, therefore, not widely practised by SADC central banks.	The draft statute should authorise central banks, in order to maintain international reserves and the conduct of foreign-exchange operations, to trade or deal in gold, other precious metals, foreign exchange, Treasury bills and foreign securities.	56
5	A situation may occur where the central bank finds there are insufficient balances in the Revaluation Account to cover losses at the end of the financial year.	• Unrealised net losses accruing to Government should be made good in the following year as these reserves are maintained, among other things, to execute monetary and exchange rate policies. • In the event that net losses are incurred, such losses should be recognised during the following year so that they do not affect the operations of the Bank. • Unrealised net gains should be credited to the Revaluation Reserve Account to offset future unrealised losses. In this regard, central banks need to maintain the revaluation account. • Given the observations above, SADC central banks in their legislative provisions in this area should adopt a clear, high-level and flexible framework. This may be complemented by written agreements to address the operational details and structured communication channels that are agreed upon with Government.	58

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Chapter VIII
Payment, clearing and settlement systems

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1. Introduction

This chapter deals with the provisions that empower the central bank to oversee, regulate, operate and supervise payment, clearing and settlement systems that are comprehensive, efficient, modern, sound and safe in SADC countries.

2. Payment, clearing and settlement systems

2.1 Problem statement

Most SADC central banks statutes do not provide adequate legal provisions mandating them to oversee, regulate, operate and supervise payment, clearing and settlement systems to fulfil the objectives of safety, integrity, efficiency and soundness of the payment system as a whole.

2.2 Discussion

There is a consensus that central banks should be responsible for the oversight, regulation and supervision of the payment systems. Accordingly, the comparative study on SADC central banks found that most SADC countries have on their statutes, provisions that place responsibility for the oversight, regulation and supervision of the payment system on the central banks.

However, the existing provisions are clearly insufficient to cover the power that is required by today's modern central banks. In fact, SADC economies are generally characterised by payment systems that lag behind modern innovative payment mechanisms found in developed countries.

The MoU on Co-operation on Payment, Clearing and Settlement Systems signed by SADC central banks and annexed to the FIP signed by the Heads of State of SADC countries is intended to culminate in convergent national payment system features, policies, practices, rules and procedures within the SADC region.

The provisions that empower the central bank to oversee and supervise the payment, clearing and settlement system should also include the achievements by the central bank of the following objectives:

a. The promotion and implementation of a safe and efficient domestic payment system, based on internationally accepted principles

b. The protection, minimisation and management of the payment system risk

c. The establishment of rules, regulations and policies to regulate the activities of the various participants in the different payments systems

d. The establishment of a payment, clearing and settlement system.

2.3 Proposal

SADC central bank legislation must provide for a clear mandate for SADC central banks to establish, oversee, operate, supervise and participate in the payment, clearing and settlement systems.

Furthermore, central banking legislation needs to provide explicit powers for supervision and oversight of clearing and settlement systems.

More specifically, legislation should provide for the following key objectives:

a. To mandate the central bank to exercise such power as may be determined in the central bank legislation or another specific legislation

b. To give authority to the central bank to

- establish rules and procedures to promote the soundness, efficiency and safety of payment, clearing and settlement systems; and
- establish and/or participate in any such payment, clearing or settlement systems. (Section 59 of the Model Law.)

3. Summary of the proposals

Table 9 summarises the proposals outlined in Chapter 8: Payment, clearing and settlement systems.

Table 9: Proposals outlined in Chapter 8

	Problem statement	Proposal	Model Law Section
2	Most SADC central banks statutes do not provide adequate legal provisions mandating them to oversee, regulate, operate and supervise payment, clearing and settlement systems to fulfil the objectives of safety, integrity, efficiency and soundness of the payment system as a whole.	• SADC central bank legislation must provide for a clear mandate for SADC central banks to establish, oversee, operate, supervise and participate in the payment, clearing and settlement systems. • Central banking legislation also needs to provide explicit powers for supervision and oversight of clearing and settlement systems. • More specifically, legislation should provide for the following key objectives: i To mandate the central bank to exercise such power as may be determined in the central bank legislation or another specific legislation; and ii To give authority to the central bank to – establish rules and procedures to promote the soundness, efficiency and safety of payment, clearing and settlement systems; and – establish and/or participate in any such payment, clearing or settlement systems.	59

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Chapter IX
Accounts and reporting requirements

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1. Introduction

The purpose of this chapter is to harmonise and strengthen principles of accounting and reporting requirements in the legal and operational frameworks of SADC central banks. The chapter endeavours to ensure that the principles of accounting and reporting requirements in the legal and operational frameworks of SADC central banks are in compliance with best international accounting practice, to create and promote clear standards of accountability and transparency in the legal and operational frameworks of SADC central banks.

2. Financial year

2.1 Problem statement

The financial year of SADC central banks is stipulated in each country's legislation and the periods differ from country to country.

2.2 Discussion

The problem with providing or stipulating the financial year of SADC central banks in the legislation is encountered when the central bank intends to change the period of its financial year. This would entail undertaking the whole legislative procedure of having to amend the legislation or Act through Parliament, which would be a lengthy or time-consuming process. (Section 60 of the Model Law.)

2.3 Proposal

The financial year of SADC central banks should be fixed by the Board and published by notice in a *Government Gazette*.

3. Accounts and audit

3.1 Problem statement

The accounts, audit and inspection requirements for SADC central banks, as provided in each country's legislation, are diverse and require harmonisation and be in accordance with international accounting practice relevant to central banking.

3.2 Discussion

The majority of SADC central banks' accounts are audited by independent auditors appointed by the Board. There are a few exceptions where the accounts of SADC central banks are audited by the Auditor General or a Council of Auditors. In most SADC central banks, the appointment of independent auditors by the Board is done with the approval of the Minister responsible for national financial matters, while in a few central banks the approval of the Minister responsible for national financial matters is not necessary and in one case the independent auditor is appointed by the Minister responsible for national financial matters. In the majority of the SADC central banks, the Auditor General has the option of examining the accounts of these banks, while in other central banks this role is carried out by a Council of Auditors or an Audit Court.

There are no specific international accounting standards for central bank accounts. In this regard, some central banks have adopted the IFRSs. This is very good for transparency, accountability and the credibility of central bank finances. However, the IFRSs are not compatible with central banking requirements in all respects. This is particularly true with regard to the treatment of foreign-exchange unrealised gains and losses. The IFRSs require that foreign exchange revaluation changes be brought to the profit-and-loss account. As most central banks have large net exposures to foreign currencies, as an essential element of their institutional roles, the use of IFRSs has potential for volatility of income and balance sheet statements.[46] This may create problems for central banks, depending on how the distribution of bank profits is done.

46. See Stella and Lonnberg, "Issues in Central Bank Finance and Independence", p. 5.

The European System of Central Banks (ESCB) has developed its own accounting policies for the preparation of the balance sheet, and the profit-and-loss account that the Governing Council of the ECB considers appropriate to the nature of central banking activity. These policies are laid down in the Decision of the Governing Council of the ECB of 12 December 2000 (ECB/200/16) OJ l 33, 2.2.2001).

The accounting principles applied are the following: economic reality and transparency, prudence, recognition of post-balance-sheet event, materiality, the accruals principle, going concern, consistency and comparability. Similarly, the Board of Governors of the Fed has developed specialised accounting principles that it considers appropriate "for the significantly different nature and function of a central bank as compared to the private sector". These accounting principles and practices are contained in the *Financial Accounting Manual for Federal Reserve Banks*.

Whereas it is important to appreciate the use of international accounting standards for SADC central banks, it is also crucial to be mindful of the peculiar needs of central banks in some special respects. It may, therefore, sometimes be necessary to depart from the application of International Accounting Standards (IASs) due to special conditions applying to central banks and the law should provide for this.

3.3 Proposals

The accounts of SADC central banks should be audited annually by an independent, external auditor from a public accounting firm of good repute, appointed by the Board without the approval of the Minister responsible for national financial matters because this may constitute the infringement of the operational independence of central banks.

Audits by the Auditor General or Council of Auditors should be an option to confirm the audit of the independent external auditors.

The independent external auditors may not serve for a period of more than five years in succession.

The accounts should be presented in accordance with best international practice that takes into account practices relevant to central banking. (Section 61 of the Model Law.)

4. Reporting requirements

4.1 Problem statement

SADC central bank legislation indicates a high level of accountability to Government, but accountability to the public is weak.

4.2 Discussion

In the SADC region, the majority of SADC central banks have to submit their accounts and annual reports to Government and the SADC central banks' legislation specifies different time frames within which audited accounts and annual reports should be submitted. The majority of SADC central banks have to submit their accounts and annual reports to the Minister responsible for national financial matters, although in some central banks they are submitted to the President. In most central banks the Minister responsible for national financial matters has to table the bank's accounts and annual report to Parliament and publish them in a *Government Gazette*. Most SADC central banks have to publish monthly returns on assets and liabilities. Overall, this shows a high level of accountability by SADC central banks to Government, but accountability to the public is not standardised and appears to be weak.

4.3 Proposals

For the purposes of accountability and transparency to Government, the SADC central banks should continue with the high level of accountability by submitting annual reports on their accounts, operations and affairs after the close of each financial year to the Ministers responsible for national financial matters, who shall table such reports before Parliament and publish them in the *Government Gazette* as soon as possible after receipt.

Each SADC central bank should, within 30 days after the last business day of each month, prepare and publish in the *Government Gazette* a

return on its assets and liabilities and deliver a copy of same to the Minister responsible for national financial matters.

For purposes of accountability and transparency to the public, SADC central banks should report at least twice a year to Parliament or the responsible committee of Parliament on the annual accounts, operations of the central bank and the state of the economy and the conduct of monetary policy. In addition, SADC central banks should report to the select committee on the operations and affairs of the central bank during the preceding 12 months at any time as requested by the central bank or such committee. (Sections 62, 63 and 64 of the Model Law.)

5. Summary of the proposals

Table 10 summarises the proposals outlined in Chapter 9: Accounts and reporting requirements.

Table 10: Proposals outlined in Chapter 9

	Problem statement	Proposal	Model Law Section
2	The financial year of SADC central banks is stipulated in each country's legislation and the periods differ from country to country.	The financial year of SADC central banks should be fixed by the Board and published by notice in a *Government Gazette*.	60
3	The accounts, audit and inspection requirements for SADC central banks, as provided in each country's legislation, are diverse and require to be harmonised and in accordance with international accounting practice relevant to central banking.	• The SADC central banks' accounts should be audited annually by an independent, external auditor from a public accounting firm of good repute, appointed by the Board without approval of the Minister responsible for national financial matters. • Audits by the Auditor General or Council of Auditors should be an option to confirm the audit of the independent external auditors. • The independent external auditors may not serve for a period of more than five years in succession. • The accounts should be presented in accordance with best international practice that takes into account practices relevant to central banking.	61

Table 10: Proposals outlined in Chapter 9			
	Problem statement	Proposal	Model Law Section
4	SADC central bank legislation indicates a high level of accountability to Government, but accountability to the public is weak.	• SADC central banks should continue with the high level of accountability by submitting annual reports on their accounts, operations and affairs after the close of each financial year to the Ministers responsible for national financial matters, who shall table such reports before Parliament and publish them in the *Government Gazette* as soon as possible after receipt. • Each SADC central bank should, within 30 days after the last business day of each month, prepare and publish in the *Government Gazette* a return on its assets and liabilities and deliver a copy of same to the Minister responsible for national financial matters. • SADC central banks should report at least twice a year to Parliament or the relevant committee of Parliament on the annual accounts, operations of the central bank and the state of the economy and the conduct of monetary policy. • In addition, SADC central banks should report to the select committee on the operations and affairs of the central bank during the preceding 12 months at any time as requested by the central bank or such committee.	62, 63 and 64

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Chapter X
Profits and reserves

---------- Contents ----------

1. Introduction

The objective of this chapter is to provide comprehensive provisions that safeguard the financial integrity of central banks through the manner in which income and profits are determined and allocated, as well as sound treatment of losses based on international best practice.

2. Determination of net profit

2.1 Problem statement

SADC central bank legislation defines how net profit should be determined. However, the concept is not similar among the countries and is not always based on modern and international accounting practice.

2.2 Discussion

The harmonisation of the net profits concept is one of the missions that the central banks have to address, even in the event of the IAS.

2.3 Proposal

The net profit should be determined in accordance with best international accounting practice, after providing for bad and doubtful debts, depreciation of assets, contributions to staff funds and staff pension funds. (Section 65 of the Model Law.)

3. Appropriation of net profit

3.1 Problem statement

It is not clear how and to whom the net profits shall be paid, and the conditions to be observed before profits are paid out.

3.2 Discussion

The general trend in SADC central bank is that a certain percentage of surplus profit is allocated to the general reserves to build up the capital base of the central bank. In addition, all central banks transfer part of their profits to Government (some at a high percentage). There are some SADC

central banks that have to redeem all Government securities from the profits before transferring the residue to Government. In other groups of countries, the legislation provides that they may transfer amounts deemed necessary by the Board to other reserve accounts.

3.3 Proposal

All central banks should establish a general reserve to which net profits shall be allocated at the end of each financial year in specified amounts. The model law should specify in very clear terms how the net profits are to be allocated. (Section 66 of the Model Law.)

4. Treatment of net losses

4.1 Problem statement

Some jurisdictions have provisions that deal with losses by the central banks. In other cases it is not clear how central bank losses should be treated, thereby creating the risk that unrealised gains may be paid out as profit without providing for unrealised losses.

4.2 Discussion

Central banks sometimes incur losses. Such losses should be charged to the general reserve account. Where the annual reserve is inadequate to cover the full amount of the loss, the balance should be carried forward in the same account. Government should be obligated to confirm the balance of the accumulated losses and deliver to the Bank funds and other qualifying instruments in such amount or amounts as may be necessary to correct the deficit.

4.3 Proposal

The treatment of such losses must be provided for in the law. (Section 67 of the Model Law.)

5. Summary of the proposals

Table 11 summarises the proposals outlined in Chapter 10: Profits and reserves.

Table 11: Proposals outlined in Chapter 10

	Problem statement	Proposal	Model Law Section
2	SADC central bank legislation defines how net profit should be determined. However, the concept is not similar among the countries and is not always based on modern and international accounting practice.	The net profit should be determined in accordance with best international accounting practice, after providing for bad and doubtful debts, depreciation of assets, contributions to staff funds and staff pension funds.	65

Table 11: Proposals outlined in Chapter 10			
	Problem statement	Proposal	Model Law Section
3	It is unclear how and to whom the net profits shall be paid, and the conditions to be observed before profits are paid out.	All central banks should allocate their net profits as specified by legislation.	66
4	Some jurisdictions have provisions that deal with losses by the central banks. In other cases it is not clear how central bank losses should be treated, thereby creating the risk that unrealised gains may be paid out as profit without providing for unrealised losses.	The treatment of such losses must be provided for in the law.	67

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Chapter XI
General provisions

---------- Contents ----------

1. Introduction

This chapter deals with general provisions that are regarded as being critical to supplementation and enhancement of the legal and operational frameworks for SADC central banks. The general provisions include confidentiality, immunity from personal liability, offences, protection of information suppliers and information supplied, liquidation or winding up of the Bank and some normal transitional arrangements.

The Comparative Study of all SADC central bank legislation found that the position of all SADC central bank legislation was similar on preservation of secrecy and confidentiality. The challenge, therefore, would be to ensure that the provisions are harmonised, robust and, in view of the increasing need for co-operation and sharing of information among the SADC central banks, that such sharing of information is without breach of secrecy or confidentiality.

Other emerging challenges revolve around international co-operation against currency counterfeiting, which is linked to AML and the CFT through emerging international treaty law, United Nations conventions, resolutions and regional initiatives.

Further challenges are due to the differences in the drafting styles among SADC countries that belong to either the common law or the civil law tradition. The quality of the text and its acceptability to different legal systems would be increased if a more precise terminology were adopted.

2. Furnishing of information

2.1 Problem statement

There are no standardised provisions in SADC central bank legislation relating to accessing this information from the supervised entities, and central banks need explicit powers to access and obtain information from banks and other financial institutions.

The impact created by the integration of access to information legislation is one of the challenges of management of information by central banks.

2.2 Discussion

SADC central banks have to ensure that information traditionally furnished to them to monitor macroeconomic performance and policy is standard, transparent, accurate and timely.

Care has to be taken in the formulation of the Model Law to preserve the confidentiality and integrity of customer information. The framework should be flexible enough to accommodate the potential requests for access to information by the public.

2.3 Proposals

There should be provision to enable central banks to obtain from any person such information as they may consider necessary.

Information obtained must be protected and disclosure should be in accordance with the law. (Section 68 of the Model Law.)

3. Oath or affirmation of secrecy and immunity

3.1 Problem statement

There are no provisions for an oath of secrecy or affirmation of secrecy in some SADC central bank laws.

3.2 Discussion

The Governors, staff members, Board members and members of the MPC should undertake an oath of secrecy in relation to information pertaining to the affairs of the Bank. In consideration of their undertakings, they should also be granted immunity from personal liability from any act or omission committed in the performance of the duties to the Bank, provided no bad faith is established.

3.3 Proposals

The undertakings of secrecy and confidentiality provisions should broadly cover the following categories: Governor, Deputy Governor, Board member, MPC members and Bank staff.

The confidentiality undertaking could be departed from when the operation of the law of disclosure is required (access to information laws included).

Immunity from personal liability for officials of the Bank, the executive, MPC and Board members must be guaranteed where it is established that the act or omission was in good faith in the performance of their duties. The onus of establishing bad faith should be discharged by the person that alleges otherwise. (Section 69 of the Model Law.)

4. Offences

4.1 Problem statement

Some SADC central bank Acts do not provide for offences and penalties.

4.2 Discussion

Offences include breach of secrecy provisions; violation of foreign-exchange provisions; supplying false information to the Bank; failure to disclose an interest in a matter by a member of the Board; wilfully soiling, tearing, defacing, mutilating coins and engraving or making upon any material whatsoever any words upon any banknotes.

There are essentially four kinds of penalties: (i) fines, imprisonment or both; (ii) penal servitude and/or fine; (iii) penalty in monetary charges; and (iv) dismissal or resignation.

4.3 Proposals

Central bank Acts should only provide for offences that have a direct bearing on central banking activities.

In the exercise of this recommendation, care should be taken to ensure that offences that need to be removed from central bank Acts are covered in other relevant Acts.

Interference with the operational independence of the Bank should be an offence as a corollary measure for further enhancement of this trite but cardinal international central banking principle.

Provision shoud also be made for unlawful disclosure of information by Bank staff and general offences. (Sections 72–78 of the Model Law.)

5. Liquidation or winding up of the Bank

5.1 Problem statement

There is no standard provision for the dissolution of a central bank in SADC central bank legislation.

5.2 Discussion

Owing to the unique nature of the Bank, as a juristic person, created through statute with operational independence firmly entrenched in the Model Law and the national Constitution, it is equally important to ensure that the Bank's demise or dissolution can only be through an Act of Parliament.

5.3 Proposal

Central bank liquidation or winding-up should only be done through an Act of Parliament. This will further enhance central bank independence. (Section 79 of the Model Law.)

6. Transitional arrangements

There may be more than just one transitional provision and it is proposed that provisions for a schedule containing transitional provisions be made.

The standard transitional arrangements for any legislation are

- regulations; and
- the repeal of laws and savings. (Section 81 of the Model Law.)

7. Summary of the proposals

Table 12 summarises the proposals outlined in Chapter 11: General provisions.

Table 12: Proposals outlined in Chapter 11

	Problem statement	Proposal	Model Law Section
2	• There are no standardised provisions in SADC central bank legislation relating to accessing information from supervised entities and central banks need explicit powers to access and obtain information from banks and other financial institutions. • One of the challenges of the management of information by central banks is the impact created by the integration of access to information legislation.	• There should be provision to enable central banks to obtain from any person such information as they may consider necessary. • Information obtained must be protected and disclosure should be in accordance with the law.	68
3	There are no provisions for an oath of secrecy or affirmation of secrecy in some SADC central bank laws.	• The undertakings of secrecy and confidentiality provisions should broadly cover the following categories: Governor, Deputy Governor, Board member, MPC members and Bank staff. • The confidentiality undertaking could be departed from when the operation of the law of disclosure is required (access to information laws included). • Immunity from personal liability for officials of the Bank, the executive, MPC and Board members must be guaranteed where it is established that the act or omission was in good faith in the performance of their duties. The onus of establishing bad faith should be discharged by the person that alleges otherwise.	69

Table 12: Proposals outlined in Chapter 11			
	Problem statement	Proposal	Model Law Section
4	Some SADC central bank Acts do not provide for offences and penalties.	• Central bank Acts should only provide for offences that have a direct bearing on central banking activities. • In exercising this, care should be taken to ensure that offences to be removed from central bank Acts are covered in other relevant Acts. • Interference with the operational independence of the Bank should be an offence as a corollary measure for further enhancement of this trite but cardinal international central banking principle. • Unlawful disclosure of information by Bank staff as well as general offences should also be provided for.	72–78
5	There is no standard provision for dissolution of a central bank in SADC central bank legislation.	Central bank liquidation or winding-up should only be done through an Act of Parliament. This will further enhance central bank independence.	79
6	There may be a number of transitional provisions.	Provisions for a schedule containing transitional provisions should be made. The standard transitional arrangements for any legislation are: • Regulations • Repeal of laws and savings.	81

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