An Assessment of the effectiveness of the regulatory tools in managing bank failures in Zimbabwe
(Case of Interfin and Royal Bank)

Ronald Tafadzwa Magondo (R0020144)

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Graduate School of Management
University of Zimbabwe

Supervisor: Dr G. Muponda
I, …………………………………………………., do hereby declare that this dissertation is the result of my own investigation and research, except to the extent indicated in the Acknowledgements, References and by comments included in the body of the report, and that it has not been submitted in part or in full for any other degree to any other university.

__________________________         ________________
Student signature                      Date
Acknowledgements

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Abstract

The continued failure of banks in Zimbabwe has left thousands of depositors stranded and reduced economic activity of the country. The stability and public confidence in the banking sector has also been eroded by the failure to effectively manage bank failures. The failure of banks has reduced the attractiveness of the country to foreign investment. The study looks at the effectiveness of the regulatory toolkit that the authorities have been using in the face of repeating bank failures.

The Zimbabwean banking sector has experienced over twenty six bank failures since independence. The study looked at a case study of Interfin Banking Corporation and Royal Bank that failed and the regulatory tools used to resolve them. Data was gathered from interviews with regulatory authorities and the curators of the failed banks.

The study established that effectiveness of the resolution tools was mainly affected by the provisions in the existing legal frameworks. As a result, the speed and finality of resolution efforts have been thwarted by legal battles and regulatory forbearance. There are no frameworks for other tools such as open bank assistance, purchase and assumption, and bridge banks to manage or resolve failing banks. Bank failures in Zimbabwe is predominantly a result liquidity challenges, poor risk management practices and weak corporate governance structure. The main players in the regulations and management of failed banks are the Reserve Bank of Zimbabwe and the Deposit Protection Corporation.
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CHAPTER 1
BACKGROUND TO THE STUDY

1.1 Introduction

The continued failure of banks in Zimbabwe raises concern over the responsiveness by the regulators and supervisors of the banking sector. Depositors in failing banks are hit the most because they bear the risk of losing all or part of their savings. In most cases, the responsiveness to inappropriate banking practices is not swift and decisive enough to restore confidence in the banking sector. As a result, the failure of banks seems to be a permanent phenomenon for the sector that once was stable just after the independence of Zimbabwe in 1980. The sector only started exhibiting signs of distress after 1995 and experienced the highest number of bank failures in 2004 when more than ten banks were declared insolvent. Since then, the possible loss of banked money still remains seeded in the minds of the banking public.

This study seeks to look at the effectiveness of the tools used by regulators and supervisors in managing the banks when they show signs of distress up to when they have failed.

The chapter will include the changes that have occurred in the banking sector architecture since the independence of Zimbabwe in 1980. The chapter will go on to outline the causes of bank failures in Zimbabwe and the regulatory tools used to correct bank failures.

1.2 Reforms of the Zimbabwean Banking Sector

When the Government of Zimbabwe (GoZ) adopted the Economic Structural Adjustment Programme (ESAP) in 1991, it resulted in the liberalization of the banking sector. Before ESAP, the banking sector was dominated by foreign-owned banks and the GoZ controlled the interest rates, deposit rates and credit ceilings amongst other controls. The sector had a few participants who only included the Reserve Bank of Zimbabwe (RBZ), five commercial banks, two discount houses, four merchant banks, three building societies, six finance houses and the Post Office Savings Bank (POSB)(Dawson and Kelsall, 2011).
Strategic institutions such as Credit Guarantee Company, the Small Enterprises Development Company (SEDCO), Agricultural Finance Corporation (AFC) the Industrial Development Corporation (IDC) and the Zimbabwe Development Bank (ZDB) also made up the sector. These had special functions to direct funds to specific sectors such as agriculture and industry (Brownbridge, Harvey and Gockel, 2008).

The deregulation of the financial services under ESAP attracted other investors into the banking sector. The sector was still seen as a beacon of entrepreneurship for the indigenous people despite the harsh economic climate which was prevailing. The liberalization of the sector resulted in the licencing of several indigenous banks as shown in Table 1.1 below.

<table>
<thead>
<tr>
<th>Banking Institution</th>
<th>Year of Licence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Commercial Bank of Zimbabwe</td>
<td>1991</td>
</tr>
<tr>
<td>2. First National Building Society</td>
<td>1993</td>
</tr>
<tr>
<td>3. Leasing Company of Zimbabwe</td>
<td>1999</td>
</tr>
<tr>
<td>4. Century Bank</td>
<td>1999</td>
</tr>
<tr>
<td>5. Zimbabwe Building Society</td>
<td>1993</td>
</tr>
<tr>
<td>6. Barbican Banking Corporation</td>
<td>1999</td>
</tr>
<tr>
<td>8. Universal Merchant Bank</td>
<td>1995</td>
</tr>
<tr>
<td>10. Trust Merchant Bank</td>
<td>1996</td>
</tr>
<tr>
<td>11. First Banking Corporation</td>
<td>1997</td>
</tr>
<tr>
<td>14. Time Bank of Zimbabwe</td>
<td>2002</td>
</tr>
</tbody>
</table>

*Source: Reserve Bank of Zimbabwe (2004)*
Table 1.1 shows that the RBZ licenced fourteen indigenous banks in just one decade from 1991 to 2001. As a result, notable changes to the financial sector architecture included the increase of discount houses from six to eight, building societies from three to five, and commercial banks from five to sixteen between 1991 and 2002. The licencing of indigenous banks was the GoZ strategy to break dominance by foreign banks and create an avenue to accumulate wealth (Chikukwa, 2004). Most indigenous banks, however, had ownership concentration and according to Mumvuma (2003) families had majority shareholding. They went on to represent top management and sat on the Board of Directors. Therefore, most indigenous banks were fraught with weak corporate governance structures which made them susceptible to failure.

During the late 1990s, the Zimbabwean economy was troubled by hyperinflation which resulted in declining savings from depositors. As a result, many of the indigenous banks were forced to use other sources to fund their lending. The policies by the GoZ to control the interest rates encouraged banks to borrow cheaply from the central bank to fill gaps created by interest income. The RBZ (2003), however, alleged that banks were using the funds to invest in speculative and non-core banking activities such as bricks, motor vehicles and immovable property. Several indigenous bankers started gambling with depositors’ funds by offering high interest rates to risky borrowers.

Depositors started facing challenges in accessing their savings in the indigenous banks due to the liquidity crisis created after the RBZ withdrew the lender of last resort function. The depositors, due to their lack of information, were vulnerable and this promoted the problem of moral hazard and insider lending as defined by Pauly (2007).

The unsound banking practices often benefited the bankers at the expense of depositors as banks had limited liability and bore a small portion for the risk. Bankers were gaining huge profits through gambling with depositors funds at expense of the depositors who despite this bear the huge costs of failure (ZEPARU, 2013).
1.3 The regulatory instruments for managing bank failures

The increase in the number of financial institutions as a result of ESAP created a regulatory burden for the RBZ. The RBZ had had a relaxed role of supervising the foreign banks which were professionally run under international best standards such as the Basel I and II Accords.

After the RBZ withdrew its lender of last resort function, which had provided temporary liquidity relief to struggling banks, most indigenous banks began to show signs of fragility. As a result, the Government of Zimbabwe introduced new regulatory tools for managing the problem and failing banks. These changes introduced intended to empower the Central Bank to swiftly enforce ownership changes and restructure the financial sector.

The Central Bank introduced regulations which enforced that founders of private indigenous banks to reduce their shareholding. In some instances, the Central Bank forced out shareholders out of their companies under varying pretexts. The RBZ corporate governance guidelines entitled shareholding by any individual not to exceed ten percent of the bank’s shareholding.

According to the Banking Act [Chapter 24:20] of Zimbabwe, a bank is said to be in distress when it is unable to meet its obligations to its depositors or other creditors. Banks go in distress as because they become insolvent or too illiquid to meet its liabilities. Further, a bank can be said to be in distress if it is failing to meet the regulatory requirements as stipulated in the Banking Act [Chapter 24:20]of Zimbabwe.

The major reasons for bank failures are bad loans which comprise a large part of the traditional banking business, along with holding depositor money. Funding issues can also cause bank failures when banks have problems refinancing its debt or repaying it. The various regulatory instruments introduced by the government to manage the failing or failed banks are discussed as follows:

- Corrective orders;
- Curatorship and liquidations;
- Troubled Bank Resolution Framework;
- Temporary relief and bailouts; and
- Deposit Protection scheme Corporation.
1.3.1 Corrective Orders

According to Bolzico, Mascaro, et al (2007) a Corrective Order is a plan imposed on a banking institution to correct deficiencies. It specifies actions, persons responsible, and a timetable and target levels for achievement. The nature of Corrective Orders issued included appointment of an advisor or supervisor, the suspending of a director, officer or employee, amending, suspending or canceling a licence, and closure and liquidation. The implementation of a Corrective Order is monitored by the RBZ’s Bank Licensing, Supervision and Surveillance Division (BLSS) which assess the progress of remedial actions (RBZ, 2006).

1.3.2 Curatorship and Liquidations

The failure of banking institutions to adhere to Corrective Orders and capital prompts the Reserve Bank to apply more stringent resolution measures. The RBZ places the affected banks under the management of a curator or recommend the winding up through liquidation. Curatorship or judicial management is aimed at protecting the interests of depositors and creditors with hope of resuscitating operations. The reports from the curator determine the next options the RBZ may implement to resolve the troubled banks.

The Banking Act (Chapter 24:20) Section 53 empowers the RBZ to place banks under curatorship. According to the Act, a curator as someone who takes over the management of a banking institution when the RBZ feels that the institution is not operating on sound administrative, accounting risk management practices. The period of curatorship is six months but may be rolled over at the discretion of RBZ. The closing of banks under curatorship is viewed as an act of closing the stables when the horses have already bolted. This is because the appointment of curator is after the rot has already happened in the bank.

The RBZ can also recommend to the high court by the use of the Insolvency Act or Companies Act placing of banks under provisional liquidation. Where an institution is found to be insolvent, or no longer able to remain viable, the Reserve Bank may cancel the licence and apply to the High Court for the placement of the institution under liquidation.
Table 1.2 below shows number of curatorships between 2003 and 2013.

<table>
<thead>
<tr>
<th>Period</th>
<th>Number of Curatorships</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>1</td>
</tr>
<tr>
<td>2003</td>
<td>3</td>
</tr>
<tr>
<td>2004</td>
<td>9</td>
</tr>
<tr>
<td>2005</td>
<td>1</td>
</tr>
<tr>
<td>2006</td>
<td>1</td>
</tr>
<tr>
<td>2011</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>16</strong></td>
</tr>
</tbody>
</table>

*Source: Reserve Bank of Zimbabwe (2013).*

The table shows that a total of sixteen banks have been placed under curatorship between 2003 and 2013. The majority of the banks were placed under curatorship in 2004 after a new Governor was installed at the Reserve Bank of Zimbabwe. All the banks placed under curatorships were indigenous banks.

### 1.3.3 Troubled Bank Resolution Framework

The Government of Zimbabwe (GoZ) enacted in 2004 the Troubled Financial Institutions (Resolution) Act (TBR) to enable the RBZ to monitor failing or problem banks. It empowers the RBZ to:

- carry on or discontinue any part of the business of the troubled financial institution;
- to freeze all or any class of deposits placed with the troubled financial institution indefinitely or for a fixed period;
- to stop or limit the payment of any obligation, including interest;
- to set aside any disposition of the property of the financial institution or of any specified person; and
• to draw, accept, make and endorse any cheque, bill of exchange or promissory note in the name and on behalf of the troubled financial institution, and, for the purpose of carrying on the business of the troubled financial institution.

Makoni (2010) indicated that since the enactment of the Act seven of the sixteen collapsed banks were placed under curatorship, one under liquidation, one closed, and the other four were bailed out from the Troubled Bank Fund. However, the Troubled Bank Fund was discontinued as banks failing to repay the loans received from the fund. The TBR framework was designed to provide:

• strong banking system and promote sound banking practices;
• permanent solutions for troubled banking institutions;
• economic development and growth;
• stability of the financial sector; and
• preservation of an indigenized financial sector.

The TBR empowered the RBZ to restructure troubled institutions namely; Trust Bank, Royal Bank, and Barbican Bank by amalgamation to then form Zimbabwe Allied Banking Group (ZABG) in 2005 (RBZ, 2005).

1.3.4 Temporary Relief and Bailout

The Reserve Bank of Zimbabwe (RBZ) has in the past provided short term funding to ease problems faced by banks such as liquidity challenges. This was the case with United Merchant Bank which had exposed other banks to liquidity risk after the fraudulent sale of fake company bills (ZEPARU, 2012). Similarly, the RBZ took over the management of Zimbabwe Building Society which was seriously undercapitalized. These measures were consistent with the implicit deposit insurance scheme of the Government at the time,

1.3.5 The Deposit Protection Scheme

The Deposit Protection Corporation (DPC) was established in 2003 as an explicit deposit insurance scheme by the Zimbabwean Government in the wake of bank failures and its effect on the financial stability. The DPC, which started as Deposit Protection Board with a mandate of being a pay box, had its mandate expanded in 2012 to include risk minimisation on weak banks.
Prior to the formation of the DPC, the RBZ had created a Troubled Bank Fund which troubled bank could use to resuscitate failing banking operations. Reports from the Deposit Protection Corporation (2014) indicate that the Corporation is undercapitalized with $14 million and require $52 million to for the insured deposits in the banking sector as at 30 September 2014. The DPC public objectives stipulate that the DPC pays out $500 per depositor per bank. However, the insurance cover is insufficient because it is short of the $1000 which would comply with the public objectives of ninety percent full deposit coverage. At a cover of $500 the DPC can only fully pay eighty-seven percent of insured depositors in full.

The deposit payout statistics by DPC as at September 2014 are shown in Table 1.3 below

**Table 1.3 Deposit Payouts by Deposit Protection Corporation as at September 2014**

<table>
<thead>
<tr>
<th>Institution</th>
<th>Number of Depositors</th>
<th>Number of Depositors Paid</th>
<th>% Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Century Bank</td>
<td>397</td>
<td>178</td>
<td>45%</td>
</tr>
<tr>
<td>Rapid Discount House</td>
<td>1215</td>
<td>472</td>
<td>39%</td>
</tr>
<tr>
<td>Sagit Finance House</td>
<td>3003</td>
<td>2832</td>
<td>94%</td>
</tr>
<tr>
<td>Genesis Investment Bank</td>
<td>85</td>
<td>56</td>
<td>71%</td>
</tr>
<tr>
<td>Royal Bank</td>
<td>5453</td>
<td>3087</td>
<td>56%</td>
</tr>
<tr>
<td>Trust Bank</td>
<td>2958</td>
<td>287</td>
<td>11%</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>10153</strong></td>
<td><strong>6912</strong></td>
<td><strong>68%</strong></td>
</tr>
</tbody>
</table>

*Source: DPC Reports 2014*

As at September 2014, the Deposit Protection Corporation (DPC) had managed to reimburse only 6912 depositors out of 10153 since its formation in 2003. This according to DPC’s website, Genesis Bank, which closed on June 11, 2012, had US$11 800 in insured deposits, of which US$8 000 has since been paid representing seventy percent of the insured sum. For Trust Bank Corporation, the DPC has only paid US$109 000 of the US$328 000 that was insured as at August 2014.
The low payout ratio is an indication of low public confidence in the deposit protection scheme and a reflection of low public awareness. Public confidence in the banking sector plays a key role in maintaining the stability of the banking system.

The DPC function had limited effect on banks placed under curatorship not until the enactment of Statutory Instrument 156 of 2013 which mandated the Corporation to payout depositors even when banks had been placed under curatorship. The effectiveness of the Corporation is hampered by publicity and the current laws which drag the liquidation process at the expense of depositors.

The implementation of the various regulatory tools resulted in bank collapses and closures. Table 1.4 shows changes in the number of financial institutions as a result of closures and restructuring in the sector.

**Table 1.4: Number of Banking Institutions from December 1990-July 2012**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Banks</td>
<td>5</td>
<td>16</td>
<td>11</td>
<td>18</td>
</tr>
<tr>
<td>Merchant Banks</td>
<td>4</td>
<td>6</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Discount Houses</td>
<td>2</td>
<td>8</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Finance Houses</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>Savings Bank (POSB)</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Building Societies</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>21</strong></td>
<td><strong>42</strong></td>
<td><strong>31</strong></td>
<td><strong>25</strong></td>
</tr>
</tbody>
</table>

*Source: RBZ (2003-2012)*

The table above shows that during the ESAP period after 1991 the number of banks doubled. The RBZ Monetary Policy (2003) which was armed with various regulatory directives resulted in eleven banks being closed in between 2003 and 2004 alone. Discount houses and finance houses failed to underwrite any meaningful business under the harsh economic climate, resulting in them either being closed or their operations being absorbed by parent banks. Several merchant
banks upgraded their licences to operate as commercial banks resulting in an increase in the number of commercial banks.

1.4 Causes of bank failures in Zimbabwe

There have been over twenty-six bank failures in Zimbabwe since 2000, according to RBZ reports (2003-2012). During the last decade since 2003 the sector has experienced fifteen bank failures as shown in Table 1.5 below.

<table>
<thead>
<tr>
<th>Period</th>
<th>Number of Failures Experienced</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-2000</td>
<td>9</td>
</tr>
<tr>
<td>2001-2010</td>
<td>12</td>
</tr>
<tr>
<td>2010-2014</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>26</strong></td>
</tr>
</tbody>
</table>

Source: RBZ Reports (2014)

The majority of bank failures were experienced during the 2001 to 2010 period, the same period the government amended laws and regulations governing the operations of banks. This allowed the RBZ to act on troubled banks more swiftly and reduced the problem of moral hazard. The failure of banks continued though at a lower rate than before despite the laws and supervisory toolkit that was in place.

Bank failures have, however, been experienced in Zimbabwe as far back as the mid-1990s when banks such as United Merchant Bank, Universal Merchant Bank, Zimbabwe Building Society, Time Bank, Commercial Bank of Zimbabwe, ZimBank, Trade and Investment Bank, Metropolitan Bank, Agribank and ZDB Financial Services failed and were either rescued or liquidated.
The major causes of bank failures are shown in table 1.6 below.

**Table 1.6 Major causes of bank failures.**

<table>
<thead>
<tr>
<th>Major Cause</th>
<th>Number of Failures Experienced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Insolvency</td>
<td>3</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>4</td>
</tr>
<tr>
<td>Liquidity challenges</td>
<td>7</td>
</tr>
<tr>
<td>Combination of all factors</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>26</strong></td>
</tr>
</tbody>
</table>

*Source RBZ Reports, 2003-2013*

An analysis of Table 1.6 shows that the major causes of bank failures in Zimbabwe boil down to a combination of various factors as follows:

- inadequate capitalization;
- poor corporate governance; and
- chronic liquidity challenges.

More than half of the bank failures are a result a combination of liquidity challenges and capital inadequacy. The causes of bank failures in the past still haunt the current banks. Banks such as United Merchant Bank and Universal Merchant Bank, failed during the period 1996-2000 due to liquidity challenges, exposure to non-performing loans, and other corporate governance shortcomings. Most cases fraudulent banks lend to projects connected with its own directors or managers (insider lending). Further, ZEPARU (2013) reiterated that there was siphoning of depositors’ funds through related party loans to the main shareholders and their associates.

Arguments by the IMF (2012) have stressed that banks were also victims of supervisory forbearance and lack of swift decision making when banks were showing signs of distress. The Zimbabwe Economic Policy Analysis and Research Unit (ZEPARU, 2013) has also argued that bank failures are a result of a weak supervisory framework necessary to rein in errant bankers. Such irregularities are what ZEPARU claim have created moral hazards or adverse incentives for
bank owners. As a result, banks act in the interest of owners and not depositors leaving them vulnerable in the event of failure.

1.5 Effects of bank failures in Zimbabwe

According to Giovanni, Detragiache, and Rajan (2004) generally banking crises are usually followed by a decline in credit and growth. The closures of UMB and UNI-Bank resulted in losses in deposits. This was because there was no deposit insurance in place then and the government could not payout the depositors of these banks.

Bank failures result in loss of deposits, contagion effect, loss in public confidence and lower economic activity amongst other factors. Table 1.5 shows the value of deposits lost due to failures of some of the banks.

1.5.1 Loss of deposits

<table>
<thead>
<tr>
<th>Failed Bank</th>
<th>Loss of Deposits (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Universal Bank</td>
<td>$10 Million</td>
</tr>
<tr>
<td>Genesis, Trust, Royal Bank, Capital Bank</td>
<td>$15 Million</td>
</tr>
<tr>
<td>First National building Society</td>
<td>US$18.7 million</td>
</tr>
</tbody>
</table>

According to an IMF report (IMF, 2004), about USD10 million worth of deposits was lost in UNI-Bank according to the IMF Report (2004). Also as reported by RBZ (2013) and DPC (2013) deposits worth about $15m were trapped when Royal Bank, Trust Bank, Capital Bank (Renaissance) and Genesis bank were closed. Genesis alone had a deposit base of US$2 million when it was closed at a time when the DPC was only paying $150 as insurance per depositor (RBZ Reports, 2013).

1.5.2 Contagion Effect
The failure of UNI-Bank in 1998, according to the IMF report, was a result of the contagion effect after the failure of UMB in 1997. The OECD (2012) report illustrates that contagion happens when banks are indebted to a bank with deteriorating risk profile. The problem of one bank can lead to the failure of other banks through the systematic connection within the sector.

1.5.3 Loss of public confidence

The failure of banks has lowered the public’s confidence levels. The monthly economic review (2014) reported that total banking sector deposits (net of interbank deposits), declined from twenty-three percent in November 2012 to minus one percent in November 2013 as a result of panic bank deposit withdrawals, liquidity challenges and the general decline in economic activity.

A report by FinScope (2012) also highlighted that thirty-one percent of Zimbabweans do not save, twenty-seven percent keep all their savings at home (these individuals do not have or use formal or informal savings products or mechanisms), sixteen percent rely only on informal mechanisms such as savings groups, nine percent use other formal (non-banking products), sixteen percent of individuals have savings products from a bank.

1.6 Background Royal and Interfin Banks

Royal Bank was founded in 2001 and closed by the Reserve Bank of Zimbabwe (RBZ) in 2004 and merged with Barbican Bank and Trust Banking Corporation to form Zimbabwe Allied Banking Group (ZABG) in 2005. In 2010 ZABG was unbundled and Royal bank was re-issued the commercial banking licenses. According to RBZ (2012), Royal bank was closed again on 27 July 2012 after the board of directors of Royal Bank Zimbabwe resolved to surrender the institution’s banking licence to the Reserve Bank of Zimbabwe. Royal Bank was closed mainly because the bank was undercapitalized and had accumulated of losses with liquidity challenges and high level of non-performing loans. As at 31 January 2015, the Deposit Protection Corporation was still in the process of liquidating Royal Bank and paying off the insured depositors.

Interfin Banking Corporation was founded in 1999 and was placed under recuperative curatorship in June 2012 for six months (RBZ, 2012). According to RBZ (2012) the bank was
considered unsafe and unsound to continue operating due to inadequate capitalization, concentrated shareholding and abuse of corporate structures, high level of non-performing insider and related party exposures, chronic liquidity and income generation challenges, poor board and senior management oversight, as well as violation of banking laws and regulations.

1.7 Problem Statement

Despite efforts by the RBZ to monitor and correct the banks the Zimbabwean banking sector continues to face failures that have brought suffering to depositors and reduced confidence in the banking sector. The bank failures continue with more than half of the operating banks showing signs of distress. The current liquidity crunch and global financial crisis only make matters worse as credit lines are reduced. Due to regulatory shortcomings some of the RBZ decisions have been challenged by banks and dragged the bank resolution processes. The RBZ and the DPC have also experienced their own capitalization challenges making affecting the enforcement of their mandate or supervising and regulation.

1.8 Purpose of the Study

The study seeks to assess the effectiveness of the regulatory instruments in managing weak and failed banks. The study will assist in prescribing the best solutions for the banking sector to avoid or minimize bank failures.

1.9 Research Objectives

The objectives of the study was:

1.9.1 To review the various regulatory instruments in place for managing and minimizing bank failures in Zimbabwe.

1.9.2 To assess the performance of the various regulatory tools in place for managing bank failures.
1.9.3 To suggest improvements to the current regulatory toolkit for managing bank failures in Zimbabwe.

1.10 Research Questions

In order to meet its objectives the study aims to answer the following:

1.10.1 What are the major causes of bank failures in Zimbabwe?
1.10.2 What is the impact of the current legislation on the supervision of banks?
1.10.3 How effective are the regulatory and supervisory authorities in managing the banking sector?
1.10.4 What effective tools should be in place to ensure effective management of failing and failed banks?

1.11 Scope of Study

This study limits its coverage to deposit taking institutions that are registered and supervised by the RBZ and are operating in Zimbabwe. It will focus on banks that have operated after Zimbabwean independence of 1980.

1.12 Justification of Study

This research will provide a better understanding of why the Zimbabwean banking sector is not learning from previous banks failures. Furthermore, the research will seek to understand why despite the existence of regulation and policy makers the depositors continue to suffer with no solution. The research findings will assist in formulating progressive strategies to ensure that public confidence in the banking sector is restored through effective management of bank failures.

1.13 Research Outline
The rest of the study will consist of four chapters beginning with chapter two which will review and discuss the existing literature on the management of failing banks and resolving failed banks across the world. Chapter Three will describe the research methodology to be employed whilst Chapter Four will analyse the results to be collected by various collection tools. Chapter Five will conclude the research basing on the evidence collected and evaluation of such.

1.14 Chapter Summary

In the chapter we noted that the banking sector in Zimbabwe experienced reforms as a result of ESAP which liberalized the sector. The financial liberalization brought with it a mixed bag of challenges as the newly licenced indigenous banks were involved in unsound banking practices. The supervisory and regulatory instruments in place were not effective enough and government had to enact several legislation and laws to empower the regulators to avoid banking crisis. As, a result bank failures have been experienced more often than ever. Bank failures are mostly a product of poor corporate governance practices, poor risk management, under capitalization, liquidity challenges and abuse of depositor’ money. The RBZ has used corrective orders, curatorship, liquidations and various acts as tools for managing failing banks. Despite the available regulatory tools the banks continue to fail due to the same reasons and has reduced confidence levels of depositors. As a result, economic growth is affected by limited bank use whilst those that have the option to continue banking are always on high alert to run on a bank on hearing adverse banking news.
CHAPTER 2
LITERATURE REVIEW

2.1 Introduction

Most empirical studies on bank failures consider a bank to have failed if it either received external financial support or was directly closed (Marco, 2005). The banks are also seen as finite institutions which with time will eventually fail despite any amount of regulation. Myerson (2013) has argued that the effectiveness of the financial regulatory reforms depends on the level of understanding by the citizens.

According to Bongini, Claessens, and Ferri (2001) a failed bank is one fitting the following categories:

- one that was recapitalized by either the central bank or an agency specifically created to address the crisis, and required a liquidity injection from the monetary authority;
- the financial institution’s operations were temporarily suspended by the government;
- the government closed the financial institution; and
- the financial institution was absorbed or acquired by another financial institution.

The chapter will evaluate the regulatory tools used in other countries and that found in literature. The review gives a theoretical base for the research and help to determine the nature of your research.
2.2 Regulatory tools for managing bank failures

According to McGuire (2011) the regulatory tools for managing weak or failed banks vary across different jurisdictions and include but not limited to:

- Bridge Banks;
- Resolution Powers;
- Special legislation;
- Curatorship;
- Corrective orders;
- Liquidations;
- Bail out;
- Mergers; and
- Deposit insurance scheme.

The tools provide the actions or processes that can be implemented to resolve problems faced with weak or failing banks. These processes may have different meanings in different jurisdictions.

The European Commission (2014) acknowledged that the failure of high profile banks such as Fortis, Lehman Brothers, Icelandic banks, Anglo Irish Bank and Dexia revealed serious shortcomings in the existing tools available to authorities for preventing or tackling failures of banks.

2.2.1 Bridge banks

The use of bridge banks or bridge financial institutions to resolve bank failures effectively is not common in many parts of the world according to BCBS (2011). The use of other tools for resolving weak banks and filing banks is not mandated and subject to confirmation by a court BCBS (2011). There are also shortcomings in the frameworks for various countries for resolving financial groups and those with cross border existence according to BCBS (2011) resolution report. The findings of the BCBS (2011) report highlighted just one jurisdiction that had adopted
legislation that appoints the same resolution authority to resolve both banks and other financial group entities that are systemically important.

### 2.2.2 Resolution powers

The frameworks to trigger resolution powers in many countries can be reviewed by the courts as a matter of administrative law according to BCBS (2011). The courts in a number of countries have powers to reverse a decision to trigger a resolution power for instance in the United Kingdom and the United States and substitute their own decision for instance Japan, Saudi Arabia, South Africa and Sweden. However, members noted that courts were unlikely to undo resolution measures and generally exercised constraint BCBS (2011).

According to BCBS (2011) report many countries continue to lack important legal powers to resolve a failing financial institution. Further, even if some powers are available, they lack of certain essential powers, including powers to terminate unnecessary contracts, continue needed contracts, sell assets and transfer liabilities. The fragmentation of regulatory system makes the development and implementation of reasonable polices almost impossible. This implies that there is a need to work toward coordination and unification of policies.

European Commission (2014) has highlighted the need for the regulatory framework for its member states after the 2008 financial crisis. The normal insolvency proceedings proved they would lead to the disorderly failure of some banks with potentially disastrous wider consequences. The EU (2014) suggested an integration and interconnections between institutions matched by a common regulatory framework for effectiveness of resolving bank failures.

Stoica and Căpraru (2009) stressed the importance of a regulatory framework in that it was connected with a better macroeconomic environment and regained the depositors’ trust. However, the state influence and involvement in the banking sector could result in Government’s preferentially crediting of some companies disregarding their economic and financial situation. The principle of the right to protect one’s private property is certainly controversial when the state intervenes and takes some interest in or takes control over or interferes with those property rights (Hopt, Kumpin, and Steffek, 2009).
Singh and LaBrosse (2012) sighted that the legislative body will also be the primary port of call for holding the financial safety net players accountable for their decisions. The legislative course to be taken considers the interest of various stakeholders. Only through legislative means could such steps be taken. The links between the banking and sovereign debt crises are quite interesting, meaning that the gap between macro- and micro-prudential oversight of the financial system needs to be addressed (Goodhart, 2011).

An analysis of the 2008 Global Financial crisis demonstrates that the authorities need to focus on economic policies as well as their implications for the financial system and its systemic stability (Singh and LaBrosse, 2012). The challenge to policy-makers is to elevate legislators’ attention to follow through with implementing supporting legislation to provide central banks with the needed authority to carry out their added responsibilities (Singh and LaBrosse, 2012).

### 2.2.3 Special legislation

Singh and LaBrosse (2012) highlighted that many countries have introduced special legislation for dealing with stressed financial institutions. For instance Singh and LaBrosse (2012) indicated that new institutions and legal frameworks have been introduced that facilitate the restructuring of stressed banks and the rescue of systemically relevant parts of banks. However, Singh and LaBrosse (2012) also highlighted the challenges of resolving stressed large financial institutions in a cross-border context. Further reforms are needed for cross-border banking activities in the European Single Market, where the issue is to match the European passport for banks with a pan-European safety net including deposit insurance and supervision (Singh and John, 2012).

The law may itself provide an obstacle to supervisory forbearance if it does not prescribe that the supervisor must act with due promptness in all situations. Elliott (2009) indicated that US laws are designed principally to ensure the viability of the banks themselves, rather than of the holding companies. As a result, there are provisions for the swift seizure of banks that are in deep trouble, but no such provisions to deal with their holding companies. Supervisory failure make then liable to formal criticism or even financial responsibilities to the injured parties, such as depositors.
2.2.4 Curatorship

Curatorship or conservatorship is considered a temporary solution to gain control of a failing institution (FDIC, 2000). However, when they are prolonged for longer periods they face limited staff resources and funding is interrupted periodically.

Duffie (2010) stressed that curatorship was outside the traditional bank failure resolution mechanism in the USA. As a result new legislation was enacted to allow the restructuring of large failing bank holding companies and other systemically important financial institutions.

Kroener (2010) explained that government-coordinated curatorship were an effective resolution tool for failing banks. According to Duffie (2010) curatorships also considers the costs and benefits to the taxpayer and the general economy with the objective to improve the balance between firm-level efficiency and economy-wide costs.

According to the OCC (2001) the OCC has authority to place a bank into curatorship to reduce or limit losses that might otherwise result if the bank is allowed to remain open. Curatorship remains rare in the USA and in most cases banks are required to be sold to another holding company or to merge with another bank in most cases. The timing of the curatorship also determines the effectiveness of the relation strategy. In the USA, a curator can only be appointed within ninety days of notification. The OCC (2011) also stressed that extensions of curatorships are possible when a capital injection is imminent. This are rare as they tend to prolong the resolution process at the expense of the stakeholders.

2.2.5 Corrective Orders

BCBS (2002) defines corrective action as action required by supervisors to deal with deficiencies and change behavior in a weak bank. The orders can be implemented under the guidance of the supervisors where or through formal supervisory intervention. The supervisor should have powers to compel the bank to take remedial action and a statutory responsibility to ensure that the remedial action taken is appropriate (BCBS, 2002).
Asse (2001) indicated that supervisors generally have a variety of tools for dealing with weak banks. These range from the ability to require specific action by the bank to mitigate the weakness, to prohibiting activities that will aggravate the weakness. Supervisors should possess effective means of addressing management problems, including the power to have controlling owners, directors and managers replaced or their powers restricted.

Barth, Caprio, et al (2001) indicated that corrective orders may suffer if they are not acted upon. Barth et al (2001) indicated that the legislation in most jurisdictions may not be very explicit and the supervisors’ decisions are usually challenged in courts.

Agarwal, Lucca, Seru and Trebbi (2013) argued that delaying corrective action may arise due to supervisory behavior and differences in human and financial resources involved in implementing the regulation. Further, decisions to use corrective orders are influenced by pressures from politicians or lobby groups. As a result, corrective orders may be postponed. To prevent undue forbearance, international standards (such as the Basel Core Principles) include recommendations that countries enact laws and regulations to ensure that supervisors act promptly and adequately in relation to the bank problems encountered.

Walter (2004) specified that in the absence of a breach of specific supervisory thresholds, most countries have no laws mandating corrective action for weak banks. In the USA supervisors generally have had 90 days, and at most 270 days, to close a critically undercapitalized bank. However, measuring a bank’s capital by valuing assets and liabilities may take more time than expected. This may diminish the effectiveness of these prompt corrective action requirements when supervisors quickly force a bank to write down uncollectible assets (IADI, 2005).

According to BCBS (2011) supervisors generally have the discretion to act preemptively, without waiting for a threshold to be breached. Supervisory measures have to be flexible and tailored to the specific situation. There is usually no pre-specified time limit within which the supervisor must act after identifying a problem. The absence of a clear legislative requirement, however, does not provide a reason for inaction; the best practice is normally to act as quickly as possible to prevent an escalation of the problem.
Basel Committee on Banking Supervision (2011) raised concerns with the supervisory discretion when issuing corrective orders. They may have the effect of ambiguity to reduce moral hazard. Corrective orders may require a more transparent process supported of Code of Practice like in the United Kingdom Basel Committee on Banking Supervision (2011).

2.2.6 Liquidation

Wihlborg (2012) indicated that the predictability of formal insolvency procedures is also influenced by arbitrariness of court procedures, corruption of judges, and political influences on the procedures. The nature of the insolvency procedures and their predictability affect the process of loss allocation, its speed, and the ability of different stakeholders to influence the allocation of losses.

Although the roles of insolvency procedures for banks in some ways are the same as for non-financial corporations the objectives of the procedures differ in important ways. These differences are explained by the special characteristics of banks and other financial firms.

Speed of action in distress resolution is of the essence. Conventional liquidation and restructuring procedures are too time-consuming to be applied to banks without modification (Wihlborg, 2012).

For the reasons mentioned, corporate bankruptcy-and restructuring laws are not often applied in cases when banks fall under the jurisdiction of these laws. Few countries have special insolvency law for banks and other financial firms. The main exception is the USA that has implemented bank-specific insolvency procedures through the FDIC through the enactment of FDICIA (Federal Deposit Insurance Corporation Improvement Act) in 1991 (Wihlborg, 2012).

Dewatripont and Xavier (2011) stressed that the failure of a large bank may undermine confidence in other banks, affect their finances and create instability across the financial system as a whole. Further, through this contagion effect, the value and viability of other banks can be rapidly eroded and the entire financial system could be destabilized. In normal insolvency
procedures, the primary objective is to maximize the value of assets of the failed firm in the interest of creditors.

Liquidation may take many years, in particular for complex institutions leading to uncertainty with a knock on effect on confidence. This is in contrast with the primary objective of bank resolution which is to maintain financial stability and minimize losses for society.

European Commission (2014) emphasizes that resolution aims to protect certain critical stakeholders and functions of the failing bank (such as depositors and payment systems). Other parts, which are not considered key to financial stability, may be allowed to fail in the normal way. Resolution also ensures that moral hazard is addressed, through minimizing the use of taxpayers' money to support failing banks. The shareholders and debt holders will bear the risk of losses to ensure market discipline on banks by attributing public perception and preferences.

Dwyer (2010) stressed that the 2008 Global Financial crisis resulted in costly bailouts and liquidations. This was as a result of non-financial liquidation laws which were being used for the banking sector. According to Oxford (2011) the bankruptcy courts should be created to provide a fair distribution of a firm’s claimants and minimize adverse effects on the whole economy.

Mitchell (2001) indicated that regulators relied on the failing banks to provide relevant information on their asset values. As a result, liquidation suffered from the existence of moral hazard and the possibility of using inaccurate data.

The IMF (2012) specified that for liquidation works effectively when combined with a quick deposit insurance payout scheme particularly the case with small banks. The IMF (2012) also stressed that when a failing bank is systemic, the authorities may seek to resolve the institution in a manner that preserves its systemic activities as a going concern. The resolution toolkit which is comprehensive and allows the authorities to act with the necessary speed and flexibility is subject to appropriate legal safeguards and due process is ideal (IMF, 2012).
Oxford (2011) review policy highlighted that regulators try to avoid a disorderly liquidation of a bank in distress that would imply a high cost generated by the disruption of the payment system, contagion, litigation, and the complexity of unwinding the bank’s contracts.

### 2.2.7 Bail Outs

Gorton and Huang (2004) argue that the government is in a better position than the market because it can provide liquidity more effectively. According to Garcia (2011) the extent to which liquidity support is accomplished is rather political rather than regulatory. According to Poncey and Rennert (2011) lender-of-last-resort interventions consist in providing banks with funds when the market sources of liquidity dry up for some of the banks. The Central Bank or Treasury becomes responsible for financing whilst the structure of assets and liabilities remains the same, so that the bank’s solvency position is unchanged (Oxford, 2011).

According to the Oxford (2011) review, whether banks facing financial distress should be liquidated or bailed out and how are obviously critical issues because of the taxpayer’s funds involved. Bailouts also determine the expectations that other banks have of being bailed out in the future, and therefore their incentives for risk-taking.

Dewatripont and Xavier (2011) argued that if shareholders and managers of the bailed-out banks are more aware of the benefits their future decisions or actions may be riskier. A reluctance to admit the poor quality of assets may encourage bank management to lobby for repeated recapitalizations in order to protect shareholders without having to be in a weaker bargaining position to recapitalize (Dewatripont and Xavier, 2011).

Hannam (2013) stressed that liquidity provision helps prevent bank runs. Depositor bank runs, such as the one that developed at Northern Rock in 2007, are the exception in contemporary banking systems (Dewatripont and Xavier, 2011). Banks that face sudden difficulties in accessing funds in the wholesale market and are therefore at risk of defaulting on their debt according to Dewatripont and Xavier (2011).
European Commission (2014) also highlighted that’s it is now becoming expensive for governments to support banks which are too big to fail with squeezed public finances.

2.2.8 Mergers

According to the Centre for Financial and Management Studies In banking crises (2012), regulators are likely to attempt to resolve some banks’ problems by engineering bank mergers and consolidation, which reduces competition.

Wihlborg (2010) indicated that a takeover or a merger generally preserves the going-concern value of an institution, as the acquirer succeeds both to a depositor base and to a base of loan customers. Further, a merger eliminates the danger that vital banking services in a community will be disrupted. Sometimes, failed banks may be placed under special administration in the form of bridge banks, new banks, special funds or other arrangements. This is often meant to be a temporary solution in order to take over the operations of the failed bank and preserve its going-concern value while the government fiduciary seeks a more permanent solution to the problems or until an acquirer is found.

A study of the Indian banking system by Subbarao (2010) revealed that mergers are complicated when they have to go through long bureaucracy such as the Competition Commission of India. This further complicates the resolution of banks through mergers and the uncertainty can be potentially destabilizing as the Commission is allowed up to 210 days to decide on it.

Marcus (2000) highlighted some of the concerns with regard to mergers and takeovers which included contagion risk where a problem or problems in one or more associate entities contaminate the bank, leading to negative perceptions of the bank. A merger can also result in the central bank having to extend lender-of-last-resort assistance to a wider range of activities.

According to Marcus (2000), mergers may result in the creation of larger banks that will become too big to fail because their activities make up a significant portion of a country. As a result, any substantial disruption in the particular institutions operations would be likely to have a serious effect on a country financial markets, either preventing the markets from operating properly or
raising questions about their integrity. The consequence of the too big to fail factor is that countries extend protection to large institutions and their customers that is not granted to others.

### 2.3 Deposit Insurance Scheme

Deposit insurance is designed to provide protection against bank runs particularly to small depositors. Hanc (2007) highlighted the importance of deposit insurance schemes to provide a formal national mechanism for handling failing banks. This is through the faster, smoother administrative process in the compensation of depositors of failed banks. The OECD (2012) has acknowledged that the deposit protection has become integral in modern banking but also highlighted its weaknesses in failing to deal with failures of large banks. The system is mainly designed to resolve a few small bank failures and avoid a run on deposits in an otherwise healthy banking system.

According to Hanc (2007) the deposit insurance is important banking system made up of a large number of independent institutions. This is the reason the Federal Deposit Insurance Corporation of USA was adopted in the 1930s with aims to avoid the adverse effects of bank failures on the money supply and to preserve the banking system (Hanc, 2007).

Based on evidence of sixty-one countries between 1980 and 1997, Demirguc-Kunt, Asli, Detragiache and Enrica (2002), observed where bank rates are deregulated an explicit deposit insurance scheme is detrimental to bank stability. Further, the deposit insurance scheme is not effective when the institutional environment is weak. Demirguc-Kunt et al, (2002) insisted that where the scheme is funded and run by the government rather than the private sector, the adverse impact of deposit insurance on bank stability tends to be stronger.

Further, Singh and LaBrosse (2012) argued that a poorly designed system of deposit protection can escalate a bank failure into a crisis, as experienced in the United Kingdom with Northern Rock. As a result, troubled banks have imposed enormous costs on the insurance funds.

### 2.4 Chapter Summary
The regulatory tools for resolving failing or failed banks vary with the magnitude of problems and the effect on other aspects of the economy. Planning and implementing a bank resolution requires the support of an adequate regulatory framework. The framework should provide for timely resolution and protect the decisions of the supervisors. It should ensure a speedy recovery process. Decisions can be to liquidate a bank after considering other supervisory tools. Other supervisory tools include the use of corrective orders, placing of banks under curatorship, mergers and the use of a deposit protection scheme. Authorities should gather the necessary tools and data to choose the right strategy for resolution as each option has its own advantages and disadvantages. However, in most cases, the authorities will have little time to plan for a bank’s closing and will have to rely on their general crisis preparedness tools to handle the resolution process as efficiently as possible. The supervisory role itself is prone to political influence. Whichever circumstances are present, planning for bank resolution should be part of a country’s overall strategy for its financial sector. The next chapter will discuss the methodology used in the study.

CHAPTER 3

METHODOLOGY

3.1 Introduction

The description of research design is covered under this chapter. It includes the area where the study was conducted geographically, the population considered and samples used. It also includes the instruments used to collect the data, including methods implemented to maintain validity and reliability of the instrument.

The purpose of this chapter is to describe the research methodology of this study and explain the sample selection. The procedure used in designing the instrument and collecting the data will also be described. The chapter will conclude with an explanation of the statistical procedures used to analyze the data.

3.2 Research approach

Qualitative and quantitative research methods both play an important role in data collection. Data from quantitative research includes data such as demographics and user preferences (Madrigal
and McCain, 2012). According to Madrigal and McCain (2012) the shortcoming of quantitative data is that it does not describe the experience or variable.

A qualitative approach was used for this study as it allows an exploration of a phenomenon within its context using a various data sources. According to Ritchie and Lewis (2003) a qualitative case study can be is holistic and analyses an entity. A case study seeks to get responds on why and how the current regulatory instruments are failing to prevent bank failures in Zimbabwe by looking at specific entities. A qualitative approach was appropriate because of the need to cover contextual conditions on bank failures and the adequacy of current regulatory toolkit for managing bank failures.

Berg (2001) highlighted that case studies can be intrinsic, instrumental or collective in nature. An intrinsic case study’s objectives is to better understand intrinsic aspects of a case. An instrumental case studies assist the researcher to better understand some external theoretical question or problem. Collective case studies involve studying several cases instrumental in nature.

According to Berg (2001), case study designs can be exploratory, explanatory, and descriptive cases. Exploratory Case Studies is when fieldwork may be undertaken before defining a research question. Explanatory Case are used when establishing causal studies. Descriptive Case Studies Descriptive case explorations the investigator must also determine before beginning the research exactly what the unit of analysis in the study will be.

The scientific benefit of the case study is that it allows the researcher to open a way to discover more. (Shaughnessy, 2012). The advantages of using a case study approach are that it allows an examination of data at a micro level. Case studies also present data of real-life situations and they provide better insights into the detailed behaviors of the subjects of interest. Qualitative case studies, however, have an inability to generalize their results. Further, they also lacks rigor and creates a possibility for a researcher to have a biased interpretation of the data.

3.3 Data Collection Tools

In-depth interviews
In-depth interviews were used to solicit information from key informants. In-depth interviews are open-ended and guided discussion that involves conducting thorough individual interviews with a small number of respondents. In-depth interviews were used to explore and understand about a person’s thoughts, ideas and behaviors.

The advantages of using interviews are that they allow interviewers to understand deeper with the participant, and gain more extra knowledge. In-depth interviews can enable the recruiting and scheduling process easier and faster. However, interviews are effective if the person feels comfortable and interested about the topic. In-depth interviews may result in bias due to the small samples chosen.

3.4 Research Strategy

3.4.1 Review of existing regulatory toolkit

The study was carried out in three phases. It proceeded by carrying out a review of the following regulatory instruments that are in place for managing bank failure.

- Curatorship;
- Corrective orders;
- Liquidations;
- Mergers; and
- Deposit insurance scheme

The purpose of the review was to assess the strengths and weakness of each of these instruments in preserving the integrity of the banking sector and protecting the interests of the depositors. Particular interest was made to the following issues:

- Ability to install public confidence.
- Capacity to enhance economic growth.
• Ability to minimize systematic risk in the sector.
• Capacity to ensure viability in the banking sector.
• Ability to sustain financial stability.

3.4.2 Analysis of Cases

The second part of the study was based on an analysis of two case studies of failed banks in Zimbabwe which are Interfin Bank and Royal Bank.

The purpose of the case analysis was to determine the reasons behind these failures despite the existence of regulatory tools. Specific references were made to the following:

• Inherent weaknesses within the financial institutions.
• How the regulatory instruments were applied.
• Why the regulatory instruments failed.

3.4.3 Collection of Data

The third part of the study was based on in-depth interviews with key informants in the financial services sector. The four key informants who were interviewed are

• The RBZ Senior Official in the Bank Licensing, supervision and Surveillance (BLSS) department. The interviewee was to provide details on the current regulations and how they have been used for the failed banks.
• The Deposit Protection Corporation Executive to provide details on the liquidation process of banks and the process of deposit payout.
• Curators of the two failed banks to get an insight of the challenges faced during curatorship.

The Zimbabwean banking sector is made up of twenty-two institutions and is regulated and supervised by the RBZ who is of the registrar of banks. Seventeen of banks are into commercial banking activities, one is a merchant bank and four are building societies.
The DPC was established in 2003 as an explicit deposit insurance scheme by the Zimbabwean Government in the wake of bank failures and its effect to the financial stability. The DPC which started as Deposit Protection Board with a mandate of being a pay box had its mandate expanded in 2012 to include bank resolution. The DPC has as at 30 September 2014 a capital base of $14 million.

3.5 Data Analysis

The initial phase of the study consisted of content analysis of the existing regulatory instruments for managing bank failures in the Zimbabwean banking sector. Data for the case studies was gathered by way of minutes of meetings, corporate reports and curatorship reports. This was followed by the in-depth interviews.

Content analysis was used to analyse the interview responses. Content analysis is a procedure for the categorization of verbal or behavioral data, for purposes of classification, summarization and tabulation. Content analysis involves coding and classifying data to make sense of the collected responds. From the analysis important findings can be deduced and conclusions made.

Content was analyzed from the original quotes coming from the respondents without applying any known theory. The next level of content analysis was more interpretive and looked at what was inferred or implied by the responds gathered. The analysis involved the use of coding of responses and categorizing the codes in line with subject under study. This was followed by deducing themes and coming with conclusions. A deductive approach was used because the researchers had an idea of probable participant responses.

3.6 Chapter summary

In summary the chapter recapped the purpose of the study which is to assess the effectiveness of the existing regulatory toolkit in managing bank failures in Zimbabwe. The study started with an analysis of existing toolkit and establishing why it was failing. Data was collected using in-depth interviews and various internal reports from RBZ, DPC and the curators of the failed banks under study. A qualitative case study on two failed banks in Zimbabwe was used to get an in-
depth analysis on why banks fail despite existing regulatory toolkit. The results from interview were assessed during content analysis and conclusions were made.

CHAPTER 4

PRESENTATION AND ANALYSIS OF RESULTS

4.1 Introduction

The chapter will look at a review of the existing regulatory instruments used for resolving bank failures. This will be followed by a study of Interfin Bank and Royal Bank which failed and were candidates for resolution using the regulatory toolkit as the disposal of the regulators. The case study in particular looked at how the banks performed, why they faced operating challenges and an evaluation of the regulatory instruments were used. An analysis of data collected from the interviews will conclude the chapter. Interviews were successfully done with the officials form the Reserve Bank of Zimbabwe, the Deposit Protection Corporation and the curators of the two failed banks under study.
4.2 Review of regulatory instruments for managing failing and failed banks

The guiding principles for dealing with failing or failed banks include the following:

- **Speed.** The regulators should act promptly and it has been observed that that regulatory and supervisory forbearance exacerbates problems of a weak bank.

- **Cost-efficiency.** The regulators should consider the least cost criterion in deciding between alternative actions consistent with achieving the supervisory objectives.

- **Flexibility.** It is important that legislation permits the regulators to exercise some form of discretion in the deployment and timing of supervisory tools rather than a rules-based approach.

- **Consistency.** In order to avoid distortion of the competitive environment, the regulator should adopt consistent and well understood actions which will also minimise confusion and uncertainty in times of crisis.

- **Avoiding moral hazard.** Regulators should not encourage other banks or shareholders to behave less prudently on the expectation that they will receive cheap or free bailout if problems occur.

- **Transparency and cooperation.** It is imperative that bank supervisors and banks aim for a high degree of information sharing and transparency about their intended actions in order for correct supervisory action to be taken.

The regulatory tools that the regulators have been using in Zimbabwe are listed as follows:

- Curatorships
- Corrective orders
- Liquidations
- Mergers

4.2.1 Curatorship

The curatorship is a tool provided for under the by the Banking Act [Chapter 24:20] under Section fifty-three. A curator is a person under whom the management of a banking institution has been placed by virtue of a direction issued in terms of section fifty-three of the Banking Act
[Chapter 24:20]. According to the Banking Act [Chapter 24:20] Section fifty-three the RBZ is responsible for placing a banking institution under curatorship under the following conditions:

- a banking institution is in an unsound financial condition and is not operating in accordance with sound administrative and accounting practices and procedures, adhering to proper risk-management policies; and

- a banking institution has failed to comply with the minimum financial requirements prescribed in terms of this Act and the Reserve Bank considers that it is unlikely to comply with them unless it is placed in curatorship.

The RBZ issues a direction to the institution placing the institution under the management of a curator for a specified period of six months which may be altered at the discretion of the Reserve Bank of Zimbabwe. The tenure of curatorship depends on whether the banking institution may be remedied or resolved.

**Implications of curatorship**

- Curatorships suspends the powers of every director, officer and shareholder of the banking institution concerned unless the curator may permit them to exercise their powers.

- All legal proceedings and the execution of all writs, summonses and other legal process against the banking institution concerned shall be stayed and not be instituted or proceeded with unless the High Court has granted leave.

- Any set-off in respect of any amount owing by a creditor to the banking institution concerned shall be suspended.

- Curator take over and assume the management of the banking institution concerned; and manage the banking institution concerned in such manner as he considers prudent and most likely to promote the interests of the institution and creditors of the institution.

- The curator should report to RBZ in writing in their opinion if it is in the interests of the institution’s creditors and depositors that the institution should remain under curatorship.
• A curator can suspend or reduce the institution’s creditors to claim or receive interest on any money owing to them by the institution.
• The curator can make payments, whether in respect of capital or interest, to any creditor of the banking institution concerned at such time, in such order and in such manner as he thinks fit.
• Curator may negotiate with any individual creditor of the banking institution concerned with a view to a final settlement of the creditor’s affairs with the institution.
• Any person who is aggrieved by any decision or action taken by a curator may appeal against it to the Reserve Bank.

4.2.2 Corrective orders

A Corrective Order is a plan imposed by the Reserve Bank to correct deficiencies. It is formalized to allow the RBZ to prepare for further regulatory sanctions if compliance with the order fails. It is imposed unilaterally, by the Reserve Bank, with directors acknowledging the order.

The RBZ issues corrective orders when it identifies significant irregularities during the course of a scheduled or targeted examination of a banking institution. Corrective orders do not have legal penalties binding but are merely centered of moral suasion or discussions at arm’s length between the supervisor and the banking institution. However, Section 48 of the Banking Act [Chapter 24:20] as well as the Troubled Financial Institution (Resolution) Act [Chapter 24:28] outlines that corrective orders as one of the supervisory actions available to the Reserve Bank in dealing with troubled banks.

Corrective orders gives the banking institution a platform to commit themselves to resolving issues within a short period of time. Such issues may include finalizing capital injection initiatives, replacing a director or manager who has been disqualified under the fitness and probity requirements of the financial sector. Corrective orders may also come with close supervision in the form of high frequency reporting.

The corrective orders used by the Reserve Bank are in the following types:
• Board Resolution
• Commitment Letter
• Memorandum of Understanding

A Board Resolution is a suggested plan for correction of deficiencies which specifies actions to be taken by board of directors and management. As applicable, it states who is responsible and sets a timetable and/or target levels for achievement. It is officially adopted and signed by members of the institution’s board of directors, although specific provisions will often be drafted or suggested by the Reserve Bank.

A Commitment Letter is used for banks which displayed moderate supervisory concerns. It is a formal letter from the board of directors to the Reserve Bank drafted by the Reserve Bank, and then accepted and signed by the board. It outlines specific actions to be taken and a timetable for accomplishment.

A Memorandum of Understanding specifies actions to be done, the period within which the actions will be accomplished, and the responsible persons. It is adopted and signed jointly by the board of directors and the Reserve Bank. A Memorandum of Understanding contains specific provisions written by the Reserve Bank, and then agreed to by the board; it is more formal in format and language but is not issued under specific provision of law. Failure to comply, however will lead to subsequent enforcement action of a more formal and legal nature. A Memorandum of Understanding is typically used where problems are not of significant and where bank management has demonstrated a willingness and ability to correct identified weaknesses.

Implications of using corrective orders

• Corrective orders have no legal binding and hence the authorities cannot use them in the court of law. When banks fail to comply with the corrective orders there is little that the supervisor can do other than to employ stringer measures such as curatorship or closures.
• Corrective orders have a short tenure and banks in most cases fail to comply with the corrective orders. Corrective orders spell out what banks already know and should have
done. As such, corrective orders are usually a stepping stone and an indicator for more formal and legalistic regulatory enforcement tools when reason and moral suasion fail.

4.2.3 Liquidations

The Reserve Bank of Zimbabwe determines that a bank should be closed and appoints Deposit Protection Corporation as the Provisional Liquidator of the bank in terms of section 571(b) of the Banking Act [Chapter, 24:20] and Section 37(3) of the DPC Act [Chapter 24:29]. The appointment of DPC as liquidator by RBZ is, however, subject to confirmation of the High Court.

The liquidation of insolvent estates including banks is governed by the provisions of the Companies Act [Chapter 24:03], Sections 199 to Section 298, and the Insolvency Act [Chapter 6:04] in Zimbabwe. After cancellation of a banking institution’s licence, the liquidation process commences once an application for provisional liquidation has been granted by the High Court. This process may take weeks to months depending on other pending cases at the courts.

During the liquidation the insured deposits are paid first by the Deposit Protection Corporation, (DPC), from the Deposit Protection Fund (DPF). The uninsured depositors, creditors and shareholders are paid from proceeds realized from sale of assets and debt recovery during the liquidation process.

Application and procedures

The Reserve Bank applies to the High Court for the winding up of any banking institution; or an order placing any banking institution under judicial management or provisional judicial management in terms of the Companies Act [Chapter 24:03]; and the Reserve Bank shall have the right to oppose any such application made by any other person.

The Reserve Bank recommends the provisional liquidator, provisional judicial manager, liquidator or judicial manager of a banking institution. According to the Deposit Protection Act the RBZ shall recommend Deposit Protection Corporation as the provisional liquidator. Claims
by insured depositors and the Reserve Bank in respect of any fees and expenses incurred in the exercise of its functions will have priority in compensation.

The High Court will make a determination on whether to grant the provisional liquidation. The Court will grant the order if the bank is insolvent or has committed an act of insolvency and there is reason to believe liquidation is advantageous to creditors of the institution.

Implications of liquidating a bank

- The liquidation of the banks has to go through the common judiciary system under the provisions of the Insolvency Act [Chapter 6:04] and the Companies Act [Chapter 24:03]. As such, the liquidator of banks reports to the Master of High Court and not the Reserve Bank of Zimbabwe.

- The liquidation process is time consuming and make take several years to finalize. Lack of patience and pressure from public results in out of court settlements as in the case of Trust Bank. Such arrangements compromise some creditors and minority shareholders. The provisional liquidator will also consider any potential investors during this period and finality may not be reached timely.

- The provisional liquidation order is granted pending submissions by the debtor/insolvent company. According to section 14 of the Insolvency Act, the High Court grants an order of provisional liquidation but at the same time issue a calling upon the debtor to appear and to show cause on why his estate should not be sequestrated finally. The stakeholders of failed banks are still afforded the opportunity to contest the liquidation decision at the provisional application stage and also during the provisional liquidation period. As such, such appeals suspendorder for final liquidation and delay the process.

- Any action, rights of action or proceedings against the company after the commencement of a winding up shall be deemed void except by leave of court according to Section 213 of the Companies Act [Chapter 24:03]. This is often referred to as the “stay of execution”. In other
words any attachment or execution against the assets of the company after the granting of the provisional order shall also be deemed void.

- According to Section 221 (2) a-g of the Companies Act, the powers of the provisional liquidator exclude the power to dispose assets, convene creditors meetings or enter into any scheme of arrangement with creditors. This means the value from sale of assets to pay off creditors can only be obtained during final liquidation.

4.2.4 Mergers

Weak banks may be resolved by a merger or consolidation with a strong, healthy institution. The Banking Act [Chapter 24:20] does not have specific provisions for mergers or consolidations. For the voluntary mergers, the Reserve Bank responds to formal request from weak banks. In that case, a merger, acquisition, amalgamation or consolidation is treated like an application for a new banking licence which is required to meet the requirements of the Banking Act [Chapter 24:20].

The RBZ will allow merger if the proposed merger by two-thirds or more of the shareholders of the applicant (troubled) bank and complies with the applicable provisions of the Companies Act, the Banking Act, and any other Act which may apply. The merger should also have a probability of success certified by an independent auditor acceptable to the Reserve Bank.

The RBZ may use Troubled Financial Institutions (Resolution) Act [Chapter 24:28] Section 10 to resolve troubled financial institutions by merging their assets and operations. The RBZ only does so by confiscating the shares of specified persons involved in the failure of banks or convert outstanding loans from the RBZ to shares of the merged bank. In the same token, the RBZ may convert deposits and sundry creditors of a failed banks into equity under Troubled Financial Institutions (Resolution) Act [Chapter 24:28] by writing off existing shareholders’ interest against accumulated loss. However, there is no law in Zimbabwe that allows that shareholding be underwritten without the consent of the shareholder.
Implications of using mergers

- The merging of banks requires that the targeted troubled financial institutions be closed first and their existence be finalized before the merger. The closing of a banking institution in most cases takes time and is prone to legal challenges from the former stakeholders.

- The RBZ places troubled banks under curatorship but the curator according to Section 55 of the Banking Act 24:20 does not have rights to dispose assets of a banking institution or cause a merger. As such, the merging cannot be done during curatorship under the current frameworks.

- Mergers may result in the same problems being carried forward from the weak bank result in failure of the merged institution. Interfin merged with CFX bank but failed later on.

An analysis of the current regulatory tools used by the authorities have shown that legislation needs to be amended and enhanced. The Banking Act [Chapter 24:20], the Troubled Financial Institutions (Resolution) Act Chapter [24:20] were designed for use by the Reserve Bank to resolve failing banks. However, loopholes in their provisions and content have led to the use of other frameworks such as the Companies Act [Chapter 24:03] and has ultimately affected the whole resolution process due to framework inconsistencies. As a result, there is need to look at other resolution tools used in other jurisdictions and to enhance the current framework to be effective in managing failing or failed banks.

4.3 Case Study

4.3.1 Interfin Banking Corporation

a. Background characteristics of the bank
Interfin was wholly owned by Interfin Holdings up to 31 December 2005 before being wholly owned by Interfin Financial Services Limited. Interfin Merchant bank was granted licence to operate as a commercial bank on 6 March 2009 and changed to Interfin Banking Corporation. The major shareholders of Interfin Financial Services were Farai Rwodzi, Timothy Chiganze and Jeremiah Tsodzai.

As at June 2012, Interfin commanded market shares of 5.01%, 5.79% and 3.52% in terms of total assets, total loans and total deposits being ranked 8th, 5th and 11th the respectively out of the eighteen commercial banks. The market share of Interfin had been decreasing since 2011 where it had total assets commanding 6.12% for all operating commercial banks.

b. Inherent weaknesses

As at June 2012, Interfin had negative core capital of US$92 million far short of the regulatory requirement of US$12.5 million (RBZ, 2012). The bank was failing to attract capital injection due to bad reputation and the high incidence of insider loans. The bank attempted to raise more capital through a rights issue and private placement with a foreign investor to no avail due to the non-performing status of shareholders loans.

According to RBZ Annual Report (2012), the bank also had insider loans of over $60 million which were prone to default. The bank was failing to finance maturing liabilities in the 0-7 maturity bucket due to negative liquidity gap. By June 2012 the bank had accrued outstanding payments of over $36 million which included RTGS settlements. The liquidity challenges of Interfin mainly emanated from non-performing loan book to insiders and related parties. The bank was being sued by several depositors who were failing to access their funds. The bank also experienced dwindling deposit base due to bad reputation after failing to meet cash withdrawals.

The bank also had weak corporate governance structures. The board of directors of the bank included non-independent directors who were also the major shareholders of the bank through various investment vehicles such as Interfin Investments and other personal companies. As a result, management had been prioritizing paying expenses to the associate companies of the shareholders and directors. The associate companies had, as at June 2012, accessed over $50 million loans which are not performing (RBZ Report, 2012).
c. Regulatory tools used

i. Curatorship

The RBZ placed Interfin Bank under curatorship on 11 June 2012 for a period of six months. The Reserve Bank appointed Mr. Peter Bailey of KPMG Chartered Accountants as the curator. The primary purpose of the curatorship is to protect depositors, preserve the assets of the Interfin Bank Limited and protect the stability of the financial system.

The placing of Interfin Bank Limited under curatorship made the bank immune to all legal proceedings and the execution of writs, warrants, summons that were being pursued against the bank. The directors, managers and shareholders of the bank were all suspended by virtue of curatorship,

ii. Liquidation

The RBZ applied for Interfin Bank to be placed under provisional liquidation on 1 January 2015 after the curatorship period failed to yield any changes to the condition of the bank. The RBZ appointed the Deposit Protection Corporation as the Provisional Liquidator which was granted by the High Court on 8 January 2015

iii. Evaluation of resolution tools used

The curator could not institute legal action against directors of banking institution deemed responsible for the bank failure despite the evidence from Audit findings. Action can only be taken during liquidation if brought up by the liquidator in terms of the Companies Act [Chapter 24:03]

When Interfin was placed under curatorship its reputation had already been tarnished by the bank runs and the information in the public domain such as abuse of depositor’s funds. As a result, the curator failed to attract new investments after failing to pursue twelve recapitalization deals. Discussions with foreign investors such as Feasey Development International, Shoma Investments Holdings, MHN Facilitation, Commercial Bank of Africa (Kenya) yielded nothing.
Curatorship also comes with immediate costs. The curator service costs amounted to $2 million for the curatorship period from June 2012 to 31 December 2014. Operating costs amounting to $13 million were also paid from the collections made by the curator. Total collection by the curator amounted to almost $19 million.

Despite the freezing of creditors payments during the curatorship period a creditor was paid amounts owing up to $3 million from the collections received. Under the Zimbabwean Laws, Government Taxes or penalties are preferred payments whilst under the Deposit Protection Corporation Act, the insured depositors are to be paid ahead of other creditors.

The curator has to work with some existing staff especially from the Information Technology, Finance and Accounting. The success of the curatorship work is premised against the co-operation of such individuals who may also have conflict of interest.

### 4.3.2 Royal Bank Zimbabwe Limited

#### a. Background characteristics of the bank

Royal Bank was incorporated on 6 November 1997 and registered as a bank in May 2002. The bank was incorporated into ZABG in 2005 after being placed under curatorship in 2004 due to poor lending practices and corporate governance deficiencies. It was re-registered in September 2010 after the unbundling of ZABG. The major shareholders of Royal bank as at May 2012 were Jeffrey Mzwimbi, Durajadi Simba and Hardy Pemiwa owning 25%, 20% and 20% respectively.

As at 31 March 2012 the bank had market shares of 0.28%, 0.06% and 0.17% in terms of total assets, total loans and total deposits. It was ranked last out of seventeen operating commercial banks. The marginal market share was a reflection of the bank’s failure to mobilize deposits to underwrite any meaningful business.

The Bank was offering a full range of Commercial Banking services mainly through four front line operating divisions namely Individual Services, Corporate and International Banking, Treasury and Business.
b. **Inherent weaknesses**

The bank was undercapitalized with capital worth $1.93 million which was short of the required $12.5 million. As at 31 May 2012 the bank had accumulated losses amount to $5 million which was eating into the capital. The shareholders demonstrated lack of capacity to capitalize the bank resulting in the going concern of the bank being doubtful.

The bank also failed to finalize negotiations with Commercial Bank of Africa based in Kenya for capital injection which would have seen the new investor being the major shareholder with 62% holding.

The bank also had liquidity challenges after it had a negative liquidity gap of short term maturities amounting to $3 million. This was a result of poor earnings and high level of fixed assets. The bank also lacked collateral to approach the interbank market for borrowings. The bank had outstanding RTGS payments amounting to $1.3 million which would make it difficult to conduct business with other banks.

As at 31 May 2012 the bank had a weak rating on its loan book with 99% of the $1.5 million loans being non-performing to related parties. The non-performing loans had been increasing since March 2012 where they were 81%. The major shareholders were involved in insider lending to their company from depositors funds (RBZ, 2012).

The ICT systems used for the banking business were flawed allowing manual intervention and compromising data integrity. The bank had weak corporate governance structures as board and management did not have adequate committees such as Loans Review Committee, Asset and Liabilities Committee to oversee the functions of the bank.

c. **Regulatory tools used**

i. **Curatorship**

The RBZ placed Royal Bank under curatorship for a period of six months on 4 August 2004 and Mr. Robert McIndoe was appointed the curator. The RBZ placed the bank under curatorship after negotiations being pursued with potential investors failed.
The Reserve Bank extended the period of curatorship for the bank from 31 December 2005 to 28 February 2006. The extension was to allow for the finalization of the appeal noted by the shareholders of Royal Bank, to the Reserve Bank of Zimbabwe, against the curator’s decision to dispose of the bank’s assets.

Royal Bank was placed under curatorship to protect depositors, preserve the assets of the Royal Bank, and to protect the stability of the financial system. Negotiations were pursued with potential investors to inject capital but these talks collapsed because due diligence exercises rendered the bank unviable.

**ii. Merger**

The Reserve Bank created a Special Purpose Vehicle called Allied Financial Services to facilitate the conversion of debt in troubled banks to equity. The three troubled banks namely Trust Bank, Royal Bank and Barbican Bank were then consolidated into a single entity known as the Zimbabwe Allied Banking Group (ZABG) which was granted a business license and commenced business on 31 January 2005.

RBZ ceded debt to Government of Zimbabwe, and Government became the biggest shareholder with almost 93% shareholding.

**iii. Liquidation**

Royal Bank Zimbabwe Limited surrendered its banking license on 27 July 2012 after realizing that it was no longer in safe and sound financial condition. Royal Bank was experiencing deteriorating financial performance and results. The Reserve Bank closed Royal Bank on 27 July 2012 after it surrendered its licence.

The RBZ commenced proceedings to wind up the Bank on 23 January 2013 and a Provisional Liquidation Order was granted by the High Court of Zimbabwe on 20 February 2013. In terms of Section 37(3) of the Deposit Protection Corporation Act [Chapter 24: 29], the Deposit Protection Corporation was appointed the Provisional Liquidator. The Deposit Protection Corporation
appointed Tudor House Consultants (Private) Limited as the Liquidation Agent in terms of Section 38 of the Deposit Protection Corporation Act [Chapter 24:29].

d. Evaluation of resolution tools used

The curatorship of Royal Bank meant that all deposits made with Royal Bank and all assets invested in it be frozen for a period of six months with effect from 4 August 2004. This means that there will be no dealing with deposits except to the extent that the curator may permit.

With many depositors failing to get their funds they were questioning the wisdom of placing banks under curatorship. As a result, depositors lost confidence in financial sector and this uncertainty could trigger runs on deposits in future. The curatorship was seen as unnecessarily delaying bank resolution.

Whilst curatorship was meant to preserve depositors’ funds, it had the unintended consequences of denying depositors access to their funds for long periods of time. The enactment of the Statutory Instrument 156 of 2013 gazetted on the 8th of November 2013 ensured that depositors of banks placed curatorship be compensated up to the insured amount of $500 per depositor per bank. Deposit compensation is done by the Deposit Protection Corporation.

The merger of Trust Bank, Barbican Bank and Royal Bank was successfully challenged in the courts because the RBZ and the curator were not empowered by the Banking Act [Chapter 24:20] to incorporate the banks into Zimbabwe Allied Banking Group (ZABG). Further, the valuation of a bank’s assets was disputed by creditors and shareholders.

According to the Supreme Court ruling on ZAGB in 2010, the curators of Royal Bank acted unlawfully when they sold the assets of Royal Bank to the ZABG because this was against Section 53 of the Banking Act 24:20 which prohibits them from selling assets of the bank. The amalgamation of ZABG was therefore declared null and void in September 2010.

The liquidation process is slow and recovery of debt is usually compromised. Secured creditors may push for liquidation unlike the unsecured creditors who have no guarantee of receiving the
full amount from the recoveries done under liquidation. Royal Bank had a loan book of about US$1.4 million but as at December 2014 the liquidator has only managed to recover US$240 000 leaving a balance of US$1.160 million. The liquidator had challenges in collecting unsecured debts whilst some debtors had changed the last known addresses. Due to the harsh economic climate some of the corporate debtors have also been liquidated.

In most cases of troubled banks, by the time the liquidator takes over source files of evidence of transactions may not be located and would require the cooperation from the existing staff to move forward. In the case of Royal Bank some former employees of the Bank who are privy to certain transactions had been declining to testify. As a result, some debt will eventually be written off due to inadequate evidence and paperwork. Further, some employees with outstanding balances with the bank were not willing to surrender bank assets such as motor vehicles preferring a setoff agreement.

The liquidator in most cases is accused by creditors of not realizing the true value of the assets having the value of the institution at heart. The creditors of Royal Bank have also complained that the sale of some of the bank assets is not in the best interest of the bank. They allege that the liquidator is undervaluing the reserve price at the auction floors. Movable assets that have been sold at auction have realized US$95 000.00 and the speed of sale depends on the market conditions prevailing.

Bank assets accrued storage costs and also depreciate in value if exposed to harsh weather conditions. At the time of sale some of the bank’s assets would have lost significant value. The auction fees also reduce the net realizable value to the assets affecting the net value due to creditors.

4.4 Interview findings

The responses from in-depth interviews was analyzed using content analysis. The four respondents were all in fit to respond to the interview questions because of their close involvement in the banks under study. The responses were tabulated as shown under appendix 1 and the codes were summarized in table 4.1 below.
Table 4.1 Codes and categories

<table>
<thead>
<tr>
<th>Codes</th>
<th>Categories</th>
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<tbody>
<tr>
<td>Freezing Of Liabilities</td>
<td>Weak Framework</td>
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<td>Shareholders Interference</td>
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<td>Suspension Of Directors</td>
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<td>Asset Stripping</td>
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The themes that were deduced from the interview findings are shown in table 4.2 below.

### Table 4.2 Themes and categories

<table>
<thead>
<tr>
<th>Category</th>
<th>Theme</th>
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<tr>
<td>Curatorship Period</td>
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<tr>
<td>Speed And Finality</td>
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<td>Deposit Insurance Cover</td>
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<td>Appeal Rights</td>
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<td>Curatorship Limitations</td>
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<td>Shareholding Down Writing</td>
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<td>Curatorship Discretion And Powers</td>
<td>Shareholder Rights</td>
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<td>Litigation Powers</td>
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<td>Pecuniary Damages</td>
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<td>Self Interest</td>
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<td>Political Interference</td>
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<td>Early Intervention</td>
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<tr>
<td>Regulatory Oversight</td>
<td>Regulatory Forbearance</td>
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<td>Amendments To Current Laws</td>
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<td>No Commercial Court For Bank Cases</td>
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<tr>
<td>RBZ And DPC Collaborations</td>
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<tr>
<td>Empower The RBZ</td>
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<tr>
<td>Early Deposit Compensation</td>
<td>Administration Weakness</td>
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<td>Curatorship Costs</td>
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<td>Revision Of Laws</td>
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<td>Harmonization Of Laws</td>
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<td>Financial Capacity</td>
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<td>Court Process</td>
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<tr>
<td>Liquidation Period</td>
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<tr>
<td>Moral Suasion</td>
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<td>Out Of Court Settlements</td>
<td>Regulatory Compromise</td>
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<td>Special Legal Framework</td>
<td>No Framework</td>
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<tr>
<td>Bridge Banks</td>
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<tr>
<td>Purchase And Assumption</td>
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<td>Open Bank Assistance</td>
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The themes that were deduced from the interview findings are shown in table 4.2 below.
The analysis of findings has shown that the current legal framework is weak and has loopholes. As a result, shareholders and directors of the troubled institutions have capacity and rights to frustrate resolution efforts. The current laws do not allow the writing down of shareholding even though the banking legal framework allows suspension of the shareholders powers. Directors of failed banks can appeal directives from the regulators with no costs. These appeals are the main reason was resolution of troubled banks takes longer at the expense of other creditors.

As a result of a weak legal system, the resolution efforts are dictated by frustrating court processes because of appeals and administrative dragging common in the judicial system. In the absence of a commercial court to deal with banking cases some cases have been settled out of court. The failure to change shareholding of troubled banks by regulators has been cited as the major reason for limited resolution options and there have no power to restructure or sell assets.

The following themes were deduced from the feedback from interviews.

- Weak legal framework creates loopholes for abuse by stakeholders.
- Weak legal system has led to challenges in problem bank resolution.
- The capacity of the regulators in both power and financial affect the management of failed banks.
- An impactful resolution kit requires enhancing the current legal framework and introducing new tools.

4.5 Summary of findings
The study established that the major causes of bank failures are undercapitalization, liquidity challenges and weak corporate governance structures. The regulatory capital is used for underwriting banking business and absorbing losses. Banks that are undercapitalized below the regulatory capital levels make losses without capital cushion and eventually fail unless there is capital injection. The reputational risk of undercapitalized banks is also high and lowers the chances of attracting new investors for capital injection. Liquidity challenges have resulted in as the bank fail to participate in the interbank market. In addition, liquidity challenges cause a constraint in meeting liabilities as they mature. Banks that face liquidity challenges experience bank runs which further weakens its financial condition and reputation. Corporate governance weaknesses in banks create loopholes to siphon depositors’ funds. Weak corporate governance result in banks engaging in malpractices such as insider lending to shareholders and directors without adequate collateral or none at all. A compromised board of directors cannot make sound business decisions in the interest of profitability of the bank and its depositors. Non-performing loans affect the bank’s revenue by reducing interest income which in turn affects its viability and going concern.

The RBZ uses the Banking Act [Chapter 24:20] and the Troubled Financial Institutions (Resolution Act [Chapter 24:28] to manage banks. These frameworks do not provide exclusive powers regulatory authority to manage banks in a timely and conclusive manner without interference. Other frameworks such as the Companies Act [Chapter 24:03] have been used to augment the existing banking resolution frameworks but they are fraught with long and winding processes making banking resolution ineffective to the general banking public.

The regulatory authority has been accused of forbearance when managing bank failures. The current framework has incapacitate the regulators to make swift decisions. The regulators are, however, faced with unending legal battles and at times have to resort to negotiations and out of court settlements with shareholder of failed banks.

The regulatory authorities have indicated that the current frameworks should include other resolution tools such as Purchase and Assumption; Open Bank Assistance and Bridge Banks. In addition, the all the relevant current frameworks should be harmonized to have the same objectives for resolving failed banks. The regulators have also indicated the need to expand their powers in the current frameworks and ensure management of banks is not interrupted
unnecessarily. The regulators have also suggested that where interruption is necessary, the compensation should be in monetary terms and not reversal of policy.

The study has to a larger extent met its research objectives. The study findings and conclusions are however mainly based on the case study of two banks out of twenty six that have failed since 1980. The causes of bank failures and resolution tools used have largely been consistent since 1980 and the study findings have been inferred meet the objectives of study.

4.6 Chapter summary

In summary the chapter first gave an overview of the current tools used by the regulators in managing bank failures in Zimbabwe. The benefits and limitations of these tools was discussed before looking at a study of two failed banks which are Interfin Banking Corporation and Royal Bank. An analysis of the tools used for management of the troubled banks was done to also establish reasons why the application of such tools failed. In depth information on the application and implications of such tools was obtained by way of interviews with RBZ, DPC and the curators of the two banks under study. The findings from the qualitative research were deduced though content analysis.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS
5.1 Conclusions

This study provides insights into the effectiveness of the regulatory tools used in Zimbabwe to manage or resolve bank failures. The study has come up with the following conclusions:

- The resolution of bank failures will remain a challenge if the status quo remains
- The current resolution tools will erode confidence in the banking sector
- Most of the challenges in resolving bank failures are a result of weak and inadequate legal framework to deal with problem banks.
- Resolution of banks is costly and time consuming.
- Banks are incorporated as companies using a separate framework and licensed to do banking operations using a different framework. As a result, when a bank fails there are inconsistencies in the frameworks to apply.
- The current resolution tools are not exhaustive and other options may be considered.

The study will be useful in designing the ideal tools for the resolution or management of failed banks in current operating environment.

5.2 Recommendations

Based on the findings of the study the following recommendations have been proposed:

a. Enhance the legal framework to address the following:
   - The Banking Act [Chapter 24:20] should be equipped with provisions for penalties if banks fail to comply with corrective orders.
   - Limit the curatorship period to three months or less in the Banking Act [Chapter 24:20].
   - Directors and staff whose negligence and willful actions resulted in the failure of the financial institution should face criminal charges and be banned from banking activities.
   - Fair and reasonable resolution methods without unnecessary interference from shareholders and creditors should be put in place. Damages against shareholders and creditors can only be pecuniary or monetary in nature without reversal of policy decision.
• Set provisions for dealing with issues relating to employees of the troubled institution such as termination of existing contracts, unpaid leave, reduction in salaries and benefits, and retrenchment and termination.

b. Setting up a special court, and an appeals court designed to urgently deal with bank resolution matters to avoid unnecessary delays experienced through the normal court.

c. There is need to harmonise the various legislation so that inconsistencies in the application of the law are removed.

d. Deposit Insurance Scheme should consider increasing the cover level to $1000 to increase public confidence and avoid bank runs that cause bank failures.

e. Consider other resolution methods as follows

• Purchase and Assumption Agreement (P&A): The resolution authorities can allow an acquiring bank to purchase assets of the failed bank with the assistance from the Deposit Protection Corporation and the Reserve Bank of Zimbabwe.

• Bridge Banks: The regulators may consider creation of bridge banks allowing the curator to transfer assets and liabilities to a temporary bank whilst waiting for a suitable investor.

• Open Bank Assistance Transaction: The Deposit Protection Corporation may provide financial assistance by making loans, purchasing of assets and depositing direct funding into a failing institution. The troubled bank will only repay when it is stable to do so.

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ANNEXURE1: Coding of interview responds

<table>
<thead>
<tr>
<th>Questions</th>
<th>Codes</th>
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</thead>
<tbody>
<tr>
<td>1. Why was the unbundling of ZABG successfully contested in September 2010</td>
<td>• Curatorship contested</td>
</tr>
<tr>
<td></td>
<td>• Loopholes in legislation</td>
</tr>
<tr>
<td>Number</td>
<td>Question</td>
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<tr>
<td>--------</td>
<td>--------------------------------------------------------------------------</td>
</tr>
</tbody>
</table>
| 2.     | Why do directors and staff responsible for failed resurface at new banks and not face criminal charges? | • Loopholes in legislation  
• Directors are opportunistic with greed intentions  
• No financial capacity  
• No legislation to protect decisions  
• Suspension of directors and management-curatorship  
• Suspension of directors and management | • Complications of evidence gathering  
• Length court process  
• Rights to appeal  
• High costs of bailing out  
• No laws for controlling  
• No right to shareholding |
| 3.     | What financial capacity and legal basis does the RBZ, DPC or government have to bail out troubled banks? | • No financial capacity  
• No legislation to protect decisions  
• Suspension of directors and management | • Laws for smooth takeover  
• Writing down shareholding |
| 4.     | How does the regulator assume the powers & rights of shareholders in troubled banks? | • Suspension of directors and management  
• No right to shareholding  
• No laws for purchase and assumptions  
• No laws for bridge banks  
• No laws for open bank assistance or bailouts  
• Change in legislation include other methods like bridge banks, bailouts, purchase and assumption.  
• Deficiency in legal system  
• Liquidation prone to appeals and delays. | • Court process dictates pace  
• Actions protected if done in good faith  
• Shareholders can appeal and |
| 5.     | What is the required framework to cause merger of banks? | • Provisions for finality  
• Provisions for speed  
• Provisions for appeals in pecuniary  
• Moral suasion  
• Court process  
• Out of court settlement | • Laws for smooth takeover  
• Actions protected by all acts of law governing the sector |
| 6.     | How does RBZ deal with the protracted legal battles with shareholders after taking any action to resolve a troubled bank? | • Provisions for finality  
• Provisions for speed  
• Provisions for appeals in pecuniary  
• Moral suasion  
• Court process  
• Out of court settlement  
• Writing down shareholding  
• Finality and speed  
• Damages are pecuniary | • Court process dictates pace  
• Actions protected by all acts of law governing the sector |
| 7.     | What rights does the resolution authority have to restructure/transfer assets of troubled bank? | • No rights to shareholding  
• No special commercial court.  
• No provisions under banking act for winding up | • No laws for purchase and assumptions  
• No laws for bridge banks  
• No laws for open bank assistance or bailouts  
• Change in legislation include other methods like bridge banks, bailouts, purchase and assumption.  
• Deficiency in legal system  
• Liquidation prone to appeals and delays.  
• No special commercial court.  
• No provisions under banking act for winding up |
| 8.     | What changes would you recommend to the current features or operational framework to make bank resolution more effective? | • No rights to shareholding  
• No special commercial court.  
• No provisions under banking act for winding up  
• Writing down shareholding.  
• Finality and speed  
• Damages are pecuniary | • No laws for purchase and assumptions  
• No laws for bridge banks  
• No laws for open bank assistance or bailouts  
• Change in legislation include other methods like bridge banks, bailouts, purchase and assumption.  
• Deficiency in legal system  
• Liquidation prone to appeals and delays.  
• No special commercial court.  
• No provisions under banking act for winding up |
| 9.     | Why does the liquidation proceedings take long to resolve troubled banks? | • No rights to shareholding  
• No special commercial court.  
• No provisions under banking act for winding up  
• Writing down shareholding.  
• Finality and speed  
• Damages are pecuniary | • No laws for purchase and assumptions  
• No laws for bridge banks  
• No laws for open bank assistance or bailouts  
• Change in legislation include other methods like bridge banks, bailouts, purchase and assumption.  
• Deficiency in legal system  
• Liquidation prone to appeals and delays.  
• No special commercial court.  
• No provisions under banking act for winding up |
| 10.    | How does the current legal framework protect the decisions made by the regulators? | • No rights to shareholding  
• No special commercial court.  
• No provisions under banking act for winding up  
• Writing down shareholding.  
• Finality and speed  
• Damages are pecuniary | • No laws for purchase and assumptions  
• No laws for bridge banks  
• No laws for open bank assistance or bailouts  
• Change in legislation include other methods like bridge banks, bailouts, purchase and assumption.  
• Deficiency in legal system  
• Liquidation prone to appeals and delays.  
• No special commercial court.  
• No provisions under banking act for winding up  
• Actions protected if done in good faith  
• Shareholders can appeal and  
• Actions protected by all acts of law governing the sector |
<table>
<thead>
<tr>
<th>Question</th>
<th>Delays/Problems</th>
<th>Solutions</th>
</tr>
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<tbody>
<tr>
<td>11. What rights do the directors or staff involved in the failure of banks have to contest decisions by regulators?</td>
<td>- Loop holes exploited&lt;br&gt;- Opportunistic&lt;br&gt;- corrective action disputable&lt;br&gt;- Investigations and pressing of charges complex under laws</td>
<td>- Disputes and appeals with no costs.&lt;br&gt;- Law does not allow writing down shareholding&lt;br&gt;- Curator benefits from fees and commissions&lt;br&gt;- Curator has discretion and advises RBZ&lt;br&gt;- Fees in line with international standards&lt;br&gt;- Curatorship benefits and may prolong service&lt;br&gt;- Bridge banks&lt;br&gt;- Purchase and assumption&lt;br&gt;- Bail-outs/open bank assistance&lt;br&gt;- Shorter curatorship period&lt;br&gt;- Liquidator to report to RBZ&lt;br&gt;- Early intervention and finality&lt;br&gt;- Less shareholder interference and any damages are pecuniary</td>
</tr>
<tr>
<td>12. Why do regulators allow curatorships to rollover for two and a half years at the expense of creditors such as depositors?</td>
<td>- Political interference&lt;br&gt;- The curator period determined by prospects of new investors.</td>
<td>- Long and winding court process&lt;br&gt;- Timely intervention&lt;br&gt;- Efficient and effective court processes&lt;br&gt;- Revisions of laws to avoid asset stripping&lt;br&gt;- Minimize rights of shareholders&lt;br&gt;- RBZ supervision&lt;br&gt;- Shareholder rights and powers&lt;br&gt;- No separate liquidation process for banks</td>
</tr>
<tr>
<td>13. How does RBZ justify the curator’s costs of amounting to over $2 million?</td>
<td>- Bridge banks&lt;br&gt;- Purchase and assumption&lt;br&gt;- Bail-outs/open bank assistance</td>
<td>- No separate liquidation process for banks</td>
</tr>
<tr>
<td>14. What other bank resolution methods should the regulators consider?</td>
<td>- The curator period determined by prospects of new investors.</td>
<td>- No separate liquidation process for banks</td>
</tr>
<tr>
<td>15. What changes would you recommend to the current features or operational framework of the DPC in order to make it more effective in resolving bank failures?</td>
<td>- Shorter curatorship duration less than three months&lt;br&gt;- Appointment of liquidator for banks to be done by RBZ and not court.</td>
<td>- Timely intervention&lt;br&gt;- Efficient and effective court processes&lt;br&gt;- Revisions of laws to avoid asset stripping&lt;br&gt;- Minimize rights of shareholders&lt;br&gt;- RBZ supervision&lt;br&gt;- Shareholder rights and powers&lt;br&gt;- No separate liquidation process for banks</td>
</tr>
<tr>
<td>16. How has the liquidation process affected the timely intervention in resolving troubled banks?</td>
<td>- Timely intervention&lt;br&gt;- Efficient and effective court processes</td>
<td>- Timely intervention&lt;br&gt;- Efficient and effective court processes&lt;br&gt;- Revisions of laws to avoid asset stripping&lt;br&gt;- Minimize rights of shareholders&lt;br&gt;- RBZ supervision&lt;br&gt;- Shareholder rights and powers&lt;br&gt;- No separate liquidation process for banks</td>
</tr>
<tr>
<td>17. What measures should be put in place to maximize value of liquidated banks?</td>
<td>- Timely intervention&lt;br&gt;- Efficient and effective court processes</td>
<td>- Timely intervention&lt;br&gt;- Efficient and effective court processes&lt;br&gt;- Revisions of laws to avoid asset stripping&lt;br&gt;- Minimize rights of shareholders&lt;br&gt;- RBZ supervision&lt;br&gt;- Shareholder rights and powers&lt;br&gt;- No separate liquidation process for banks</td>
</tr>
<tr>
<td>18. How effective is curatorship from a depositor’s point of view in Zimbabwe if it can roll over for more than two years?</td>
<td>- If it ultimately resuscitates a bank&lt;br&gt;- If it has a short time duration.</td>
<td>- If it ultimately resuscitates a bank&lt;br&gt;- If it has a short time duration.</td>
</tr>
</tbody>
</table>
ANEXURE 2: In-depth interview script-RBZ

INTERVIEW QUESTIONS: RESERVE BANK OF ZIMBABWE (RBZ)

This interview is to be done voluntarily in partial fulfilment of the Master Degree in Business Administration with the University of Zimbabwe’s Graduate School of Management. All information
submitted will be treated with the **confidentiality and anonymity**. The research topic is “The effectiveness of the regulatory toolkit in managing failing or failed banks in Zimbabwe”.

For further information please contact on mail to: rmagondo@dpcorp.co.zw or phone 0712880071

1. What rights do the directors or staff involved in the failure of banks have to continue contesting the RBZ’s decisions? Why are those implicated in failed banks not facing criminal charges?

2. Why did the RBZ allow the curatorship of Interfin to rollover for two and half years at the expense of creditors such a depositors?

3. What measures have been put in place to ensure the judiciary, the consumers and the banks are informed of the procedures and implications of bank resolution?

4. How does RBZ justify the curator’s costs of $2 million in Interfin at the expense of other creditors? Are these costs agreed with the owners of the bank beforehand? How do such costs determine the final decision of resolving the troubled bank?

5. How did Royal Bank successfully contest its incorporation into ZABG in September 2010 after RBZ had successfully merged it together with Barbican Bank and Trust Bank in 2005?

6. What capacity and legal basis does the RBZ, DPC or government have to bail out troubled banks?

7. How does the regulator assume the powers & rights of shareholders as in the case of Royal Bank when it was incorporated into ZABG?
8. What is the required framework to cause a merger or amalgamation in the banking sector as a way of resolving bank failures?

9. How does RBZ deal with the protracted legal battles with shareholders after taking any action to resolve a troubled bank?

10. What rights does the resolution authority have to restructure/transfer assets of troubled bank?

11. Why are normal or general liquidation proceedings taking long to resolve banks such as Interfin and Royal Bank?

12. How does the current legal framework protect the decisions made by RBZ or DPC against the failed banks?

13. Any other contributions / recommendations

End of interview

ANNEXURE 3: In-depth interview script-Curator

INTERVIEW QUESTIONS: CURATOR

This interview is to be done voluntarily in partial fulfilment of the Master Degree in Business Administration with the University of Zimbabwe’s Graduate School of Management. All information
submitted will be treated with the confidentiality and anonymity. The research topic is “The effectiveness of the regulatory toolkit in managing failing or failed banks in Zimbabwe”.

For further information please contact on mail to: rmagondo@dpcorp.co.zw or phone 0712880071

1. What rights of creditors or shareholders of the troubled banks have impacted your operations?

2. What justification was in place to rollover the curatorship when all the potential capital injections investment were not yielding progress?

3. What are the limitations of the curator which in your view would have helped resolve the troubled bank faster?

4. How can you convince the creditors, shareholders or depositors that your role is in their best interest if curatorships rolled for over two years and incurring costs amounting to over $3 million in some cases?

5. Any other contributions / recommendations

End of interview

ANNEXURE 4: In-depth interview script-DPC

INTERVIEW QUESTIONS: DEPOSIT PROTECTION CORPORATION (DPC)

This interview is to be done voluntarily in partial fulfilment of the Master Degree in Business Administration with the University of Zimbabwe’s Graduate School of Management. All information
submitted will be treated with the confidentiality and anonymity. The research topic is “The effectiveness of the regulatory toolkit in managing failing or failed banks in Zimbabwe”.

For further information please contact on mail to: rmagondo@dpcorp.co.zw or phone 0712880071

1. What measures should be put in place to maximise value of liquidated banks?

________________________________________________________________________
________________________________________________________________________
________________________________________________________________________

2. How has the liquidation process affected the timely intervention by DPC in resolving troubled banks?

________________________________________________________________________

3. What changes would you recommend to the current features or operational framework of the DPC in order to make it more effective in resolving bank failures?

________________________________________________________________________

4. What other bank resolution methods should be incorporated into the frameworks to ensure that the interest of creditors is protected and preserved?

________________________________________________________________________

5. Any other contributions / recommendations

________________________________________________________________________

End of interview