FRANK TUMUSIIME & COMPANY ADVOCATES

The Law on Interest Rates in Uganda

1.0.Introduction

Interest rate is defined to mean the cost of borrowing funds or capital earned on loaned funds[1]. Interest is the return or compensation for the use of retention by one person of a sum of money belonging to another[2]**.** Interest rates can be classified as either short-term or long-term. For example, you can take out a home loan with the interest rate fixed for 20 years. This is considered a long-term interest rate. You make the same payments over these years, regardless of whether interest rates rise or fall. Alternatively, when you use your credit card or take out a personal loan you are borrowing money at an interest rate that can change in the short term. As a general rule, short-term interest rates tend to be higher than long-term interest rates.

Inflation is a key factor in things that affect interest rates. Inflation is defined to mean when currency loses its value due to constantly raising prices[3]. When a surge in inflation occurs, a corresponding increase in interest rates takes place. In general, as interest rates are lowered, more people are able to borrow more money. The result is that consumers have more money to spend, causing the economy to grow and inflation to increase. The opposite holds true for rising interest rates. With less spending, the economy slows and inflation decreases.

The Bank of Uganda in trying to avoid massive swings in the business cycle will adjust short-term interest rates. It raises interest rates to slow down an economy that is expanding too rapidly and lowers them when the economy is heading for a recession[4]. Rising and falling interest rates will directly affect consumer and personal financial decisions. Rising interest rates make saving relatively more attractive and borrowing relatively more expensive. Falling interest rates have the opposite effect. Consequently, the effect of an interest rate rise or fall will depend on whether you are a saver or a borrower. For the borrower if the interest rate is high it means the money, he has to return to the bank is higher than would have been.

2.0.Commercial Interest rate

Uganda's financial system is characterized by the co-existence of formal and informal financial markets. The formal institutions include banks, Microfinance Deposit-taking institutions, Credit Institutions, Insurance companies, Development Banks, Pension Funds

[1] The Black's Law Dictionary 2nd Edition
[2] Stanbic Bank (U) Ltd vs. Atyaba Agencies Ltd HCMA 235/2006
[3] The Black's Law Dictionary 2nd Edition
[4] For example, the Bank of Uganda held its benchmark lending rate at 9% during its February 2020 meeting, citing balanced risks to inflation and the need of maintain an accommodative monetary stance to support growth

and Capital Markets. The semi informal institutions include Savings and Credit Cooperative Associations (SACCOs) and other Microfinance institutions, whereas the informal ones are mostly village savings and loans associations. To a great extent, these banks primarily concentrate on providing working capital mainly to medium and large-scale enterprises.

The number of commercial banks in Uganda has continued to increase day by day at a high rate, which has aggravated the competition between government and the private sector for loanable funds. Despite the increased competition especially amongst many commercial banks, interest rates have remained high.

2.1. Common Methods used to calculate commercial interest rates

There are two common methods which are used for calculating interest on loans; the flat interest rate method and reducing balance interest rates method. Flat interest rate, as the term implies, means an interest rate that is calculated on the full amount of the loan throughout its tenure without considering that monthly EMIs gradually reduce the principal amount. This method is particularly used to calculate the interest payable for personal loans and vehicle loans. In this method, you have to pay interest on the entire loan amount throughout the loan tenure. It is actually less popular among the borrowers because even if you gradually pay down the loan, the interest does not decrease. Flat interest rates generally range from 1.7 to 1.9 times more when converted into the Effective Interest Rate equivalent.

Reducing or Diminishing balance rate, as the term suggests, means an interest rate that is calculated every month on the outstanding loan amount. In flat rate method, the interest rate is calculated on the principal amount of the loan. On the other hand, the interest rate is calculated only on the outstanding loan amount on monthly basis in the reducing balance rate method.

2.2. The law regulating commercial interest rates

Interest rates are a major concern in the banking and lending industry in Uganda. Commercial banks and financial institutions generally have been accused of charging high interest rates and exploiting the consumers. This has led to government through the Ministry of Finance passing the **Financial Institutions Act 2004 and its Amendment in 2016** with an aim of among others regulating the banking and lending industry. The Tier 4 Microfinance Institutions Act and Money Lenders Act, 2016 And The Tier 4 Microfinance Institutions And Money Lenders (Money Lenders) Regulations, 2018 are in place to among others to provide for the licensing and management of tier 4 microfinance institutions; to provide for management and control of money lending business; to provide for licensing of money lenders; to provide for self-help groups and commodity microfinance; to provide for receivership and liquidation of a tier 4 microfinance institution.

The above-mentioned laws that govern this sector do not come up with clear cut interest rates and almost leave it to the Banks and financial institutions to determine the interest rates they charge on loan facilities. For example, the Tier 4 Microfinance Institutions Act and Money Lenders Act, 2016 does not specify interest rate that should be charged, however the Act attempts to regulate how interest rates can be charged; for example Section 86 prohibits compound interest. A money lending contract is illegal and unenforceable if it directly or indirectly provides for the payment of compound interest; or the rate or amount of interest being increased by reason of a default in the payment of sums due under the contract. The section further provides that where a borrower defaults to pay the sum payable to the money lender on the due date, the moneylender is entitled to charge simple interest on that sum from the date of default until the sum is paid**.** The above mentioned laws do not define the term compound interest however **the Black's Law Dictionary 2nd Edition** defines compound interest to mean Interest upon interest that is to say; when the interest of a sum of money is added to the principal, and then bears interest. This definition was also used in the case of **Camp v. Bates**[5],

2.3**. Approach of the Ugandan Courts of Judicature to commercial interest rates**

Quite often borrowers dissatisfied with interest rates levied on running loan run to Courts of law for protection. Because of this the courts following the facts that are different in every case presented to them have held and determined what interest rates would be harsh and unconscionable.

Where an agreement for the payment of interest is sought to be enforced, and the court is of the opinion that the rate to be paid is harsh and unconscionable, and ought not to be enforced, the court may give judgment for the payment of interest at such a rate as it may think". The Courts of Judicature have taken a stand that an award of interest be just and reasonable in the circumstances[6]**.** In **Alice Okiror & Michael Okiror v Global Capital Save Ltd & Anor HCCS No. 149 of 2010,** (un reported), Lady Justice Hellen Obura, found that;

"Interest charged at 12% per month would translate to 144% per annum. It is harsh and unfair for a money lender to charge sun amount of interest in disregard of the money lenders Act. In circumstances like this, the court is obliged to exercise its discretion to award reasonable interest.

In determining a just and reasonable rate, courts take into account **"**the ever rising inflation and drastic depreciation of the currency. A Plaintiff is entitled to such rate of interest as would not neglect the prevailing economic value of money, but at the same time one which would insulate him or her against any further economic vagaries and the inflation and depreciation of the currency in the event that the money awarded is not promptly paid when it falls due***".*** The Supreme Court pointed out that the time when the amount claimed was due is the date from which interest should be awarded[7].

3.0**. Court Interest Rate**

Upon completion of hearing of a case, the successful party is awarded usually in form of compensation and damages. In other instances, as already indicated above, where the parties

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[5] 11 Conn. 487
[6] Mohanlal Kakubhai Radia Vs Warid Telecom Ltd High Court Civil Suit Number (HCCS) 234 of 2011
[7] J.K Patel v Spear Motors Ltd**,** Supreme Court Civil Appeal number 4 of 1991

to a contract don't set an interest rate, the Court will come in to set a reasonable rate. The award will usually carry an interest clause to cover for any period; the judgement creditor may delay to pay the ward. Interest has been defined by courts to mean the return or compensation for the use of retention by one person of a sum of money belonging to another[8]**.** The court interest rate is usually set at the discretion of court this was clearly enunciated in the case of **Attorney General Vs Goodman Agencies Limited** [9], it was further stated in **Harbutt's Plasticide Ltd vs. Wayne Tank & Pump Co. Ltd**[10]; that an award of interest is discretionary and its basis is that the defendant has kept the plaintiff out of his money or that the defendant had the use of the money himself and ought to compensate the plaintiff accordingly. Where interest was not agreed upon by the parties, Court should award interest that is just and reasonable which was further enunciated in the case of Mohanlal **Kakubhai Radia Vs Warid Telecom Ltd** **(supra)**

Under the Civil procedure Act, where a decree is for the payment of money, the court may, in the decree, order interest at such rate as the court deems reasonable to be paid on the principal sum adjudged from the date of the suit to the date of the decree, in addition to any interest adjudged on such principal sum for any period prior to the institution of the suit, with further interest at such rate as the court deems reasonable on the aggregate sum so adjudged from the date of the decree to the date of payment or to such earlier date as the court thinks fit. Where such a decree is silent with respect to the payment of further interest on the aggregate sum specified from the date of the decree to the date of payment or other earlier date, the court shall be deemed to have ordered interest at 6 percent per year[11].

In the case of **Kazinga Channel Office World Ltd vs. A.G.** [12] it was held that interest may be prescribed by statute or be agreed by the parties and the court would only interfere with an agreed interest rate under section 26 (1) of the Civil Procedure Act if it is harsh and unconscionable; and in **Kituni Construction Ltd vs. Julius Okeny**[13] it was held that the plaintiff should be compensated for the loss occasioned to its business and mere recovery of the principal debt was not sufficient.

4.0. Conclusion

Interest rate is more of social economic policy issue than a legal matter. However, currently there is no certainty and uniformity in the application of interest rates; the parties to a particular contract always determine their own rate. But we live in a world where the lender sets the pace and rate of interest to the desirous borrower.

According to the Bank of Uganda, Lending interest rates in Uganda have averaged 21 percent since the early 1990s. Research indicates that the main driver of lending interest rates is

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[8] **Stanbic Bank (U) Ltd vs. Atyaba Agencies Ltd** High Court Miscellaneous Application Number 235 of 2006
[9] Constitutional Appeal No.05 of 2010
[10] 1 All ER 849
[11] Section 26 of Civil procedure Act Cap 71
[12] HCCS 276/2005
[13] HCCS 250/2004

overhead costs. Because financial institutions are riddled with high overhead costs, the lending interest rates must be high enough to cover operational costs. Overhead costs are partly dependent on the size of the institution and the type of clientele. In a market where most of the lenders are small, with high operating costs and largely rely on interest income from loans, and the majority of the borrowers are Small Medium Enterprises and households, the resulting lending interest rates are high.

Since most Small Medium Enterprises have no reliable credit histories, banks must rely on alternative methods to manage credit risk and ensure repayment and these alternative methods involve continuous monitoring whose cost is reflected in the high lending interest rates. Generally, the higher the risk, the higher the interest rate charged by the lender.[14]

The above expose is testimony that the consumer or borrower remains at the mercy of the lender- a take it or leave it situation. Although the Tier 4 Microfinance Institutions and Money Lenders Act, 2016 attempts to protect the consumer against compound interest, it fails to set out the parameters for determination of the rate of interest. It is therefore time to enact a policy regulating the rate of interest. The current trend of leaving the direction to a judicial officer and the courts of law is a post-mortem approach that will never solve the root cause.

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[14] What Explains High Lending Interest Rates in Uganda? Bank of Uganda Working Paper Series Working Paper No. 06/2018