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College of Law and Governance Studies

School of Law

LL.M in Business Laws

Regulation of Savings and Credit Cooperative Societies in Ethiopia

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Declaration

I, the undersigned, declare that this thesis is my original work, and has not been presented for a degree or other certification in any other University and that all sources of materials used have been properly acknowledged.

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Dedication

To Baye Shiferaw who was our classmate and passed away due to hepatic disease in the middle of the LLM course work.

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In the years 2020 and 2021, Ethiopia and its people faced numerous hardships. The global pandemic of Covid-19 and political turmoil were the most significant challenges. Nonetheless, God gives me extra time and protection to complete my studies, which I am grateful for.

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ACRONYMS AND ABBREVIATIONS

ACCOSCA- African Confederation of Co-operative savings and Credit Associations

BCBS- the Basel Committee for Banking Supervisions

FCA- Federal Cooperative Agency

FCs- Financial Cooperatives

FDRE- Federal Democratic Republic of Ethiopia

GTP- Growth and Transformation Plan

ICA - International Cooperatives Alliance

ILO – International Labor Organization

MFIs- Micro Financing Institutions

NBE- National Bank of Ethiopia

NCUA- National Credit Union Administration of America

RUFIP- Rural Financial Intermediation Programme

SACCO – Savings and Credit Cooperative Societies

WOCCU -World Council of Credit Unions

ABSTRACT

The Existing Ethiopia's SACCO regulatory framework does not aim to provide a supportive policy and legal framework consistent with the nature and function of SACCOs guided by cooperative values and principles. Since the Cooperatives Society Proclamation 147/1998 was enacted, SACCOs in Ethiopia have been regulated by the general cooperative offices; nevertheless, these general cooperative offices lack the technical expertise to oversee SACCOs. Hence, this study concludes that SACCOs should be supervised by a SACCO supervisory body. Since the National Bank of Ethiopia establishment proclamation 591/2008 (as amended) was enacted, SACCOs in Ethiopia have also been governed solely by a general cooperative law. SACCOs, on the other hand, have special characteristics that necessitate a special SACCO law. In this regard, the findings of this study support the enactment of a SACCO-specific law. Moreover, the existing general cooperative law does not effectively address the legal regulatory implementations of SACCOs. Hence, this research identifies aspects of regulatory implementations that should be included in the SACCO-specific law.

CHAPTER- ONE

INTRODUCTION

1.1. Background of the Study

Robust public and private sectors, as well as strong cooperative, mutual, and other social and non-governmental sectors, are all necessary for a well-balanced society.¹ Cooperatives are an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.² Cooperatives have identity principles³ that are set by International Cooperatives Alliance.⁴ These cooperative identity principles are recognized by the ILO Recommendation No. 193 of 2002.⁵ In Ethiopia, as well, these cooperative identity principles are fully recognized by the Cooperatives Societies' proclamation.⁶

The potential of cooperatives to respond to the socio-economic needs of communities, and to constitute a distinctive sector of the economy, has been recognized internationally regardless of the nature and type of the political economy.⁷

¹ ILO R193, 'Promotion of Cooperatives Recommendation' (2002) section II para 6 < [Recommendation R193 - Promotion of Cooperatives Recommendation, 2002 \(No. 193\) \(ilo.org\)](#)> accessed 19 December 2020

² ILO R193 (2002) (n 1) section I para 2; ICA Statement on Cooperatives Identity (1995) <[Cooperative identity, values & principles ICA](#)> accessed 19 December 2020; See Cooperative Societies Proclamation, 2016, Art. 2(1), Proc. No. 985, Fed. Neg. Gaz. Year 23, no.7

³ These Cooperative Principles are: Voluntary and open membership, Member economic participation, Autonomy and independence, Education, training, and information, Cooperation among cooperatives, Concern for community. ICA Statement on Cooperatives Identity (1995) (n 2); See Cooperative Societies Proclamation 985/2016 (n 2), Art 5.

⁴ ICA is a non-governmental body representing the international cooperative movement. Its statements represent a source of international customary law. Jan Theron, 'Cooperative policy and law in East and Southern Africa: A review (2010) CoopAFRICA Working Paper No. 18, 4 <https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/coop/documents/publication/wcms_672838.pdf>accessed 20 December 2019

⁵ ibid

⁶ Cooperative Societies Proclamation 985/2016 (n 2) Art, 5(1), 5(2) &5(3)

⁷ Theron (n 4) 1

SACCOs are financial cooperative societies that operate per the cooperative principles and are significant participants in the national financial markets of many developed, emerging, and transitional economies, irrespective of the type of the market economy.⁸ SACCOs are in particular guided by the principle of autonomy and independence and the principle of democratic member control.⁹ Though principle of cooperative autonomy and independence is used as a litmus test for assessing a country's policy and legislative framework in the area of cooperative development, it does not preclude government regulation at all.¹⁰ Yet, a SACCO regulation should aim to provide a supportive policy and legal framework consistent with the nature and function of SACCOs guided by cooperative values and principles. SACCOs have net savers (members who have savings in excess of borrowings) and net borrowers (members who have more borrowings than savings) and member-manager interest conflicts.¹¹ This requires a regulatory framework with a proper regulatory objectives, regulatory structures, legal regulatory framework, and regulatory implementations.¹²

Currently, SACCOs in Ethiopia took second-place holding 25% next to agricultural cooperatives that holds 31% in terms of their sector of engagement.¹³ At the end of 2020, there were 21,328 primary SACCOs having 5,384,559 members and 131 SACCO Unions with 17.38 billion Birr savings mobilization contributing for 5% domestic national savings,¹⁴ and disbursed average annual loan amount of 4 billion birr and hold a capital of 5.19 billion Birr.¹⁵ However, SACCO

⁸ Emma Allen and Sam Maghimbi, 'African Cooperatives and the Financial Crisis' (2009) CoopAFRICA working paper 3, 2 <https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---coop/documents/publication/wcms_117872.pdf> accessed 21 December 2020

⁹ ICA, 'Guidance Notes to the Co-operative Principles' (2015) 45 <<https://www.ica.coop/en/media/library/research-and-reviews/guidance-notes-cooperative-principles>> accessed 21 December 2020

¹⁰ Theron (n 4) 4

¹¹ Carlos E. Cuevas and Klaus P. Fischer, 'Cooperative Financial Institutions: Issues in Governance, Regulation, and Supervision' (2006) World Bank Working Paper.82, 8 <<https://openknowledge.worldbank.org/handle/10986/7107>> accessed 25 December 2020

¹² Jeffrey Carmichael, *The Development and Regulation of Non-Bank Financial Institutions*, (World Bank 2002) 21

¹³ FCA, 'Cooperative Sector 10 Years Plan' (2020/21- 2029/30), 2 <<http://www.fca.gov.et/#>> accessed 17 July 2021

¹⁴ At the end of 2020, the national savings to GDP was 20.9%. see The FDRE Planning and Development Commission, *Ten Year Development Plan (2020/21-2029/30)* 4

¹⁵ FCA, Cooperative Sector Ten Years Plan (n 13)

regulatory framework has not kept pace with the development of the SACCO movement in Ethiopia. SACCOs are currently regulated by a general cooperative law and they are under the regulatory structure of general Cooperative offices both at federal and regional levels. But, the legal and regulatory structure deficiencies can impede the safety and soundness of SACCOs and restrict their ability to meet their members' financial service needs.

1.2.Problem Statement

The current Cooperatives Society Proclamation emphasizes to maintain the cooperatives guiding principles including cooperative autonomy and independence through a self- regulation approach as its regulatory objectives. Nevertheless, Ethiopia's cooperative legal framework does not aim to provide a supportive policy and legal framework consistent with the nature and function of SACCOs.

The current government cooperative sector policy documents and plans have identified that Cooperative Promotions implementing bodies' management and experts at federal and regional levels have limitation of skills, knowledge, attitude, and commitment to organize, capacitate and regulate cooperatives. Nonetheless, the current regulatory structure placed SACCOs that require a professional SACCO regulator under the regulatory structure of the general Cooperative offices, which are plagued with those problems.

There is also an understanding from the cooperative sector regulator that there is an enabling cooperative proclamation, regulation, supportive policy, and strategy to organize and strengthen cooperatives. However, the existing general cooperative society's law, which regulates activities of agricultural, consumer, and other cooperatives, is insufficient for SACCOs in Ethiopia. SACCOs are financial cooperatives that collect deposits from their members and make loans to them, with members having divergent interests, which necessitate legal regulatory implementations that are special to them, which a general cooperative law does not adequately handle.

1.3. Research Questions

General Research Question

Is there a proper regulatory framework for SACCOs in Ethiopia?

Specific Research Questions

- What objectives does Ethiopia's SACCO regulatory framework aim to achieve?
- How is the regulatory structure of SACCOs in Ethiopia designed?
- What is the appropriate legal regime which fairly considers the Cooperative and Financial aspect of SACCOs?
- What aspects of legal regulatory implementations ought to be ascribed in Ethiopia's SACCO regulatory framework?

1.4. Research Objectives

General Objective

The major goal of this thesis is to evaluate the adequacy of Ethiopia's SACCO regulatory framework in responding to the features of SACCOs based on Ethiopia's past regulatory experiences, international best practices and recommendations.

Specific Objectives

The study is designed to achieve the following specific objectives:

- To examine the objectives of the regulatory framework of SACCOs in Ethiopia.
- To assess and show the desirable regulatory structure of SACCOs in Ethiopia.
- To assess and show the appropriate legal regulatory framework of SACCOs in Ethiopia.
- To demonstrate aspects of SACCO legal regulatory implementations in Ethiopia.

1.5. Significance of the Study

The findings of the research will contribute for the government's policy and legal reforms as access to finance is identified as a major problem of the country.¹⁶ It will also have importance for the revision of FDRE ten-year development plan on financial policy and financial sector development.¹⁷

This study also aims to contribute modestly to the knowledge base on the subject by examining the regulatory framework of SACCOs in Ethiopia. Lessons and best practices learnt are highlighted in order to propose better approaches to regulate SACCOs. In this regard, this study offers policymakers and regulators important advice for installing a proper SACCO regulatory framework in Ethiopia.

1.6. Scope of the Study

The scope of the thesis focuses on the primary level SACCOs, as the regulatory issues for primary SACCOs do safely apply to the other tiers of SACCO societies.

1.7. Limitation of the Study

In addition to a lack of significant domestic literature on the subject, the study's principal limitation was a lack of time.

1.8. Research Methodology

This study adopts mainly a doctrinal research technique to conduct a critical examination of Ethiopia's SACCO regulatory framework. The Cooperative Societies Proclamation No. 985/2016 is the legal instrument that sets the current regulatory framework of all types of cooperatives including SACCOs and hence this proclamation is the main source of this study.¹⁸ Yet, the Co-

¹⁶ See , for example, Movable Property Security Right proclamation, 2019, Preamble first para, Proc. No. 1147, Fed Neg Gaz., Year 25, no. 76

¹⁷FDRE Planning and Development Commission, *Ten-Year Development plan* (n 14) 11. This plan mentions only Banks, Insurance and Micro finances.

¹⁸This is because Art. 3 of this proclamation in its scope of application states that 'this proclamation shall apply to cooperative societies established in the country; and in its preamble second paragraph it is reiterated that cooperative

operative Societies Proclamation Act No. 241/66, Cooperative Societies Proclamation No. 138/1978, Cooperative Societies Proclamation No. 147/1998, the Monetary and Banking Proclamation No. 99/ 1976, the Monetary and Banking Proclamation No 83/94, the licensing and supervisions of Banking Proclamation No. 84/1994, the National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008, and the Ethiopian Business License Issuing Category Directive 17/2019 are also employed as a primary sources of data to the research to identify the regulatory framework that has been applied to regulate SACCOs and to shed light on the current regulatory framework.

Primary data about SACCO regulatory implementations has also been supplied based on the researcher's observations as a member of a SACCO Management Committee. The draft FCA SACCO prudential inspection directive 2021¹⁹ is also scrutinized on the regulatory implementations.

The research has also attempted to analyze Ethiopia's legal framework in light of Kenya's SACCO regulatory framework. Kenya's Experience is selected with the purposive sampling technique as Kenya and Ethiopia are located in the same geographical region and Kenya's legal framework is extensively researched in sub-Saharan Africa and also the overall SACCO movement in Kenya is deemed to be the largest in Africa, and among the top ten globally by mobilizing savings equivalent to 33 % of national savings, and is considered a major driver of the economy.²⁰ As such, the Kenyan SACCO Act (2008) and the SACCO Societies (Deposit-taking Sacco Business) Regulations (2010) are analyzed and interpreted. Furthermore, with the purposive sampling method, because the United States, like Ethiopia, has a federal state system, the experience of the United States is cited whenever appropriate. The 2015 Model law for Credit Unions that is

societies are required ... to sustain one economic community in accordance to [FDRE] constitution; through a uniform cooperative societies proclamation'.

¹⁹ This draft directive is made available to the public through the FCA's website lately on August 27th 2021.

²⁰ Carlos E. Cuevas and Juan Buchenau, 'Financial Cooperatives: Issues in Regulation, Supervision, and Institutional Strengthening'(WorldBank2018),30<<https://documents1.worldbank.org/curated/en/156561539766530807/pdf/Financial-Cooperatives-Issues-in-Regulation-Supervision-and-Institutional-Strengthening.pdf>> accessed 17 January 2021

developed and recommended by the World Council of Credit Unions²¹ is also scrutinized to elucidate the legal regulatory implementations for SACCOs in Ethiopia.

To gather secondary data, a thorough analysis of official reports, policy documents, scholarly books, and articles are collected, analyzed, and interpreted. The web resources of the FCA, the ACCOSCA, ICA, ILO, etc. have been thoroughly searched for relevant data & information. Particularly, 2001 UN Guidelines aimed at creating a supportive environment for the development of cooperatives, 2002 ILO R193 on the promotion of cooperatives; the ICA Cooperative Identity statements which have international customary law status in the field of cooperatives are thoroughly examined as standards of the study. Moreover, the FCA GTP-2 (2015-2020) main document, and the FCA ten-year cooperative sector plan (2020/21-2029/30) are used as primary sources of data to identify the SACCO regulatory problems.

1.9. Organization of the Study

This research has five chapters. Chapter one deals with the background of the study, research questions, objectives, significance of the research, limitations of the research, scope of the research, hypothesis, and methodology of the research. Chapter two is dedicated to providing the general overview of SACCOs with special emphasis on the nature, rationale, and historical development of SACCOs in Ethiopia.

The regulatory objectives and structure of SACCOs in general and in Ethiopia in particular are dealt under chapter three. Under this chapter, a comprehensive analysis of the laws and institutions regulating and supervising SACCOs is made. Chapter four deals with the legal regulatory framework and regulatory implementation of SACCOs with some purposively selected country's comparative experience and international best practices. Lastly, chapter five presents the conclusions and recommendations which aims at suggesting better mechanisms of regulating and supervising SACCOs in Ethiopia.

²¹ WOCCU is the apex trade association and development organization of the international credit union system. It promotes the sustainable growth of credit unions and financial cooperatives across the globe. <https://www.woccu.org/documents/2005_Legislation_Guide> accessed 8 April 2021

CHAPTER-TWO

CONCEPTUAL FRAMEWORK AND DEVELOPMENT OF SACCOs IN ETHIOPIA

2.1.Nomenclature and Definition of SACCOs

Savings and credit businesses are financial services, and this has led to SACCOs being referred to in some jurisdictions as financial services cooperatives²², while in other jurisdictions particularly in the USA, the UK, and the Latin Americas, specifically referred to as Credit Unions.²³ In Kenya, they are referred to as SACCOs.²⁴ In Ethiopia, while the Cooperative Societies Proclamation No. 138/1978 had used the term Thrift²⁵ and Credit Cooperative societies, the Cooperative Societies Proclamation No. 147/1998 had used the term savings and Credit societies as the current Cooperative Societies Proclamation No. 985/2016 does.²⁶ In this thesis, the word SACCO is interchangeably used with Credit Unions or Financial Cooperatives.

²²Yet, sometimes, the term financial cooperative is broad that encompasses SACCOs/ Credit Unions, Cooperative Banks, Mutual, building societies that offer credit on home mortgages, cooperative land development banks etc. International Cooperative Banking Association, 'Regulation and Sustainability of Cooperative Banks: A Cross Country Study' (2020) 12 <<https://www.icba.coop/master/document/images/image1869.pdf>> accessed 28 April 2021

²³SACCO Societies Regulatory Authority, 'An annual report on the operations and performance of Deposit-Taking Sacco Societies in Kenya' (2015)

14<https://www.sasra.go.ke/index.php?option=com_phocadownload&view=category&id=11:sacco-supervision-reports&Itemid=200> accessed 10 January 2021

²⁴SACCO societies Act No. 14 of 2008, Art 1.

<http://www.kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/SaccoSocietiesAct_No14of2008.pdf> accessed 10 January 2021

²⁵ However, the term thrift has a conventional meaning of 'thrift of building societies who pooled their resources to provide housing finance to members' Carmichael (n 12). But contrary to the conventional meaning of the term, this proclamation under Art 10 had defined 'thrift and credit cooperatives' as cooperatives established by individuals working in one undertaking or office for making regular savings and to obtain credit for individual needs or productive purposes.

²⁶ Cooperative Societies Proclamation, 1998, Art. 2(1)(e), Proc. No. 147. Fed. Neg. Gaz. Year 5, no. 27; Cooperative Societies Proclamation 985/2016 (n 2), Art 2(7)

ACCOSCA defines SACCOs in 1969 as ‘A thrift and credit cooperative is a free association of people with a common bond who save and lend money to one another at a low interest rate for productive and provident purposes’.²⁷ And latter in 1990, ACCOSCA has defined SACCOs as ‘A credit union is a cooperative financial organization [savings, to use pooled funds, to make loans, and to provide other related services to members] owned and operated on a not-for-profit basis by its members according to democratic principles’.²⁸

The Model Law for Credit Unions defines it as ‘A credit union is a financial cooperative that may accept savings deposits, issue shares, and provide credit and other financial services to members.’²⁹

The USA Federal Credit Union Act defines ‘Federal credit union means a cooperative association organized in accordance with the provisions of [the Federal Credit Union Act) for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes’.³⁰

Similarly, Ethiopia's current Cooperative Societies Proclamation defines SACCOs as a society established to provide members with savings, credit, and loan-life insurance services.³¹

²⁷ ACCOSCA was established in 1968 at a conference held in Nairobi. Dejene Aredo, *The informal and semi-formal financial sectors in Ethiopia: a study of the iqqub, iddir, and savings and credit co-operatives* (Zakuna Printers Ltd.1993) 38

²⁸ *ibid*

²⁹ WOCCU, ‘Model Law for Credit Unions’(2015) part I, section 1.30 <<https://www.woccu.org>> accessed 15 January 2021

³⁰ Federal Credit Union Act, (Chapter 750; 48 Stat. 1216; 12 U.S.C. 1751) sect 101(1) <<https://www.govinfo.gov/content/pkg/COMPS-264/pdf/COMPS-264.pdf>> accessed 7 April 2021

³¹ Cooperative Societies Proclamation 985/2016 (n 2), Arts. 2(1), 2(7) & (8). Cooperative Society in turn is defined as an autonomous association having legal personality and democratically controlled by persons united voluntarily to meet their common economic, social and cultural needs and other aspirations, which could not be addressed individually, through an enterprise jointly owned and operated on the basis cooperative principles. And Loan-life-insurance is an insurance given by a cooperative society to its members to cover loan taken by a deceased member before full repayment of debt.

2.2.Rationale of SACCOs

Although there are exceptions, cooperatives are usually created in response to the constraints of other organizational forms and market failures, such as the absence of availability of goods and services to certain groups and the supply of low-quality or high-priced goods and services.³²

Deposits are channeled from small depositors to high-income agents through big banks in many low and middle-income economies, and the original depositors are rarely able to benefit from these funds, as high-income agents finance their new investments with deposits from low- and middle-income agents, and banks serve the interests of these few large corporatists.³³ Because they do not have enough information about these borrowers, investor-owned, profit-maximizing financial intermediaries tend to reject low- and middle-income agents (the information asymmetries problem).³⁴

But, if middle and low-income agents can pool their deposits together in a new financial institution that they own themselves based on some homogeneity among them, then they can increase their credit social capital.³⁵ That makes SACCOs not only important for financial inclusion and economic growth but their distinctive ownership structure also allows them to be practical instruments for redistributing economic resources, correct imbalances in income distribution that result from imperfect credit markets with asymmetric information, and ultimately serve for the democratization of capital.³⁶

Amr Khafagy succinctly explains the rationale of having member-owned financial institutions from the vantage point of increasing the members' leverage ratio and social credit capital as 'Access to credit depends mainly on the value of the borrowers' collaterals relative to the loan size

³²Murray Fulton and Jean-Pierre Girard, *Demutualization of Co-Operatives and Mutuals* (2015) 22 <<https://usaskstudies.coop/documents/pdfs/demutualization-of-co-ops-and-mutuals.pdf>>accessed 7 April 2021

³³Amr Khafagy, *The Economics of Financial Cooperatives: Income Distribution, Political Economy and Regulation* (Routledge Taylor & Francis Group 2000), 4

³⁴ ibid 39

³⁵ ibid 16

³⁶ ibid 4 and 35

(leverage ratio), and the borrowers' credit social capital, that is, the lender-borrower relationship developed from social relations or previous credit contracts'.³⁷

The economic objective of a SACCO is to maximize the welfare of its members who are also the owners, by providing financial intermediary services at lower interest rates to their borrowers and higher interest rates to their depositors compared to the market rate.³⁸ SACCOs grant loans to members who might not qualify for credit elsewhere and who cannot afford the high loan rates offered by other types of investor-owned financial institutions such as Banks and Micro Finance Institutions.³⁹

The other basic goal of a SACCO is to encourage thrift among its members not to make a profit, creating jobs, strengthens the social fabric, and heightens social stability.⁴⁰ Credit Unions have also played a major role in the United States and Canada in fighting usury.⁴¹ The main intention in establishing SACCOs by the colonial powers in many of Africa was, however, mainly to have instruments through which they would implement colonialists' socio-economic policies.⁴²

The model law for credit unions lists the objects of a credit union such as accepting savings deposits from members, provide a source of credit for members at a fair rate of interest and provide any other financial services that are useful and convenient for its members.⁴³

In Ethiopia too, the purposes of establishing SACCOs, among other things, are to develop and promote saving culture between members, to provide loans to members and promote investment, and to provide loan-life- insurance coverage to members.⁴⁴

³⁷ *ibid* 40

³⁸ *ibid* 33

³⁹ Aredo (n 27) 37

⁴⁰ Carmichael (n 12) forward

⁴¹ Khafagy (n 33) 39

⁴² Fredrick O. Wanyama, Patrick Develtere and Ignace Pollet, 'Reinventing the wheel? African cooperatives in a liberalized economic environment' (2009) 80 (3) *Annals of Public and Cooperative Economics*, 3

⁴³ Model Law for Credit Unions (2015) (n 29) Part I, section 1.30

⁴⁴ Cooperative Societies proclamation 985/2016 (n 2) Art 4(6-8)

2.3.The Nature of SACCOs in relation to Investor owned Financial Institutions

SACCOs like banks and MFIs are deposit-taking financial institutions that accept the demand, fixed-term and other types of deposits and make loans.⁴⁵ Nonetheless, SACCOs are also cooperatives and differ from banks among other things by that: (i) SACCO's shareholders are the members who receive the financial services provided by the SACCO and each member is entitled to one vote in the democratic governance processes of the SACCO, regardless of the amount of the member's individual shareholdings; (ii) Owners or the residual claimants of SACCOs are the main suppliers as well as users of funds; (iii) dividends are distributed to depositors as well as borrowers based on the monetary value of transactions carried out by members through the SACCO.⁴⁶

2.4.Development of SACCOs in Ethiopia

Most cooperatives have their philosophical roots in the self-help movement that emerged in England and spread to entire Europe and elsewhere during the 19th century and expanded to encompass the field of finance, over time.⁴⁷ The three dominant forms of financial cooperatives throughout the world have been building societies⁴⁸, credit unions, and friendly societies.⁴⁹

In Sub-Saharan Africa, the SACCO movement has grown in popularity, presently accounting for 30 to 50 percent of all cooperative firms and providing financial services to 8.81 percent of the population.⁵⁰ In Kenya, for example, in the year 2005, the share capital and deposits in savings

⁴⁵ Carmichael (n 12), 5

⁴⁶ Johnston Birchall, *Resilience in a downturn: The power of Financial cooperatives* (ILO 2013) 2

⁴⁷ Carmichael (n 12) 170

⁴⁸ Which pooled their resources to provide housing finance to members and when the loans were fully repaid, the societies terminated; then, terminating building societies evolved into permanent building societies or thrifts, which specialize in housing finance. *ibid*

⁴⁹ That provided insurance against a wide range of contingencies, including death, sickness, and unemployment. *ibid* 170- 172

⁵⁰ Allen and Maghimbi (n 8) 15

and credit cooperatives accounted for over 24% of domestic savings.⁵¹ Being SACCOs originated in Germany in the mid-nineteenth century, today there are about 78 million SACCOs in all over 80 countries.⁵² The history of formal⁵³ cooperatives in Ethiopia dates back to 1960 when the first directive of cooperatives, the Farm Workers Cooperative Decree No. 44/1960, was enacted.⁵⁴ In comparison to international development, Ethiopian SACCOs are relatively new, as they match to the country's overall cooperative society history. The first two SACCOs in Ethiopia were established in 1964 by employees of Ethiopian Airlines and by employees of the Ethiopian Road Authority and the Telecommunication Agency (now Ethio-telecom).⁵⁵ These SACCOs were formed even before the comprehensive cooperative society's proclamation No. 241/1966 was enacted. Some, on the other hand, traced the origins of SACCO back to the 1930s, claiming that it was during the Italian invasion of Ethiopia that SACCO was formed for the first time by Italians.⁵⁶

Though the SACCOs development started sixty years back, the expansion was concentrated within urban areas until 1998/9 and there were only 495 SACCOs with 119, 799 members and capital of birr 78,772,710.⁵⁷ Nevertheless, in the First growth and transformation plan (GTP I) (2011-2015), SACCOs planned to mobilize 2.5 billion birr saving and mobilized 6.6 million birr from members and also planned to provide 2.1-billion-birr loan and disbursed 4.78 billion birr to members.⁵⁸ SACCOs were also expected to raise mobilized savings from Birr 6.6 [million] to Birr 21.5 billion by GTP II (2015-2020), as well as the saving share collected by SACCO to domestic national

⁵¹ Graham Owen, 'Rural Outreach and Financial Cooperatives: SACCOs in Kenya' (2007) the World Bank Agricultural and Rural Development,2 <<https://docplayer.net/126662339-Rural-outreach-and-financial-cooperatives-saccos-in-kenya.html>> accessed 20 December 2019

⁵² Birchall (n 46) 8

⁵³ The word formal is employed here to exclude the informal social cooperatives such as equip and Iddir and other kind of self-help associations.

⁵⁴ Bezabih Emana, 'Cooperatives: a path to economic and social empowerment in Ethiopia' (2009) CoopAFRICA working paper 9, 1 <[http://www2.ilo.org/global/topics/cooperatives/publications/WCMS_672876/lang--en/index.htm](http://www2.ilo.org/global/topics/cooperatives/publications/WCMS_672876/lang-en/index.htm)> accessed 20 December 2019

⁵⁵ Aredo (n 27) 38

⁵⁶ Bealemene Cherinet and Chalu Tamiru, Interview with Haile Gebre, former commissioner of the FCA, Interview to FCA Magazine (Feb 2019), 55

⁵⁷ FCA, 'Cooperative Sector Ten Years Plan (n 13) 12

⁵⁸ *ibid* 2

saving to 5%, and loan issued by SACCOs to increase from Birr 4.78 billion to Birr 12.4 billion.⁵⁹ And as of March 2016, 18,000 SACCOs were spreading throughout the country, mainly in rural areas.⁶⁰ And, up to the end of 2020, 21,328 primary SACCOs were in operation having 5,384,559 members and these SACCOs have mobilized 17.38 Billion Birr savings, provided an average annual loan amount of 4 billion birr to over 500,000 members and their capital has reached 5.19 Billion Birr.⁶¹

⁵⁹ ibid 43

⁶⁰National Bank of Ethiopia, 'National financial inclusion strategy'(2017) 19
<<https://www.mfw4a.org/publication/ethiopia-national-financial-inclusion-strategy-2014-2020>> accessed 20 January 2020

⁶¹ FCA, Cooperative Sector Ten Years Plan (n 13) 6 and 27

CHAPTER- THREE

REGULATORY OBJECTIVES AND STRUCTURE OF SACCOs IN ETHIOPIA

3.1. Regulatory Objectives of SACCOs

The regulatory objective focuses on why SACCO needs to be regulated and what people expects regulation to achieve.⁶² Several international, albeit non-binding, instruments urge governments to create a supportive policy and legal framework that is consistent with the nature and function of cooperatives and guided by cooperative values and principles, allowing for the adoption of cooperative regulatory measures on terms that are appropriate to their nature and functions.⁶³

ILO Recommendation No. 193 on the promotion of cooperatives states that cooperatives should be treated in conformity with national law and practice and on conditions no less favorable than those provided to other types of enterprises.⁶⁴ In this regard, the ILO recommendation No.193 states that governments should provide a supportive policy and legal framework consistent with the nature and function of cooperatives, guided by cooperative values and principles, that would: (i) establish an institutional framework to allow cooperatives to be registered in as quick, simple, and efficient manner as possible (ii) make provisions for the adoption of cooperative oversight measures that are appropriate to their nature and functions, respect their autonomy, are consistent with national law and practice, and (iii) encourage the development of cooperatives as autonomous and self-managing organizations.⁶⁵

For the WOCCU Model Law for Credit Unions, establishing sound financial cooperatives/credit unions is the objective of a Credit Union legislation that strike an appropriate balance in terms of establishing safe and sound regulation without imposing unreasonable regulatory burdens.⁶⁶

⁶² Carmichael (n 12)21

⁶³ILO R193 (n 1) section II para 6; 2001 UN Guidelines aimed at creating a supportive environment for the development of cooperatives, section 11

<https://www.un.org/esa/socdev/social/documents/AnnexE200168.pdf>>accessed 10 January 2021

⁶⁴ ILO 193 (n 1) Section II, para 6(c)

⁶⁵ *ibid*

⁶⁶ Model Law for Credit Unions (2015) (n 29) 6

Because, in their financial institution aspect, SACCOs are similar to banks in that they are deposit-taking institutions, regulation is required to protect the large number of small depositors who lack the knowledge or ability to monitor the behavior of the SACCO in which they may have invested a significant portion of their life savings.⁶⁷ Furthermore, SACCOs in their cooperative aspect are dominated by two key interest conflicts: net borrower vs. net-saver and members vs. manager.⁶⁸ These conflicts in SACCOs are among the situations that necessitate regulation.

(i) **The net-borrower vs. net-saver interest conflict**

The interest of SACCO members are not homogeneous and may change over time based on the nature of their transactions with the cooperative; differing from shareholders of investor-owned banks whose primary interests are homogenous as they seek to maximize the returns on their capital.⁶⁹ The depositor-shareholder agency conflict that exists in investor-owned financial institutions does not exist in SACCOs, as depositors are shareholders, and members in SACCOs have no incentive to increase the risk of the mutual institution, at least theoretically, they are more interested in long-term access to financial services than in short-term gains.⁷⁰

In a SACCO, the main conflict is between net-saver and net-borrower interests. A SACCO has two groups of owners: net savers (members who have savings over borrowings) and net borrowers (members who have more borrowings than savings). The interests of these two groups are often contradictorily creating either borrower -dominance or saver dominance problems. The borrower-dominance problem arises when a SACCO's management is dominated by borrowers who support a policy of easy loans, low loan interest rates, and lax discipline in the recovery of loans. Net savers, in contrast, would prefer policies producing high returns, strict discipline on loans, and high interest on savings and loans.⁷¹

⁶⁷Glenn D. Westley and Brian Branch(eds), *Safe Money: Building Effective Credit Unions in Latin America* (Johns Hopkins University Press 2000) 9

⁶⁸ Cuevas and Fischer (n 11)

⁶⁹ Khafagy (n 33) 97

⁷⁰ *ibid* 96

⁷¹ World Bank, *Providing Financial Services in Rural Areas: A Fresh Look at Financial Cooperatives* (2007) 96

As a result, borrower-dominated SACCOs may maintain inefficient lending standards and conditions, thereby increasing default rates, while saver-dominated SACCOs may impose excessively stringent lending restrictions and high loan interest rates.⁷² The opposing motives of these two interests of owners of SACCOs usually lead to conflict between net-saver members and net-borrower members.⁷³ To preserve the balance between a net-borrower and net-saver member-owner interest conflicts, government regulatory intervention is required.

(ii) **Members vs. Manager's conflict**

The SACCO model of finance relies to a certain extent on the common bonds shared by members which foster trust between members. However, regulatory safeguards must be in place to improve discipline, long-term viability, and ensure that the SACCO's net worth is not jeopardized by the principal-agent problem, since a common bond declines with the expansion of membership.⁷⁴

A principal-agent problem occurs in a SACCO because owners (members) do not participate in managerial decisions, which may go against their interests.⁷⁵ This principal-agent conflict necessitates regulations that address the conflicting interests of SACCO management with members as a result of the former's dual status as members/owners/and management members, as well as a regulation that prevents management decisions from favoring either depositors or borrowers, and prevents the SACCO from becoming either a borrower or a saver controlled.⁷⁶

3.2. Regulatory Objectives of SACCOs in Ethiopia

The objectives of enacting the cooperative law were stated in the preamble of the Cooperatives Societies Proclamation 241/1966 as: (i) providing a proper basis for the formation of cooperatives that shall promote thrift, mutual help, and self-help among persons sharing common needs and

⁷² Khafagy(n 33) 96

⁷³ *ibid*

⁷⁴ World Bank, *Providing Financial Services in Rural Areas: A Fresh Look at Financial Cooperatives* (n 71)

⁷⁵ *ibid*

⁷⁶ *ibid*

desires, (ii) reducing the cost of credit, and (iii) reducing the cost of goods and services production and consumption.⁷⁷

In contrast, the Cooperative Societies Proclamation No. 138/1978 stated in its preamble the objectives of the law for (i) raising the living standard of peasants, artisans, and workers and developing the national economy, (ii) combating rampant feudalistic and capitalistic means of exploitation such as usury and laissez faire pricing, (ii) encouraging collective ownership of the means of production, and (ii) encouraging collective ownership of the means of production.⁷⁸

Because SACCOs were under the supervision of National Bank of Ethiopia during the Monetary and Banking Proclamation 83/1994, fostering monetary stability, sound financial system that are conducive to the balanced growth of the economy of Ethiopia could also be the regulatory objective of SACCOs.⁷⁹

The recently repealed Cooperatives Proclamation 147/1998 had set forth regulatory objectives of establishing cooperative societies which were formed by individuals voluntarily and who had similar needs for creating savings and mutual assistance among themselves by pooling their resources, knowledge, and property, and enabling cooperative societies to actively participate in the free market economic system.⁸⁰

The current Cooperatives Society Proclamation, in its preamble, states the regulatory objectives of (i) establishing and managing cooperative societies for those persons with a common interest by bringing together their finance, knowledge, resource, and labor voluntarily to meet their common economic, social, and cultural needs and other aspirations which would then allow mutual support and create savings, (ii) establishing and strengthening cooperative societies that are directed and managed by members and also ensuring their rights, owners, and benefits, (iii) causing the cooperative societies to play a pivotal role in the free market economic system by maintaining their guiding principles and unique features.⁸¹

⁷⁷Co-operative Societies Proclamation, 1966, preamble and Art. 4, Proc. No. 241, Neg. Gaz., Year.25, no. 24

⁷⁸Cooperative Societies Proclamation, 1978, preamble para 2, 3 and 4, Proc. No. 138, Neg. Gaz., Year 37, no. 7

⁷⁹ Monetary and Banking Proclamation, 1994, Proc. No. 83, Neg. Gaz., Year.53, no. 43

⁸⁰ Cooperative Societies Proclamation, 1998, preamble para 1 and 2, Proc. No. 147, Fed Neg. Gaz., Year. 5, no. 27

⁸¹ Cooperative Societies Proclamation 985/2016 (n 2) preamble, para 1, 3 and 4

The current cooperatives society proclamation has incorporated all the regulatory objectives dictated by the ILO recommendation No.193 and the 2001 UN Guidelines aimed at creating a supportive environment for the development of cooperatives. The proclamation emphasizes maintaining the cooperatives guiding principles including cooperative autonomy and independence. The principle of autonomy and independence dictates the co-operatives to have the freedom to act independently to govern themselves, control their own affairs and set their own rules of operation.⁸² This principle is reinforced by the principle of democratic member control that requires cooperatives to be democratic organizations controlled by their members, who actively participate in setting their policies and making decisions with one-member, one-vote.⁸³ To this end, the proclamation has empowered the general assembly of cooperative society members to approve and amend the by-laws and internal regulations, elect and dismiss members of the management committee, control committee and other members of sub-committees, determine the amount of shares of the cooperative society and decide the distribution of the annual net profit of the cooperative society.⁸⁴

Nonetheless, Ethiopia's cooperative legal framework does not aim to provide a supportive policy and legal framework consistent with the nature and function of SACCOs guided by cooperative values and principles that would: (i) establish an institutional framework to allow SACCOs be registered in as quick, simple, and efficient manner as possible and supervised by a professional SACCO regulator, (ii) make provisions for the adoption of legal regulatory implementations that are appropriate to their nature and functions by respecting their autonomy and (iii) encourage the development of SACCOs as autonomous, self-managing and sound financial intermediary.

The regulatory objectives of SACCOs should have been addressing the net-debtor-net-saver and member-manager interests taking in to consideration their financial and cooperative aspects. Yet, this regulatory objective cannot be achieved only through self-regulation approach based on cooperative autonomy and member democratic control; because SACCOs in Ethiopia are governed

⁸² ICA, 'Guidance Notes to the Co-operative Principles' (2015) (n 9)

⁸³ *ibid*

⁸⁴ Cooperative Societies proclamation 985/2016, (n 2) Arts. 32(2), (4) &(5)

by management committees made up of members who lack technical and management skills and SACCO members lack a sense of ownership that could not able to set self-regulatory rules.⁸⁵

Recently, however, the FCA has issued a draft SACCO prudential inspection directive with the objective of making SACCOs effective, successful and competitive and preventing them from bankruptcy and corruption and boost trust on members, the government, and creditors of SACCOs.⁸⁶ Though his draft directive is commendable, as it is limited in scope of its regulatory implementations and fails to address regulatory structures, it will not address the SACCO regulatory problems at all.

3.3. Regulatory Structure of SACCOs

Regulatory Structure is concerned with the structure of regulators that carry out regulatory and supervisory responsibilities.⁸⁷ There are various possible types of SACCO regulatory structures from an institutional regulatory structure standpoint, and most countries have adopted one of the following models to oversee the SACCO sector.⁸⁸

- i. First Model:** Direct supervision of SACCO by institutional financial regulator entrusted with the entire financial sector.

Direct supervision of all SACCO by an institutional financial regulator with the statutory responsibility of regulating the entire financial sector ensures uniform standards of competition, market integrity, and product regulation, and eliminates the chance for regulatory arbitrage, and promotes greater consumer confidence.⁸⁹ There is widespread agreement that because of the highly technical nature of financial regulation, SACCO supervision should be carried out by an institutional financial regulator charged with overseeing the entire financial sector, rather than by

⁸⁵ FCA GTP-2 (2015-2020) Main Document (2015) 11<<http://www.fca.gov.et/#>> accessed 17 July 2021

⁸⁶ FCA SACCO Prudential Inspection Directive 2021 (draft), introduction < <http://www.fca.gov.et/> > accessed 1 September 2021

⁸⁷ Carmichael (n 12) 21

⁸⁸ Khafagy (n 33) 113

⁸⁹Andrew Poprawa, ‘Regulation and Legislation of Cooperative Banks and Credit Unions’ (2009) 2<<https://www.un.org/esa/socdev/egms/docs/2009/cooperatives/Poprawa.pdf>> accessed 21 May 2021

a cooperative development agency, which is typically not able to do so.⁹⁰ In the same vein, the WOCCU Model Credit Union Law recommends for SACCOs be supervised by a specialized organization responsible for regulating financial institutions.⁹¹

Nonetheless, because SACCO financial intermediaries are small and do not pose a systemic threat to the financial system as a whole as they do not mobilize funds from the general public, and because SACCOs are often geographically dispersed, have small memberships, represent a small share of the financial markets, and have limited economic impact, the institutional financial regulator may lack the institutional capacity and interest to oversee them.⁹²

- ii. Second Model:** Direct supervision by institutional financial regulator over large SACCOs only based on asset size or deposit base, while small SACCOs are supervised by another governmental agency (like ministries of cooperatives).⁹³

This type of direct supervision extends the technical expertise in a financial regulator to and focuses resources on the largest SACCO institutions, which could present systemic problems if they fail.⁹⁴ The disadvantages of this regulatory structure include that, while it requires fewer resources from the supervising agency, it may promote regulatory arbitrage and divide the SACCO sector into two segments, each with its own compliance requirements. This separation can cause depositors to be confused about which SACCOs are supervised (and sound) and which are not, resulting in a loss of trust in all SACCOs.⁹⁵

- iii. Third Model:** Delegated or auxiliary supervision which gives the supervisory responsibility to a third party—most commonly to the national federation of SACCOs.

The institutional financial superintendency would assign regular data collection and much or all on-site inspection tasks to the SACCO federation, including the right to intervene in failing

⁹⁰ *ibid* 6

⁹¹ Model Law for Credit union Law (2015) (n 29)

⁹² Westley and Branch (eds) (n 67) 143

⁹³ *ibid* 155

⁹⁴ Poprawa (n 89) 3

⁹⁵ *ibid*

SACCO institutions and liquidate or merge them, to the SACCO federation under delegated supervision.⁹⁶

This model benefits the government in the short run by allowing it to avoid the financial cost of supervision.⁹⁷ This model, however, has disadvantages such as a lack of robust conflict of interest management because the supervisor is the primary advocate for SACCOs and is governed by the organizations it oversees, as well as a lack of considerable technical capacity development in the delegated entity.⁹⁸

iv. Fourth Model: Supervision by designated SACCO regulator

The Kenyan and the USA approaches are good examples of this model of SACCO regulatory structure. The SACCO Societies Act in Kenya established the SACCO Societies Regulatory Authority, which is led by a board that includes the Permanent Secretary to the Treasury, the Governor of the Central Bank, and four members who are not public officers and are appointed by the Minister [under which cooperatives are accounted for] based on their knowledge and experience of at least ten years in cooperative practice and management, law, finance or economics⁹⁹, and this Authority is responsible for supervising SACCO societies to ensure that they comply with the provisions of the SACCO societies act, regulations, bylaws, policies, procedures, and any other applicable law.¹⁰⁰

In the United States, an autonomous agency called the National Credit Union Administration, led by the Board comprised of individuals with expertise in a wide range of financial services, financial

⁹⁶WOCCU, 'Technical Guide on Credit Union Regulation and Supervision' (2008), 13<http://collaboration.worldbank.org/content/usergenerated/asi/cloud/attachments/sites/collaboration-for-development/en/groups/cooperative-financial-institutions/documents/_jcr_content/content/primary/blog/technical_guide_cred-K39k/Technical%20Guide-Credit-Union-Regulation-and-Supervision-2008.pdf> accessed 25 May 2021

⁹⁷ *ibid* 14

⁹⁸ Poprawa(n 89)

⁹⁹ Kenyan SACCO Societies Act (n 24) Art. 4 and 6

¹⁰⁰ Kenya SACCO Societies (Deposit-taking Sacco Business) Regulations, 2010, sect.66(1)<http://www.kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/SaccoSocietiesAct_No14of2008.pdf> accessed 10 January 2021

services regulation, or financial policy as evidenced by their education, training, or experience, was established inside the executive department of the government to oversee Federal credit unions.¹⁰¹

Supervisions by designated SACCO regulators attempt to achieve balance by recognizing the special nature of SACCOs in their regulatory implementations, allowing them to continue to expand sustainably and safely and ultimately increase their market share in the financial sector.

v. Fifth Model: Supervision by Cooperative Sector Regulator

This is the regulation and monitoring of the entire cooperative sector, including agricultural or housing cooperatives and other non-SACCOs, by the Ministry or Agency of Cooperatives. The benefit of this model is that it avoids the fragmentation of the cooperative movement that would otherwise occur if different types of cooperatives, including SACCOs, were placed under the supervision of different public authorities with potentially divergent policies.¹⁰² However, the general cooperative sector regulator is incapable to oversee SACCOs because the general cooperative sector regulator, which oversees the business operations of agricultural, consumer, commercial, and industrial cooperatives, is usually insufficient for SACCOs, which are depository institutions with business operations that most closely resemble those of banks and require a financial sector regulation skill set.¹⁰³ Ethiopia's current SACCO regulatory structure exemplifies this approach.

3.4. Regulatory Structure of SACCOs in Ethiopia

The regulatory structure of SACCOs in Ethiopia may be divided into two key phases, using the adoption of the Cooperative Societies Proclamation No. 147/1998 as a benchmark, as this proclamation marked a complete paradigm shift in SACCO regulatory structure. These two critical phases, as well as the necessary regulatory reforms, will be described more below.

¹⁰¹ Federal Credit Unions Act, (n 30) section 102 and 106[12 U.S.C. 1756]

¹⁰² Hagen Henry, *Guidelines for Cooperative Legislation (2nd rev edn ILO 2005)*, 15

¹⁰³ Model Credit union law (2015) (n 29)10

I. Pre- 1998 Period

During this period, in the history of cooperatives, the Cooperative Societies Proclamation No. 241/1966, Cooperative Societies Proclamation No.138/1978, Monetary and Banking Proclamation No. 99/ 1976, and Monetary and Banking Proclamation No. 83/1994 were enacted that had relevance with the regulatory structure of SACCOs.

Application for registration of cooperative societies was made to the Registrar of Cooperative Societies under Cooperative Societies Proclamation No. 241/1966, specifying the object and areas of operation of the society, and they were examined and audited by the Registrar of Cooperative Societies.¹⁰⁴ Then, under Cooperative Societies Proclamation No. 138/1978, a Cooperative Board was established to issue policies and directives and to coordinate and supervise the activities of producer, service, thrift, and credit cooperatives, as well as housing cooperatives.¹⁰⁵ During this time, however, the National Bank of Ethiopia had registered, supervised, audited, and inspected thrift and credit cooperatives.¹⁰⁶

The Cooperative Societies Proclamation No. 138/1978 had, in fact, followed the dictations of the Monetary and Banking Proclamation No. 99/ 1976 which did provide for the NBE to supervise, regulate and control the operations of banks and other financial institutions-the Ethiopian insurance corporations, institutions of savings, postal savings, credit cooperatives, and other similar institutions.¹⁰⁷

Despite the fact that the Monetary and Banking Proclamation 99/1976 was repealed by the Monetary and Banking Proclamation No. 83/1994, the NBE retained the authority to license, supervise, and regulate banks, insurance companies, and other financial institutions (savings and credit cooperatives, and other similar institutions engaged in any type of banking business) *in*

¹⁰⁴ Cooperative Societies Proclamation No. 241/1966 (n 77) Arts. 9, 5, 38, 39 and 40

¹⁰⁵ Cooperative Societies Proclamation No. 138/1978 (n 78) Arts. 14 and 17, the governor of the National Bank was a member of the board.

¹⁰⁶ *ibid* Arts. 12(1)(d), 2(1), 19(b), 26 and 27

¹⁰⁷ Monetary and Banking Proclamation, 1976, Art 2(3) and 9(4), Proc. No. 99, Neg. Gaz., Year. 36, no.1

*accordance with the law.*¹⁰⁸ The emphasized phrase ‘in accordance with the law’ referred to the Cooperative Societies Proclamation No. 138/1978 for SACCOs.

As a result, while before Cooperative Societies Proclamation No. 138/1978, SACCOs were under regulatory structure of the Registrar of Cooperatives, after this Proclamation SACCOs were put under NBE’s regulatory structure.

II. Post – 1998 Period

The Licensing and Supervision of Micro Financing Institutions Proclamation No. 40/1996, which paved the way for the shift in regulatory structure of SACCOs, was enacted in 1996 and for the first time admitted micro-financing business institutions into the Ethiopian monetary and financial system.¹⁰⁹

Two years after the Micro Financing Institutions Proclamation, the Cooperative Societies Proclamation No. 147/1998 was issued on 29th day of December 1998. Under this Proclamation, every society was made to be registered by the appropriate authority- an organ established at the federal level, or a bureau or an organ established for the same purpose at the Regional or City Administration level, to organize and register cooperative societies...¹¹⁰ SACCOs were one of the societies listed in the proclamation to be regulated and supervised by the same government agency that oversees all non-financial cooperatives, such as agriculture, housing, fisheries, transportation, supply, and marketing.¹¹¹

The National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008 thus repealed the Monetary and Banking Proclamation No. 83/1994, confirming the NBE's authority

¹⁰⁸Monetary and Banking Proclamation 83/1994 (n 79) Art 2(4) and 41 (emphasis added)

¹⁰⁹ Licensing and Supervision of Micro Financing Institutions Proclamation, 1996, preamble, first para, Proc. No. 40, Fed Neg Gaz., Year.2, no. 30

¹¹⁰ Cooperative societies proclamation No. 147/1998(n 80) Art 9(1) and Art 2(7)

¹¹¹ *ibid* Art 2(1)(e)

only to license and regulate banks, insurers, and other financial institutions, specifically excluding SACCOs.¹¹²

Subsequently, Cooperative Societies Proclamation No. 147/1998 has been repealed, and Cooperative Societies Proclamation No. 985/2016 has taken its place. This proclamation follows the same regulatory structure as the previous one and places SACCOs under the regulatory oversight of a general cooperative offices. The proclamation provides that, *any cooperative society* is required to be registered by the appropriate authority- the FCA, or an organ established at regional levels to execute the cooperative societies proclamation, lead and regulate the cooperative sector.¹¹³

III. Required Reform on the Regulatory Structure for SACCOs- Establish Special SACCO Regulatory Authority

The National financial inclusion strategy of Ethiopia identifies that weak governance and lack of technical and management skills and systems are serious challenges facing the [SACCO] sector, which is reflected in the low (and of declining) levels of savings mobilized through SACCOs.¹¹⁴ To this end, the strategy provides that to promote rural financial services, particularly agricultural finance, Ethiopia will devise options for strengthening the structure of SACCO sector based on international best experiences.¹¹⁵ And it stipulated that the FCA needs to strengthen its capacity to oversee the SACCO sector.¹¹⁶

Nonetheless, the FCA GTP-2 (2015-2020) Main Document has identified problems related to cooperative promotions implementing bodies (from federal to regional cooperative promotion offices) including the absence of uniform organizational structure and manpower to able to organize, capacitate and regulate cooperatives.¹¹⁷ And improper implementations of cooperative proclamations, regulations, and guidelines and from man power perspective weak business and

¹¹²National Bank of Ethiopia Establishment (as Amended) Proclamation, 2008, Art 2(10), Proc. No. 591, Fed Neg. Gaz., Year. 14, no.50

¹¹³ Cooperative Societies Proclamation No. 985/2016 (n 2) Art 10(1) and Art 2(20) (emphasis added)

¹¹⁴ National Bank of Ethiopia, ‘National financial inclusion strategy’(n 60) 19

¹¹⁵ *ibid* 34

¹¹⁶ *ibid*

¹¹⁷ FCA GTP-2 (2015-2020) Main Document (2015)(n 85)

management skills in cooperative managements, limitations of skill, attitude, and commitment on management and experts were identified as a weakness and challenging situations to the cooperative promotion bodies.¹¹⁸

The FCA 10 year Cooperative sector plan has also identified that there is attitude, knowledge, and skill gap on management employees and cooperative sector promotion bodies' experts.¹¹⁹ And lack of uniform understanding of cooperatives working procedures and weak performance of management and staff of cooperatives implementing bodies are identified as challenges.¹²⁰ For instance, though, the appropriate authority is empowered to audit or causes to be audited the accounts of any cooperative society at least once in a year in accordance to its fiscal year to examine and verify overdue debts, if any, and cash balance, securities and assets and liabilities; and inspect any cooperative society's organizational status, operations, documents, and financial conditions to measure the status of a cooperative society,¹²¹ the FCA's cooperatives sector inspection and audit performance at the end of 2020 was 58% and 33% respectively.¹²²

Ironically, the existing regulatory system places SACCOs that require a professional financial regulator under the general Cooperative offices regulatory framework, which are plagued by the aforementioned problems. To gain the long-term benefits given by SACCOs, finding a regulatory structure that provides the highest level of member confidence for individual depositors and borrowers is critical.

Kifle Tesfamariam had suggested that specific regulatory suggestions should be based on thorough assessment of a number of factors, including capacity issues and the consequences of various arrangements on the growth and sustainability of financial cooperatives.¹²³ And, before the enactment of the current cooperative's proclamation, the RUFIP proposed a separate supervisory

¹¹⁸ *ibid* 13 and 17

¹¹⁹ FCA, 'Cooperative Sector Ten Years Plan' (n 13) 22

¹²⁰ *ibid* 26

¹²¹ Cooperative Society Proclamation, 985/2016 (n 2) Arts. 50(1), 50(2), 52(1) and 52(4)

¹²² FCA, 'Cooperative Sector Ten Years Plan' (n 13) 4

¹²³ Tesfamariam, 'Savings and Credit Cooperatives in Ethiopia: Development, Challenges and Proposed Intervention' (2015) 4 *International Journal of Cooperative Studies*, 7

authority different from cooperative bureaus for rural financial cooperatives.¹²⁴ The proclamation, however, has brought SACCOs under the general cooperative offices both at federal and regional levels, contrary to the RUFIP's suggestion.

The NBE, according to Kifle Tesfamariam, cannot be expected to undertake SACCO supervision on top of its current responsibilities of regulating and supervising banks and Microfinance Institutions, given the enormous number and dispersed location of the financial cooperatives.¹²⁵ For instance, up to end of 2020, there were, 21,328 primary SACCOs having 5,384,559 members.¹²⁶ This recommendation is further supported by the Basel Committee for Banking Supervisions (BCBS) in its guidance for the implementation of its Core Principles for institutions engaged in financial inclusion, which addresses financial cooperatives as well that provides for proportionate supervision - that countries can allocate supervisory resources efficiently among the financial system based on the risk associated with the financial institution on depositors and the whole financial system.¹²⁷

Now, because the general cooperative offices are plagued by capacity problems that prevent them from overseeing SACCOs, which rank second only to agricultural cooperatives in terms of sectoral engagement, and because the NBE cannot regulate SACCOs due to the principle of proportionality of supervisions, Ethiopia should establish a SACCO regulatory authority similar to the Kenya SACCO Societies Regulatory Authority and the United States Credit Union Administration. This Authority should be led by a board comprised of individuals with education, training, or experience in a broad range of financial services, financial services regulation, or financial policy.

In addition, as Ethiopia is a federal state and because the ILO recommendation No.193 requires governments to provide a supportive policy and legal framework that establishes an institutional framework to allow cooperatives to be registered in as quick, simple, and efficient manner as

¹²⁴ FDRE Rural Financial Intermediation Programme II Supervision report (2013) 19

¹²⁵ Tesfamariam (n 123)

¹²⁶ FCA, Cooperative Sector Five Years Plan (2020- 2025) 6 and 27 <<http://www.fca.gov.et/#>> accessed 17 July 2021

¹²⁷ Bank for International Settlements, “Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion, (2016) 1 <<https://www.bis.org/bcbs/publ/d351.pdf>> accessed 15 November 2019

possible¹²⁸, this SACCO regulatory authority should be established both at the federal and regional levels. The power sharing can, however, follow the general cooperatives societies proclamation power allocation that primary cooperative society established at federal level to consist members from two or more regional states.¹²⁹ Hence, a SACCO authority that will be established at the federal level may regulate SACCOs that will be established by members from two or more regional states and the regional SACCO authorities may regulate the rest. This is also in line with the experience of the USA that the regulatory architecture of credit unions has two tiers since they may apply to a federal agency- NCUA – and state supervisory authorities. The NCUA licenses Federal Credit Unions, determines their prudential requirements, enforces them, and supervises their risk management. On the other hand, each of the state authorities is responsible for licensing and supervising state-chartered Credit unions.¹³⁰

Nevertheless, the federal SACCO regulatory authority should have a direct legal relationship with the regional SACCO regulatory offices and with the National Bank of Ethiopia on regulatory rules and reporting mechanism as SACCOs are part of the financial sector and the National Bank should have performance reports for the general financial sector. The FCA was accountable to several government ministries and it is now accountable to the Ministry of Agriculture.¹³¹ Since, the Monetary and Banking Proclamation No. 83/1994 was repealed by the National Bank of Ethiopia Establishment (as Amended) Proclamation No.591/2008, there is nowhere that FCA and NBE have been legally linked to each other on the area of SACCO regulation.

¹²⁸ ILO R193 (n 1) section II

¹²⁹ Cooperative Societies Proclamation 985/2016 (n 2) Art 7(4)

¹³⁰Rodrigo Coelho, Jose Angelo Mazzillo (et al), 'Regulation and supervision of financial cooperatives, FSI Insights on policy implementation No. 15' (2019) 75 <<https://www.bis.org/fsi/publ/insights15.pdf>> accessed 15 December 2019

¹³¹ Definition of Powers and Duties of the Executive Organs of the FDRE Proclamation, 2018, Art 33(9)(c), Proc. No.1097, Fed Neg Gaz., Year.25, no. 8

CHAPTER – FOUR

LEGAL REGULATORY FRAMEWORK AND REGULATORY IMPLEMENTATIONS OF SACCOS IN ETHIOPIA

The regulator of a particular financial intermediary has to be effective to meet its regulatory objectives.¹³² The legislative backing available to the regulator and regulatory implementations are litmus tests to measure the effectiveness of a regulator.¹³³

4.1. Legal Regulatory Framework of SACCOs

The first cooperative law was enacted in Germany in 1867, and currently cooperative laws have been enacted or are in the process of being enacted in all countries where cooperatives exist.¹³⁴ However, there is no consensus on whether there should be one law covering all types of cooperatives, activities, professions, single-purpose and/or multipurpose cooperatives, and all levels of cooperative organizations; or one law with separate parts covering all or some types of cooperatives/activities; or several distinct laws covering some types of cooperatives/activities.¹³⁵

Cascading the issue to SACCOs, there are three main legal regulatory frameworks, with their own merits and limitations, adopted to regulate their operations in most countries. These are regulations through (a) a specialized SACCO law, (b) a general cooperative society law, and (c) a banking law.¹³⁶

i. Regulating SACCOs through General Cooperative Law

This legal regulatory framework follows one single general cooperative law covering all types of cooperatives including SACCOs; because it is believed that:¹³⁷

¹³² Carmichael (n 12) 48

¹³³ *ibid*

¹³⁴ World Bank, *Providing Financial Services in Rural Areas: A Fresh Look at Financial Cooperatives* (n 71)

¹³⁵ Henry (n 102)

¹³⁶ Cuevas and Fischer (n 11)30

¹³⁷ Henry (n 102)

- One general cooperative law for all types of cooperatives, possibly with specific parts for specific types of cooperatives/activities, for example, housing or SACCOs, best guarantees the autonomy of cooperatives, as it might allow to regulate their specific affairs as far as possible through their bylaws.
- One single general cooperative law avoids the fragmentation of the cooperative movement that might occur where different types of cooperatives were registered under different laws, perhaps with heterogeneous policies.
- One single cooperative law creates legal security for those dealing with cooperatives, as legal security relates to structural and liability aspects than to a specific type of cooperative activity.

However, general cooperative law is insufficient to regulate SACCOs for the following reasons:

- SACCOs mobilize deposits from their members and need deposit-safety measures, and the legal framework should provide regulatory implementations specifically relevant for SACCOs, which a general cooperative law lacks to effectively address.¹³⁸ and
- General cooperative society's laws which govern the business operations of agricultural, consumer, commercial, and industrial cooperatives are usually inadequate for SACCOs, which are depository institutions whose business operations most closely resemble banking institutions.¹³⁹

ii. **Regulating SACCOs through Banking Laws**

Banking law is usually applied either to all SACCOs in a country or applied only to the largest SACCOs while smaller ones are regulated by the general cooperative society law.¹⁴⁰ The later legal framework is referred to be 'dual regime', widely common in Latin America, where most SACCOs are under cooperative law and only a few largest of them are governed by the banking laws based on specific criteria.¹⁴¹

¹³⁸ Khafagy (n 33) 92

¹³⁹ WOCCU, *Technical Guide Credit on Union Regulation and Supervision* (n 96), 14

¹⁴⁰ Khafagy(n 33) 91

¹⁴¹ *ibid*

SACCOs, on the other hand, are not suited to be regulated by conventional banking law for the following reasons:

- Regulation through general banking laws without different provisions for SACCOs is generally inadequate because, some regulatory implementations, for instance, high initial capital requirements may be unreasonably challenging for SACCOs, as low- and middle-income classes will probably be unable to raise large initial start-up capital.¹⁴²
- SACCOs are not-for-profit organizations with members that are more concerned with receiving adequate financial services than end-of-year profits.¹⁴³

As a result, considering the limitation of regulating SACCOs by the general banking laws, the BCBS had recently issued guidance in its core principles that different types of financial institutions should be regulated differently than commercial banks, especially if they do not possess a significant percentage of the financial system's deposits.¹⁴⁴

iii. **Regulating SACCOs through Special SACCO Law**

In the light of the cooperative distinctiveness that is cooperatives with differing activities, needs, membership bases, stages of development, sizes, degrees of complexity, and inter-relatedness with competitors, there is a consideration to have different laws than one general cooperative law.¹⁴⁵

Having a separate SACCO law has been a subject of academic debate, and it has been recognized in a number of international soft laws. Some countries have also enacted a special SACCO law. Kenya is a good example of this approach. The Kenyan SACCO Societies Act, is enacted for the licensing, regulation, supervision, and promotion of SACCO societies.¹⁴⁶ However, SACCOs are subject to Kenya's general cooperative law, and in the event of a conflict between general

¹⁴² *ibid* 92

¹⁴³ WOCCU, *Technical Guide on Credit Union Regulation and Supervision*, (n 96) 2

¹⁴⁴ Bank for International Settlements, "Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion (n 127)

¹⁴⁵ Henry (n 102)

¹⁴⁶ SACCO Societies Act (n 24)

cooperative law and special SACCO law on subjects that are unique to SACCOs, the SACCO law will prevail.¹⁴⁷

The 2001 UN Guidelines aimed at creating a supportive environment for the development of cooperatives provides that ‘consistent with the basic provisions of general cooperative legislation, and recognizing the distinctive nature of the business of some cooperatives, it may be appropriate to make special provisions in the law for certain types of categories of cooperatives to safeguard their ability to enjoy real equality with other types of associations and enterprises and not be discriminated against because of their special character’.¹⁴⁸ As such, the guideline dictates that a cooperative law shall contain a provision that states a general law applies to all categories of cooperatives but that, to respond to the situation of certain categories of cooperatives, special laws might be enacted, consistent with the general law.¹⁴⁹

In the same vein, the WOCCU justifies the enactment of special model credit union law by saying that ‘while SACCOs are cooperative organizations, their specialization in financial services makes them different in many significant respects from other cooperative societies’.¹⁵⁰ This is because, regulating SACCOs within a legal framework that targets other non-SACCOs, including banks, or microfinance institutions usually fails to recognize the cooperative aspects of SACCOs as well as their small scale, narrow scope, and the specific risks they face.¹⁵¹

4.2. Legal Regulatory Structure of SACCOs in Ethiopia

The legal regulatory structure of SACCOs in Ethiopia can be divided into two primary phases using the enactment of the National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008 as a foundation for categorization, as this proclamation created a complete legal regulatory shift for SACCOs.

¹⁴⁷ Kenyan Co-operative Societies Act, 1997, section 67

¹⁴⁸ UN Guidelines aimed at creating a supportive environment for the development of cooperatives (n 63) para 12

¹⁴⁹ *ibid* para 11

¹⁵⁰ Model Law for Credit Unions (2015) (n 29) 10

¹⁵¹ Khafagy (n 33) 91

i. Pre- 2008 Period

Because the monetary and banking proclamation 206/1963 was passed before the comprehensive cooperative society proclamation No. 241/1966, it did not expressly state that the proclamation's rules apply to SACCOs. However, the Monetary and Banking Proclamation No. 99/1976 was enacted while the comprehensive cooperative society's proclamation No. 241/1966 was in effect. Under this Proclamation, the National Bank was empowered to issue directives concerning credit transactions of banks and other financial institutions including credit cooperatives.¹⁵² Through these directives, the National Bank also had the authority to set the minimum and maximum interest rates that banks and other financial institutions could charge for various types of loans, advances, and other credit transactions, as well as for various categories of borrowers; and to pay on various classes of deposits.¹⁵³

The National Bank though its directives used to mandate banks and other financial institutions to keep a certain percentage of their deposit liabilities with it in cash and other forms of liquid assets, such as government securities, as well as set reserve requirements for different types of deposits.¹⁵⁴

Then, the Cooperative Societies Proclamation No. 138/1978 was enacted, and thrift and credit cooperative societies were among the several cooperatives that had been established under this proclamation.¹⁵⁵ Furthermore, the Monetary and Banking Proclamation No. 83/1994 repealed the Monetary and Banking Proclamation No. 99/1976. Under this proclamation, the National Bank of Ethiopia had the power to issue directives governing credit transactions of banks, and other financial institutions including credit Cooperatives.¹⁵⁶ The directives were, however, either made uniformly applicable to all banks, insurers, and other financial institutions, or, if the National Bank so provided, exclusively to those banks or institutions that carry on credit transactions as defined by the regulations.¹⁵⁷

¹⁵² Monetary and Banking Proclamation No. 99/ 1976 (n 107) Art 30(2) and 2(3)

¹⁵³ *ibid* Art 32(1(a&b))

¹⁵⁴ *ibid* Art 33(1) and Art 33(2)

¹⁵⁵ Cooperative Societies Proclamation No. 138/1978(n 78) Art, 4(3)

¹⁵⁶ Monetary and Banking Proclamation No. 83/1994(n 79) Arts. 28(1)(b), 41 and 2(4)

¹⁵⁷ *ibid* Art 28(2)

The National Bank had the authority to fix the minimum and maximum rates of interest which banks and other financial institutions would charge for different types of loans, advances, and other credit transactions; and pay on various classes of deposits.¹⁵⁸

In summary, prior to 2008, SACCOs were governed by general cooperative law, and the National Bank of Ethiopia's directives were also, in principle, applicable to SACCOs where appropriate. During this time, however, no SACCO-specific legislation had been passed. Nonetheless, the licensing and supervisions of Banking Proclamation No. 84/1994 did not mention SACCOs.¹⁵⁹ As a result, it cannot be exclusively concluded that the banking law approach has been used to regulate SACCOs before 2008.

ii. Post -2008 Period

The Monetary and Banking Proclamation No. 83/1994 was repealed by the National Bank of Ethiopia Establishment (as Amended) Proclamation No.591/2008, which excluded SACCOs from the definition of "Other Financial Institutions."¹⁶⁰ Other financial institutions are now defined only to include microfinance institutions, postal savings institutions, money transfer institutions, and other similar financial institutions that are established in compliance with Ethiopian law and as determined by the National Bank.¹⁶¹

The Cooperative Societies Proclamation 147/1998 was the only legal framework in place to regulate SACCOs after the issuance of NBE Establishment (as Amended) Proclamation No.591/2008. Now, Cooperative Societies Proclamation No. 147/1998 has been repealed, and Cooperative Societies Proclamation No. 985/2016 has taken its place. This new proclamation sets out *inter alia* general provisions for objective of the cooperative societies, cooperative principles and values, registration of cooperatives, rights and duties of members, governance and management of cooperatives, special privileges of primary cooperatives, assets and funds of

¹⁵⁸ *ibid* Art 30(1(a&b))

¹⁵⁹ Licensing and supervisions of Banking Proclamation 1994, Proc. No. 84, Neg. Gaz. Year 53 no. 44

¹⁶⁰ National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008 (n 112) Arts. 2(10) and 28(1)

¹⁶¹ *ibid* Art 2(10)

primary cooperatives, audit and inspection, dissolution of cooperatives and other miscellaneous provisions.

The Council of Ministers is empowered to issue regulation necessary for the implementation of the cooperative societies Proclamation.¹⁶² Regions, on the other hand, may enact a law that is not in contradiction with the cooperative societies proclamation and regulations that will be issued under the proclamation.¹⁶³ The FCA may also issue directives for the implementation of the cooperative societies Proclamation and regulation.¹⁶⁴ In fact, FCA's draft SACCO prudential inspection directive is drafted in line with this authority.

Moreover, the cooperative Societies proclamation allows a cooperative society to provide in the society's bylaws particulars not contrary to the proclamation, and regulation and directive enacted for the implementation of the proclamation.¹⁶⁵

Nonetheless, some researchers, such as Kifle Tesfamariam, have suggested that [A] separate legislation focusing on SACCOs is needed, based on the premise that SACCOs are financial institutions that must be treated and nurtured as such.¹⁶⁶ Even during the deliberation of the Cooperative societies proclamation No. 985/2016, there was a discussion on whether SACCOs should be regulated through a separate law or a section or chapter within the existing Cooperative law.¹⁶⁷ For instance, though 'there is nothing that is 'rural' about the legal framework of financial cooperatives, and their regulations, and supervision'¹⁶⁸, the RUFIP proposed a separate legal code for rural financial cooperatives.¹⁶⁹ Nevertheless, contrary to the suggestion of RUFIP and some researchers, the expected proclamation was promulgated only by defining the term SACCO and

¹⁶² Cooperative Societies Proclamation No. 985/2016 (n 2) Art 76(1)

¹⁶³ *ibid* Art 76(2)

¹⁶⁴ *ibid* Art 76(3)

¹⁶⁵ *ibid* Art 12(1)(m)

¹⁶⁶ Tesfamariam (n 123)

¹⁶⁷ FDRE Rural Financial Intermediation Programme II (n 124)

¹⁶⁸ World Bank, Providing Financial Services in Rural Areas: A Fresh Look at Financial Cooperatives (n 71) 4

¹⁶⁹ FDRE Rural Financial Intermediation Programme II (n 124)

leaving other matters to be dealt with by the Council of Minister's regulation.¹⁷⁰ Despite this, the Council of Ministers has not yet issued any regulation.

iii. **Required Reform on the Legal Structure of SACCOs- Enact Special SACCO Law**

The FCA's main document for GTP-2 and the 10-year cooperative plan identifies the existence of cooperative laws as a strength of the cooperative sector and the availabilities of cooperative proclamations, regulations, supportive policies, strategies, and implementing manuals to organize and strengthen cooperatives as the enabling situation to achieve the GTP-2 of the cooperative sector.¹⁷¹ However, unlike FCA's assessment, the current general cooperative society law, which regulates the business operations of agricultural, consumer, and other cooperatives, is insufficient for SACCOs, which are depository institutions with business operations that are most similar to those of banks.¹⁷² Because SACCOs collect deposits from members and give loans to members, they require special law tailored to their needs, which a general cooperative law does not adequately handle, as the existing Ethiopian SACCO legal regime demonstrates.

In addition, the Cooperatives Societies Proclamation through a self-regulatory approach empowers the general assembly of cooperative society members to approve and amend the by-laws and internal regulations, elect and dismiss members of the management committee, control committee, and other members of sub-committees¹⁷³, due to weak governance and lack of technical and management skills and systems¹⁷⁴, due to unskilled management committees drawn from their members,¹⁷⁵ and due to low sense of ownership of members on their cooperatives and their failure to exercise obligations based on their bylaws¹⁷⁶, only a self-regulation approach through bylaws model cannot be successful in regulating the SACCO net-saver and net debtor and member manager interest conflicts.

¹⁷⁰ Cooperative Societies Proclamation No. 985/2016 (n 2) Art 21(9) and 21(10)

¹⁷¹ FCA GTP-2 (2015-2020) Main Document (2015) (n 85); FCA, 'Cooperative Sector Ten Years Plan' (n 13) 4

¹⁷² Model Law for Credit Unions (2015) (n 29)

¹⁷³ Cooperative Societies proclamation No. 985/2016 (n 2) Arts. 32(2) and 32 (4) &(5)

¹⁷⁴ National Bank of Ethiopia, 'National financial inclusion strategy' (n 58)

¹⁷⁵ Eman (n 52)27

¹⁷⁶ FCA GTP-2 (2015-2020) Main Document (2015) (n 84)

Hence, besides the general cooperatives law, Ethiopia should have a SACCO specific law that is in conformity with the ILO recommendation No.193 requirements that requires to have a supportive policy and legal framework consistent with the nature and function of cooperatives. As a result, at a very minimum, the Council of Ministers should enact a regulation for SACCOs on how to collect member savings, offer credit, and provide a microcredit life insurance service for members' loans or savings, while respecting the SACCOs autonomy and independence.

Moreover, Regions may also enact SACCO specific laws that is not in contradiction with the general cooperatives' societies proclamation and the federal SACCO law.¹⁷⁷ For instance, in the USA, states have credit union laws for their own state-chartered Credit unions.¹⁷⁸ The FCA's draft SACCO prudential inspection directive, which considers the financial and cooperative aspects of SACCOs, is an attempt to address the aforementioned self-regulatory difficulties.

SACCOs in Ethiopia, however, should not be regulated by banking laws because, according to the BCBS core principles, different types of financial institutions should be regulated differently than commercial banks, especially if they do not hold a significant percentage of the financial system's deposits.¹⁷⁹ For instance, up to the end of 2020, the saving share collected by SACCO to domestic national saving was only 5%.¹⁸⁰

4.3. Regulatory Implementations of SACCOs in Ethiopia

In this section, the regulatory implementations of SACCOs in the United States, Kenya, and the Model Law for Credit Unions are analyzed to shed light to the Ethiopian legal framework. As such, this analysis is made mainly to incite and show the areas of regulatory implementations to the Ethiopian legislature to construct a SACCO law taking the national socio- economic particularities, rather than full transplantation. This is because cooperatives are centered on members whose behavior is closely tied with cultural specificities and full copy of foreign

¹⁷⁷ Cooperative Society Proclamation No. 985/2016 (n 2) Art 76(2)

¹⁷⁸ Coelho, Mazzillo (et al) (n 130)

¹⁷⁹Bank for International Settlements, "Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion (n 127)

¹⁸⁰ FCA GTP-2 (2015-2020) Main Document (2015) (n 85) 43

cooperative laws has been identified as phantom laws.¹⁸¹ Nevertheless, irrespective of local context differences, regulatory implementations of SACCOs cover areas including capital adequacy, licensing and entry requirements, qualifications of management bodies, liquidity requirements, loan portfolio diversification, market conduct requirements, calculation of loan delinquency, external credit, investment activities, etc.¹⁸²

4.3.1. Preconditions for SACCO Entry

i. Licensing

The most basic form of entry restriction is licensing.¹⁸³ The focus of licensing on consumer protection, though, has led many countries to exempt institutions from the need to hold a license where they do not make financial promises to the public at large.¹⁸⁴

In Kenya, however, in addition to registration, SACCOs are required to hold a valid license issued under the SACCO Societies Act.¹⁸⁵ In the USA, NCUA licenses Federal Credit Unions; and State authorities licenses state-chartered credit unions.¹⁸⁶

SACCOs in Ethiopia, unlike their counterparts in Kenya and the United States, do not required to get licenses before they may begin operations. It is proclaimed that any cooperative society which has been legally registered [...] shall engage in business per its objectives and activities endorsed in its by-law as of the date of registration without the need to secure an additional business license.¹⁸⁷ The law does only require each cooperative society to renew its certificate of registration every three years starting from its establishment.¹⁸⁸ Nevertheless, the Ethiopian Business license issuing category Directive 17/2019 has included the SACCOs under the licensing category of

¹⁸¹ Henry (n 102) iv

¹⁸² WOCCU, *Technical Guide Credit Union Regulation and Supervision* (n 96)

¹⁸³ Carmichael (n 12) 56

¹⁸⁴ *ibid* 57

¹⁸⁵ SACCO society Act (n 24) Art 23(1).

¹⁸⁶ Coelho, Mazzillo (et al)(n 130) 76

¹⁸⁷ Cooperative societies Proclamation No. 985/2016 (n 2) Art 10(7). This had been also a rule in the repealed proclamation. See Cooperative Societies (Amendment) Proclamation, 2004, Art 2(1) (6) Proc. No.402, Fed. Neg. Year 10, no.43

¹⁸⁸ Cooperative Societies Proclamation No. 985/2016 (n 2) Art 20(1)

81112, and the verification body and the licensing authority to be the NBE of Ethiopia. The Cooperative Societies Proclamation, however, takes precedence over this directive due to the legal hierarchy, therefore SACCOs are not obliged to get license.

ii. Capital Requirements

Capital requirements typically take one of two forms: minimum size requirements and variable capital adequacy requirements (a minimum ratio of capital to risk-weighted assets).¹⁸⁹ WOCCU does not recommend a minimum statutory capital requirement to form a new credit union; rather it requires capital adequacy requirements.¹⁹⁰

In Kenya, all SACCO societies are required to comply with and maintain at all times the minimum capital and capital adequacy requirements as prescribed by the SACCO Societies Authority.¹⁹¹ For this, the Kenyan SACCO societies regulation provides that a SACCO Society shall at all times maintain (a) core capital of not less than ten million shillings; (b) core capital of not less than ten percent of total assets; (c) institutional capital of not less than eight percent of total assets; and (d) core capital of not less than eight percent of total deposits.¹⁹² The Kenyan SACCO Act divides capital into two categories: core and institutional, based on whether or not members' shares are included in their definitions. While core capital includes share capital, institutional capital does not.¹⁹³

Under the Model Law for Credit Unions, ownership shares may only be considered as institutional capital of the credit union if shares are non-withdrawable, paid-in-full, may only be redeemed upon membership termination, or may only be redeemed out of proceeds of newly issued shares subscribed to by other members and only if the credit union can meet its capital adequacy

¹⁸⁹ Carmichael (n 12) 58

¹⁹⁰ Model Law for Credit Unions (n 29) section 2.10

¹⁹¹ SACCO Society Act (n 24) Art 29

¹⁹² The Sacco Societies (Deposit-taking Sacco Business) Regulations (n 100) sect. 9 and Art 11(1)

¹⁹³ *ibid* sect.3

requirements.¹⁹⁴ To this end, the Model law suggests that credit unions should maintain a ratio of institutional capital to assets of at least 10 percent.¹⁹⁵

In the USA, members' shares are considered as deposits and are not eligible for regulatory capital because they are redeemable and considered to be liabilities.¹⁹⁶ On the other hand, others count members' shares as capital, adding to institutional capital to derive the total capital.¹⁹⁷ In this case, SACCOs would no longer redeem member shares, but act only to facilitate their transfer.¹⁹⁸ Member shares can be used as regulatory capital in Kenya, but they can't be redeemed or refunded by the SACCO, and if a member wishes to leave, its share must be transferred to another member.¹⁹⁹

In Ethiopia, the Cooperatives society proclamation provides that capital means the amount of asset accumulated after deducting liability of a cooperative society, and it includes shares of the members.²⁰⁰ And any primary cooperative society shall be established with an initial capital that covers at least one-year operation cost based on its plan and feasibility study.²⁰¹ In so doing, the proclamation considers shares of members as the capital of the SACCO and it does not fix either the minimum capital or the capital adequacy requirement. Though, the draft FCA prudential directive proposes for SACCOs to maintain a ratio of institutional capital to assets of at least 10 percent.²⁰²

¹⁹⁴ Model law for credit Unions (2015) (n 29) section 6.10. The Model law for credit unions provide that, the bylaws [of a credit union] shall identify the redemption conditions of shares and shares cannot be redeemed above par value.

¹⁹⁵ Westley and Branch(eds) (n 67) 10

¹⁹⁶ International Cooperative Banking Association, 'Regulation and Sustainability of Cooperative Banks: A Cross Country Study (n 22) 25

¹⁹⁷ Westley and Branch(eds) (n 67) 10

¹⁹⁸ *ibid*

¹⁹⁹ Sacco Societies (Deposit-taking Sacco Business) Regulations (n 99) sect. 21(3)

²⁰⁰ Cooperative Proclamation No. 985/2016 (n 2) Art, 2(19)

²⁰¹ *ibid* Art, 22(1)

²⁰² FCA draft SACCO prudential inspection Directive (n 86) Part 5, section 25. Yet, neither the proclamation nor the draft directive has defined institutional capital unlike the Kenya's SACCO regulation.

Nevertheless, the Ethiopian Cooperatives society proclamation grants a right to a member to withdraw from the cooperative society on his request upon securing his rights and benefits.²⁰³ Hence, during dismissal and withdrawal from membership, SACCOs are required to redeem members' shares and refund to members as shares are part of the rights and benefits of a member. Nonetheless, the law requires that members' shares be included in a SACCO's capital. The proclamation requires the bylaws of cooperative society to set down the conditions for withdrawal and dismissal from membership.²⁰⁴ And the proclamation requires the rights of any dismissed member to be respected per the by-laws of the cooperative society.²⁰⁵ Hence, it may be argued that the bylaws of SACCOs may prohibit the redemption of members shares upon withdrawal and dismissal. But, this argument may not hold water, on one hand, that the bylaws can only set the conditions of withdrawal and cannot deprive a right that is conferred by the proclamation; and on the other hand, even if the argument would be accepted, there might be cases where the bylaws keep silent on this issue.

4.3.2. Ongoing Regulatory Implementation Requirements

I. Qualifications and Duties of Management Bodies

This regulatory implementation covers the qualification, disqualification and removal criteria, and liability of SACCO board members and purports to set an ethical norm for officers and directors to abstain from participation within the SACCO on any business matter that affects their personal or family financial interest.²⁰⁶

The Model Law for Credit Unions while defining the authority and duty of the Credit Union management bodies states that directors and committee members owe a fiduciary duty to the credit union to operate the institution with reasonable prudence and in the best interests of the credit union and its members and also owe the members a duty of fair dealing concerning issues of membership, ownership, and corporate governance.²⁰⁷ To avoid conflicts of interest, this Model

²⁰³ Cooperative Societies Proclamation 985/2016(n 2) Art 25(1)(d)

²⁰⁴ *ibid* Art 12(1)(g)

²⁰⁵ *ibid* Art 26(3)

²⁰⁶ Model credit union law(2015)(n 29) section 5.10 (5)

²⁰⁷ *ibid*

Law states that no officer, director, committee member, agent, or employee of the credit union shall participate in any way in the deliberation or determination of any question affecting that person's pecuniary interest or the pecuniary interest of any member of that person's immediate family or of any company or organization.²⁰⁸

In Kenya, the board of directors consists of elected non-executive directors and in the conduct of the affairs of the SACCO Society, they shall exercise prudence and diligence of ‘*ordinary men of business*’ and shall be held, jointly and severally, liable for any loss occasioned by their actions contrary to SACCO law and bylaws.²⁰⁹ Among other things, the board of directors is required to establish appropriate policies including credit policy, investment policy, savings policy, liquidity policy, information preservation policy, dividend policy, and risk management policy.²¹⁰

Under Kenya’s SACCO regulation, a person shall not be permitted to hold the position of a director in more than one SACCO Society licensed under the Cooperatives Act.²¹¹ The SACCO Authority may also prohibit any individual seeking to be a director or employee of a SACCO Society if the individual has been charged or convicted with a crime involving monetary loss, fraud, perjury, or breach of contract of a licensed financial institution²¹² The SACCO Authority or SACCO Society may also remove an officer from office if the officer directly or indirectly violates the Cooperatives Act, SACCO Regulations or the SACCO societies bylaws; engages or participates in any unsafe or unsound practice in connection with the SACCO Society; or has a non-performing loan or becomes a bad debtor.²¹³

In the regulation of insider lending, Kenya’s SACCO regulation states that an officer of a SACCO Society shall not use that position to further his or her interest.²¹⁴ And the rates, terms, and conditions of any loan made to an officer, his immediate family member, or their business associates shall not be in any way more favorable than those offered to other SACCO Society

²⁰⁸ibid section 5.35

²⁰⁹ Sacco Societies (Deposit-taking Sacco Business) Regulations (n 100) sect.59(3) and 60(1)(*emphasis added*)

²¹⁰ ibid sect. 60(4)

²¹¹ ibid sect. 62

²¹² ibid sect 72(1)

²¹³ ibid sect 72(6)

²¹⁴ ibid sec. 36(1)

members, and a SACCO Society is required to notify the Authority of every approval given pursuant to directors and employees within fourteen days of such approval.²¹⁵

In Ethiopia, the Cooperative Societies Proclamation reserves the qualification, disqualification, and grounds of removal criteria, if any, to the by-laws of cooperative society to set conditions for election, appointment, term of office, and suspension or dismissal of the members of the management committee or other management bodies.²¹⁶ Nonetheless, the proclamation contains mandatory provisions that each cooperative society is obligated to follow. As such, any cooperative society is required to have a management committee that is loyal and respectful and also can discharge their responsibility and accountability to the general assembly and whose members and manner of election are determined in the by-laws of the cooperative society.²¹⁷

The term of office of the management committee is set to be three years with a possibility of re-election but which will not exceed more than two consecutive terms.²¹⁸ These members of the management committee may be dismissed at any time by the general assembly.²¹⁹

In addition to the management committee, any cooperative society is mandated to have not less than three control committee members who are accountable to the general assembly and the number and manner of election of which shall be specified by the by-laws of the society.²²⁰ Other additional sub-committees may also be established pursuant to the by-laws of the cooperative society.²²¹ For SACCOs, this other sub-committee may include Credit Committee that is entrusted with the duty to review loan applications and provide recommendations to the management committee.

Nevertheless, unlike Kenya's SACCO regulation, the Cooperatives Society proclamation does not have detailed regulations on the qualification, disqualification, the reasons for removal, insider

²¹⁵ *ibid* sect. 36(3) and (4)

²¹⁶ Cooperative Societies Proclamation No. 985/2016(n 2) Art 12(1(h)

²¹⁷*ibid* Art 34(1)

²¹⁸ *ibid* Art 34(2) and Art 34(3)

²¹⁹ *ibid* Art 34(4)

²²⁰ *ibid* Art 36(1)

²²¹ *ibid* Art 38

lending, and conflict of interest of management bodies and officers of SACCOs. As a result of this, SACCOs may be infested with member-manager conflicts and the management committee may be filled with unfit personalities in the management of the SACCO. For example, the researcher has seen that SACCO management members obtain interest rates that are lower than the typical loan interest rates that apply to ordinary members.

II. Market Conduct Requirements

i. Deposits and Interest on Deposits

Deposits in a SACCO can be both withdrawable and non-withdrawable. The Model Law for Credit Unions provide that a SACCO may receive savings deposits from members in demand or fixed-term accounts in which the terms, rates, and conditions of deposits may be established by the board of directors or executive committee based on market conditions and business planning that ensures all operational and financial costs are covered; interest rates should not be established in the law or by-laws.²²²

In Kenya, non-withdrawable deposit accounts shall be operated in accordance with the SACCO bylaws and shall be refunded only when a member withdraws from membership and provided the member has fully repaid all his debts and is free from the guarantee; and attract interest at a rate to be determined by the SACCO Society as dictated by external market forces or internal funding needs.²²³ On the other hand, withdrawable deposits attract interest at a rate prescribed in the terms and conditions of the deposit.²²⁴

In Ethiopia, the National Bank had the authority to fix the minimum and maximum rates of interest which other financial institutions including SACCOs would charge on various classes of deposits.²²⁵ But now, the Cooperative societies proclamation does not have provisions on SACCO members' deposits and interest on deposits. The proclamation indicates for SACCO business detail implantations be prescribed by regulation that will be issued by the Council of Ministers.²²⁶ This

²²² Model Law for credit unions (2015) (n 29) section 6.25

²²³ Sacco Societies (Deposit-taking Sacco Business) Regulations (n 100) sec. 22(1) and sec. 22(4)

²²⁴ *ibid* sec.22(2)

²²⁵ Monetary and Banking Proclamation No. 83/1994 (n 79) Art 30(1(a&b))

²²⁶ Cooperative Societies Proclamation No. 985/2016 (n 2) Art 21(10)

regulation is expected to have regulation of SACCO member deposits. And as long as SACCO by-laws are permitted to contain other particulars not contrary to the cooperative society proclamation, regulation, and directives,²²⁷ until the Council of Ministers' regulation is approved, SACCOs may set deposit and interest rates through bylaws. Nonetheless, SACCOs may not be able to effectively set deposit interest rate rules due to technical knowledge deficiencies as depicted in this research and this requires a guiding regulation to that effect. The FCA draft SACCO prudential directive proposes only the ratio of saving deposits to total assets to be 70-80% without having a detail deposit regulation.

ii. **Loan Limit, Security, and Interest on Loans**

A SACCO as any financial service intermediary is expected to devise lending policies taking into consideration a variety of factors, such as its capital, liquidity, and local economic conditions, as well as the needs, character, and financial capabilities of its members subject to its conformity with the regulatory laws. A SACCO should also ensure that the security offered for a member loan is of sufficient value to repay the loan.

The Model Law for Credit unions recommends for a single borrower loan concentration limit be set at the lesser of 10% of assets or 25% of regulatory capital.²²⁸ The model law explicitly provides that a member's ownership shares cannot be used as security for a loan, but can be charged against if he or she has a debt outstanding to the credit union.²²⁹ The Model law provides that interest rates on loans shall be determined subject to the limitations established in the appropriate statute and the regulation on lending disclosure and fair credit practices.²³⁰

In the USA...no loan may be made to any member if, upon the making of that loan, the member would be indebted to the Federal credit union loans made to him in an aggregate amount that would exceed 10 per centum of the credit union's unimpaired capital and surplus.²³¹ And the loan rate of interest may not exceed 15 per centum per annum on the unpaid balance inclusive of all finance

²²⁷ *ibid* Art 12(1)(m)

²²⁸ Model law for credit unions (2015) (2015) 38

²²⁹ *ibid* section 6.05

²³⁰ *ibid* section 7.20

²³¹ Federal Credit union Act, (n 30) Sec. 107 (12 U.S.C. 1757) (x)

charges, except that the Board may establish.²³² If a greater interest was collected by the credit union, it becomes a usurious act and can be reclaimed by the member who paid the excess within two years reckoning from the date of payment.²³³

In Kenya, no SACCO society shall grant a loan or credit facility to a member where the loan or credit facility, in the aggregate, in respect of that member at any time exceeds ten percent of the SACCO Society's core capital.²³⁴ Loan interest rates may be established by the management and shall be approved by the board of directors.²³⁵ A SACCO Society shall ensure that all loans granted are fully secured, but a SACCO Society shall not grant a loan or credit facility against a member's shares.²³⁶ A member shall not pledge shares as collateral or security for a loan granted by the SACCO Society.²³⁷

In Ethiopia, the National Bank had the authority to fix the minimum and maximum rates of interest which other financial institutions including SACCOs would charge for different types of loans, advances and other credit transactions²³⁸ The maximum interest rate fixed by the National Bank had been used to replace the rate specified by the Civil Code, where the rate fixed exceeds that of the Civil Code.²³⁹ The current cooperatives society proclamation provides that particulars as to amount and conditions under which any cooperative society may extend loans shall be specified in the by-laws of the cooperative society and it shall prescribe the interest rate in its by-laws based on the special resolution of the General Assembly.²⁴⁰ However, unlike the current proclamation, with respect to the applicable loan interest rate, in the repealed cooperative proclamation, it was

²³² *ibid* SEC. 107. 12 U.S.C. 1757

²³³ *ibid* SEC. 107. [12 U.S.C. 1757]

²³⁴ Sacco Societies (Deposit-taking Sacco Business) Regulations (n 100) sect. 35(5)

²³⁵ *ibid* sec 30(1)

²³⁶ *ibid* sec. 32(1) and Art 32(4)

²³⁷ *ibid* sec. 21(2)

²³⁸ Monetary and Banking Proclamation No. 83/1994 (n 79) Art 30(1(a&b))

²³⁹ *ibid* Art 30(2)

²⁴⁰ Cooperative Societies Proclamation No. 985/2016 (n 2) Art 48(2) and Art 48(3)

clearly stated that interest on loans received from cooperatives including SACCO members may not exceed the interest rate of a bank.²⁴¹

Concerning loan securitization, the current cooperative society proclamation provides that any cooperative society may decide and use in its by-laws the types and alternative guarantees it uses for the loans it extends.²⁴² As such, unlike the model law for credit unions and the Kenyan SACCO regulation, the proclamation does not outlaw a SACCO from granting a loan against a member's shares and does not provide a rule on the presentment of member's shares as collateral or security for a loan granted by the SACCO Society.

While other issues remain untouched, the FCA draft SACCO prudential inspection directive proposes only the ratio of total loan delinquency to gross loan portfolio to be less than 5%.

iii. **Balance Sheet Restrictions**

Regulators use different balance sheet restrictions including limits on asset/liability mismatches, restrictions on the type of assets held, or mandated maximum or minimum holdings of a particular asset.²⁴³

In Kenya, a SACCO society shall not acquire external borrowings over 25% of its total assets unless the limit has been waived by the Authority.²⁴⁴ A SACCO Society acquiring external borrowing for on-lending to members shall charge interest at least two percentages higher than the rate it is charged in procuring the loan facility.²⁴⁵ In the USA, a Federal credit union may borrow, per rules and regulations as may be prescribed by the Board, from any source, in an aggregate amount not exceeding 50% of its paid-in and unimpaired capital and surplus...²⁴⁶

A SACCO may invest the accumulated funds that are not used for loans to members, subject to regulatory limits. In Kenya, the funds of a SACCO society may be invested in securities,

²⁴¹ Cooperative Societies Proclamation No. 147/1998(n 80) Art 34(2)

²⁴² Cooperative Societies Proclamation No. 985/2016 (n 2) Art 49

²⁴³ Carmichael (n 12) 65

²⁴⁴ Sacco Societies (Deposit-taking Sacco Business) Regulations (n 100) sect. 35(1)(3)

²⁴⁵ Ibid sec. 35(4)

²⁴⁶ Federal Credit union Act (n 30) Sec. 107 (12 U.S.C. 1757) (9)

obligations, or other debt instruments issued or guaranteed by the government or any agency of the government; shares, stocks, deposits in, loans to or other obligations of any SACCO society or co-operative society. Nevertheless, such SACCO investment shall not in the aggregate exceed over forty percent of its core capital or five percent of its total deposits liabilities.²⁴⁷ And a SACCO society shall not purchase or acquire any land or any interest or right therein except as may be reasonably necessary for conducting its deposit-taking business and where such investments do not exceed ten percent of total assets, of which land and buildings shall not exceed five percent unless a waiver to that effect has been obtained from the Authority.²⁴⁸

In Ethiopia, the Cooperative societies Proclamation provides that a cooperative society shall receive loans from its members or other organizations to such extent and on such conditions as may be specified in the by-laws of the cooperative society.²⁴⁹ This proclamation does not limit the external borrowings for SACCOs. Yet, the FCA draft SACCO prudential inspection directive proposes SACCOs to have 70% up to 80% of the source of funding of its total assets from membership saving and to allocate 70% up to 80% of its total assets to loan.²⁵⁰ Indirectly, this draft directive is to some extent limiting external borrowings and investment of SACCOs. Nonetheless, unlike, the Kenyan counterpart, neither the proclamation nor the draft directive attempts to regulate the areas and limits of investment of funds by SACCOs.

iv. **Liquidity Requirements**

Liquidity requirements are designed to ensure that a regulated institution has the funds available to meet any undertakings it has made concerning the liquidity of its promises.²⁵¹ The Model Law for Credit Unions defines liquid assets as assets that can immediately be converted to cash for clearing and settling payments, meeting loan disbursements, withdrawals, or other immediate cash needs of an institution.²⁵² Ideally, credit unions should allocate the major portion of their members'

²⁴⁷ Sacco Societies (Deposit-taking Sacco Business) Regulations (n 100) sec. 48(4 &5); SACCO society act (n 24) Art 38(1-3)

²⁴⁸ *ibid*

²⁴⁹ Cooperative Societies Proclamation No. 985/2016(n 2) Art 47

²⁵⁰ FCA Draft SACCO prudential directive (n 86) clauses 11(3)(3))

²⁵¹ Carmichael (n 12) 65

²⁵² The Model Law for Credit Unions (n 29) Section 1.35

savings to making loans to members, if sufficient loan demand exists, to serve their members' borrowing needs. Nevertheless, a reasonable percentage of the credit union's savings and other liabilities should be kept in liquid investments to meet members' withdrawal and loan demands.²⁵³

In Kenya, a SACCO society shall maintain such minimum holding of liquid assets of its members' deposits and borrowings as may be prescribed by the Authority.²⁵⁴ And SACCO Society shall maintain fifteen percent of its savings deposits and short-term liabilities in liquid assets- notes and coins, balances at banks.²⁵⁵

In Ethiopia, other financial institutions including SACCOs had been required by the National Bank to maintain with it in cash and in other forms of liquid assets including government securities a proportion of their deposit liabilities as prescribed by it.²⁵⁶ The National Bank had used to prescribe the percentage of reserve requirements for different types of deposits.²⁵⁷ Other financial institutions including SACCOs were required to maintain liquid assets in such ratio to its short-term liabilities as the National Bank did prescribe from time to time.²⁵⁸ The National Bank had also used to make short and long-term refinancing facilities available to these other financial institutions including SACCOs per terms and conditions set by it.²⁵⁹

Now, SACCOs as any cooperative society are only required to maintain a reserve fund from its net profit.²⁶⁰ There is neither specific liquidity requirement for SACCOs in proportion to members' savings or liabilities nor a requirement for a SACCO to deposit a reserve fund if there is no profit. Nevertheless, the FCA draft SACCO prudential inspection directive proposes each SACCO to put

²⁵³ *ibid* 8

²⁵⁴ Sacco Societies (Deposit-taking Sacco Business) Regulations (n 100) sec. 30 (1)

²⁵⁵ *ibid* Art 13(2)

²⁵⁶ Monetary and Banking Proclamation No. 99/ 1976 (n 107) Art 33(1); Monetary and Banking Proclamation No. 83/1994 (n 79) Art 31(1)

²⁵⁷*ibid* Art 33(2); *ibid* Art 31(2)

²⁵⁸ *ibid* Art 50

²⁵⁹ *ibid* Art 37; Monetary and Banking Proclamation No. 83/1994 (79) Art 34

²⁶⁰ Cooperative societies Proclamation No. 985/2016 (n 2) Art 45(1)

in the account of the cooperative at least 15% of the total saving after subtracting payments to be made within one month from total savings.²⁶¹

v. **Deposit Insurance / Deposit Guarantee fund/ and Depositor Compensation**

Deposit insurance systems for financial cooperatives may be established to protect members' deposits and enhance confidence, as well as to attract new depositors (members) or encourage existing members to invest more in their cooperative.²⁶²

In Kenya, there is a deposit Guarantee Fund established by the SACCO Act and a SACCO Society shall pay annual premiums of fifty thousand shillings or zero point zero five percent of total savings and deposits, whichever is higher, to the Fund.²⁶³ The Fund shall compensate members of a failed SACCO Society for up to 100 shillings net of any liabilities, and all SACCO societies are required to inform their members of the existence of the Fund.²⁶⁴ In the event of a collapse of a licensed SACCO Society, its members may lodge their compensation claims with the Fund within ninety days from the time notice is given. And the Fund shall settle all verified claims lodged with it within ninety days after the date from which lodging of claims is closed.²⁶⁵

In the USA, the Board ...shall insure the member accounts of all Federal credit unions upon application of each credit union²⁶⁶ and each insured credit union shall pay premium fixed in the Act to the National Credit Union Share Insurance Fund.²⁶⁷

The type of fund proclaimed to be established by the cooperative society proclamation in Ethiopia is unique in purpose. It is for cooperative promotion rather than a safety net for depositors of a failed SACCOs.²⁶⁸ There is no member's deposit account insurance that would compensate depositors of failed SACCOs so far. There is only an optional loan life insurance- insurance given

²⁶¹ FCA Draft SACCO prudential directive (n 86) clauses 14(2)

²⁶² Khafagy (n 33)105

²⁶³ Sacco Societies (Deposit-taking Sacco Business) Regulations (n 100) sec. 81(1)

²⁶⁴ *ibid* sec.80(2)

²⁶⁵ *ibid* sec.82(1) &(2)

²⁶⁶ Federal Credit union Act (n 30) SEC. 201. [12 U.S.C. 1781]

²⁶⁷ *ibid* SEC. 203. [12 U.S.C. 1783]

²⁶⁸ Cooperative societies Proclamation No. 985/2016 (n 2) Art 2(22) and Art 46

by a cooperative society to its members to cover loans taken by a deceased member before full repayment of debt.²⁶⁹

The recently enacted Ethiopian Deposit Insurance Fund Council of Ministers Regulation No.482/2021 does not also apply to SACCOs. The regulation limits its scope of application only to commercial banks and a microfinance institution licensed by the National Bank.²⁷⁰

SACCOs which does not have access to the national deposit insurance fund are required to enforce relatively high liquidity requirements, which reduces their loanable resources. For instance, the cooperatives society proclamation requires, any cooperative society to deduct 30% of the net profit and allocate for the reserve fund until the fund reaches 30% of the capital of the cooperative society and it shall be deposited in the saving account of the society.²⁷¹ SACCOs would not have had to meet such high liquidity requirements if deposit insurance scheme had been implemented. In addition, in the absence of deposit safety net, it will be the net savers who might have interest to protect the safety of SACCO. This will ultimately cause for a net saver dominance problem.

vi. SACCO Consumer Protection

The existence of a sound financial consumer protection framework is fundamental to increasing access while maintaining trust in the system.²⁷² The NBE Financial inclusion strategy provides that while the NBE, can improve and enforce rules covering institutions under its regulatory scope, other institutions, such as SACCOs, are not covered by any consumer protection and business conduct regulation and the FCA's mandate is not clear in this area.²⁷³

The NBE financial consumer protection directive is enacted to establish clear and objective financial consumer protection regulation, supervision, complaint handling, and dispute resolution mechanisms that are necessary to promote fair, responsible, and transparent financial transactions and shape professional conduct of financial service providers towards financial consumers and

²⁶⁹ *ibid* Art 2(8)

²⁷⁰ Establishment and Operation of Ethiopian Deposit Insurance Fund Council of Ministers Regulation, 2021, Art 3 and 2(11), Reg. No. 482, Fed. Neg. Gaz. Year 27, no. 12

²⁷¹ Cooperative societies Proclamation No 985/2016 (n 2) Art 45(1)

²⁷² National Bank of Ethiopia, 'National financial inclusion strategy'(n 60) 21

²⁷³ *ibid* 22

security providers.²⁷⁴ This directive does not extend its scope of application to SACCOs. In fact, it is not expected to do so as SACCOs are not within the regulatory supervision of NBE.

The Federal Trade Competition and Consumer protection Proclamation does not also cover SACCOs as the proclamation applies only to business customers. This proclamation limits its scope of application to any commercial activity or transaction in goods or services conducted or having effect within Ethiopia.²⁷⁵ In turn, commercial activity is defined by the proclamation as any activity carried by a business person who professionally and for gain carries any of the listed activities in the Commercial Code or activities designated by law.²⁷⁶ Surely, SACCOs do not fall within this definition of business persons.

Therefore, even though SACCO members are owners and control the SACCO, as a result of the members' divergent interests and member-manager conflicts, a reform on SACCO financial consumer protection is inevitable.

²⁷⁴ NBE Financial Consumer Protection Directive FCP/01/2020, preamble para 3, Art 2(16), Art 3

²⁷⁵ Trade Competition and Consumer Protection Proclamation, 2013, Art 4(1), Proc. No. 813, Fed. Neg. Gaz. Year 20, no.8

²⁷⁶ *ibid* Art 2(6) and 2(5)

CHAPTER- FIVE

CONCLUSION AND RECOMMENDATION

5.1. Conclusion

SACCOs as a cooperatives financial institution fall both within the deposit-taking financial institutions and specialized group of sectoral financiers; because, on the one hand, they accept savings deposits, issue shares, and provide credit and other financial services and intermediate between savers and borrowers of funds; and on the other hand, they provide financial services only to members.²⁷⁷

Even though the SACCOs' share of the overall domestic financial system is relatively limited when measured by their share of total savings or credit, they have been playing an important financial intermediation role in Ethiopia since 1960s.

The Ethiopia's Monetary and Banking Proclamation No. 99/ 1976 and the Monetary and Banking Proclamation No. 83/1994 had defined SACCOs under 'other financial institutions' categories, considering SACCOs as financial institutions.²⁷⁸ But, the National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008 has excluded SACCOs from the definition of 'other financial institutions'.²⁷⁹ Yet, SACCOs are excluded from the definition of other financial institutions not because they are not financial institutions, but because of a regulatory structural shift from the NBE to general cooperatives offices.

Because members of the SACCO are concurrently owners and clients, their inducements as clients are directly transformed into the operating policies and procedures of the SACCO in their role as owners and members do not have homogeneous objective to maximize for. Members do not join

²⁷⁷ Exceptionally, SACCOs may provide service to non- members for the purpose of distributing revolving funds to the society availed by different development partners; see the Cooperative Societies proclamation No. 985/2016 (n 2) Art 23(1)(c)

²⁷⁸ Monetary and Banking Proclamation No. 99/ 1976 (n 107) Art 2(3); Monetary and Banking Proclamation, 83/1994 (n 79) Art 2(4)

²⁷⁹ The National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008 (n 112) Art 2(10)

SACCOs for the return on shares rather for loans and deposits at a competitive interest than the investor-owned financial institutions.

These divergent incentives will create SACCOs to have net saver and net borrower members interest conflicts. While net-debtor try to promote cheaper interest rates on loans, more flexible repayments, and less emphasis on loan collection; the net -savers, on the other hand, wish to see conservative and prudent lending practices, high returns on savings and stringent loan terms.²⁸⁰ SACCOs' governance structure, in which management members are owners and customers, can also lead to a broader spectrum of conflicts of interest.²⁸¹ The regulatory objective of SACCO regulation is to address these dualities of incentives and member interest conflicts while maintaining the autonomy and independence cooperative principles.²⁸² The Ethiopian SACCO regulatory framework, on the other hand, makes no mention of any of these regulatory objectives.

The cooperative promotion bodies from federal to regional cooperative promotion offices lack the capacity to implement cooperative proclamations, regulations, and have limitations of skill, attitude, and commitment to regulate cooperatives.²⁸³ Yet, after the enactment of Cooperative Societies Proclamation No. 147/1998, the regulatory system has placed SACCOs that require a professional financial regulator under the regulatory structure of the general Cooperative offices.

Though the inherent regulatory synergies of financial intermediaries would be undermined, in view of the SACCOs' small share of domestic financial market, their spread across the Country and the high costs of supervision, it is difficult to argue that the National Bank of Ethiopia should exercise the prudential supervision of SACCOs, on top of its banking, insurance and micro finance institutions supervision role.

Though the FCA policy documents identify the existence of supportive cooperative laws to achieve the GTP-2 of the cooperative sector,²⁸⁴ the general cooperative society's law which regulates

²⁸⁰ Westley and Branch(eds) (n 67) 139

²⁸¹ *ibid*

²⁸² Coelho, Mazzillo (et al) (n 130)

²⁸³ FCA GTP-2 (2015-2020) Main Document (2015) (n 85) 11; FCA, 'Cooperative Sector Ten Years Plan' (n 13) 4

²⁸⁴ *ibid*

activities of agricultural, consumer, and other cooperatives is insufficient for SACCOs, which are depository institutions with operations that are most similar to those of banks.²⁸⁵

Moreover, because SACCOs in Ethiopia are currently small and do not represent a systemic threat to the financial system as a whole, the banking supervision laws cannot be expected to regulate their operations. Nonetheless, while the principle of autonomy for self-regulation to make by-laws is acknowledged, due to the challenges of self-regulation, SACCOs should remain within the framework of an appropriate SACCO law to protect them from failure and help to achieve their competitiveness, efficiency, safety, and soundness.

5.2. Recommendations

- Though the Ethiopian law considers SACCOs as cooperatives and the regulatory objective of such cooperatives is defined in the general cooperative law, Ethiopia needs to clearly define the specific objectives of its regulations that are consistent with the nature and function of SACCOs guided by cooperative values and principles especially the principle of autonomy and member democratic participation.
- Ethiopia should have a specific law for SACCOs that takes into consideration their financial and cooperatives aspects. Enacting a SACCO specific law does not fall by the postulation of Montesquieu that “Where it is not absolutely necessary to make a law, it is absolutely necessary not to make such law.”²⁸⁶ Meanwhile, it is recommended that the promised Council of Ministers Cooperative Regulation and the FCA's draft SACCO prudential inspection directive be enacted.
- Because of the financial regulation technical skills required for the prudential supervision, SACCOs should not be put under the supervision of general cooperative authorities. To this end, Ethiopia should plan to have a SACCO regulatory authority, both at federal and regional levels. This Authority should be led by individuals with education, training, or experience in a broad range of financial services, financial services regulation. In the meanwhile, given Ethiopia's current situation and the cost of establishing a SACCO

²⁸⁵ Model Credit union law (2015) (n 29)

²⁸⁶ Hans-H. Münkner, ‘Ensuring Supportive Legal Frameworks for Co-operative Growth’ (2014) 3< [Ensuring Supportive Legal Frameworks for Co-operative Growth \(ica.coop\)](#)> accessed January 11 2021

Supervisory Authority, it is recommended that the FCA and Regional Cooperative Promotion Authorities be strengthened as long as the SACCO law is adopted.

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