

**IN THE HIGH COURT OF  
SOLOMON ISLANDS**

**Civil Case No. 095 of 2004**

***Civil Jurisdiction***

**IN THE MATTER OF THE DEVELOPMENT  
BANK OF SOLOMON ISLANDS**

**AND IN THE MATTER OF SECTION 18 OF  
THE FINANCIAL INSTITUTIONS ACT 1998**

**BETWEEN:                   CENTRAL BANK OF SOLOMON ISLANDS                   Plaintiff**

**AND:                         DEVELOPMENT BANK OF SOLOMON ISLANDS                   Defendant**

*Banks and Banking – appointment of statutory manager – regulatory authority seeking appointment-circumstances in which such appointment appropriate  
Financial Institutions Act 1998, s.18.*

*Banks and Banking – respondent Bank created by statute – powers and responsibilities of the Board of the respondent Bank when circumstances exist for the regulatory authority to seek to intervene in the management of the Bank.  
Development Bank Act (Cap.50).*

*Practice and Procedure – Judicial discretion – discretion given by statute – extent of discretion – manner of exercise.*

The Central Bank of the Solomon Islands by notice of motion, seeks to become the court appointed manager of the Development Bank of the Solomon Islands. The Central Bank is the regulatory authority for financial institutions in the country and derives its regulatory powers from the terms of the Financial Institutions Act 1998 (the Act). Evidence had been led by the applicant Bank that the respondent Development Bank was insolvent so as to give rise to its right to seek an order of the Court to intervene and manage the subject financial institution.

- Held*
- (1) The Act prescribes three criteria either of which must be shown to exist, before the regulatory authority may seek a court order for appointment and all three criteria are affected in this case.
  - (2) The applicant has shown that the respondent Bank is for the purposes, insolvent and consequently may claim the right to manage the respondent Bank.
  - (3) Notwithstanding the various other matters put forward by the respondent Bank as justifying the exercise of the court's discretion not to accede to the Central Bank's request, the weight and importance of the respondent's concerns does not overcome the importance the court must place on the criteria set out in s.18(1) of the Act when the court comes to consider the exercise of its statutory discretion.

(*Mallet -v- Mallet (1984) 58 A.L.V.R 248* cited and applied on the aspect of discretion.)

(4) On being satisfied of the existence of the criteria to be satisfied in terms of s.18(1) of the Act, the applicant has discharged its onus under s.18(2) and is entitled to orders appointing it court supervised manager.

### **NOTICE OF MOTION**

**At Honiara on 13<sup>th</sup> April, 10<sup>th</sup> June 2004**

*Andrew Radclyffe for the applicant*

*Billy Titiulu for the respondent*

**Brown PJ.** Mr. Radclyffe appeared for the Central Bank. He says the application by the Bank to be appointed manager of the respondent Development Bank under the provisions of the Financial Institutions Act 1998 ("the Act") is by reason of the insolvency of the respondent Bank for the Central Bank has the responsibility to intervene and take over, as it were, the Development Bank in such circumstances.

### **THE LEGISLATION**

The motion is brought in accordance with the Act, s.18(1) which provides;

*"If the Central Bank considers that it is proper to take control of and manage the banking business of a licensed financial institution in order to protect the stability of the financial system, the interests of depositors or in the public interest, it may apply to the Court for any order under this section."*

The Central Bank is, in terms of the Act, the regulator of the banking system in the Solomon Islands. Consequently by the powers found in s. 18(2) of the Act, the Court may appoint the Central Bank or its nominee, Court Appointed Manager of the banking business of a licensed financial institution.

The respondent Development Bank is such a licensed financial institution and the provisions of the Act apply to the respondent Bank by virtue of the Order of the Minister of Finance dated the 16 August 2002 gazette by supplement no. 26 dated Tuesday, 20 August 2002.

Mr. Radcliffe referred me to the powers which the Court may specify in any order under s. 18(2). The Court has a duty to exercise its powers to appoint a manager in terms of s. 18(2) in these terms;

*"s. 18(2) The Court may, if it considers that in the circumstances of the case it is appropriate that the Central Bank or its nominee be appointed to take control of and manage the banking business of a licensed financial institution, make any or all of the following orders-"*

The orders are listed in the notice of motion, for the applicant Bank seeks all those powers enumerated to effectively "take control of the banking business" of the respondent bank.

The respondent Bank is a statutory authority created by the Development Bank Act (Cap.50)

Its establishment, purpose and functions of the Bank are to be found in Part II while by Part III a Board is constituted to govern the Bank.

I am satisfied no argument has been raised to doubt either the Ministers' powers to name the Development Bank or the efficacy of the terms of his order, and the applicability of the Act to the Development Bank is established.

To highlight the choices of the Central Bank under the provisions of the Financial Institutions Act, Mr. Radcliffe pointed to ss.16, 17 and 18 illustrating powers of the regulator to deal with situations progressively becoming worse in the circumstances of the target bank.

(Although there is provision for the conversion of Statutory Bodies to a Company under the Companies Act 1999, no order to that effect, is sought here.)

Looking at s.18 – (court supervised management)- the applicant says the Central Bank needs satisfy itself in terms of s. 18(1) before moving to manage the Development Bank and then so satisfy this Court " in the circumstances of the case it is appropriate that the Central Bank or its nominee be appointed to take control and manage" the Development Bank. That calls for the exercise of a statutory discretion.

### **THE MATERIAL EVIDENCE OF THE APPLICANT**

The grounds on which the Central Bank seeks management of the Development Bank are those set out in Mr. Hou's affidavit. In effect he says the Development Bank is insolvent and it is proper for the Central Bank to take over the other Bank's affairs.

I reproduce the material part of Mr Hou's evidence for it deals with the independent Audited Reports of the Auditor General for three (3) years 2000-2001 and 2002 and is put forward as the basis for the Court to take the view that the Central Bank has discharged the onus resting on it by section 18(1) of the Act, by showing that circumstances enumerated exist, and thus it is proper to take over business of this failing financial institution.

I quote:

*"The circumstances that have resulted in the Plaintiff concluding that this action is necessary are as follows:-*

*Pursuant to section 17(1)(b) of the Act an external audit of the financial accounts of the Defendant for the year ended 31<sup>st</sup> December 2002 by the Auditor General resulted in a qualified audit opinion dated 23<sup>rd</sup> September 2003. The opinion, states: "In my opinion the financial accounts of the Development Bank of Solomon Islands comply with the provisions of the Development Bank of Solomon Islands Act (Cap.50), however, because of the effects of the matters discussed in the qualification*

paragraphs, the financial accounts do not present fairly in accordance with the applicable Accounting Standard in Solomon Islands, the financial position of DBSI as at 31<sup>st</sup> December 2002 and the results of its operations and sources and application of funds for the year then ended."

The relevant matters in the qualification paragraphs are:

*Loan Provisioning*

"..... Due to the uncertainty with respect to current political and economic conditions I am of the opinion that the amount of provisioning is materially understated. In this situation the Development Bank of Solomon Islands financial position is not properly stated."

*Going Concern*

"The Development Bank of Solomon Islands is experiencing cash flow problems and is unable to meet repayments when due for certain term deposits. Currently the Development Bank has made arrangement with the Government and negotiations are yet to be finalized. At this stage I am unable to conclude positively that the Development Bank of Solomon Islands is a going-concern, on the basis that it is not currently able to pay debts as and when they fall due."

*Breach of terms of Rural Community Development Fund*

"The Development Bank of Solomon Islands had drawn down a total of \$1,124,249.35 from the Rural Community Development Fund to meet its own expenses. Use of the funds in this matter is in breach of the terms of the loan agreement. Consequently, the board has breached its fiduciary duties."

The Auditor General published similarly qualified audit opinions in respect of the financial accounts of the Development Bank for 2000 and 2001. Copies of the Audit Reports for 2000, 2001 and 2002 are attached hereto and marked RH2, RH3 and RH4.

By virtue of Section 9(8)(a)(1) and 17(1) of the Act, the audit opinion of the Auditor General constituted "reports to be Central Bank" as the supervisory body that the Defendant is insolvent.

Conscious of its duty to protect and preserve the priority given to deposit liabilities of distressed financial institutions under Section 15 of the Act, and pursuant to Section 11(1) of the Act, the Plaintiff conducted an on-site examination of the Defendant during November and December 2003. From the results of that examination and in relation to Sections 16(1)(a) and (b) and Section 17(1)(b) of the Act in the opinion of the Plaintiff, the Defendant:-

- (a) is following unsound or unsafe practices that are likely to jeopardize its obligations to depositors and other creditors;
- (b) has contravened or failed to comply with the provisions of the Act;

- (c) *is carrying on business in a manner that is detrimental to the interests of its depositors and creditors; and*
- (d) *is likely to be unable to meet its obligations when they fall due.*

*The on-site examination confirmed that the Defendant is insolvent with severe liquidity problems. The Defendant is illiquid and cannot pay its depositors and creditors as and when due. The Defendant is in breach of the minimum standards required under the Act (Section 8(1)(a) and (d)) and the Plaintiff's prudential statements for capital adequacy (P/S 1) and adequacy of liquidity (P/S 4)."*

### **THE RESPECTIVE ARGUMENTS OF THE PARTIES**

Mr. Radcliffe says there is no dispute on the affidavit material filed by the applicant that the respondent Development Bank is insolvent. That evidence is to be found in the affidavit of Mr. Rick Hou read in support of the motion. With that I am obliged to agree for there is no material to contradict the reports of the Auditor-General and Mr. Hou who is the Governor of the Central Bank. Relying on an external audit of the financial accounts of the respondent Bank carried out by the Auditor General (for the financial year to 31 December 2002) and reported on the 23 September, 2003, the other qualified reports for earlier financial years and the Central Banks own on-site examinations, Mr. Hou deposed to the fact of the Bank's insolvency for it cannot pay its depositors and creditors as and when due.

The applicant, then says that it is undesirable in the public interest to allow this Bank to continue to operate in this fashion and in the interest of depositors a court supervised manager should be appointed. The public interest aspect is a paramount factor because of the large number of persons likely to be affected in country.

Mr. Radcliffe said that the court should be mindful of the conclusions to be drawn from the manner in which the regulators powers are framed, for they echo to an extent, powers in the Companies Act, ss. 232 (powers of liquidator); 233 (exercise and control of powers).

Mr Titiulu appeared for the Development Bank.

He read the affidavit of Mathias Taro, the Chairman of the Board of Directors of the Development Bank which addressed why the Central Bank's application was opposed. In paragraph 5 of this affidavit Mr Taro says "*at no time since the Auditor's Report where produced by the Auditor General did the Auditor General discuss with the Board or Management of the Defendant of his intention to disclose the information and the nature such information to the Central Bank.*"

Mr Taro goes on to say that in view of the likelihood of intervention by the Central Bank the Auditor General had an obligation to discuss his intention to disclose the Audit Reports with the Defendant Bank's Board and Management. He further says that by not discussing the Report with the Management of the Development Bank the Auditor General has not afforded the Bank the opportunity to peruse the Report and perhaps have the Auditor General qualify it. I should say that assertion was left unsupported by legal argument, although what is possibly

expected and right, is not necessarily echoed in a legal imperative. Of course, this aspect is one which goes to the exercise of my discretion. Mr. Radcliffe addressed it in his reply.

Mr Titiulu suggested that the Central Bank is in some way party responsible for the Development Bank's position but I am somewhat at a loss to understand his argument on that point. Mr Titiulu did suggest however that since the Central Bank is a shareholder in the Development Bank a conflict of interest may arise. He further went on to say that having regard to the terms of Mr Hou's evidence, any recovery action by way of selling assets of defaulting borrowers of the Development Bank is in fact what the Board of the Development Bank has been doing in any event to correct the financial slide of the Bank. He says that the Development Bank has been aggressively taking steps to place the Bank back on a proper financial footing. He further argues that since the Development Bank is a creature of statute the Government may consider re-capitalising the Bank. Mr Titiulu also asked that the Court consider whether another entity should not be appointed to manage the affairs of the Development Bank and the consequent interest of the Government in the Banks' survival in the present form, having regard to the shareholding of the Central Bank.

Mr Radclyffe in reply pointed to the fact that for some two years no new loans had been made by the Development Bank for the Bank was affectively unable to function. It is not now available to the Board of the Development Bank he says, to blame the Central Bank for it was not until the Gazettal order made in 2002 that the Central Bank became responsible to oversee the financial affairs of the Development Bank.

It was not until 2003 following the Auditor General's Report that the Central Bank was in a position to affirmatively determine the state of affairs of the Development Bank a state of affairs which Mr Radclyffe says justifies the Central Bank's proceedings. So far as the criticism of the Auditor General's disclosure of the Audit Report to the Central Bank is concerned, Mr Radclyffe says the Auditor General has that very duty to report which he did by laying the Reports before Parliament. That public duty was discharged and criticism of the Auditor-Generals' function is unwarranted. Since the publication of the Auditor General's Report the Central Bank has been conducting its own enquiries.

I should say at this stage that I am satisfied nothing turns on the fact of disclosure of the Auditor General's Report in this fashion when the Central Bank has a primary duty to oversee the affairs of the Development Bank and that duty is facilitated by the appropriate audit.

Mr Radclyffe addressed the assertion of a supposed conflict of interest; he points out that the Central Bank does not receive a benefit as a shareholder in terms understood under the Companies Act.

In this case the Minister had appointed an independent Board for the Governance of the Development Bank and in fact there can be no conflict of interest. Any assertion that some 14.4% of the shareholding of the Development Bank has not been paid for is quite wrong and deliberately misleading for the paid up capital of the Development Bank does not extend to the amount of the authorized capital.

Mr Radclyffe pointed out that it was inappropriate to blame others for the problems affecting the Development Bank. He says that interest has been accruing on deposits and that the Development Bank is unable to meet its obligations as shown in the various Audit Reports and as deposed to by Mr Hou. Finally Radclyffe pointed to the fact that the terms of the Financial Institutions Act 1998 does not permit the Court to consider a Manager other than the Central Bank or its nominee.

### **FINDINGS AND REASONS**

I should say I am satisfied on the material set out in Mr Hou's affidavit, that the Central Bank has shown grounds to consider it proper to take control of and manage the banking business of the Development Bank. The Audit Reports and Mr Hou's own evidence evince a Development Bank which is, in effect, insolvent. It cannot pay its obligations as when they fall due.

In the circumstances of the case I am satisfied that it is appropriate the Central Bank be appointed to take control of and manage the Banking business of the Development Bank. Nothing has been raised to show how the Development Bank can trade out of these difficulties.

On a proper reading, Section 18 of the Act cannot mean to imply a supervisory role by this Court in the management of the Development Bank for -

- (a) the nature of any appointment is statutory
- (b) the obligation to seek the Court approval rests with the regulatory authority, the Central Bank
- (c) Phraseology in Section 18(2), to which "the Court may, if it considers that in the circumstances of the case etc" does not of it self, suggest such a role.
- (d) The Courts consideration relates only to it being satisfied of the matters or some of the matters set out in Section 18(1).

As I say I am satisfied of the insolvency of the Development Bank and consequently three matters are significant; stability of the financial system, interests of depositors or the public interest; all have resonance when I read Mr. Hou's affidavit. I believe when one reads Mr. Hou's affidavit that it is self-evident that, having regard to the purpose of the Development Bank, its status in the Solomon Islands and the interests of its stakeholders, all three criteria are affected in this case.

Once satisfied the Central Bank has discharged the onus resting on it in accordance with Section 18(1), the Central Bank has the right, consistent with statute, to claim management.

To countenance Mr Titiulu suggestion that the Development Bank itself or by its nominee, should continue trading ignores to my mind, the statutory imperative resting on the Central Bank to take control, in circumstances of the Central Bank's choosing. In any event the Financial Institutions Act does not allow me any such discretionary cause. To allow outsiders, (nominees of the Board) to manage the Bank is not permitted by law.

The other aspect raised by Mr Titulu which should be addressed, is that relating to the Development Bank Board's assertion that it is capable (as evidenced by the regime of sales) of managing the affairs of the Bank and thus should be allowed to continue to do so. I do not think there is need to enter upon the incidents of good management, as Mr Radclyffe obliquely says, "for while sales" is but one tool of management in these cases and a matter for my discretion in the course of the Central Bank's application to this Court for orders to manage. While the Development Bank's legislative framework imbues the Board of the Bank with responsibilities, upon its true interpretation, the Financial Institution Act Section 18, applies without reservation in the circumstances of this application for while the Boards Authority and responsibilities in respect of the Bank stand while a going concern, the right of the Central Bank to seek orders in terms of Section 18(2) cannot be fettered or constrained by reference to the terms of the Development Bank Act, now that I am satisfied the Development Bank is no longer a going concern. Those aspects may still fall to be considered in the exercise of my discretion, however.

Before making any order under Section 18(2) it is a condition of the Court's powers that the onus on the Central Bank under Section 18(1) of the Act has been fulfilled. I am so satisfied for the reasons that I have set out above.

#### **THE STATUTORY DISCRETION**

I make these findings in exercise of my statutory discretion found in s. 18(2) of the Financial Institutions Act. Such discretion has been described as a judge applying rules of reason and justice (*Mallet v- Mallet* (1984)58 ALJR 248 per Gibbs CJ at 249; Mason J at 257; Wilson J at 262; Deane J at 263 and Dawson J at 266,);

*"It is proper, and indeed often necessary, ...in dealing with the circumstances of a particular case, to discuss the weight which it considers should be given, in that case to one factor rather than another. It is understandable that practioners, desirous of finding rules, or even formulae, which assist them in advising their clients as to the possible outcome of litigation, should treat the remarks of the court in such cases as expressing binding principles, and that judges, seeking certainty, or consistency, should sometimes do so. Decisions in particular cases of that kind, can however, do no more than provide a guide; they cannot put fetters on the discretionary power which the Parliament has largely left unfettered. It is necessary for the court, in each case, after having regard to the matters which the Act requires it to consider, to do what is just and equitable in all the circumstances of the particular case."*

(per Gibbs CJ at 249)

There precedes then, this courts consideration of the material matters to be weighed in the exercise of this discretion. I consider the weight to be placed on the three criteria set out in s. 18(1) when demonstrated, by evidence as has been in this case, means that a respondent to an application by the Central Bank has a difficult task. The matters raised by the respondent in this case are of not sufficient import, as I have explained, to justify exercising my discretion in the respondent's favour.



**ORDERS**

I consequently make orders in terms of paragraph 1,2, 4,5,6,7,8,9 and 10 of the Notice of Motion filed on the 17<sup>th</sup> of March, more particularly as per orders set out in the document entitled "Order" initialed by me this day.