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Introduction to Branch Banking

Importance of a Branch

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Learning Outcome

By the end of this chapter you should be able to:

- Discuss the concept of branch banking
- Discuss the importance/use of a branch and its role in commercial banking
- Differentiate between a branch, a booth and sub-branch
- Explain the difference between sales centre and service centre
- Define a sub-branch and list its functions
- Define inter-branch transfer of accounts

Introduction

The term “bank” is derived from the Italian word "banca". The Jews of Lombardy (a province in Italy) used to transact money sitting on benches placed in market places. Those benches were called "‘banca” meaning “the money changer’s place”. “Banca” later converted into the word "bank". The first modem bank, “Bank of St. George”, was founded in Italy in 1406. In the beginning banking operations were restricted to the giving and taking of money, whereas today they are engaged in performing many other financial activities like management of investment funds, credit operations and insurance activities.

A bank is defined as an institution which has been licensed by the Central Bank of its country to accept deposits repayable on demand or otherwise, and withdrawal by cheques, draft, order or otherwise. This definition also includes specialized banks such as agricultural banks, investment banks, SME banks, microfinance banks and Post Office Saving Banks, etc. A bank can also be defined as “an institution whose primary activity is to act as a payment agent for customers to borrow and lend’ , .

According to the Banking Companies Ordinance 1962 Sub Section (c): "Banking Company means any company that transacts the business of banking in Pakistan and includes their branches and subsidiaries functioning outside Pakistan of banking companies incorporated in Pakistan inserted by Finance Act 2007)". Section 13 of the Banking Companies Ordinance deals with the minimum paid-up capital and reserve requirement for the commencement of banking business in Pakistan. The authority to alter this requirement lies with the State Bank of Pakistan.

Primarily there are two main functions of a bank - accepting money from the depositors and offering that money in the form of loans to the creditors. Depositors lend money to the bank and are paid for it; similarly the bank lends money to the creditors and is paid for it. The earnings of a bank and its shareholders are thus the difference between these two costs - the cost of deposits and the cost of credits. A bank's primary aim is to keep its depositors and lenders satisfied by giving both parties the maximum benefits in terms of attractive profits and quality services.

Itaboduction

At the time of partition there were only a limited number of commercial bank branches present in Pakistan and banking facilities were available only in big cities. With the passage of time, the number of banks and their branches has increased substantially. At present there are more than 8500 branches of commercial banks providing banking services to more than 26 million customers. Banks have played a vital role in the development of Pakistan's agricultural and industrial sector.

Every country has its own set of laws and regulations for protection of public interest and to ensure smooth and lawful running of its banks. Similarly, in order to commence banking operations in Pakistan, either domestically or internationally, a bank has to obtain a banking license from the regulator. This license is issued upon ensuring successful adherence and fulfillment of relevant laws and regulations as prescribed by the State Bank of Pakistan. The State Bank of Pakistan is the official regulator of banks in Pakistan as per the Banking Ordinance 1962.

After obtaining a license to operate, a separate license is required to open every new branch under Section 28 of Banking Companies Ordinance 1962. Microfinance banks are licensed under Micro Finance Institutions Ordinance 2001 , while Khushhali/Microfinance Banks were established under Khushhali/Microfinance Bank Ordinance 2000.

The State Bank of Pakistan provides guidance and support to the banking sector for developing and maintaining good business practices. In order to ensure availability of banking facilities to all corners of the country, SBP has instructed banks to open at least 20% branches in rural7under- served areas. New options for opening sub-branches, sales and service centers and mobile banking units have also been introduced. Banks are being encouraged to enhance their scope towards branchless banking and collaborate by signing Service Level Agreements (SLA) with large companies to extend banking services to the public at non-banking locations.

Functions of Commercial Banks

Banks are vital for a country's overall economic growth and well-being. Banks receive deposits from all around the country and lend advances to areas where funds are insufficient. Due to the availability of abundant financial resources, banks are able to finance large projects and invest in those areas of the economy which need resources and funding.

Commercial banks perform the following functions using various channels ' of operation:

1. Payment of cash from accounts subject to the presentation of or payment at the customer's order.
2. Netting and settlement of payments through the Central Bank via NIFT. Banks act both as collecting and paying agents for

customers and participate in inter bank clearing and settlement systems to collect and pay against payment instruments.

3. Issuance and settlement of local remittances for quick settlement of domestic trade.
4. Lending money to commercial and private borrowers which helps in regulating the overall economic activities of the country.
5. Financing of international trade and international settlements on behalf of customers.
6. Financing of long-term projects.
7. Maturity distribution enables banks to extend long-term loans in spite of being subject to the terms of "demand and time deposits".

Almost all the functions of commercial banks can be performed via their branch networks.

Inter-Branch Transfer of Accounts

With the increase in bank branch networks, inter-branch bookkeeping has become more important. It is generally handled on a branch-to- branch basis via the main / head office account.

If an amount is due from head office, the head office account is debited and if the amount is to be received by the head office, the account is credited. It is also to be ensured that these accounts are reconciled immediately. In the event of entries in the head office account remaining outstanding for more than 30 days, the State Bank of Pakistan can penalize the bank for negligence. The penalty thus levied to the bank is at the rate of Rs 20,000 per instance and an additional Rs 1,000 per day after the specified duration of 30 days.

Banking Channels

Banks operate through various distribution channels, enabling customers to utilize their services and facilities as per convenience and preference:

1. Branch: A branch is a retail location that offers a wide array of face-to-face and automated services to its customers. These services range from account and locker operations to acquiring loans/advances and repayment facilities. Most of the functions of a bank involving customer interaction are done via bank branches. Branches often act as both sales and service centers for bank products. Branches that are designated as per the bank's policy to provide only customer support and not solicit new customers for their loan products can be termed service center branches. However, when a branch is involved both in providing sales support and selling loan products it can be termed a sales center. The salesand service specialists deployed in the branch function also act as the sales and operations staff. In addition to selling the bank's products to the customers, the sales staff are also responsible for

greeting and servicing the customers and performing teller transactions. The responsibilities of the Branch Manager, generally labeled as the "captain of the ship", along with the sales staff, include functioning as a scheduled seller.

Operations staff is responsible for establishing, retaining and encouraging relationships with existing and future potential customers to help achieve sales goals and provide quality customer service. They are also responsible for processing transactions accurately and efficiently to build customer confidence and trust, based on established policies and procedures. The head of operational work in the branch is called the Operations Manager.

2. ATMs: An Automated Teller Machine (ATM) permits the holder of the appropriate magnetic encoded card to obtain funds 24 hours a day, as well as allowing the account holder to view their account balances statements, order cheque books and make money transfers. The latest ATMs also accept deposits and collect utility bills. These machines are automated and work on principles of telecommunication so does not require a physical teller.

   Pakistan's ATM industry runs on two operating switches - 1-Link and MNET. As per SBP , s instructions both switches were interconnected in March 2004. All the member banks share their electronic networks using these two switches, which primarily means that customers of member banks can use MNET as well as 1-Link ATMs nationwide for carrying out their ATM transactions. VISA certification and connectivity is provided by 1-Link to the member banks to issue/acquire VISA debit cards which can also be used on the Global VISA Network, enabling the member banks to open their local networks for international card acceptance. Both switches are owned by the consortium of banks and operate through a Chief Executive Officer.

   Banks provides Debit / Credit Cards to their customers to facilitate their ATM Transactions like Balance Inquiry / Cash Withdrawal from ATM centers or POS Transactions like make purchases from any merchant outlets throughout the world, Internet Transactions, Online purchases, and round the clock. For this arrangement banks have tie-ups with shared Network's or partners like VISA, MASTER CARD etc. These shared Networks provide access on shared ATMs and at POS (Point of Sale) terminals (the merchant location). Every transaction depending on Issuer or Acquirer goes through the ATM, Switch, General Ledger (Host) and ultimately the shared Networks. At day end each shared network sends reports to the issuer bank for the transactions that were carried out using their network. Issuer Bank also generates corresponding reports for the day from General Ledger, Electronic Journal (ATM) and Switch. These are called on-us and off-us transactions. In other words on-us transaction from a network's perspective means that any other network has used carried out a transaction usingtheir net work and off-us means that their customers carried out transactions using other networks.

3. CDMs: A Cash deposit machine (CDM) permits the holder of the appropriate magnetic encoded card to deposit cash in the form of physical notes into his/her bank account. These machines can be further classified as a Single Note acceptor CDMs and Multiple note acceptor CDMs.

4. Mail/Post: Mail is also a banking channel whereby documents enclosed in envelopes are delivered to the customers. This can be used to deposit cheques and to send orders to the bank. Banks also use mail to deliver periodic account statements, product details and any change in policy to the customers.

5. Mobile Banking: Telephone banking is a service provided by the banks enabling their customers to perform banking transactions via telephone.

6. Internet Banking: Internet banking is used for conducting electronic monetary transactions over the Internet. Customers can use this channel for funds transfer, repayments and settlement of utility bills, etc.

Branch Opening Procedure and Other Places of Business

The Banking Policy & Regulation Department of the State Bank of Pakistan deals with branch licensing policy. This policy is revised via issuance of BPRD circulars as per the needs of the banking industry from time to time.

Whenever any bank or a DFI wishes to open a new place of business, they are required to submit their Annual Branch Expansion Plan (ABEP) to the State Bank of Pakistan for approval by the 31st of October. SBP's decision is conveyed to the relevant bank/institution generally by 31st of December. The branches approved by ABEP must be up and running before 31st December of the subsequent year else permission stands cancelled. As per the SBP's instructions, at least 20% of a bank's branch network must exist in rural areas. Rural areas are defined as villages, small towns and tehsil headquarters where any bank branches do not already exist. Any bank willing to open branches in rural areas over and above 20% of .the mandatory requirement can approach the SBP any time for permission.

When opening a new branch, the following points should be considered to ascertain feasibility:

- What is the population of the area?
- How many branches are already functioning in the same locality?
- What is the nature of the area? Is the area agricultural, commercial or industrial?
- What means of transportation are available?
- What is the deposit and business potential of the area?
- Any other major considerations.

Opening of a Sub-branch

Banks can open a sub-branch as a conduit of a branch to which it is affiliated. Opening of a sub-branch should be a part of ABEP. Banks cannot convert an existing branch into a sub-branch. However, a booth can be converted into a sub-branch, and a sub-branch into a full branch under the ABEP after approval from SBP.

A sub-branch is not empowered to open an account, including allotment of an account number. Completion of the Know Your Customers (KYC) process and exercise of due diligence before account opening are also to be carried out by the controlling branch.

Sub-branches can perform the following functions:

- Cash receipt and payment
- Issuance and payment of remittances, travel cheques
- Disbursement and recovery of Agri / rural financing
- Settlement of insurance claims of Agri / rural financing
- Group-based lending

A sign board, both in English and in Urdu, stating that "this is a subbranch/limited function branch of______________________________bank" is required to be affixed on every sub-branch.

Opening of Booths

Permanent booths can be opened by any bank after obtaining a license from the SBP for performing the following activities:

- Collection of utility bills
- Collection of Government dues and revenues
- Collection of fees from educational institutions
- Collection and disbursement of loans to farmers
- Collection of bills from hospitals
- Providing limited banking activities at the embassies
- Exchange of foreign currencies at the port of entry
- Collection of cash for institutions such as National Bank of Pakistan
- Collection of cash for the Pakistan Railways

Temporary booths can be opened without prior permission from the SBP for g period not exceeding one month. For a temporary booth of over one month but not exceeding three months, prior written approval from SBP is required. Dates of opening and closing of temporary booths should be intimated to the SBP in the prescribed format within seven days of opening. Temporary booths can be opened for temporary facilities such as exhibitions, on-the-spot facilities for growers and for hajj pilgrims during hajj seasons, etc.

Importance of a Branch

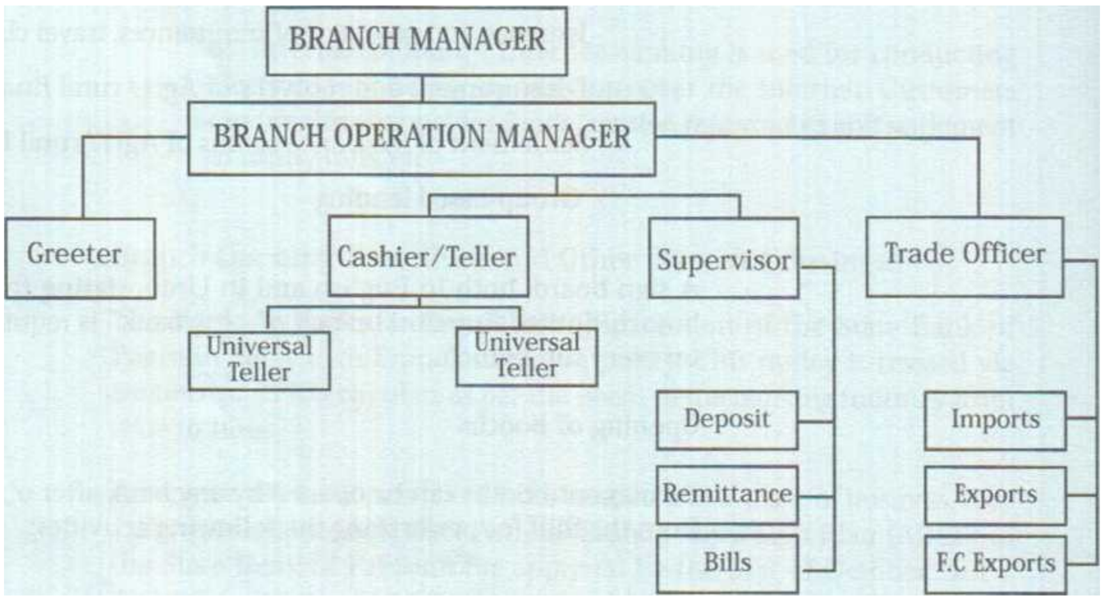
Part One **Introduction to Branch Banking**

Chapter 2 Branch staff

Learning Outcome By the end of this chapter you should be able to:

- Discuss the roles and responsibilities of branch staff

ORGANOGRAM OF A TYPICAL BRANCH



Roles and Responsibilities of Branch Staff

Branch Manager

A Branch Manager is considered as the "captain of the ship". He/she is responsible for achieving, exceeding and maintaining the service, sales and control targets by managing, coaching and motivating the branch team to deliver outstanding performance. He/she should ensure that the branch team delivers results without compromising the bank's service and sales processes and procedures. He/she provides leadership, direction, and support to team members and is expected to maximize business performance and ensure that relationships with customers are strengthened. In a nut shell the responsibilities of a branch manager can be broadly categorized as follows:

1. People Management
2. Customer Franchise Management
3. Risk Management
4. Cost Management / Maintaining Financials of the branch

Branch Operations Manager

The Branch Operations Manager is also referred to as the second in command of the branch. As a retail banking operation manager he/she should lead, manage and coach the team to achieve and exceed branch objectives by proactively taking steps to make the branch the most helpful financial services provider in the area. Operations managers must have full knowledge of the bank's policies and procedure and coach their teams to deliver efficient customer service.

The following are the traits of an efficient operations manager:

- To act as a point of reference and give instructions on technical issues to the staff and external/internal customers.
- Provide guidance and coaching to staff, customers and relationship managers.
- Identify training needs and undertake technical training of staff.
- Review new and amended policy directives and guidelines issued by the Central Bank and assess the impact on the existing processes and customer requirements.
- Propose policies and adjustments thereto, and/or manage the implementation of process changes as appropriate.
- Consider continuous improvement suggestions with regards to technical aspects for approval and implementation.
- Ensure all strategy and work undertaken is consistent with and in accordance with the bank's published policies in order to minimize risk.
- Ability to work under pressure.

Chief Teller

A chief teller, also called the vault teller, has the keys to the cash safe. He/she manages and handles the cash / cheque transactions at the teller counter and ensures delivery of quality service to the customers while adhering to operational controls and avoiding cash excesses and shortages.

The responsibilities of the chief teller entail:

- Meeting transaction processing standards and maintaining a high level of customer service standards.

.Processing cash transactions (deposits / withdrawals) in both local and foreign currencies and ensuring that the ledger is balanced at the end of the day.

- Verifying signature (s) on payment cheques and ensuring that these are approved as per authority levels prior to disbursement.
- Monitoring cash deposit amounts / quality of notes in order to detect unusual transactions (money laundering, forgery, etc).
- Informing the Branch Manager of any unusual transaction (s) (money laundering / forgery) that may be detected.

- Arranging and sorting of cash as issuable, not issuable, soiled / defective notes and depositing these at the cash center for onward delivery to the State Bank of Pakistan.

Teller

A teller processes cash and other types of transactions (deposits / withdrawals issuance/ payment of different banks' products) in both local and foreign currencies and ensures that the cash is balanced at the end of the day. The following is expected of a teller:

- Verifying signature(s) on payment cheques and ensuring that these are approved as per authority levels prior to disbursement.
- Accepting and processing all types of clearing / collection cheques.
- Issuing pay orders and drafts, cashier cheques.
- Monitoring cash deposit amounts / quality of notes in order to detect unusual transactions (money laundering, forgery, etc).
- Highlighting security concerns to the Chief Teller and / or the Branch Manager.
- Achieving set targets in terms of service standards for customer transactions.
- Informing the Chief Teller / Branch Manager of any unusual transaction (s) (money laundering / forgery) that may be detected.
- Maintaining consistent service standards.
- Managing cash position of the branch / till in order to ensure that sufficient cash is held for customers. Verifying large cash holding of cash or particular denominations.
- Sorting out of soiled notes and depositing these at the Central Bank and adhering to all the rules prescribed by the State Bank of Pakistan's BSC Cash monitoring policy.

Trade Officer

The Trade Officer should have a working knowledge of Letters of Credit, Collections and Guarantees and works as part of a team to carry out a range of Trade Finance transactions and technical support duties in accordance with established policies and procedures and service standards.

A Trade Officer is supposed to ensure that trade instruments are correctly processed and that internal/external rules, procedures and regulatory requirements are met. He/ she must have a working knowledge of systems including the Trade Innovation & Common System, to approve andcheck trade products, within agreed limit thresholds, and to act as a point of reference, as well as directing the staff and external/internal customers on the handling/resolution of any technical problems.

Learning Outcome

By the end of this chapter you should be able to:

- Recall the evolution of branch banking in Pakistan and discuss the difference in the current functions of a branch from those in the past

Evolution of banking industry in Pakistan

Before partition the only central bank under which banks operated was the United Bank of India. At that time there were only two banking institutions - The Habib Bank Limited and Australasia Bank, which later became part of Pakistan. The then government of the newly established state of Pakistan felt the need to have a central regulatory authority to ensure smooth operations of all the existing and future banks. Despite the shortage of experienced staff and other resources, Quaid-e-Azam Muhammad Ali Jinnah inaugurated The State Bank of Pakistan (SBP) on 1st of luly 1948.

In October 1948 Pakistani notes were issued. The National Bank of Pakistan came into being in 1949 as a scheduled bank and to serve as an agent of SBP. Later , Industrial Development Bank of Pakistan and Agriculture Development Bank of Pakistan were formed to support the industrial and agricultural sector. With the development of agriculture, trade and industry, the functions of the state bank became wider. To progress this situation, the State Bank of Pakistan Act 1956 was promulgated. During this period two new banks, Muslim Commercial Bank (MCB) and Pakistan Industrial Credit and Investment Corporation (PICIC) , were formed. This was the period of expansion in the banking arena. In late 1959 United Bank Limited (UBL) was established, while Commerce Bank limited and Standard Bank Limited followed soon after.

Nationalization

On 1st of January 1974 banks in Pakistan were nationalized and the Banks Nationalization Act 1974 was promulgated. After nationalization, the formation of new banks in the private sector stopped completely. Due to increasing political interference in the affairs of the banks, business decisions and appointment of staff were not taken on merit. Office discipline deteriorated to a point of non-existence and some nationalized banks were on the verge of collapse.

Denationalization

After 16 years of experiencing nationalization it was realized that, rather than being productive , nationalization actually proved to be quite disastrous for the banking industry. In 1991 the government changed its stance and announced a policy of denationalization of nationalized banks so as to encourage the formation of new banks in the private sector.

Today , the five large network banks - The National Bank of Pakistan, Habib Bank Limited, United Bank Limited, Muslim Commercial Bank Limited and Allied Bank Limited - possess more than 50 % of the country's deposit base. The remaining 50% is divided between other foreign and private sector banks. Both Muslim Commercial Bank and Allied bank were privatized in 2000 and showed significant improvements in profit and deposit growth. The privatization of Habib Bank and United Bank Limited soon followed. The National Bank of Pakistan, however, is still government owned and is currently the largest bank in deposit base and is almost the sole beneficiary of lucrative government deposits.

Before privatization the five large network banks used to support certain non-lucrative projects on government demand, which included:

- Lending to support projects patronized by influential authorities under government sponsorships.
- Extending loans without requisite collateral.
- Extending loans below market rate returns.
- Utility bill collection below banks cost of management the bill collection process.
- Over-collection of taxes from these institutions to cover Government revenue shortfall.
- Over-staffing of these institutions with under-skilled 'preferred' people.
- Forced branching in unbanked areas.

The above mentioned have been reduced substantially as a result of privatization as well as parallel reforms within the sector. Other than the banking industry, Pakistan's financial sector comprises of the development finance institutions (DFIs), insurance companies, mutual funds, the stock exchange and leasing companies.

The future growth of the banking industry depends on overall economic activity but, more specifically, on the expansion of the industrial sector. The ongoing privatization process is providing momentum to the industrial sector which in turn is fueling the growth of the banking industry.

Steps toward Turnaround

After privatization of the four big banks, the following actions were taken to enhance profitability and reduce costs:

- Headcount reduction to eliminate redundancy by almost 50%.
- Closing down of loss making business areas.

Merging of close vicinity branches into single units.

- Automation at both head office and branch level.
- Introduction of new products.

- Induction of competitive staff based on merit and emerging requirements.
- Streamlining of the internal audit and compliance functions.
- Increased focus on developing both corporate and consumer portfolios to enhance profitability.
- Streamlining international operations to ensure enhanced profitability.

The above steps have resulted in improvements in the banking arena both in terms of profitability and service standards. These changes have been recognized both locally and internationally, the impact of which can be seen in the form of improved credit ratings by Moody's Investor Services.

Introduction to Branch Banking

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Branch Banking in the future

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By the end of this chapter you should be able to:

Lc3jming Outcome

- Predict the future trends in branch banking in Pakistan given the increase in automation, bank customer vs. branch customer, centralization of operational functions, increase in customer awareness and regulatory requirements geared towards customer protection.

trends in Pakistani • tg industry

Trends in the Pakistani banking industry in the next few years are likely to be extraordinarily competitive. After a decade of aggressive progress the industry will take some time for consolidation. Due to the rise in inflation, interest rates will increase further and the net income spread of the banks will be reduced. Due to the economic uncertainty, the number of non-performing portfolios will also increase. The future approach of the banks will be to focus on Information Technology (IT).

The future success of the banking industry lies in the effective use of information technology, because it benefits the banks and their customers in terms of cost, speed and convenience. At present IT is playing a key role in managing all types of banking operations, product development and improvement of services. It has also helped in defining new customer service standards with the increase in usage of phone banking, IVR systems, internet banking, Point of Sale (POS) , credit and debit cards. With the increased dependency on the use of information technology, it is imperative that maximum security standards be adopted to ensure the safety, security, and maintenance of e-banking transactions. The number of Automated Teller Machines (ATM) in the country is now well over 4500. Out of 10,300 branches in the country, more than 7,100 branches are offering real time online banking services. Banks must design infallible data security processes to strengthen controls. Information technology and compliance requirements will, over the next few years continue to be the most significant determinants of productivity. Skills are a mid-ranking factor among the drivers of productivity, although in the wholesale sectors and in investment and fund management, technical skills will be the most important contributors.

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Use of Core Banking System (CBS)

The majority of banks are using the Core Banking System (CBS) as a comprehensive banking solution. It works on a real time basis and the entire banking network resides on one host which leads to efficient reconciliation of head office account entrees and maintenance of customers' account details under one CIF (customer information file)with information on borrowing of all kinds. This system allows an insight of all the relationships a customer maintains with the bank on the basis of a unique ID, generally the CNIC of the customer. In the absence of a core banking system, different departments within banks use different programs for their banking needs. Post implementation of CBS, all functions are centralized at one point of control. All banks in future will move on to implementation of the Core Banking System.

Rules for customers' protection

Since 2008, the State Bank of Pakistan has witnessed an unprecedented growth in consumer banking, which has led to an increase in the grievances of consumers about the products and services of banks/DFIs. In order to deal effectively with these increasing consumer grievances and to put in place an appropriate policy and regulatory mechanism for their redress, SBP has created a Consumer Protection Department. In addition to dealing with and deciding on consumers'/public grievances *I* complaints regarding consumer products and services, the newly created department also handles complaints related to all types of bank products. It serves a dual purpose, i.e. it protects the customers of the bank and on the other hand it also supports the banking industry by suggesting improvements in banks' policies. In future, principles-based regulations will be modified for banks' as well as for customers' protection.

Centralization of processes

Maximum centralization of processes will be a key factor in future. Account opening, clearing processing inward and outward, collection, CADs affairs, etc will all be centralized. A few major banks have already centralized these functions.

Outsourcing services

Due to unproductive union activities, some banks have started outsourcing various tasks, including security services and hiring of third party staff. In some parts of the world, for example in India, a public sector bank has outsourced work for the installation and maintenance of 1,000 ATMs as part of its plan to scale up alternative channels for business operations. In Pakistan also, instead of setting up a fully fledged department and hiring a huge work force, the trend for allocating specialized jobs to third parties is becoming more popular.

Branchless Banking

It is said that "branchless banking" is the future of Pakistan's financial sector, as it opens up great opportunities for banks to bring the unbanked segment of society into the financial system. The State Bank of Pakistan, being the central bank of the country, is taking steps to make the branchless banking regulatory framework more flexible to broaden the scope of financial services in line with the other, more traditional banking channels. Branchless banking has huge potential to reach this unbanked and untapped segment of society. This is not only cost effective for the banks but represents an affordable solution for the financially excluded, underprivileged class of society. That is why Pakistan's financial sector is witnessing a dynamic transition, led by this branchless banking solution, rhis transition can be witnessed by a comparison of the number of branches versus branchless banking outlets. At present, numbers of branchless banking outlets have reached around 14,000 in around two years, against a total branch network of around 10,300 in 63 years.

According to one estimate, the cost of setting up a conventional branch is 76 times higher than using a third party agent to bring the unbanked areas into the financial system. At present the most popular branchless banking products in the market are "Omni" of UBL, "Easy paisa" ofTameer Bank, MCB Mobile, KASB Mobile and HBL Uphone. According to the SBP disclosure, more than 400,000 branchless/ mobile banking accounts were opened collectively by all banks in the last 18 months. In branchless banking billions of rupees have been transferred from one person to another, from one account to another, and from government to the public sector.

Priority to the agriculture sector

These days an increasing number of resourceful people are setting up agri-based businesses because real farmers are not getting benefits of agricultural reforms. The major land holding is with the "Zameendars/ Waderas".

Since 2008 the government has increased the purchase price of wheat, the cost of cotton is increasing worldwide, rice production is increasing although its price is stable, fruit production and exports are also increasing and all these factors have led to an increasing interest in the agricultural sector.

Part 2: Services and Products

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Ckapter 1

Services and Products

Conventional Banking

learning Outcome

By the end of this chapter you should be able to:

- List and explain the characteristics of various types of accounts available for customers in commercial banks i.e. current, savings and time deposits
- Recall the services related to accounts available for the customers
- List the types of accounts with respect to the ownership of the account such as single, joint, etc and the account opening documents required
- Describe various requirements for opening a foreign currency account vs. a rupee account
- List the various types of business entities who can open accounts and describe the documentation required to open tneir accounts
- Define remittances
- Explain the common types of remittances
- Recall the SBP regulations related to remittances
- Explain the remittance products offered by banks and their features
- Explain what type of relationship is created between the bank and licensee when issuing a locker for rental and state some of the common risks associated with this service

Introduction

Conventional banking is based on the debtor-creditor relationship between the depositors and the bank on one hand and between the borrowers and the bank on the other. Interest is considered to be the price of credit, reflecting the opportunity cost of money.

Deposits

Deposits are sources of funds which are used by banks for lending and/or investment purposes. The basic function of any bank is accepting deposits. Deposits can be divided into two main categories: Demand and Time/Term deposits/liabilities. Banks use deposits for lending and investing activities in such a way that withdrawals are possible on demand - both for demand and time deposits.

Demand deposits/liabilities are accounts, withdrawals from which can be made immediately on demand at any time; whereas in the case of Time/Term deposits/liabilities, funds are available for withdrawal only after a fixed term or determinable period. All deposit products are Liability products and all lending/investment products are Assets products and reported in the balance sheet accordingly.

A bank's profitability depends on its ability to mobilize deposits effectively. Generating expensive deposits and lending or investing at cheaper/lower interest rates can cause profit erosion. ^Cost of deposit' is a term used for the rate that the bank pays to its depositors. This rate must be high enough to attract desirable levels of deposits but low enough to ensure profit sustainability. Banks lend at a particular interest rate which is determined by keeping in view the cost of the bank's deposits and other economical factors. It is the treasurer's job to maintain the pool of the bank's money in a profitable and feasible manner.

Furthermore, the rate of return on deposits is linked with Treasury bill rates (T-Bills) and rates of Pakistan Investment Bonds (PIBs). Rates for T- Bills are floated by the State Bank to finance short-term gaps between government receipts and expenditure. Rates of Pakistan Investment Bonds (PIBs) are issued to finance the long-term gaps and are used for determining long-term deposit rates.

SBP has advised all banks and DFls to prominently disclose all terms and conditions for both depositors and creditors, along with the projected rate of return to the depositors and interest or markup rates for the creditors. This information must be clearly communicated and disclosed in all forms of communications including in media campaigns.

Section 26-A of Banking Companies Ordinance 1962 pertains to Deposits. The salient features of this section are:

- Banks may accept deposits on participation in profit and loss (PLS).
- Free of interest or return in any other form.
- Banks shall make a complete record of the investment made and funds allocated for liquid assets.
- Deposits which are received on a PLS basis shall be invested by the banks at their absolute discretion in businesses where return is not fixed (interest). Depositors who have invested money on a PLS basis are entitled to receive periodical profits from a share of profits of banks as may be determined by them and in case of loss shall be liable to bear the proportionate loss.

Types of Accounts

An account is a relationship with the customer, operated on a day-to-day basis, into which deposits are received and out of which cheques are paid. A deposit account is usually in credit, but an overdraft facility may be taken by pre-arrangement with the bank. Some deposit accounts are opened for a limited time such as:

- Notice Account - repayable after a notice period of seven days, or 29 days, etc.

• Term Deposit Account • repayable after a fixed time ranging from one month to 10 years or even longer.

1. Current Account

A current account is an account from which any part of the balance may be withdrawn on demand. Withdrawal from the account can be made via cheques, direct debit, standing instructions or ATM. Funds in the account can be debited or credited in the form of cash, cheques and financial instruments. No interest/ profit is paid on the current account.

These accounts are generally for business purposes and can be overdrawn on arrangement with the bank. Zakat is not deducted on current accounts. The initial deposit can be as per each bank's own policy.

Before account opening, due diligence should be exercised and all Know Your Customer (KYC) requirements are to be fulfilled (KYC is explained in detail in Part Four - Chapter 1).

2. PLS Saving Account

Saving accounts are meant solely for saving purposes. Saving means to set aside money for future use or to retain money to meet future spending needs. Saving accounts have all the features of a current account, except that profit is paid on the balance maintained as per the PLS rules of the bank. Saving accounts are generally opened in the name of individuals but can also be opened in the name of charitable institutions, for provident funds, benevolent funds and pension funds. Initial deposit and minimum balance requirement features can be decided by each bank as per their own policies. Zakat is deducted on the balance maintained on the valuation date (first day of Ramadan). Exemption from Zakat can be claimed by submitting Zakat declaration 30 days prior to the Zakat valuation date.

Different banks have introduced different variation products of saving accounts for individuals and companies where profit is paid bi-annually. Zakat rules for these accounts are similar to that of the normal saving accounts.

As per BPRD circular no 7 dated 30th May 2008, SBP has instructed all banks to pay a minimum of mandatory 5% profit to their saving account holders.

As per SBP BPRD Circular No.07 of May 27, 2011 , State Bank of Pakistan has prohibited all the banks from levying any service charges for opening and maintenance of regular savings accounts with effect from July 01, 2011. This means thatthe sendees reodderedby banks for the ooening and maintenance of regular savings accounts shall be free of charge. There shall be no condition of maintaining a minimum balance for these accounts. These instructions are applicable equally on all existing and new accounts. Similarly, no charges would be recovered by banks at the time of closing an account. Banks shall not demand more than Rs.100 as an initial amount for opening of regular savings accounts. However, no initial deposit would be required for opening of accounts by (i) Mustahkeen of Zakat, (ii) Students (iii) Employees of Government or

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Semi Government institutions for salary and pension purposes (including widows/children of deceased employees eligible for family pension/benevolent fund grant, etc.) and other similar types of accounts.

The banks must also ensure that all terms and conditions for the operation of an account, especially in case of its dormancy, closing and/or subsequent reactivation are brought into the knowledge of the customer at the time of account opening. Key features of the Account Opening Form must be translated into Urdu and a printed copy of such translation shall be shared with the account holders at the time of opening of the account.

3. Basic Banking Accounts (BBA)

BBAs were introduced by SBP, with special features; vide BPD circular No. 30 dated 29th November 2005, to facilitate banking for low income people in Pakistan. Prior to the introduction of BBAs banks used to collect service charges from all the customers who failed to maintain a minimum balance in their accounts as per each bank's policy. In order to resolve this issue and to facilitate banking for small depositors , SBP has formulated the BBA scheme with the following features:-

- Initial deposit to open a BBA is Rs.1000/--
- No profit is paid into this account.
- No minimum balance is required and no service charges are to be paid by the customer.
- If an account remains at Nil for a continuous period of six months, the bank has the right to close it.
- Maximum two deposits and two cheque withdrawals are allowed free of charges in a month.
- Unlimited free of charge ATM withdrawals are allowed from bank's own ATMs.
- In case of withdrawal from ATMs of any other bank, charges will be recovered from the other bank.
- A regular banking account can be converted to a BBA on the customer's request / consent..
- There is NO bar on opening a joint BBA account.

4. PLS Term Deposits

Term deposits are the deposits repayable after a predetermined future date. Such deposit transactions may be for a period ranging from seven days to ten years or even longer.

- Profit is paid on the simple interest basis.
- Roll-over option can be made available.
- Zakat is applicable on the face value, if TDR was outstanding on Zakat valuation date or payment of profit whichever is earlier.
- Tax / withholding tax shall be recovered as per law of the land on profit disbursed.

Different banks have issued different liability products for RTA (Rupees Transactional Accounts) and Term Deposit Accounts. The applicable rules are within the parameters explained above.

5. Cash Management Account

A Cash Management Account is a banking service provided to high profile business customers through which they can speedily obtain funds from their collection accounts and transfer to their main account through a computer module. The module collects and consolidates data from the customer's bank account in any location in the country. Through cash management, customers can speed up collection of their accounts receivable and utilize their funds to the optimum level.

6. Collection accounts

Collection accounts are opened for collection of funds at the request of business customers, charitable institutions and on the instructions of the government in the case of any disaster.
For the scenarios listed above, a main account is opened in any branch of the bank. In lieu of this main account, collection accounts are opened in other branches from where funds are transferred to the main account as per instruction / arrangement.

7. Share Subscription account

When a public limited company floats its shares for subscription, it has to open accounts in banks that are called "bankers to the issue". These banks authorize their branches to collect share applications from the public against deposits of subscription money in a collection account; this is ultimately transferred to a main account of the bank on the closing date of the subscription. If the number of share applications is more than the shares offered, balloting takes place and refunds to unsuccessful applicants are made through the branches via which the applications were received. No cheque book is issued and collection accounts opened in lieu of main accounts are closed.

8. Dormant Accounts

Dormant means sleeping, inactive, and inoperative. If an account which has not been used by the customer for a long time, it is classified as dormant. Banks are allowed to make their own policy regarding dormant accounts. In most banks the period of dormancy is one year. Profit is paid and charges are recovered as usual. System-generated entries do not change the status of the account. Statute / Law of limitation does not apply to dormant accounts, but Sec. 31 of BCO 1962 (unclaimed deposit accounts) does. As per SBP instructions, before declaring the status of an account to be dormant, a notice should be sent to the customer at his/ her last available address, informing him / her that the account is no longer operative and its status will be changed to dormant if not operated, and fulfills all formalities for activation of the account."

Record of the notice thus sent must be maintained for an SBP Inspection Account to be activated against a written request and on production of an attested copy of CNIC or Passport or Pakistan Origin Card (POC) or National Identity Card for Overseas Pakistani (NICOP), if already not on record.

According to the Prudential Regulation M l section 8-A:

"Customers and clients whose accounts are dormant and an attested copy of account holder's computerized national identity card (CNIC) is not in Bank's / DFI record, Bank / DFI shall not allow operation in such accounts until account holder produces an attested photo copy of his / her CNIC..

9. Deceased Accounts

On the death of an account holder, the account is immediately marked as "deceased". No further withdrawals are allowed, but credit in accounts can be received. If the balance in the account is small, it *cmi* be released against indemnity on production of the death certificate and heir ship certificate, as per procedure given In the deposit manual of the bank. In the case of a large amount, production of a succession certific^te.becpmes mandatory, along with other related documents, as per the operations manual of the bank.

10. Account of Minor

A person below the age of 18 years is classified as a Minor. When the age of 18 years is attained, they become entitled to obtain their CNIC from NADRA and can enter into a valid agreement in their own name. An account in the name of a minor is generally initiated or operated by the guardian.

Example: Salman Aziz (Minor) Muhammad Aziz (Guardian).

The account opening form is signed by the guardian only, who continues to operate the account even when the minor attains majority. In practice, a note to this effect is taken and signed by the guardian at the time of account opening, generally savings accounts. Required documents for such account openings are a photo copy of the CNIC of the guardian and a photo copy of Form B of the minor.

Account opening procedure and documentation (Regular)

Account opening is the fundamental and most important function of any bank. This is the foundation on which banks strengthen their relationship with their customers. If an account is not correctly opened or an account of any non-existent (benami) person is opened, the bank's interest will always be at stake and Regulators can penalize the bank for the lapse.

An account is opened by completing an Account Opening Form (AOF). This is the basic document to be used, while selling any asset or liability product, apart from some consumer products, requires the maintenance of an operative account. In case of any legal action against the customer, AOF is considered as one of the main documents to be cited in any legal action (filing suit) if required. As per SBP requirement, banks / DFls must obtain a photo copy of CNIC before starting any new customer relationship and continuation of any previous relationship.

Procedure

The customer visits the bank in order to open the account.

The bank officer should explain the requirements with respect to account type desired by the customer and should also explain the minimum account balance and documentation required to open the account of the customer.

The Account Opening Form, Specimen Signature Card (SS Card), Cheque Book request form should be given to the customer.

The officer should also offer other products of the bank to the customer.

The customer will fill in the Account Opening Form, Cheque Book, and ATM card request (if required) SS Card and submits other relevant documents as per requirement of the bank.

The AOF and other documents should be signed by the customer in the presence of the bank's designated officer.

The customer should provide any of the following verification documents, along with the photo copy, for attestation / verification to the designated officer. The original documents will be returned to customer after verification / attestation.

1. CNIC
2. Passport
3. Pakistan Origin Card (POC)
4. National Identity Card for Overseas Pakistani (NICOP)

NADRA verification should be completed immediately but not later than 5 working days.

The authorized officer shall scrutinize the AOF, other documents and SS card.

Blank spaces on AOF and SS card shall be crossed out or marked VOID.

Ensure that the account operating instructions are clearly defined and specified.

The dealing officer should interview the customer to ensure authenticity of the information provided.

The dealing officer should admit the customer's signature after affixing "signature admitted" stamp.

The dealing officer must ensure that the documents are complete in all respect. In case of any missing or incomplete documentation, the same should be referred to the Branch Manager for deferral / approval.

- The dealing officer / supervisor can approve the AOF provided everything is in order.
- The missing / incomplete documents must be completed by the designated officer as soon as possible.
- If the branch is computerized, the dealing officer should feed details of the account opening form into the system and all mandatory fields should be correctly fed. To avoid incorrect data entries and subsequent SBP objections, it is suggested that entering dummy information/numbers in mandatory fields should be avoided.

  .Manual branches should allot the account number from Account Opening / Closing register.

- Computerized / manual branches should file the SS card in respective card boxes in sequential order.
- The Letter of Thanks should be prepared by the dealing officer and mailed to the customer at the given address.
- If the Letter of Thanks is returned undelivered, the dealing officer should call the respective customer and verify the address and then mail the letter again.
- The returned Letter of Thanks shall be recorded in the dispatch register and filed in the account holder's AOF folder.

Account-Opening Procedure

Customer visits Bank to open Account	Customer will complete AOF in duplicate and sign it. Original verification documents (CNIC, Passport, POC, NICOP) along with photo copy shall be obtained for verification
Bank officer explainsdocumentation requirement with respect to the account type and provide AOF in duplicate and SS Card	Authorized officer will scrutinize AOF and SS card and other documents provided, interview customer to ensure all information correctly completed and shall approve AOF
	Documents Photo from illiterate persons. Declaration from proprietor. 8irth Certificate / Form 8 issued by NADRA. Partnership deed and Registration. From Limited Company Resolution to open and operate account. Memorandum and Articles of Association. Certificate of Incorporation. Certificate of commencement in case of public ltd company. List of directors. Form 29. Other accounts as per requirement.
	CNICs of persons opening the account (individual, joint account holder, proprietor, partners, directors, executors, administrators, trustees, etc shall be verified from NADRA)
	After CNIC Verification, account number shall be a'libtteJ™
Duplicate copy shall be handed over to the customer	

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Documentation

1.Individual/Joint and Sole Proprietorship

- Declaration Form (mandate or authority form) for operating of account by an authorized person.
- Illiterate person's account with "thumb Impression" shall be discouraged unless unavoidable; however, proper identification duly supported by two attested passport size photographs must be obtained from the customer and attached to the AOF and SS card besides taking his/her right and left thumb impression on the SS card.
- A letter of undertaking should be obtained from illiterate customers to the effect that they should personally come to the bank and place their thumb impressions on the cheque in the presence of the bank officer.

.The Sole Proprietor of a trading concern should sign a declaration that he is the proprietor of the firm. Mandate portion of the AOF should be completed if proprietor delegates the account operation authority to any other person to operate on his behalf.

- For Joint account, instructions for operation should be "either or survivors" or joint operation.
- In the case of a minor's account the guardian only should sign the AOF. Although an account in the name of a minor can be opened in the shape of a Current Account, it is recommended that it be opened as a Savings Deposit Account by the guardian. For example: Asghar Ali (Minor) Shaukat Ali (Guardian). Birth certificate / Form B (issued by NADRA) are required in the case of a minor.
- In the case of a Pardah Nashin lady, one who keeps her physical identity under a veil, and has a CNIC without her photograph, she needs to submit any other document that has her photograph affixed on it, such as a driver's license, passport, student admit card, etc. If the intending customer does not have any document which bears her photograph, the following procedure shall be adopted.

1. A copy of the photograph duly attested by any gazetted officer/Nazim
2. A copy of CNIC without photograph should also be attested by the same person who has attested the photograph.
3. A certificate to the effect that the intending customer has no proper document bearing a photograph.
4. CNIC verification from NADRA shall be obtained in usual manner.

- Partnership declaration / Mandate Form duly signed by each partner under firm's stamp.

- Attested photocopies of CNIC or other verification documents of all partners.

- CNIC must be duly verified from NADRA.

- Attested copy of "Partnership Deed" duly signed by all the partners of the firm.

- Attested copy of Registration Certificate issued by Registrar of Firms.

- In cases where the partnership is unregistered, this fact should be clearly mentioned on the AOF.

- Authority letter, in original, in favor of the person authorized to operate the account of the firm in cases where authority is given.

1. Joint Stock Companies

- Account Opening Form completed in all respects and signed under company's stamp.

- Certified copies of:

    1. Resolution of Board of Directors for opening of account specifying the person(s} authorized to operate the company account.

    2. Memorandum and Articles of Association

    3. Certificate of Incorporation

    4. Certificate of Commencement of Business (public LTD Co only).

- Attested photocopy of identity cards of all the Directors, which should be verified from NADRA.

- List of Directors corresponding to the ones printed in the Memorandum and Articles of Association.

  .All subsequent changes, additions/deletions of directors evidenced by a letter or a certificate issued by Registrar of Companies (Form 29).

- All documents to be signed under Company's stamp.

2. Clubs, Associations, Societies, Charitable Organizations

- Certified copies of Certificate of Registration, By-Laws / Rules and Regulations.

- An undertaking signed by all the authorized persons on behalf of the institution, mentioning that when any change takes place in the list of the persons authorized to operate the account on behalf of the club/ association, the bank shall be informed immediately.
- Certified copy of the resolution passed by the Governing body /Executive Committee/ Managing /Working Committee of the Society / Club or Association, authorizing opening of account with the Bank, and nominating authorized person to operate the account.
- Attested copies of the identity card or other verification documents of the authorized person (s) should be obtained and should be verified from NADRA.
  - List of Members of the Executive / Managing / Working Committee.
- It is advisable that the accounts of Clubs, Associations , Societies and Charitable Organizations should be opened only after clearance from the Legal Department of the bank.

3. Trust Account

  - An attested copy of Certificate of Registration.
  - Attested copies of CNIC of all the trustees.
  - Certified copies of Instrument of Trust.
- No trust account should be opened without prior permission from the Legal Department or any other competent authority of the bank.
  - CNIC of Trustees should be verified from NADRA.

4. Executors and Administrators

  - Attested photocopy of CNIC of the Executor/Administrator.
  - Certified copy of Letter of Administration or probate.
- Accounts of Executors and Administrators should not be opened without prior permission/ clearance from Legal Department of the bank.
  - All the Executors/Administrators should sign the AOF; if more than one, then all nominated in the probate should sign.
- The probate or Letter of Administration should be duly registered at the branch.
- Clear instructions under the signatures of all the Executors and/or Administrators should be obtained to determine as to which of the Executors or Administrators shall operate the account.

. Bank should not accept any power of attorney or authority letter given by the Executors or Administrators to third parties to operate the account.

Account opening procedure for Visually Impaired Persons

- An illiterate visually impaired person can also open an account
his/her name individually or, if he/she desires, join
- In no case shall a visually impaired person be asked by. the bank open a joint account with a person having eyesight.
- The CSM shall explain all the terms and conditions of the AOF the visually impaired person. Two photographs of the illiterate acco holder(s) must be obtained and pasted onto the AOF and SS C
- Two visually impaired persons can also open a joint account (bo jointly operated or either or survivor).
- Treatment of account operation of literate /illiterate visually impai person shall be the same as for persons having eyesigh
- Initial deposit required for opening the account shall be as per bank's po[11]
- One copy of the AOF shall be retained by the bank and the seco copy shall be delivered to the customer under acknowledgemen
- Customer will be required to submit a copy of valid CNIC along with ori
- Account of senior citizen of age 65 years or over can be opened agai expired CNIC as per NADRA policy where the expiry date of CNICs of people of age greater than or equal to 65 is considered as life time.
- All other terms and conditions applicable to persons having eyesight shall be applicable to the accounts of visually impaired persons.
- As far as possible, both deposits / withdrawals should be witnessed by *iny* person other than bank staff, but this is not mandatory.

Documentation

1. Photo copy of CNIC.
2. For an illiterate person's account, two attested passport size photographs must be obtained from the customer and attached to AOF and SS card, as well as taking his right and left thumb impressions on the SS card.
3. Form "B" issued by NADRA is required in the case of a minor.
4. In the case of the CNIC of a Pardah Nashin literate lady that does not contain a photograph, in addition to CNIC, any other document such as driver's license or passport that contains a photograph should be obtained.
5. If the individual does not have any other valid document which bears a photograph, the following documents should be obtained:

(i) A copy of the photograph duly attested by gazette officer / Nazim.

(ii) A copy of CNIC without photograph duly attested by the same person who attested the copy of photograph as per Sr. No

1 Investment of Pakistani citizens resident abroad.

Opening of Foreign Currency Accounts

Accounts other than Pak Rupees are Foreign Currency Accounts. A foreign currency account can be opened only in those branches that have been permitted by SBP to deal in Foreign Exchange. Rules related to foreign currencies are given in SBP's Foreign Exchange Manual chapter VI. All CDD/KYC and AML rules and regulations applicable to Pak rupee accounts are applicable to Foreign Currency Accounts.

According to the SBP Foreign Exchange Manual (chapter VI), the following private foreign currency accounts can be opened without prior approval from SBP:

- Pakistani nationals resident in or outside Pakistan, including those having dual nationality.
- All foreign nationals residing abroad or in Pakistan.
- Joint account with resident and non-resident.
- All diplomatic missions and their diplomatic officers.
- All international organizations in Pakistan.
- Companies established in Pakistan including foreign share holdings.
- Charity trusts, foundations, etc which are exempted from Income Tax.
- Branches of foreign firms and companies in Pakistan.
- Non-resident Exchange Companies even if owned by a bank or financial institution.
- All foreign firms, corporations' other than the banks and financial institutions owned by the banks, incorporated and operating abroad, provided these are owned by persons who are otherwise eligible to open foreign currency accounts.

Opening of foreign currency accounts, whose general permission is given in above cases, should not be fed by:

- Foreign exchange borrowed under any general or specific permission given by SBP, unless permitted.
- Any payment for goods exported from Pakistan.
- Proceeds of securities issued or sold to non-residents.
- Any payment received for service rendered in or from Pakistan. Earning of profit of the overseas offices or branches of Pakistani firms and companies, including banks.

issued, vide FE circular No.12 of 1998. Accounts covered under FE 12 are transferable from one bank to another. The main points of FE circular No.12 of 1998 were:

.Withdrawals in foreign currencies from the then existing foreign currency accounts - whether maintained by the resident or non-residents - were temporarily suspended.

- Withdrawals were allowed in Pakistan rupees if so desired by the account holders. Payments in such cases could be made at the rate of Rs. 46 per dollar and for other currencies, at the rate matched with New York's closing mid-rate for the previous working day.

The facility of a foreign currency account is NOT available to the following:

.Airlines, shipping companies operating in / through Pakistan or collecting passage, freight in Pakistan.

- Investment banks.
- Leasing companies/ Modaraba companies including those which have been granted permission to deal in foreign exchange. Financing facilities can be given against marking lien on Foreign Currency Accounts.

SBP Forward cover Scheme

Under this scheme, SBP provides foreign currency on a future date on a rate agreed today. This provides help to importers in calculating the correct cost of goods to be imported. SBP provides forward cover on deposits and interest in multiples of US $ 1 000 , GSP 1000 , Euro 1000 and Japanese Yen 250,000. A fee is payable on the full amount of forward cover. The maximum rates for payment of interest allowed by SBP are published daily by the Foreign Exchange Rates Committee.

F.E. 25 Schemes

With regard to the amount of foreign exchange accepted outside the SBP forward cover scheme, i.e. under the provision of SBP F.E. Circular No. 25 of 1998 , foreign exchange is not required to be surrendered to SBP. Banks that accept such deposits are free to lend, invest money in or outside Pakistan on the rates of currency not exceeding LIBOR (London Interbank Offered Rate) of such date. The main features of the scheme are:

- Foreign currency deposits, mobilized under the FE 25 Scheme, after netting-off deposits utilized to finance trade-related activities, such as financing against import and export, should not at any point exceed twenty percent (20%) of the local currency deposits of the bank DFsat the close of business of the last working day of the preceding quarKt

.In 2004 , SBP made certain changes to the policy of settlerr.er^ of Fr- 25, Loans for Export; vide FE circular N016 of 2004, which saoes Afll "FE-25" loans against intended exports shall only be serriedilPwHpi
realization of export proceeds or remittance from abroad, of FE-25 loans for export maturing after Nov 2nd 2004.

- Import financing against import bills under the FE-25 Scheme can be allowed from the date of import payment by creating a foreign currency loan against the importer for a maximum period of six months.
- The repayment can be made by purchasing foreign currency from the interbank market at the rate prevailing on the date of repayment.
- Banks can purchase foreign currency from the interbank market to cover the amount of interest and the same should be reported to SBP by submitting MMM form along with monthly foreign exchange returns.

Private Non-Resident Rupee Account

Accounts of individuals, firms or companies resident in countries outside Pakistan are designated as non-resident accounts. All Pakistani nationals, except persons holding office in the service of Pakistan, who go out of the country for any purpose, i.e. employment, study, business tour, pleasure trip, etc, are treated as non-resident for as long as they remain outside Pakistan. On permanent or temporary return to Pakistan, their accounts will become resident and for that no permission from SBP is required. Non-resident accounts can broadly be divided into four groups:

- Non-resident Pakistani nationals permanently residing abroad.
- Non-resident Pakistani nationals who are abroad for a short visit.
- Non-resident foreign nationals residing abroad.
- A non-resident foreign national who is an ordinary resident in Pakistan but who has gone abroad for a short visit.

Other important points

- Accounts of United Nations and its organizations are free from financial control and such accounts are treated as resident accounts.
- There is no bar to maintaining joint accounts of residents and nonresidents operated on a singular or joint basis. In both cases the account shall be treated as non-resident.
- Non-resident accounts in the name of persons, firms, corporations, other than banks can be opened without approval from the SBP.
- Non-resident accounts where accounts are to be opened with the funds received from abroad through banking channels or with rupee funds which have been accepted by the SBP for remittance abroad should be reported in monthly returns with the approval number of the SBP.
- In the case of non-resident accounts, declaration on Form Q.A.22 is not required.

When a pay order is presented for payment, the banker should check the

following:

- Issued by the same branch and duly signed by authorized officers.
- There is no alteration on the instrument.
- If presented in clearing, special crossing and clearing stamp is affixed and endorsement is given on back of the instrument.
- Pay order date should not be more than six months old, otherwise it will require revalidation.

After checking all the above points the pay order should be posted in the register / system and should be marked as paid.

Duplicate issuance

- The purchaser of the pay order should submit an application for loss of the pay order and issuance of a duplicate.
- Signature of the purchaser should be verified from the original application form.

.Prescribed indemnity on required value of stamp paper should be obtained; signed by the purchaser and duly witnessed.

- Approval from competent authorities of the bank for issuance should be obtained.
- Duplicate pay order should be issued and new numbers of the duplicate pay order should be written on PO application form.

Cancellation

Application from the purchaser, along with original instrument, requesting cancellation of pay order is required.

The banker should verify the signature of the purchaser from the pay order application form.

If pay order was issued other than in personal name, clearance / discharge from beneficiary must be obtained.

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Pay order should be marked as cancelled and the signature portion of the pay order should be torn out.

Cancellation should be marked in the PO register / system.

Proceeds of the pay order should be credited to the customer’s account after recovering cancellation charges.

If pay order was issued for walk-in customer, another pay order in the name of the purchaser should be issued.

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- Form A-7 in support of transactions in non-resident accounts should be sent to the SBP along with Schedule “K", which is part of a foreign exchange return that is required to be submitted to the SBP.
- In the case of credits to non-resident accounts, the receiving banker is responsible for ensuring that Form A-7 is completed, or SBP approval is obtained, where required, before crediting funds in non-resident accounts.

In the case of debits from non-resident accounts, where a cheque is presented without submission of Form A-7, the paying banker should return the cheque with remarks "Non-resident account, Form A-7 required".

Remittances

Remittances can be defined as an act of transferring money to a distant place. Banks issue remittances on behalf of customers after receiving the value of remittance and related charges/Govt taxes, if any, are taken care of. Payment in cash is not only very risky but also time consuming. Remittances as such play a vital role in day-to-day business. Remittances payable within the country are called ‘In Land Remittances’. Remittances payable outside the country and received from foreign countries are called ‘Foreign Remittances'.

In order to provide for an ownership structure in Pakistan for remittance facilitation, State Bank of Pakistan, Ministry of Overseas Pakistanis and Ministry of Finance launched a joint initiative called ‘Pakistan Remittance Initiative’. This initiative has been taken to achieve the objective of facilitating, supporting, faster, cheaper, convenient and efficient flow of remittances. This initiative shall take all necessary steps and actions to enhance the flow of remittances.

Types of Inland Remittances

- Pay order
- Demand draft
- Telegraphic transfer
- Cashier’s cheques / banker’s cheques / Rupee traveler’s cheques
- Online transfer

1. Pay order (PO)

Pay order is an order to pay a certain amount of money mentioned in the instrument on demand or to the endorsee on behalf of the payee. The bank is discharged by payment in due course. Pay order is generally used for making local payments and the same is done by the branch that issues it. This is an order instrument and transferred through negotiation. This is like a Banker's Cheque but issued locally for local payments. This is different from a demand draft which is payable for outstations and is generally used for outstation payments.

Issuance procedure

- Request shall be received on standard application form or on customer s written request.

- In the case of a walk-in customer, the necessary KYC (know your customer) procedures should be completed, such as address of the purchaser, telephone number (s) and a photo copy of the CNIC for due diligence. Check that all required information on the application is completed and that it is duly signed.

- If the pay order is to be issued against casH, then the same needs to be collected along with charges and a cash-received stamp is affixed onto the pay order application.

- If the pay order is to be issued against a cheque, then it should be posted in the account. Service charges, if not collected in cash, will have to be posted in the customer's account through a debit voucher. A transfer stamp needs to be affixed onto the voucher and the pay order before issuing it, either manually or through the system.

Issuance of Pay order / Cashier cheque

Customer approaches the bank for issuance of PO/CC	
Request will be received[1] either on standard application form or customer written request	In the case of walk-in customer, required KYC should be completed, such as: Address and telephone number(s) of the purchaser. Photo copy of CNIC and its comparison with original for due diligence. Purpose of remittance.
	Dealing officer must check that all required information in the application form is completed and it is signed
	if PO/CC is to be issued against cash, then same shall be collected along with charges and cash received stamp shall be affixed onto application form
	If PO/CC is to be issued against cheque, it shall be posted in the account, if charges are not included in the cheque separately, debit voucher shall be prepared and charges shall be recovered
	Cheques will be cancelled and transfer stamp must be affixed onto all related vouchers
Duplicate copy shall be handed over to the customer	Pay order/cashier cheque shall be prepared as per details in the application, either manually or through system It shall be signed by the maker and counter signed by the checker

2. Demand Draft (DD)

A demand draft is a value received instrument issued by the bank. It is I issued in order to pay money drawn by one branch of a bank upon I another branch of the same bank or its correspondent. Since this is an I order instrument, the drawee bank is discharged by payment in due I course and the instrument is transferred through negotiation. DDs are 1 generally drawn on other cities with an objective of making payments I there.

Issuance

- Request should be received on standard application form or on customer's I written request / instruction.

- In the case of a walk-in customer, the necessary KYC (know your I customer) procedures should be completed, such as address of the I purchaser, telephone number (s) and a photo copy of the CNIC for due I diligence.

- Check that all required information on the application is completed and that it is duly signed.

- If DD is to be issued against cash, then the same needs to be collected along with charges and a cash-received stamp is affixed onto the pay order application.

- If DD is to be issued against a cheque, then it should be posted in the account. Service charges, if not collected in cash, will have to be posted in the customer's account through a debit voucher. A transfer stamp needs to be affixed onto the voucher and the DD before issuing it, either manually or through the system.

- DDs should be prepared according to the draft application form, signed by two authorized officers and should be delivered to the purchaser.

- If presented in clearing, a special crossing and clearing stamp is affixed and endorsement is given on the back of the instrument.
- DD date should not be more than six months old, otherwise it will require re-validation.
- After checking all the above points , the DD should be posted in the register / system and should be marked as paid.

Duplicate issuance

- The purchaser of the draft should submit application for loss of the demand draft and issuance of duplicate.
- Signature of the purchaser should be verified from the original application form..
- Drawee branch should be informed about the loss of the draft, with request to mark caution for its payment.
- On receipt of confirmation that draft is outstanding, prescribed indemnity on required value of stamp paper should be obtained, signed by the purchaser and duly witnessed.

Duplicate demand draft should be issued with a note "duplicate draft is issued in lieu of original draft no dated "•

New number of the duplicate draft should be written on draft application form.

- No fresh credit advice should be issued.
- If purchaser wants his money back, drawee branch should be asked to remit back money by debiting their DD payable account and by issuing a credit advice.
- On receipt of funds, the same should be credited to customer's account.

Cancellation

- Application from purchaser along with original instrument requesting cancellation of the demand draft.
- The banker should verify signature of the purchaser from the draft application form.
- If demand draft was issued in other than a personal name, clearance/dischai^e from beneficiary must be obtained.
- Draft should be marked as cancelled and signature portion of draft should be torn out.

- Proceeds of the draft should be paid by debiting suspense account crediting customer's account (s) respectively.
- On receipt of credit advice, the suspense account created in lieu of cancelled DD should be reversed within a maximum of 30 da

3. Telegraphic transfer (TT)

Telegraphic transfer is a transfer of money by cable or through telegra from one branch of a bank to another branch of the same bank or correspondent of a named beneficiary. TT message is prepared under t number. The authenticity of the TT message should be confirmed by the drawee branch by verifying a secret test number. When the test is confirmed, the proceeds of the TT are credited in the account of the beneficiary.

Issuance

- Customer should apply for remittance of funds through TT on standard application form or on instructions letter duly signed.
- If remittance is requested against deposit of cash, it should be counted and a received cash stamp should be affixed.
- If cheques are tendered along with remittance application they should be posted in the customers account and vouchers for the charges should also be prepared and posted.
- The details of the TT should be entered in the TT issue register.
- TT message should be prepared and test should be applied.
- The message should be transmitted by a cable/telegraph.
- Delivery of message over phone should be avoided.

Payment

- On receipt of message at the DRAWEE branch, test should be verified on the message.
- If test is not agreed, message should be sent to the issuing branch for revision of test.
- If test is agreed, "Test Agreed Stamp" should be affixed on the message.
- Vouchers shall be prepared by debiting head office account of issuing branch and crediting bills payable TT payable account.
- If beneficiary's account is in the same branch, bills payable TT payable shall be debited and customer's account will be credited.

4 Cashier cheque / banker's cheque

A cashier cheque is a kind of a draft drawn by a branch on its Head Office or Main Office. Cashier cheques are a guaranteed form of payment. This is an order instrument that can be paid when presented at the counter, but generally issued as a crossed cheque. This is a very customer-friendly instrument as it serves the purpose of both demand draft and pay order. A pay order is issued and paid by the same branch; a DD is paid by the branch on which it is drawn, whereas a cashier cheque can be paid at any branch of the bank. Any customer, including walk-in customers, can order a cashier's cheque from any bank simply by handing them the money over the counter, but if he/she has an account with the bank it is sometimes cheaper.

In western countries such as the UK, cashier cheques are issued with special characteristics , such as:

- Generally issued with enhanced security features, including special bond paper.
- These are designed to decrease the vulnerability to items being counterfeited.
- The cheque is generally signed by one or two bank employees; however, some banks issue cashier's cheqes featuring a signature of the bank's or other senior official.

A cashier cheque includes the name of the issuing branch and its code, instrument number, date, drawn on main office and amount in words and figures. It can be issued for any amount and requires the signatures of two authorized officers.

Issuance

- Application for issuance of cashier cheques should be submitted on a standard form or can be issued against a customer's written instructions.
- Customer's name, address and telephone number should be obtained on the application form.
- If purchaser is a walk-in customer, copy of CNIC should be obtained along with original for attestation. This is SBP's minimum requirement for walk-in customers.
- If a cashier cheque has to be issued against cash, then cash should be counted and "Received Cash Stamp" should be affixed onto the application.
- If a cheque is tendered along with an application, it should be posted in the customer's account and a transfer stamp should be affixed on both the cheque and the application form.

- Post the details of the cashier cheque in the system; as such, details *i*the instrument are updated at Head Office record online and on time basis.

- After posting in the system, the instrument may be delivered to customer.

- Dispatch related credit advice to the cashier cheque cell.

Encashment

- Cashier cheque can be paid in cash, transfer or clearing.
- Before encashment, dealing officer should verify signatures on the instrument.

- It is advisable that before encashment, a list of lost instruments should be referred to.

- For walk-in customers, a copy of CNIC should be obtained.

- In the case of a lost instrument being presented for payment, it should be marked as Reported Lost and returned to the presenter.

- The dealing officer, after satisfying himself about the non-authenticity of the instrument, should cancel it in the same manner as other instruments are cancelled and post the same in the system. The holder should be paid in the mode it was presented for payment (cash, transfer, clearing) and a stamp shall be affixed.

5. Rupee Traveler’s Cheques (TC)

Cheques issued in Pak rupees by the banks to their customers who wish to travel within the country are called Rupee Traveler's Cheques. Each cheque has a space for the customer to sign immediately on receipt of the cheque and another space to sign in the presence of the paying banker at the time of encashment.

Issuance

- Application of issuance of rupee traveler's cheque should be submitted only on the standard form.

- Customer's name, address and telephone number should be obtained on the application form.

- If purchaser is a walk-in customer, copy of CNIC should be obtained along with original for attestation.

If a cheque is tendered along with the application, it should be posted in the customer's account and a transfer stamp should be affixed on both cheque and application form.

TCs of the required denomination should be issued under full signature and attorney number, in the name of the beneficiary, the details of whom should be written on the application form. TCs should be issued after obtaining first the signature on each TC and on the purchase receipt.

- Related credit advice should be dispatched to the TC's cell. Encashment
- TCs can be presented for payment either in cash, transfer or in clearing.
- Authenticity of the TC should be checked by verification of the signature on the TC and signature of the purchaser on the purchaser receipt.
- Customer should be asked to put his/her signature in the second space.

-nt, it should

- For walk-in customers, a copy of CNIC should be obtained.
- After verification of signature and CNIC, payment can be made.
- If presented in clearing, crossing, clearing, discharge on the reverse should be verified and if everything is in order, cheque should be marked as cancelled, and related credit advice should be issued.

6. Online Transfer

Online transfer means transfer of funds electronically through a computer system. In a cash-free world all transactions can be done electronically. To receive money the customer should have a bank account in the country, but to transfer money, a walk-in customer can also make use of the online fund transfer facility. This is a highly effective and secure way to transfer money.

Through an online system, branches are linked to computer centers and customer’s account records are held and processed centrally. Details of counter transactions are transmitted for action from branch terminals online and on a real time basis. This online service can be used for inquiry purposes and for actual banking transactions. The funds are generally available to the beneficiary within minutes and there is no receiver fee. The processing of online funds transfer should be in line with the provisions given in the Payment System and Electronic Funds Transfer Act 2007.

- Procedure for online transfer

- Customers can apply for online transfer either through a standard application form or by using deposit slips. These slips are designed in a manner so that a depositor can write the name of a local branch where the cash is deposited and name of the remote branch where funds have to be credited.

- Before accepting an online transfer it should be checked if the re branch is computerized and online.

  .If cash is deposited, a 'received cash' stamp should be affixed onto the] application form after counting the cash and recovering charges.

- The customer's cheque and written instructions can also be accepted for online transfer.

  .In the case of written instructions, vouchers for debit of the customer s account should be prepared for remittance amount plus charges.

- If the remitter is a walk-in customer, a copy of CNIC should be obtained along with the original for attestation.

- After all cheques are cleared, access to the remote branch should be made and vouchers should be posted. After posting and supervision, fund transfer through the online system should be completed on a real time basis.

Precautions

In recent times, fraudulent activities in processing of online cash payment of cheques have increased. Fraudsters use chemicals to change the words and figures of the cheque, converting small amounts into large amounts. With a view to preventing fraud and payment of tampered cheques, the following additional control steps may be taken for payment of online cash cheques over the counter:

- Collection of photo copy of CNIC of bearer of cheque and its verification from original.

- All cheques presented for online cash payments should be checked under an ultra violet lamp which can detect whether cheques have been tampered with. These lamps are not costly and can be purchased from local markets.

For online payment of cheques of large amounts, a call back process must be followed by the payee branch. This can be done by referring the details of the cheque to the drawer branch for a call back verification of the cheque with the account holder.

Lockers

Bank lockers have long been considered the best place to store valuables such as jewelry, certificates, property papers, etc. Most banks now offer this facility to their account holders. Rent is taken on an annual basis and at the time of allotment of a locker key, a deposit is taken, which is refundable on surrender of the locker. Banks have various sizes of lockers, but as most of them are occupied most of the time, customers have to settle for the size which is available.

When a locker is given on rent by the bank, a contract of bailment is created. Bailment describes a legal relationship where physical possession of personal property, or "chattel , , , is transferred from one person (the "bailor") to another person (the "bailee") who subsequently has possession of the property. Such a contract arises when a person gives property to someone else for safekeeping purposes.

In this case the customer acts as "bailor" and the bank acts as "bailee".
Salient Points

- Locker is allotted to account holders only.
- Locker allotment form has to be signed by the customer at the time of allotment.
- Locker can be taken in a single name or in joint names by adult person or persons.
- Customers intending to acquire a locker must visit the branch at the time of allotment and sign locker application in front of bank officer including signatures on terms and conditions.
- Lockers are allotted on first come first served basis to customers.
- Key deposit is also called security deposit which remains under lien in case of rent overdue.

Locker can be taken in the name of a firm, association or a company. Document requirements are the same as for account opening of the firm, etc.

voification

At the time of allotment of a key, a deposit is taken, which is refunded on surrender of the locker.

Rent is taken in advance on an annual basis.

Locker can be taken any time during the year. Rent is charged from the date the locker was allotted.

Amount of rent differs according to the size of the locker.

Locker charges must be published in the Schedule of charges (SOC).

Every bank is free to decide the amount of charges on lockers.

Loss of the key must be reported to the bank. Charges for replacement of the lock and a new key shall be paid by the locker holder.

Bank prefers to collect rent from the link account on the due date. Locker holder can also pav rent in cash.

Locker can be operated by the locker holder or by his / her authority holder during specified times displayed at branches.

In the case of the death of the locker holder, the following is applicable:

-Ii locker was in a single name, the succession certificate must be obtained.

- If locker is in joint names with joint operation, succession be obtained.

  -If locker is in joint names but instructions include either survivor, the surviving person can operate the locker. It advisable that in such cases the locker may be surrendered re-allotted to the surviving person in his/ her na

- Mandate / attorney are automatically cancelled in the case the death of the executer.

Procedure for Allotment of Locker

- Customer shall submit locker allotment form and Specimen Signature Card duly completed in all respects, with CNIC / other documents if not already provided with account opening form.
- Customer's operating instructions shall be obtained by checking correct box is given in the allotment form.
- Account number shall invariably be written in the required place.
- Dealing officer shall obtain customers signature on the required places of the allotment form (both on front page and back page) and also on S. S. Card.
- Signatures shall be admitted under signature admitted stamp.
- Customer Service Manager or authorized officer shall approve the locker allotment form and S.S. Card.
- Key deposit and annual rent shall be recovered by debiting customer's account mentioned in the allotment form.
- Customer shall be asked to select the locker of their choice from available lockers in the locker plan.

Services and Products

Retail Banking

By the end of this chapter you should be able to:

- Differentiate between a retail bank and a commercial bank
- List the loan products available in branches in a retail bank

Every month, the credit card user is sent a statement of account, w covers all the details of the purchases undertaken against the card, outstanding fees and the total amount to be paid by the cardholder receipt of the statement, the cardholder should check all the transact listed and dispute any transaction that seems incorr The cardholder must pay a defined minimum proportion of the bill a specified date, or may choose to pay a higher amount up to the en " amount due.

The credit provider charges a markup on the amount owed. Some b can arrange for automatic payments to be deducted from the user's * account, thus avoiding late payment altogether, as long as the card hoi has sufficient funds. For this purpose, linking of accounts through internet is a good option.

Banks generally do not apply markup charges if the balance is paid in full by the prescribed due date. If the amount of the bill is not paid in full, the bank will charge markup on the entire bill amount, from the date of each purchase.

A credit card transaction is more secure than other forms of payment. Once the transaction is made, the bank is committed to paying the merchant within an agreed time frame, regardless of the fact that the consumer might end up being a defaulter. Through credit card sales, risk of theft by the merchant's employees can be avoided or at least reduced to a great extent. Card sales also minimize cash at premises, thus reducing the risk of robberies. The bank charges the merchant a very low rate of commission (in the form of a discount rate) for this service, which is much more than the benefits attributed. The commission is often a percentage of the transaction amount.

2. Personal Loans

A personal loan is a clean loan where the full amount of the facility is disbursed for the customer's use. The loan is re paid in regular monthly installments over an agreed period that can range from six months to 5 years. Since a personal loan is a facility without collateral,a higher lending rate is always charged. Borrowers must choose carefully from the best offers available in the market. At present, lenders have set qualifying criteria for the borrower of having a reasonable minimum monthly salary with a good credit record.

Employees in Government, Public Sector Undertakings, and Reputable Private Enterprises, etc. who are confirmed in service, as well as self employed professionals, can apply where the age bracket is generally set between 20 to 60 years. The take-home pay, after deduction of the proposed loan installments, should be more than 50% of the gross pay. Repayment capacity is also judged.

The loan is repayable in equal installments. In some banks, checking accounts are not required; loans may be disbursed through a pay order. A personal loan can be used for any consumer purpose, including any social / financial commitment. If financing is approved for the purchase of consumer durables, the same should be hypothecated with the bank.

3 Running Finance

Running finance is a facility whereby a borrower may obtain a continuous rJidrawal facility up to an agreed limit on a revolving basis. The markup is calculated on a daily basis. The borrower pays only for what is used. A running finance facility is described as the cheapest form of bank financial accommodation. Eligibility and terms and conditions of a clean personal loan and bank running finance under consumer credit are the same.

4. Auto Loans

Auto loans can be defined as financing of vehicles for personal use, including light commercial vehicles used for personal purposes. If any person needs money to buy a new or used car, they can contact a bank offering an auto loan facility.

The following are the salient features of car loans being offered by different banks:

- An auto loan can be applied for on the standard forms of any bank offering an auto loan facility.
- After approval, the customer can take a Purchase Order to any of the bank's authorized dealers, make a payment (if required) and simply drive away with the chosen car.
- The financed car is registered in joint names of the bank and the customer.
- The car should be comprehensively insured.
- The eligibility criterion defines the age limit as from 21 years up to 60 years; both salaried applicants and the self employed may apply for a loan provided they are able to repay the installment amounts.

5. Housing Loan

A housing loan, secured by property mortgage, is given for:

- Purchase of a house or flat
- Construction of a house
- Procurement of land and cost of construction.

A home buyer or builder can obtain financing either to purchase or to secure the facility against the property from a financial institution (HBFC) or the mortgage offering banks. Features of mortgage loans, such as the size of the loan, maturity of the loan, markup rate, method of paying off the loan and other characteristics, can vary on a case by case basis within parameters described by the SBP.

A mortgage is a loan on a property for a secured amount. As with other types of loans, housing loans have markup and are scheduled to be repaid over an agreed period of time; the maximum period is 20 years.

The basic components of mortgage lending are:

Property: there should be some defined property.

Mortgage: the security created on the property by the lender.
Borrower: the person borrowing who either has or is creating an ow interest in the property.

Lender: usually a bank or other financial institution.

Principal: the original size of the loan, which may or may not inc certain other costs; as any principal is repaid, the principal will go d in size.

Markup / profit: a financial charge for use of the lender's mo Foreclosure or repossession: The possibility that the banker has to fore : repossess or seize the property under certain circumstances is esserr* to a mortgage loan. Without this aspect, the loan is no different from other type of loan.

House loans are generally long-term loans; the periodic payments calculated according to the time involved. The most basic arrangeme requires a fixed monthly payment over a period not exceeding twen years. Over this period the principal component of the loan (the origi loan) should be gradually paid off.

6. Mortgage

The formal definition of a mortgage is the conveyance of a legal/ equitable interest in real/ personal property as security, by a debtor tor discharge of financial obligation. A legal mortgage is accomplished by signing of a deed of mortgage on the required value of stamp paper, and duly registered with the Registrar of properties (either token or 100%). An equitable mortgage is created by simply depositing title documents with the lender (bank) and by signing a memorandum for deposit of the title deed.

7. Islamic mortgages

Islamic laws prohibit payment or receipt of interest / riba. Real estate is very expensive for most people to buy outright using cash funds available at their disposal. Islamic mortgages solve this problem by having the property change hands twice. In one variation, the bank will buy the house outright and then act as a landlord. The home buyer will pay a contribution towards the purchase of the property. When the last payment is made, the property changes hands.

Typically, this may lead to a higher final price for the buyers. This is because in our country there is a transfer fee / Stamp duty, which is a tax charged by the government on a change of ownership. Because ownership changes twice in an Islamic mortgage, a stamp tax may be charged twice. An alternative scheme involves the bank reselling the property according to an installment plan, at a price higher than the original price. Other Islamic products offered by retail banks are discussed in detail in the next chapter (Ch 3).

Services and Products
Islamic Banking

By the end of this chapter you should be able to:

- Define Islamic Banking
- List the different banking products

Islamic banking is a system of banking or banking activities, which consists of and operates with Islamic laws. Islamic law prohibits the collection and payment of Interest / Riba. In addition, Islamic law prohibits investing in businesses that are considered unlawful according to Islamic jurisprudence. In the late 20th century, a number of Islamic banks were incorporated into the Islamic world, including Pakistan, to cater for the needs of Islamic banking.

The purpose of Islamic banking is the same as that of conventional banking, except that it operates in accordance with the rules of Shariah. The basic principle of Islamic banking is the sharing of conveyance profit and loss and the prohibition of interest (riba). The main Islamic concepts *I* modes used in Islamic banking are (Modaraba), safekeeping (Wadiah), (Musharakah), cost plus (Murabahah), and (Ijarah).

Islamic banks formed in the Islamic world are flourishing, but they constitute a very small share of the global banking system. Since 1981 banking in Pakistan has been converted into a system based on Profit and Loss Sharing (PLS). Although full implementation of islamization has taken some time, all domestic banking business schemes are now based on Islamic laws.

In a bid to comply with the verdict of the Shariah Appellant Bench of 1999, SBP issued detailed guidelines for the establishment of Islamic Commercial Banks with effect from December 1 2001.A license under these guidelines was issued to Meezan Bank Limited (as a model Islamic Bank in Pakistan) for the commencement of Islamic banking business in January 2002. Additionally, in November 2002, the Banking Companies Ordinance (BCO) 1962 was amended to implement the process of Islamization of the financial system in parallel with conventional banking. Following these amendments, detailed criteria for the establishment of Islamic Commercial Banks, and Islamic Banking Subsidiaries and/or Stand-alone branches for Islamic banking by the existing commercial banks was issued; vide BPD Circular No.l dated January 1 2003. After issuance of these guidelines, five banks applied for permission to establish stand-alone branches for Islamic banking, leading to the issuance of the first Islamic Banking Branch License to MCB in May 2003. Now all five large network banks have established stand-alone branches for Islamic banking.

Deposits

Like interest-bearing banks, sources of funds in Islamic banking are also deposit driven. From January 1st, 1981 all commercial banks operating in Pakistan have introduced profit and loss (PLS) deposit schemes and interest has been abolished. All types of savings, as well as business accounts, can be opened on the PLS basis, such as Current Accounts, all types of Saving Accounts, and all types of Term Deposit Accounts.

Each month, banks announce projected Rates of Return for all liabilities products. Banks and DFIs are required to display these projected rates on notice boards or at a prominent place so that intending customers can take decisions on the basis of these projected rates. After every six months, banks declare profits on deposits and distribute them to the depositors, either into their accounts or through pay orders/ cashier cheques.

Gift Hibah

This is a token given voluntarily by a creditor to a debtor in return for a loan. Hibah usually arises in practice when Islamic banks voluntarily pay their customers return / profit on savings account balances.

Shariah Advisory Council

It is advisable that Islamic banks and banking institutions that offer Islamic banking products and services should establish a Shariah Advisory Committee. The purpose of such a committee should be to advise them on Shariah law and to ensure that the operations and activities of the bank comply with Shariah principles.

Lending / investment under Islamic modes of financing Sale and Buy Back Agreements:

1. Bai' al-Inah

This is the most common mode of Islamic financing in Pakistan. The financier (bank) sells an asset to the customer on a deferred-payment basis. The asset is then immediately repurchased by the financier for cash at an agreed rate. The buyback agreement allows the bank to assume ownership over the asset in order to protect it against default, without explicitly charging interest in the event of late payments or insolvency.

2. Deferred Payment Sale: Bai' Bithaman Ajil

This concept refers to the sale of goods on a deferred payment basis at a price which includes a profit margin agreed to by both parties. This is similar to Murabahah, except that the debtor makes only a single installment on the maturity date of the loan. By the application of a discount rate, an Islamic bank can collect the market rate of interest.

3. Credit Sale: Bai muajjal

Literally bai muajjal means a credit sale. Technically, it is a financing technique adopted by Islamic banks that takes the form of Murabahah

f al.It is a contract in which the bank earns a profit margin on the riurchase price and allows the buyer to pay the price of the commodity a future date in lump sum or in installments.

--os [of the commodity must be detailed and the margin of profit is :uall\ agreed. The price fixed for the commodity in such a transaction r_ be the same as the spot price or higher or lower than the spot price.

4 Leasing: Ijarah

means lease, rent or wage. Generally, the Ijarah concept means Sc.lir.g benefit or use or service for a fixed price or wage. Under this -cn<epi. the bank makes available to the customer the use or service of equipment such as plant, office automation, or motor vehicle for i fixed period and price.

chantages of leasing Ijarah

- advantages of Ijarah to the lessee are:

- I;^rah conserves capital as it may provide 100% financing.

-I arah enables the lessee to have the use of the equipment on payment first rental. Without getting ownership, the customer uses it and generates income from it.

- a r a h arrangements are flexible because the terms and rental provision be tailored to suit the needs of the lessee. This helps in r^rporate planning and budgeting.

The borrowing capacity of the lessee is not affected when leasing is resorted to as a means of financing, because leasing is an off balance sheet item and is not considered while calculating ratios. All payments c: rental are treated as payment of operating expenses and are, therefore, ruliy tax-deductible. Leasing therefore offers tax advantages to profit- making concerns.

- .: the equipment in use is for a relatively short period of time, it may be more profitable to lease than to buy.

-. : the equipment is for a short duration and the equipment has a very poor second-hand value (resale value), leasing would be the best method for acquisition.

- 5 Hire Purchase: Ijarah Thumma A1 Bai

Hire purchase is the combination of leasing and contract to buy. For eizmple, in a car financing facility, a customer enters into the first contract ni leases the car from the bank at an agreed rental over a specific period. V.hen the lease period expires, the second contract comes into effect, ^nich enables the customer to purchase the car at an agreed price.

6. Profit Sharing: Modaraba

Modaraba companies are now very common in Pakistani money markets. Modaraba is an arrangement or agreement between the bank , or a capital provider, and an entrepreneur, under which the entrepreneur can mobilize the funds from capital providers for their business. The entrepreneur provides expertise, labor and management. Profits are shared between the bank / capital providers and the entrepreneur according to a predetermined ratio. In the case of loss, the bank / capital providers lose the capital, while the entrepreneur loses his provision of labor.

7. Cost plus: Murabahah

Murabahah refers to the sale of goods at a price, which includes a profit margin agreed to by both parties. The purchase and selling price, other costs, and the profit margin must be clearly stated at the time of the sale agreement. The bank is compensated for the time value of its money in the form of the profit margin. This is a fixed-income loan for the purchase of a real asset such as real estate or a vehicle, with a fixed rate of profit determined by the profit margin.

Banks are not allowed to charge for the time value of money outside of the contracted term. Banks cannot increase their margin of profits, even if market dynamics change. However, the asset remains as a mortgage with the bank until the Murabahah is paid in full.

8. joint Venture: Musharakah

Musharakah is an agreement between two parties, who contribute capital to a business, and divide the net profit and loss on a pro rata basis. This is often used in investment projects, letters of credit, and the purchase of real estate or property. In the case of real estate or property, the banks assess projected rent and share it as agreed in advance. All providers of capital are entitled to participate in management, but not necessarily required to do so. The profit is distributed among the partners in pre agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions.

9. Good Loan: Qarz Hassana

This is a loan extended on a goodwill basis, and the debtor is only required to repay the amount borrowed. However, the debtor may, at his or her discretion, pay an extra amount beyond the principal amount of the loan (without promising it) as a token of appreciation to the creditor. In the case that the debtor does not pay an extra amount to the creditor, this transaction is a true interest-free loan. Some Muslims consider this to be the only type of loan that does not violate the prohibition on riba, since it is the one type of loan that truly does not compensate the creditor for the time value of money.

10. Islamic Bonds: Sukuk

Sukuk is an Arabic word which is used for a financial certificate. Since bonds are also certificates issued by the government, these are also termed

Islamic certificate equivalent of bond. Fixed income, which is given :r. interest-bearing bonds, is not permissible in Islam. Hence, Sukuk are securities that comply with Islamic laws and investment principles, which prohibit the charging or paying of interest (fixed income).

11. Islamic Equity Funds

Islamic investment equity funds are one of the fastest-growing financial sectors within the Islamic financial system. There are more than 100 Islamic equity funds worldwide. The total assets managed through these funds are in billions of dollars and are growing by more than 15% per annum every year. The main players in world financial markets are taking a keen interest in the Islamic financial system and it is expected that more Islamic equity funds will be launched around the world in general and in the Islamic world in particular. The main target markets are in the Gulf / Middle East, and in other Muslim countries such as Malaysia, Indonesia, Pakistan, etc. In Pakistan, the Islamic equity funds market is in the initial stage. More than a dozen companies are operating, but there is a lot of potential and scope available which has yet to be explored.

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Part 3: The Banker’s Role

Chapter l:Banker - Customer Deposit Banking Relationship The Banker

Services offered by a Bank The

Customer

Relationship between a Banker and a Customer Rights

of a Banker Duties of a Banker

General Term and Conditions Applicable to Account opening

Unclaimed Deposits Termination of Relationship Zakat

Banks’ right of “Set Off”

Duties of Confidentiality

Fiduciary Responsibility

■l :] :)me By the end of this chapter you should be able to:

- Define the term ‘Customer’
- Define the term Banker’
- Recall the rights and duties of a banker
- Recall the rights and duties of a customer
- List the functions of a banker
- Explain the concept of the ‘ banker-customer , relationship
    - Define contractual relationship and explain its main features

- List and explain the obligations of bankers and customers
  - Explain the account opening procedure and describe the documentation required
- Define Unclaimed Deposits
    - State the concept behind surrender of an unclaimed deposit
  - List the legal rights and responsibilities of a banker while operating customer accounts
  - Explain the concept of termination of bank-customer relationship
    - List the aspects of terminating a bank-customer relationship
  - Discuss the circumstances that permit termination of the bank-customer relationship
  - Discuss what is meant by a bank's right of set off and bank's right of lien and the circumstances when these can be exercised
  - Explain the obligations of bankers prior to and upon terminating the relationship
- Recall the Zakat and Usher Ordinance (1980)
- Recall the Zakat Collection and Refund Rules (1981) a Discuss the

  exemption from Zakat deduction

Explain the importance of the banker's duty of maintaining customer confidentiality

- Identify the circumstances when customer details can be shared with a third party or by other departments
- Explain the ethical issues related to sharing customer information with other departments within the bank and outsiders
- Describe the fiduciary responsibility of a banker
- Discuss the legal implications of breaching the common law duty of confidentiality
- Discuss the legal implications of breaching the statutory duty of confidentiality

The Banker

A banker is the person who carries out the business of banking, i.e. w on behalf of a bank, accepts deposits from those who have surplus mon either in the form of a current and/or savings account, or any operati account, including Term Deposits, withdrawable by cheque or otherwise^ and who lends to those who need the funds, against a certain percentage of profit. The Negotiable Instrument Act 1881 , section 3 (b) defines a banker as follows:"Banker means a person transacting the business of accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by a cheque, draft, and order or otherwise and includes any Post Office Saving Bank". Section 5 (c) of the Banking Companies Ordinance 1962. defines a bank as follows: Banking company' meaning a company, which transacts the business of banking in Pakistan".

Services Offered by a Bank

Nowadays, bankers provide multiple services. Modern banking has become highly developed and increasingly automated and therefore the role of the banker is now also substantially more extensive. Following are the major services currently provided by bankers:

1. Custodian of public money as deposits.
2. Lending money to those who fulfill the required criteria.
3. Collecting of cheques and other instruments on behalf of customers.
4. Purchasing of bills both in local and foreign currencies.
5. Collection of utility bills as agent from walk-in customers.
6. Undertaking and executing trusts.
7. Buying and selling of foreign exchange.
8. Issuance of guarantees.
9. Providing investment advisory services and management of wealth.
10. Providing underwriting services in public issue of shares etc.
11. Managing international trade by issuing and honoring letters of credit.
12. Providing safe custody services.

lobe ₂ customer, a person should have some recognizable business f :
nship with the bank. A person shall be deemed to be a customer :f i r^r;k when he *I* she goes to a bank with money, requests to open an n[. completes an account opening form (AOF), completes the -T- - : red formalities and bank officials accept the request by issuing an h:: unt number and receiving deposits. Terms and conditions of opening it account are included in the printed account opening form. The -5 omer is required to read and understand these terms and signs the >rm. After signing the AOF, an agreement between the bank and the : 'jstomer then formally exists.

Therefore to be a bona fide customer of a bank, one is supposed to have account with that bank. If a person merely walks into the bank, deposits a utility bill or purchases a pay order, this action does not constitute the person becoming a customer of the bank.

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In the banker-customer relationship, duration is not the essence of the account opening. A person becomes a customer as soon as he or she opens an account with the bank. If a person visits a bank to take payment of cheques issued by other persons, he/she does not qualify as a customer even if visiting the bank on a daily basis. To become a customer of the bank, he/ she should have an operative account.

The account opening form (AOF) is a formal agreement between the bank and the customer; as such, rules applicable to other agreements are also applicable to this agreement. The rules applicable to opening an account are given below:

1. He/she should be an adult person (not a minor). A person is deemed to have attained the age of majority when he / she has attained the age of 18 years.

   He/she should be a person of sound mind.

3. She/he should possess a valid Computerized National Identity Card, or Pakistan origin card, or a Passport, or Pakistan Origin Card (POC) or National Identity Card for Overseas Pakistani (NICOP).

4. She/ he should not have been debarred from entering into a contract under any law of the land.

Relationship between a Banker and a Customer

Different forms of relationships between a banker and a customer are listed below:

Debtor and creditor: The day a customer deposits money with the bank, he/she becomes a creditor of the bank, and if a customer borrows money from the bank, he/she becomes a debtor of the bank.

Principal and agent: When a customer authorizes a bank to co certain act on his or her behalf, such as collection of cheques, co of utility bills, managing an investment portfolio etc, the relatio that of principal and agent.

Bailor and bailee: When a bank provides safe custody facilities customers, this is a relationship of bailer and bailee.

Pawnor and pawnee: When a customer pledges goods with the security against financing /advance, either funds based or non funds he/she becomes a pawnor and the bank becomes a pa

Mortgager and mortgagee: When financing is made against the of some immoveable security, in this case the customer beco mortgagor and the bank becomes mortgagee.

Assigner and assignee: When financing is made against assignmenL against an insurance policy, the policyholder becomes assigner and bank becomes assignee.

Rights of the Banker

The rights of the bank/banker are listed below:

General Lien: The Contract Act 1872, section 171, provides some guid about a bank's general lien, which means, a banker has a general lien the extent of the customer's liability, to all securities placed with him his customer. In cases where banks allow funds based or non funds facilities to their customers, the banks must obtain a letter of lien, signed by the customer.

Write of set-off: This is a statutory right of bankers where bankers adj a debit balance against a credit balance of the same customer. It preferable to obtain a letter from the customer to allow setting off of customer's liability against the credit balance. In ordinary course business , banks can exercise the right of set-off when (i) an advance due, (ii) between the same parties, (iii) under the same rights, (iv) tT credit balance is not appropriated for a specific purpose, (v) if the leti of set-off is not on record, in which case a notice advising of the adjustm of the credit balance against the debit balance should be sent to t customer.

Recover service charges: Banks have the right to recover service charg for the services availed of by the customers. As per SBP instructions, ba are supposed to display their schedule of charges (SOC) on the noti board at the branches so that customers can have firsthand knowledge of these charges.

Revision of charges: Banks have the right to increase or decrease their

Reco\ er\ of mark-up: Banks have a full right to recover mark-up / profit :r. the funds utilized by their customers, whether against an approved limit or against temporary accommodation.

Right to close account: A bank has the right to close a customer's account

authority requires the certificate to be authenticated / verified by the bank. In this case this is treated as an implied permission from the terms of the contract and operation of the account to the court on their description, to protect their interest.

Sometimes customers have to provide a statement of their account, or a certificate to other departments or agencies, where the other relevant

any other purpose as per the law of the land in force, debit collection of share any information, details or the data relating to the customer's transactions with any competent authority or agency. The Bank, in complying with laws and regulations, may intercept and investigate any payment message and other information or communications sent to or by the account holder or on the account holder's behalf via another Bank. This process may involve making further future enquiries.

- The method of calculating return/profit under the profit/loss sharing scheme is governed by the Bank Rules under prevailing Regulations/Directives of the State Bank of Pakistan and is subject to change without prior notice.

- No profit or interest is paid on current accounts, whether in respect of local or foreign currency.

- 1 ne bank may accept for collection cheques and other instruments promptly but by the account holder/depositor him/herself at his/her sole risk. All cheques and other instruments should be crossed before they are deposited for crediting in the account.

  In the event of any instrument deposited being returned for any reason whatsoever or being returned at any time, although previously advised as paid, the account holder will refund the proceeds of the said instrument and indemnify the Bank against all losses and costs arising there from and authorize the Bank to debit such amount and expenses to any account which the account holder may have with the bank.

- The bank will take due care to ensure that the credit and debit entries are correctly recorded in the accounts of the account holder/depositor, but in case of any error, the Bank shall be within its right at all times to make the correct adjusting entries without prior notice and recover any amount due from the account holder/depositor without prior notice.

- In the case of a deposit maturing on a public or bank holiday, then the Bank shall pay the deposit and/or the interest/retum/profit on the next working day when the Bank is open for banking business. Cheques may only be drawn on printed cheques supplied by the Bank. The Bank reserves at all times the right to refuse payment of cheques drawn otherwise.

- Cheques should be signed by the account holder/depositor as per specimen signature supplied to the Bank and any alteration(s) thereon must be authenticated by the drawers full signature. In order to comply with any instructions given by the account holder/depositor , the Bank shall only rely on the signature as provided/inscribed by the account holder/depositor on the specimen signature card at the time of opening of the bank account.

- In the case of the Bank receiving notice of the demise of an individual customer, the Bank will not be obliged to allow any operation or withdrawal except on production of the succession certificate or other court orders from a court of competitive jurisdiction.

- In the case of an operating instruction ‘either or survivor , , in the event of the death of either the account holder (s)/depositor, the credit balance in the account will be payable to the surviving account holder(s)/depositor.

If a deposit / instrument remains inoperative for a period of ten v then it will become an unclaimed deposit and will be surrendered SBP as per the provisions of the Banking Companies Ordinance 1 Periodic statements of account shall be issued by the Bank to the a holder I depositor concerned. Any discrepancy in the statement account should be promptly brought to the notice of the Bank in wti[1] within fourteen days of dispatch, failing which the statement of a shall be deemed to be final and conclusive, for all purposes whats

If a statement of account is lost or spoiled, a duplicate statement account may be provided by the Bank, subject to charge as is appli under its Schedule of Bank Charges, upon receipt of written request the customer / account holder only.

Rupee and foreign currency accounts not meeting the Bank's minim balance requirement may be subject, at the discretion of the Bank, to service charges as per the Schedule of Bank Charges. However, the following accounts will be exempted from levy of service charges: I) Students, II) Mustahiqueen of Zakat, III) Employees of Government Semi-Government institutions for salary and pension purposes, IV | Basic Banking Account. Details of minimum balance requirement service charges with exemptions are listed in the Bank's Schedule of Charges and are also displayed in all the branches.

The Bank, at its sole discretion, shall be constrained to close those accounts which show nil balance at the time of half yearly closings. Besides this, the Bank reserves the right to close without prior notice, any account which in its opinion is not satisfactorily operated, or for any other reasons whatsoever. It shall not be incumbent on the Bank to disclose to the account holder I depositor the reason(s) for doing so.

The account holder / depositor wishing to close the account must surrender unused cheques, if any.

The Bank shall have discharged its liability with respect to any account so closed by mailing to the account holder / depositor at his/her last known address as per the Bank's record, a Bank draft in the currency of such account, payable to the account holder / depositor of the amount of the credit balance of such account less deduction(s) in respect of the amount of any claim that the Bank may have on such funds.

The Bank shall determine from time to time the rate of interest/retum/profit payable on the account/deposit in accordance with the prevailing rules and regulations of the State Bank of Pakistan and the policies of the Bank which are subject to change from time to time and the account holder / depositor agrees to accept such rate of interest/return/profit.

Foreign currency current or savings accounts and time deposits may be established in the U.S. Dollar, Pound Sterling , Euro, Saudi Rial, Arab Emirates Dirham and such other currencies as the Bank shall determine/allow and in accordance with the local regulations in force from time to time.

1 Current/saving accounts that remain inoperative for one year will be classified as dormant. Any change of address/signature(s) can be requested during the period of dormancy of the account, but the account will not be charged for any change in the status of the dormant account. For reactivation of any dormant account, the account holder must in person request a change of status and will produce original CNIC or Passport or Pakistan Origin Card (POC) or National Identity Card for Overseas Pakistani (NICOP) with a photocopy for Branch I Bank attestation.

Profit on foreign currency saving and term deposits is paid at periodic •rirervals as determined by the Bank and/or upon respective maturity dates of such deposits at such rate as may be determined by the Bank from time to time.

Foreign currency accounts/deposits are opened and maintained subject *10* Foreign Exchange Regulations and Directives of the Government of Pakistan, or any of the organizations/agencies and State Bank of Pakistan from time to time.

Zakat. wherever applicable, shall be deducted on valuation data from applicable accounts having balance in excess of the exempted limit as declared for that particular Zakat year.

Declaration on prescribed Performa for exemption of deduction of Zakat will be registered with the Bank at least one month prior to valuation date or as per Zakat rules applicable from time to time. Zakat will be deducted as per Zakat and Usher Ordinance 1980.

All applicable taxes shall be recovered as per tax laws in force. The Bank should within its right make investment of credit balance deposits in any manner at its sole discretion and make use of funds to the best of its judgment in the banking business under the PLS system. The account holder/depositor undertakes to reimburse the Bank with any claim in respect of losses/charges on the basis of half yearly/yearly closing of the Bank's books of account. The Bank would be within its authorized rights to debit their accounts for the amount(s) of such claims/charges in settlement of business accounts of the Bank.

The account holder/depositor undertakes to reimburse the Bank with any claim in respect of losses/charges on the basis of half yearly/yearly closing of the Bank's books of account. The Bank would be within its authorized rights to debit their accounts for the amount(s) of such claims/charges in settlement of business accounts of the Bank.

The Bank is subject to all applicable circulars, orders, directives, rules, regulations, laws, decrees and restrictions issued by competent Government and other regulatory authorities in Pakistan and the liability of the Bank for payment is governed by applicable laws and regulation in force in Pakistan at the relevant time. Repayment of any deposit, account, balances, or interest/profit thereon is subject to any acts of the Govt, of Pakistan or the State Bank of Pakistan or any competent governmental and other regulatory authority in Pakistan.

On a request for Hold Mail service, the Bank will hold all mail addressed to the account holder/depositor. The account holder will collect any mail so held personally, or through an authorized person, unless he/she advises the bank to the contrary in writing. It is acknowledged that the request for Hold Mail service is being made entirely for the account holder's convenience and at his/her risk and responsibility and without any obligation on the part of the Bank. All transactions will be charged as per Schedule of Charges.

- For a BBA account, a maximum of two deposits and two withd per month are allowed free of charge as per policy in force. How any transaction in a calendar month over those mentioned above be charged a flat fee as per the prevailing Schedule of Bank Ch

- Any existing customer wanting to convert his/her account into B can do so by giving a written application to the Branch Manager, ai which a new BBA account will be opened. A new account number be provided to the customer after due account opening proced including submission of CNIC, if not provided earlier. The state of account will be issued once a year. The account is exempt from 1 of service charges in the case of not meeting minimum bala requirements. Only one account per CNIC shall be allowed to bel opened regardless of the branch. No duplication shall be allowed, e\ e^i as a joint account or sole proprietorship account.

Unclaimed Deposits

According to section 31 of the Banking Companies Ordinance 1962 , all banks and DFls operating in Pakistan are required to surrender to SBP all deposits, including foreign currency deposits, inoperative bills payable outstanding in the books of banks and DFls for 10 years and more, and where no transaction has taken place, no statement of account has been requested or acknowledged, shall be classified as unclaimed deposit / instrument except deposits / instruments in the name of:

- Government Accounts
- Minors'Accounts
- Court of Law
- Articles retrieved from unclaimed lockers are not required to be surrendered to SBP as per clarifications issued by SBP. These articles shall continue to be kept with the branches or by the bank centrally and a proper record should be maintained.

Surrender of unclaimed deposits

- All Banks and DFls should submit a list of unclaimed deposits and instruments separately for Pak Rupees and Foreign Currency on form XI, in both soft and hard copy, within 30 days after close of each calendar year.

- The amount of unclaimed deposits and instruments, both in PKR and FCY, will be actually surrendered in the first week of April of the following year.

- Lists of deposits and instruments, which were refunded by the bank and DFls from the date of reporting (31st December) and the date of surrender of outstanding amount, should also be provided.

'ii| *KL* ^mks and DFIs, upon completion of a ten years time period, should ser '≷三 three months notice in writing, by registered post, to the beneficiary / instrument at the last available address. The instrument deposit be surre ndered, due to the non-operation of the deposit account instrument.

and /or Lnd DFIs shall maintain a complete record of the notices sent duly ┌ = ;i b\ the Branch Manager. Any notices returned un-delivered should rr.arked against the entry of dispatch.

Banks a icdition to the notice sent to the respective account holder, the bank ir.d DFIs should make efforts to contact holders of such inactive accounts.

Bank and DFIs should also intimate in writing to the appropriate Govt department, agencies, court of law and minors (after attaining the age of majority) that such deposit/ instruments are outstanding in their name and should take steps for its settlement.

After surrender of the deposits / instruments, banks and DFIs should continue to keep relevant records such as SS card, AOF and other related documents till the time SBP informs them in writing that they are no longer required to preserve such records.

Bank and DFIs should insert a clause in their account opening form in bold wording that deposit *I* instruments remaining inoperative for ten years and more will be surrendered to SBP as per provision of BCO 1962.

Existing account holders should also be informed in the same way by letter with the bi-annual statement of account or through any other method banks / DFIs may find feasible.

Procedure for refund

If the beneficiary of a deposit/instrument contacts the bank/DFI for withdrawal of the same, the following documents should be prearranged, duly attested:

- Original application requesting refund.
- Signature (s) *I* thumb impression should be attested by the relevant Branch Manager with name and stamp.
- Claimant's address and contact number (if any) should also be obtained on the application form.
- A copy of the three months notice served to the account holder should be attached with the application.

- Copy of the relevant page of the record submitted to SBP.
- In the case of a deceased account, a copy of the succession certificate the deceased account holder.
  - On receipt of the claim at SBP, documents shall be evaluated approval may be given.

.Account of the respective bank shall be credited with the claim amount

.The respective bank should credit account of the claimant or issue a pay order in the name of legal heirs of the deceased, as the case may be.

Termination of Relationship

The banker-customer relationship is a contractual one which is established when the customer fills in and signs the Account Opening Form (AOF). This occurs with the approval of the Branch Manager or Branch Operation Manager or any other authorized person. The contract may be terminated by any one of the two by serving a notice to the other.

Notice by the customer:

Since a regular operative account is the basis of the banker-customer relationship, a customer may terminate this relationship by closing his/her account on any of following grounds:

a) Due to a change in his/her residence, the customer may not be able to conveniently operate the account from the place of residence.

b) A customer may not be satisfied with the services offered by the bank and may close the account because of:

   - impoliteness of staff
   - undue delays in encashment of cheques
   - unsatisfactory manner of sending periodic statements and other information, etc
   - high service charges as compared to other banks.

In the above situations the bank must review its service quality, and should take immediate steps to improve its performance so that the customer is discouraged from closing the account.

An account may also be closed due to the death of the customer. The law does not authorize the heirs to operate the account of the deceased customer. Therefore, the account is closed and the credit balance available in the account of the deceased customer is paid to the heirs according to the legal requirements (Section 122 A of Negotiable Instrument Act 1881).

Sco:e b\ the bank:

- r .he other hand the bank may also close the account of its customer :〒 a number of valid reasons, but this cannot be done without giving
  rr₂sonable notice to the customer. This allows the customer to make the accessary arrangements to protect his/her reputation. Some of the reasons foe closing an account are given below:

  If the transactions in the account do not match the nature of the account. Customers due diligence)

  Customer may not have fulfilled KYC requirements.

  Frequent presentation of cheques without sufficient balance in the account.

- Customer is not complying with minimum balance requirement.
- If customer does not respond to the bank's notices, the bank may close the account by returning to the customer the entire balance in the form of a pay order or cashier cheque and asking him/her to return unused leaves of cheques to the bank.
- Insanity of the customer automatically terminates the banker's authority to work as agent of the customer (reference case Young Vs Toynbee (1910) England).
- Insolvency of the customer is treated as "civil death" of the customer. His/Her affairs are transferred to the official assignee or liquidator. As soon as the banker receives notice of insolvency of any customer, his/her authority to honor cheques on behalf of the customer comes to an end. The bank must close or block the account of a customer on the order of the competent court.

Zakat

Zakat is one of the five pillars of Islam. Zakat is so important that, in the Quran, often where Allah has discussed Salat (Namaz), the application of Zakat is also discussed. Zakat collection in Pakistan is regulated under Zakat and Usher Ordinance 1980 (ZUO) 1980.

Zakat and Usher Ordinance 1980 has designated banks as "Zakat collection agencies" and bank branches as Zakat collection offices (ZCOs) who are responsible for the actual deduction and collection of Zakat. Zakat laws are applicable to all Muslim citizens of Pakistan as well as to a company, association of persons, or a body of individuals , whether incorporated or not, the majority of the shares of which is owned or beneficial ownership of which is held by a Pakistani citizen. Zakat shall be calculated and deducted/recovered @2.5 % of the Zakatable asset value.

First Schedule of ZU01980

In this Schedule, all types of assets are defined on which Zakat is d at source. Branches of banks are concerned only with the following

I. Saving Accounts (excluding Foreign Currency Accounts) and =' accounts, by whatsoever name described, with bank opera® Pakistan, post offices, National Saving centers and financial insti keeping such accounts (Code 101).

2. Notice Deposit and Accounts, and similar receipts and accoumi whatsoever names described (excluding Foreign Currency r and Accounts) (Code 102).

3. Fixed Deposits receipts (other than those mentioned in 2 above) accounts and similar receipts and accounts (excluding Foreign Ct Accounts) and certificates (e.g. Khas deposit certificates) by wha names described and issued by banks operating in Pakistan, post o National Saving centers and financial institutions, on which ret income is recoverable by the holder periodically or is received e than maturity or withdrawal (Code 103).

4. Saving/Deposit certificates (Defense Saving certificates, National De Certificates) receipts and accounts by whatsoever names described offices, National Saving centers and financial institutions, companies and statutory institutions, on which return is recoverable or is received by the holder only on maturity or encashment (Code 104 .

5. Units of National Investment Trust (unit) Trust (Code 105).

6. ICP Mutual Funds certificates (Code 106).

7. Government Securities (other than prize bonds and certificates mentioned at serial No 3 & 4) on which return is receivable by the holder periodically (Code 107).

8. Securities including shares and debentures (other than those mentioned at serial no 5, 6 & 7 above) of companies and statutory corporations (excluding those held in the names of a company or a statutory corporation), on which return is payable periodically or otherwise, and is paid (Code 108).

9. Annuities (Code 109).

10. Life insurance policies (Code 110).

II. Provident Funds (Code 111).

Zakat Collection and Refund Rules 1981

a) Central Zakat administration (CZA) means the office of the administrator general.

b) Valuation date means the commencing day of the Zakat year that is the first day of Ramzan.

c) Zakat deduction or deduction of Zakat means deduction of Zakat at source in respect, not the assets mentioned in the first schedule of the Ordinance.

d Zakat collection controlling agency (ZCCA) means the central office or the head office or the main office in Pakistan directing and controlling the affairs and operations of an institution responsible for collection of Zakat at source and collection of Zakat paid voluntarily, grant “atiyyah” and other receipts.

e! Zakat collection office (ZCO) means a department or a branch or a sub office or regional office of the ZCA actually responsible for deduction of Zakat at source and collection of Zakat paid voluntarily, grant “atiyyah” and other receipts and includes a ZCCA performing the functions of a ZCO.

Exemption from Zakat Deduction

- Zakat is not to be deducted in respect of non-Muslim sects. To establish whether the individual is non-Muslim, a solemn affirmation in writing is required by the person concerned.
- Zakat is not to be deducted in respect of the assets of a person who is not a citizen of Pakistan.
- Zakat is not to be deducted in respect of certain companies etc where not less than fifty (50) percent of shares are owned by non-Muslim citizens of Pakistan. To establish that the individual is non-Muslim, a solemn affirmation in writing is required by the person concerned.
- Zakat is not to be deducted in respect of assets of a person claiming exemption on the grounds of faith and fiqah. Persons claiming exemption on the grounds of faith and fiqah must provide CZ 50 or an attested true copy within a period not less than 30 days preceding the valuation date. The time limit of 30 days preceding valuation date is not applicable to those account holders who open their accounts less than 30 days before the valuation date. Therefore the declaration of such account holders may be accepted if it is submitted immediately before the valuation date.
- Zakat shall not be deducted in respect of the assets of a person excluded from the definition of Sahib-e-nisab.
- Zakat is not to be deducted in respect of “Frozen Accounts”. If and when assets de-freeze, such assets will become subject to Zakat.
- Zakat is not to be deducted in respect of the assets of a dead person. This fact is to be established through an attested true/photo copy of the death certificate issued by a competent authority.
- No Zakat shall be charged or collected on a compulsory basis in respect of any of the assets mentioned in the first schedule which has been acquired against payment in Foreign Currency, or maintained in foreign currency.

dministrator

- For the purpose of computation of Zakat, the value of an asset securing a debt shall be reduced to the extent of the debt if:

    a) the debt and the asset primarily securing that debt are name of the same person and the same ZCO (

    b) the asset securing the debt and the asset created from are in the name of the same person and except, as pn in sub rule (3) of rule 13 , it is in the custody of the same

    c) the asset created out of the debt was so created within months of the loan having been disbursed, and

    d) the asset created out of the debt is included in the first sc of the Ordinance.

These facts are to be established through appropriate documen evidence. The extent of the reduction allowed in the value of the shall not exceed the balance of the debt as on valuation d

Banks' right of "set off'

Generally, banks have the right to transfer cash from savings accounts pay off other debts held, such as credit cards or loans, etc. This is kno as the right to "Set Off".

In most account opening forms (AOF) there is a term or condition wh" allows the bank to exercise "right of set off". Following is an example:

•The Bank may, without notice, set off a debit balance, or debit interest on an Account against any Account with a credit balance or credit interest held by the same Account Holder."

In banking and tax recovery, there is an automatic right to exercise the above.

It is not unusual for a customer to have a current account, a savings account and a credit card account - all with the same bank. The same customer might also have a loan. And some of those accounts might be held jointly with someone else, usually a spouse or business partner.

However, the bank has a right – but not a duty – to look at a customers overall position and to "combine" the accounts held by that customer. This is sometimes called a right of "set off" or a right to "combine" accounts. A bank has this as a general right, whether or not it mentions the right in the account terms. So, in the examples above, the bank can transfer money from an account that is in credit in order to make payments due on another account. But it does not necessarily have to do this.

There are certain conditions that must be met before the bank can exercise its right of "set off":

a) Amount of loan / bill must be due

b) Between the same parties

c) Under the same right

d) Money lying in liability account is not appropriated for a particular purpose.

Tr-e account from which the bank transfers funds must be held by the oisiomer who owes the bank money.

The account from which the bank transfers the money - and the account from which the money would otherwise have come - must both be held with the same bank.

The account from which the bank transfers funds - and the account from which the money would otherwise have come – must both be held in the same capacity by the customer concerned. So, for example, if Mrs. Farzana holds a savings account in her capacity as treasurer of a local society, the bank cannot take money from that account to pay Mrs. Farzanas personal credit card bill that she normally pays from the current account she holds in a personal capacity.

The debt must be due and payable. For example, if a customer misses making a loan payment , then (at least until it calls in the loan) the bank can take only the missed payment - not the balance of the loan. It is not necessary for a bank to warn customers before it exercises its right of "set off". A warning might prompt customers to move their money to an account with a different bank. But it is usually good practice for a bank to tell a customer as soon as possible after it has made a transfer.

Generally banks do not exercise "set off" before giving the customer a reasonable opportunity to pav the debt. However, what is "reasonable might depend on the customer and the history of the account.

The general position can be modified by agreement between the bank and its customer. This might include:

- An agreement that "set off" be available to a bank’s mortgage arm, where it is a separate legal entity
- An agreement to regularly "sweep” any money over a certain balance out of a current account and into a savings account
- An agreement that money held by a customer in one capacity can be used to pay debts owed by the same customer in a different capacity. This practice of the banks in some cases is affecting the most vulnerable segments of society since they can have all their income debited, making it difficult for them to meet their basic needs and requirements.

Duty of Confidentiality

The relationship between a bank and its customers is secret/private and confidential. According to the Banking Companies Ordinance (BCO) 1962 , section 33-A, banks in Pakistan are under obligation to maintain complete secrecy and confidentiality relating to the operation of customers’ accounts. It is an implied term of the banker/customer contract that the banker has a duty of secrecy. Confidentiality may be breached only in the following four scenarios:

1. Where disclosure is made under compulsion of law.

2. Where there is a duty to the public to disclose.

Part Four

3. Where the interest of the bank requires disclosure.

4. Where the disclosure is made by the express or implied co customer.

Chapter 1

Fiduciary Responsibility

A fiduciary duty is a legal relationship between one party, the p— who is dependent on the better knowledge and judgment of the he/she trusts, the fiduciary. This relationship exists between the and the customer; the banker is a fiduciary to his/her customer firsi foremost. A fiduciary duty is the highest form of duty for the bank dispensing advice, offering services and conducting business. On strong foundations of the fiduciary relationship sits a solid and banking system.

When the customer deposits his/her life savings with a bank, he requires absolute standards of care, i.e. fiduciary standards. Nothing replace lost savings set aside for retirement. The banker has an endur* obligation of fiduciary care. The banker as fiduciary can then act in best interest of the customer by investing the money allocated for len ” thus earning interest. Should some of the assets of the banks (the 1 turn bad, it is the liability of the partners, not the account depositors

4: Account Relationship Establishment

ぴ= • 1:Walk-In and Solicited Customers & Establishing Customer Credentials

Walk-in Customer Solicited Customer

Account opening basics for People/Natural Persons Account opening basics for Companies Customers Due

Diligence (CDD) / Know Your Customer (KYC)

Inapter 2: Introduction, Legal Documents, Authorized Signatory and Account handling in various scenarios

Account Introduction Market Check

Essential Legal Documents and Authorized Signatory

Handling of Customer Accounts - Common Issues arising from: Mandate Power Attorney

Appropration of Payment- Claytons Case Banks obligation of maintaining secrecy

Handling of Customer Accounts - Unusual Circumstances

Account Relationship Establishment

Walk-In and Solicited Customers & Establishing Customer Credentials

Learning Outcome

By the end of this chapter you should be able to:

- Differentiate between walk-in and solicited customers
- Discuss the importance of KYC compliance
- Recall the SBP regulations related to KYC

Walk-in Customers

Solicited Customers

- Recall Customers Due Diligence (CDD) and Enhanced Due Diligence (EDD)
- Define ‘Politically Exposed Person’ and ‘Public Figure[1]
- Explain the due diligence process for a customer considered to be high risk
- Define Private Non-resident Rupee Account.

\::ount opening basics for People/Natural persons:

Fx natural persons the following information should be obtained, where sppikable:

1-Legal name and any other names used (such as maiden name);

= Correct permanent address (the full address should be obtained; a Post = ffice box number is not sufficient);

1 Telephone number, fax number, and e-mail address;

4 Date and place of birth;

i Nationality;

i I<rupation, public position held and/or name of employer;

... official personal identification number or other unique identifier xritained in an unexpired official document (e.g. passport, identification CNIC. POC, NICOP) that bears a photograph of the customer;

Type of account and nature of the banking relationship;

4 Signature.

Letter of thanks must be prepared and mailed to the customer on :be given address.

If .he letter of thanks is undelivered, the dealing officer should call respective customer and verify the address and mail the letter again.

Th ≷ bank should verify this information by the following methods:

a. Confirming the date of birth from an official document (e.g. birth certificate, passport, Identity Card, social security records);

b. Confirming the permanent address (e.g. utility bill, tax assessment, bank statement, a letter from a public authority);

c Contacting the customer by telephone, by letter or by e-mail to confirm the information supplied after an account has been opened (e.g. a disconnected phone, returned mail, or incorrect e-mail address should warrant further investigation);

c. Confirming the validity of the official documentation provided through certification for example CNIC through NADRA.

Account opening basics for Companies

For companies the following information should be obtained:

1. Name of institution
2. Principal place of institution's business operations
3. Mailing address of institution
4. Contact telephone and fax numbers
5. Partnership deed
6. Letterhead of proprietorship
7. Some form of official identification number, if available (e.g. tax identification number)

8. The original or certified copy of the Certificate of Incorporation and Memorandum and Articles of Association

9. The resolution of the Board of Directors to open an account and identification (CNIC) of those who have authority to operate the account

10. Nature and purpose of business and its legitimacy.

Customers Due Diligence (CDD) / Know Your Customer (KYC)

Customers Due Diligence (CDD)/ Know Your Customer (KYC) are primarily procedures that are required to be implemented by the bank to identify their clients / customers in order to ascertain relevant information pertinent to doing business with them. Financial managers are increasingly recognizing the importance of ensuring that their banks have adequate controls and procedures in place so that they know the customers with whom they are dealing.

Adequate due diligence on new and existing customers is a key part of these controls. Without this, banks may become subject to reputational, operational, legal and concentration risks, which can result in significant financial cost. In Pakistan, CDD/KYC is a regulatory policy requirement to be implemented to check the customer, their sources of funds and nature of business, etc. KYC implementations have become increasingly important globally to prevent theft, fraud, and AML activities. KYC should not be treated as just a formality of form filling; in fact it is a process to be undergone from the start of a customer relationship till the end.

The second aspect of CDD/KYC checking is to verify that the customer is not on any list of known persons suspected or convicted of financial crime or default. SBP issues a 'negative' list which is updated from time to time, highlighting such negative persons, companies and associations. This list contains thousands of entries which are required to be referred to when starting any new financial relationship.

A key aspect of CDD/KYC control is to monitor transactions of customers against their recorded profile, including their historical data.

Banks exercising CDD/KYC monitoring for (AML) and (CTF) purposes should use specialized Transaction Monitoring Software, as well as Names Analysis Software and Trend Monitoring Software. Such software should automatically highlight accounts appearing on a negative list and should also generate alerts to identify unusual activities.

According to the SBP Prudential Regulation M-l, banks and DFIs should formulate in writing a comprehensive Know Your Customer (KYC) policy, duly approved by the bank's Board of Directors and in line with international best practices. This policy should be applicable when starting a new relationship (new account) with the customer and a continuing relationship with existing customers. This has become more important in view of the recent rise in terrorist activities, where terrorists have used banking channels to transfer illegal funds.

Customer Due Diligence (CCD)

The following Due Diligence measures should be taken:

- No account of an anonymous or fictitious person shall be opened or maintained.
- All reasonable measures should be taken to identify beneficial ownership of an account.
- If a customer is acting on behalf of any other person(s), measures should be taken to verify the identity of the other person(s).

g) Customers dealing in high value items.

EDD should also be used in the following situations:

- Customer who has been refused banking facilities by any other DFI
  - Opening correspondence banking account
  - Dealing with no face-to-face *I* online customers
- Dealing with politically exposed persons (PEP).'Politically exposed persons' (PEPs) are persons holding or who have held a position of public trust.

The following must be carried out at the time of establishing a relatio with a customer:

1. All prospective customers must be seen face-to-face (except on customers, for whom a separate identification process is definedL
2. Proper completion of Account Opening and KYC forms and authorizations.
3. Documents produced by the customer must be original. In the case of photocopies, each copy must be marked “Original seen” after verifying the original documents.
4. All documentary evidence, information provided and signatures must be consistent.
5. Purpose and reason for opening the account or establishing the relationship.
6. Expected origin and use of funds that are routed through the bank.
7. Prepare and document customer’s business and transaction profile including details of occupation/employment/business activities and sources of wealth and income.
8. Evidence of identity and address of all account holders (including third party mandate) must be obtained and should be independently verified for authenticity.
9. Photocopy of CNIC along with original must be obtained at the time of opening the account. Original may be returned after marking copy “Original seen”.
10. Documents required under SBP Prudential Regulation No. M-l must be obtained.
11. Where there are doubts about the quality or adequacy of previously obtained customer identification material for existing customers, then, on the basis of materiality and risk identification, verification should *be* carried out at appropriate times.

Purpose of CDD/KYC and AML

The purpose of CDD/KYC and Anti-Money Laundering (AML) procedures is to check the authenticity of the customer and their business account. For this purpose, the following steps should be taken.

Obtain all necessary identification documents. The customer can provide any of the following verification documents, along with a photocopy, for attestation / verification to the designated officer. The original documents should be returned to the customer after verification / attestation.

1. CNIC
2. Passport
3. Pakistan Origin Card (POC)
4. National Identity Card for Overseas Pakistani (NICOP) for accounts other than individual or joint. Various additional documents are required, the details of which are provided in the Account Opening portion of this book. NADRA verification should be completed immediately but no later than 5 working days. In no circumstance should the verification cost of CNIC verification be passed on to the account holder.

Generally, branch staff knows their customers well; the CDD/KYC exercise helps to document their knowledge of the customer. If information is not documented, verbal information will not be acceptable to the regulator.

CDD/KYC should not be merely a form-filling exercise but should be instrumental in building future relationships.

CDD/KYC is an ongoing process and does not end at the account opening stage. Any fresh information regarding the account holder, his/her new business, new sources of funds, or conversion of status from student to business / service, etc should be immediately updated in the AOF and in the computer system.

No customer is exempt from CDD/KYC. They all have to be taken through this route in a very professional manner, without annoying them. The banker should not behave like an investigator or a police officer, but instead be very courteous and tactful in their approach.

CDD/KYC is a very confidential part of the customer AOF and in no circumstances should it be shared with him/her. Do not write generalized statements / words such as “private service”, “business”, etc.; rather be more specific in recording information such as “serving in KESC”, “Kauser Medical Store”, etc.

It is not necessary that all information is backed by documentary evidence, but must be done wherever possible. Ensure that Government accounts are not opened in the personal name of government officials.

For opening any government account (Federal, Provincial.
Govt.) in an official capacity, the relevant government officiab produce an authority letter from the department concerned, duly by the Ministry of Finance or Finance Department of the provincial/ local government.

Additional diligence should be applied to high risk customers engaged in cash-based businesses and whose actual source of funds clearly identifiable.

As per SBP instruction, any account that has not submitted a CNIC a specified period can be discontinued.

Bank and DFls should undertake due diligence and identification of in customers who undertake transactions above the limit prescribed the bank's/DFI's internal policies.

Public figures and politically exposed persons

The term "public figure" applies to a person who performs an impo public function and is known by the public at large. Individuals belonging to political and social environments, showbiz. etc. should also be considered as public figures. These people will take advantage of their public figure status in order to achieve personal benefits. Following are a few examples of public figures:

- Head of State (present or past)
- Cabinet Ministers
- Chief Executives of nationalized industries and senior officials of government administration

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Pakistan.

permanent or temporally return to Pakistan their accounts will become resident and for that no permission from SBP is required.

Non-resident accounts can broadly be divided into four groups:

Non resident Pakistani nationals permanently residing abroad.

Non resident Pakistani nationals who are abroad for a short visit.

Non resident foreign nationals residing abroad.

- Non resident foreign national who is an ordinary resident in Pakistan but has gone abroad for a short visit.

Accounts of United Nation and its organizations are free from financial control and such accounts are treated as resident accounts. There is no bar in maintaining joint accounts of resident and non-resident operated as singularly or jointly. In both the cases account shall be treated as nonresident.

- Non-resident accounts in the name of the persons, firms, corporations, other than banks can be opened without approval from the SBP.

- Non-resident accounts where accounts are to be opened with the funds received from abroad through banking channel or with rupee funds which have been accepted by the SBP for remittance abroad should be reported in monthly return with approval number of the SBP.

  - In case of Non-resident accounts, declaration on form Q.A.22 is not required.

  - Form A-7 is required to be filled in respect of all debit and credit transactions.

- Form A-7 in support of transactions in non-resident accounts should be sent to the SBP along with the schedule “K”, which is part of a foreign exchange return that is required to be submitted to the SBP.

- In case of credit to non-resident accounts, the receiving banker is responsible for ensuring that the form A-7 is completed, or SBP approval is obtained where required, before crediting funds in non-resident accounts

  - In case of debit in non-resident account, where cheque is presentee without submission of Form A-7, the paying banker should return cheque with remarks ^Non-resident account, Form A-7 requlredr

»Valk-In and Solicited Customers & Establishing Customer Credentials

Account Relationship Establishment

Introduction, Legal Documents, Authorized Signatory and Account handling in various scenarios

Learning Outcome

By the end of tJys chapter you should be able to:

- List the preferred introducers and discuss the need for introduc^

- Discuss the importance of conducting a market check

- List the types of different ownership documents for different entities
- Recall the SBP regulation related to account opening for each of the above
- Identify the authorized signatory for various business accounts
- State the possible issues that can arise from:
  - Mandate
  - Power of attorney
  - Appropriation of payment - Clayton's case .Bank's obligation of maintaining secrecy
- Explain the process of handling a customer's account in the case/event of:

i. Minor

ii. Death

iii. Mental incapacity

iv. Insolvency

Account Introduction

In previous times banks in Pakistan used to ask customers to have the account introduced. In particular, the bank needed to know and verify the authenticity of the person intending to open the account and ask for a reference from a banker, any existing accountholders, or a professional reference.

Now, although personal introduction is no longer compulsory, anyone who wants to open an account, including firms/companies, and anyone who will be granted account signatory rights, has to be properly identified and has to provide a number of documents, such as a certified copy of the CNIC, Passport copy, NICOP, POC, etc.

While account introduction through an approved intermediary is still often possible without the appearance in person, in the bank, of the owner of the company, nevertheless the bank still needs to know their clients in substantial detail, and is also a requirement of the laws that regulate the banking industry.

Market check

Before opening a business account it is advisable to conduct a market check of the person/ persons intending to open the account. The need for proper business account screening is to avoid potential problems arising if we fail to evaluate the background, reputation and nature of business of the intending customers. Implementation of Know Your Customer (KYC) and Customer Due Diligence (CDD) procedures is an essential part of the market checking process.

Essential Legal Documents and Authorized Signatory

The different business entities include the following:

- Individual/Joint and Sole Proprietorship
- Partnership
- Joint Stock Companies
- Clubs, Associations, Societies, Charitable Organizations
- Trust Account

The documentation requirement, along with the SBP guidelines, is covered in detail in chapter 1-“Conventional Banking” of Part Two.

Handling of Customer Accounts - Common Issues arising from:

1.Mandate

A bank mandate is a contract between the bank and its customers setting « out all the terms and conditions of use of banking services, including the respective rights and obligations of the bank and the customer. It is a document given by a customer of a bank requesting that the bank should open an account in the customer's name and honor cheques, etc.

A mandate can also be described as a written and/or command by a person, group , or organization (the 'mandator') to another (the 'mandatory') to a certain • Normally until,a mandate is automatically terminated on the bankruptcy , incapacitation, removal from office, or death of the mandator. A cheque, for example, is a mandate issued by a customer of a bank , to pay it, as instructed, from a customer’s bank account.

2. Power of attorney

This is a legal authority given by one person, the donor , to another person or persons (the attorney or attorneys) to conduct the donor’s financial or legal affairs. Power of attorney can be for a general purpose’ in which case it is called General Power of Attorney. Special Power of Attorney is given for specific/ defined purposes.

Some types of power of attorney automatically come to an donor loses mental capacity. Other types - known as ‘enduring: or ‘continuing’ powers of attorney – can continue in force e\ en donor loses mental capacity, although (depending on the type ofl of attorney) some additional legal formalities may be

An agent, an attorney-in-fact, is a fiduciary for the principal, so an must be completely honest with and loyal to the principal in their with each other. If the attorney is being paid to act for the princi contract is separate from the power of attorney itself, so if that is in writing, it is a separate document, kept private between

In order for a power of attorney to be a legal document it must be and dated by both the principal and the agent.

The document is reviewed and signed, and often stamped, by a public. This process augments the authenticity of the document. Ho such notarization is not always necessary for such a document to considered legal.

In financial situations wherein a principal requests a securities broker perform extensive investment functions on the principal's be) independent of the principal's advice, power of attorney must be fon granted to the broker to trade in the principal's account. This rule applies to principals who instruct their brokers to perform certain sp € trades, and principals who trust their brokers to perform certain trades] in the principal's best interest.

3. Appropriation of payment - Clayton's case

Clayton's case – Devaynes v. Noble (1816) – decided that where there is a deposit account between a debtor and a creditor and neither one appropriates the payments made, then those payments are attributed or appropriated to the earliest debts, i.e. the payments are made against the oldest debt unless the debtor prescribes otherwise. The rule is based upon the simple notion of first-in, first-out to determine the effect of payments from an account, and will normally apply in the absence of evidence of any other intention.

Payments are presumed to be appropriated to debts in the order in which the debts are incurred. This case is also referred to as a leading authority on what is known as "appropriation of payments".

From Clayton's case the following rules are derived, taken mainly from Roman Law:

1. Adebtor making a payment has a right to appropriate it to the discharge of any debt due to the creditor.

2. If at the time of payment there is no express or implied appropriation thereof by the debtor, then the creditor has a right to make the appropriation.

3. In the absence of any appropriation by either debtor or creditor, an appropriation is made by presumption of law, according to the items of account , the first item on the debit side being the item discharged or reduced by the first item on the credit side.

A bank’s obligation to maintain secrecy is discussed in detail in Chapter
1- under “Banker – Customer Deposit Banking Relationship” and “Banker’s Duty of Confidentiality/Fiduciary Responsibility” of Part Three.

Handling of Customer Accounts - Unusual Circumstances Minor

A person below the age of 18 years is classified as a Minor. When the age of 18 years is attained, they become entitled to obtain their CNIC from NADRA and can enter into a valid agreement in their own names. An Account in the name of a minor is not opened by the minor themselves but generally done by a guardian.

Example
Salman Aziz (Minor) Muhammad Aziz (Guardian).

The account opening form is signed by the guardian only, who continues to operate the account even when the minor attains the age of majority. In practice, a note to this effect is taken and signed by the guardian at the time of account opening, which are generally savings accounts. Documents required, in addition to all other documents mentioned in Chapter 1 of Part Two, include a photocopy of the CNIC of the guardian and a photocopy of Form B of the minor.

Death

On the death of an account holder, the account is immediately marked as “deceased”. No further withdrawals are allowed, but credit into the accounts can be received. If the balance in the account is small, it can be released against indemnity on production of the death certificate and heir-ship certificate, as per procedure given in the Deposit Manual of the bank. In the case of large amounts, production of a succession certificate becomes mandatory, along with other related documents as per the Operations Manual of the bank. The law does not authorize the heirs to operate the account of the deceased customer. Therefore, the account is closed and the credit balance available in the account of the deceased customer is paid to the heirs according to the legal requirements (Section 122 A of Negotiable Instrument Act 1881).

In the case of an operating instruction“either or survivor”, in the event of the death of either of account holder(s)/depositor, the credit balance in the account will be payable to the surviving account holder(s)/depositor.

Mental Incapacity and Insolvency

Mental incapacity of the customer automatically terminates the banker’s authority to work as agent of the customer (reference case Young Vs Toynbee (1910) England).

Insolvency of the customer is treated as “civil death” of the customer. His/Her affairs are transferred to the official assignee or liquidator. As soon as the banker receives notice of insolvency of any customer, his/her authority to honor the cheques on behalf of the customer comes to an end.

The bank must close or block the account of a customer on the order of the competent court.

Part 5: Negotiable Instruments and Endorsements

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Part 5: Negotiable Instruments and Endorsements

Part 5: Negotiable Instruments and

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Negotiable Instruments and Endorsements

Negotiable Instruments and Bills of Exchange

Chapter 1

Learning Outcome By the end of this chapter you should be able to:

Write the characteristics of negotiable instruments

ıyments

List the types of negotiable instruments ® Discuss the functions of negotiable instruments

:xchange

Negotiable Instruments

A negotiable instrument is a document guaranteeing the payment of a specific amount of money, either on demand, or at a set time. The three main negotiable instruments are a promissory note, a bill of exchange and a cheque, payable either to order or to bearer.

As payment of money is promised subsequently, the instrument itself can be used by the as a store of value; although instruments can be transferred for amounts in contractual exchange that are less than the instruments face value (known as "discounting") .

A negotiable instrument is transferable from one person to another by delivery or by endorsement and delivery. The legal holder of the instrument is entitled to receive the sum of money mentioned in it. The holder of a negotiaole instrument has the right to file a suit in his name for payment from all or any of the concerned parties. If the transferee has accepted the negotiable instrument in good faith, then he is not affected by the defective title of the transferor in any way.

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A stop payment is executed when a bank account holder instructs his or her financial institution not to honor payment. Stop payments are issued after a cheque has been delivered, but before the receiving party has cashed it.

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As mentioned above, there are three types of negotiable instruments:

All three are payaole dtfaer *to* (Mtier or to bearer.

Negotiable Instruments

Functions of negotiable instruments

Negotiable instruments serve the following functions:

1.Substitute for money

2. Credit device

3. Record-keeping device

Most purchases by businesses and many individuals are made by negotiable instruments instead of cash.

A cheque is a bill of exchange drawn on a specified banker, and not expressly to be payable otherwise on demand (for the legal definition of a cheque, please refer to Section 6 of Negotiable Instrument Act 1881).

A bill of exchange is defined as an unconditional order in writing addressed by one person to another; signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time, a certain sum in money to or to the order of a specified person or to bearer (for the legal definition of a bill of exchange, please refer to Section 5 of Negotiable Instrument Act 1881).

Difference between Inland and Foreign Bills

A bill of exchange may be inland or foreign. An inland bill is a bill which is both drawn and payable within the country. A foreign bill is one which is drawn in one country but accepted and payable in another country.

Parties to a bill of exchange

There are three parties to a bill:

1. Drawer

2. Drawee

3. Payee

Specimen/Sample of a bill of exchange:

Stamp Amount 21st May, 2011

Three months after date pay to or order the sum of (amount) only for value received

To,
(Drawer)

City Signed.:. (Drawer).

Part Five

Chapter 2

Negotiable Instruments and Endorsements

Cheques

Learning Outcome

By the end of this chapter you should be able to:

Define a cheque

Identify the various parties involved in the process of cheque payment List the basic attributes of a cheque Differentiate between a cheque and a bill

Discuss the responsibilities of the collecting banker and the paying banker

State the legal protection available to the collecting bank and the paying bank

Explain what is meant by payment in due course while processing a cheque

Cheques

A cheque is a standard document drawn on a particular bank, through which cash is withdrawn; payments are made to settle financial transactions. It is a negotiable instrument, which can be issued payable to the bearer or order on demand.

According to the Negotiable Instrument Act 1881 Section 6 , a “cheque” is a Bill of Exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.

Differences between a cheque and a bill of exchange are discussed in detail under “Bills of exchange”.

Types of cheques

1. Bearer cheque

   This is a cheque tljat is expressed to be payable to the bearer. Ownership of a bearer cheque passes to the holder by simple delivery of the cheque, with an intention to transfer the title.

2. Order cheque

   This is one that is payable to a named person or to his or her order. The ownership of an ordered instrument is transferred through endorsement.

3. Blank cheque

   A blank cheque is one that is signed by the drawer but no details are filled in.

4. Open cheque

An open cheque is just that, one which does not bear a crossing on the face and therefore can be presented across the counter of the bank for cash payment.

5. Crossed cheque

A crossed cheque is one that bears across its face two parallel lines with r or without words “not negotiable”, “payee account only”, “& co” , or two,: lines with the name of a bank. A crossed cheque must be collected through a banker and cannot be cashed at the counter.

6. Stale cheque

A banker receiving a cheque bearing a date that is six months old or : more, would regard this as a stale cheque. Such an instrument is returned j unpaid, unless instruction from drawer is received to pay it. j

7. Stopped cheque

This is a cheque for which instructions of “Not to be paid” j are received ***from the*** ***drawer.***

8. Traveler's cheques (TCs)

This is a value received instrument, issued in local as wel l as foreign currencies, to the banks regular customers as well as walk-ir customers. Each traveler’s cheque has a space for customers to sign at receiving it and another space for signing in the the time of presence of a paying agent I bank officer at time of payment.

Parties involved in the process of cheque payment

Following are the parties that can be involved in the proce: ss of cheque payment:

Payment in cash

- Cheque drawer/ customer
- Payee or the beneficiary
- Endorse if cheque is in order form
- Drawee bank Payment of cheque in clearing
- Cheque drawer/ customer
- Payee or the beneficiary
- Endorse if cheque is in order form
- **Collecting bank**
- Paying bank
- Bank functioning as an agent for collection
- Nil **INBP** being clearing agency

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Basic attributes of a cheque

- Date must be written on the cheque Amount in words and figure must be the same

It must be signed by the authorized person/persons

Wherever required it must be signed under stamp Cutting/alteration must be authenticated by full

signature Cheque must be drawn on a particular bank It must be payable on demand

Holder

The “Holder” of a promissory note /bill of exchange or a cheque means the payee or the endorsee who is in possession of it or a bearer of the instrument. If an instrument is lost and not found again, or is destroyed, the person in possession of it at the time of loss or destruction will continue to be treated as its holder.

Holder in due course

Holder in due course means the claimer of a cheque / negotiable instrument, who has lawful title free from any defect. Title will be treated as defective if possession of the instrument / cheque has been taken by means of any offence, fraud or any unlawful consideration.

The conditions of being a holder in due course are:

- The holder has taken the instrument before it became overdue, ***without notice that it was previously dishonored.***
- Instrument was taken in good faith against value.
- Without knowledge that the person who has given the instrument (negotiated) had defective title.

The Negotiable Instruments Act 1881 section (9) defines holder in due course as follows:

“‘Holder in due course’ means any person who for consideration becomes the possessor of a promissory note, bill of exchange or a cheque, if oavable to bearer, or payee or endorsee thereof if payable to order, before it became overdue, without notice that the title of the person from whom he derived his own title was defective.”

Payment in due course

Bankers are supposed to exercise due care and skill while making payment of the instruments either a: ihe counter or through clearing. The bank paying the instrumen: should check that the instrument is correctly written, it is not posidaied or stale, signed by an authorized person and having the knowledge tha: the person presenting the instrument has not taken the same by unfair means (defective title). If the banker is found negligent in tracing an apparent defect in the cheque / instruments, this will result in losing the protection available to the paying banker under section 128 of the Negotiable Instrument Act 1881.

According to The Negotiable Instrument Act 1881 section 10:

"'Payment in due course' means payment in accordance with the apparent tenor of the instrument, in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned."

Legal protection of the Paying Bank

Cheques are normally paid by the paying banker who has protection under section 128 of Negotiable Instrument Act 1881. When collecting cheques, the collecting bank gives endorsement on the reverse of the cheque, such as 1)"payee's account credited" 2) "payee's account will be credited on realization" 3) "First payee endorsement confirmed, second payees account credited". When paying the instrument, the paying banker relies on the endorsement that the money is being paid to the true owner of the instrument. Before making payment, the banker must ascertain that the cheque is complete and regular by strictly checking the following:

- Correctly dated
- Amount in words and figure are matching
- Signatures are according to the bank records
- There is no unauthorized alteration
- The cheque is not mutilated
- Endorsement, if required, is correctly given
- There are clear funds in the account
- Payment of the cheque is not stopped by the drawer
- There is no legal bar
- Cheque is not crossed by two clearing banker (except agent for collection).

Section 128 of The Negotiable Instrument Act says that:

"Where the banker on whom a crossed cheque is drawn (in good faith and without negligence pays it, if crossed generally to a banker and if crossed specially, to the banker to whom it is crossed or his agent for collection, being a banker) the banker paying the cheque, and (in case such cheque has come into the hands of payee) the drawer thereof, shall respectively be entitled to the same rights, and be placed in the same positioning all respect, as they would respectively be entitled to and placed in if the amount of the cheque had been paid to and received by **the true owner thereolT**

If a bank is found negligent in paying the instrument, it will lose the protection available to the paying banker under the relevant section.

Legal protection to the collecdns; banK

The bank that assists in collecting payment of the negotiable instrument is called the collecting bank. The banker collects proceeds of cheques and other instruments for his/her customers. As such they should exercise extra care and skill in the acceptance and collection of the same; for example, while accepting a cheque for collection it should be checked that:

Cheque is order or bearer

If order, it is deposited in the *account* of the payee or the endorsee

Cheque is correctly dated

Amount in words and figure are matching

There is no unauthorized alteration

The cheque is not mutilated.

There is no legal bar

Cheque is not *already* crossed in favor of any other bank.

Section 131 of the Negotiable Instrument Act 1881 provides statutory protection to the collecting banker if they have exercised their duties in good faith and without negligence.

Section 131 says that: “Subject to the provision of this Act relating to the cheques crossed ‘Payee account’ , where a banker in good taith and without negligence receives payment for a customer of a cheque crossed generally or specially to himself, and the customer has no title or a defective title thereto, the banker shall not incur any liability to the true owner of the cheque by reason only of having received such payment”.

Section 13IB, “where a cheque is delivered for collection to a banker which does not at the time of such delivery appear to be crossed ‘account payee , or to have had a crossing ‘account payee , which has been obliterated or altered, the banker in good faith and without negligence collecting payment of the cheque and crediting the proceeds thereof, to a customer, shall not incur any liability by reason of the cheque having been crossed ‘account payee’ or of such crossing having been obliterated or altered and of the proceeds of the cheque having been credited to a person who is not the payee thereof."

SBP inspectors, while conducting inspection, specially check that cheques were properly scrutinized at the time of accepting for collection. If cheques *are returned due to a bank's negligence, they take it exceptionally seriously* and impose a penalty as per the rule.

Part Five

Negotiaoie Instruments and Endorsements

Payment of cheques

Learning Outcome By the end of this chapter you should be able to:

it Explain the procedure for payment of cheques and transfer payments against written instructions

si List the critical features of cheque scrutiny

風 List the errors that render the cheque invalid for payment

凝 State the importance of signature verification

箱 Describe the reasons and procedure for returning (dishonoring) cheques

si State the ambiguous reasons for returning cheques

a Differentiate between a wrongful dishonor and a proper dishonor

m State the legal implications of wrongful dishonor of cheques and need for prior customer interface

Procedure for oayment *of* cheques in cash

The customer / bearer presents the cheque to the Teller for payment.

The Teller receives the signed cheque from the customer / bearer and asks for/one signature on the reverse of the cheque.

The Teller scrutinizes the instrument for:

-Validity, i.e. stale / post dated

-Amount in words and figures match

-Cheque is not mutilated

-Cheque is bearer

-Alteration / addition / cutting, if any, are authenticated.

The Teller verifies drawer's signature from the system and posts the cheque. Signature verification is of prime importance, because this is the authority by which the customer's account is debited.

In case the cheque amount is in excess of the Teller's limit, real time (before payment) supCTvision is required.

The cheque is defaced by cancellation either by Teller or by Teller and Supervisor / Operaiioos NIanager, if amount exceeds the Teller limit.

.The Teller asks for the signaazre of the customer / bearer again on the reverse of the cheque to:

.Confirm the identity ***of the presenter*** and in acknowledgement for having received the payment.

- The Teller records the denomination on the back of the cheque and cash is delivered to the customer / bearer.

The Teller affixes branch “Cash Paid” stamp with branch name, code and date on the face of the cheque and writes amount paid and signs.

Procedure for payment of cheque in transfer

Transfer involves the transaction to be settled between the customers of the same branch or customer (s) of remote branch in the case of authorized system user (Online) branch. Procedure:

. T h e Teller receives cheque from depositor along with the deposit slip. The Teller scrutinizes cheque and deposit slip for any discrepancy and confirms that:

- Cheque is signed and in favor of account holder, endorsed or bearer.

.Cheque and deposit slip amount agrees.

- Details and amount on both parts of deposit slip tally.

- Cheque is not stale / post dated or mutilated.
  - Alteration ***I*** cutting / additions on cheque, if any, are authenticated by the drawer and on deposit slip by depositor.
  - Cheque is drawn on the same branch or remote branch. In the case of cheque being drawn on a remote branch, confirms drawee branch is Online.

.Deposit slip is signed by the depositor.

  - The Teller verifies signature, title of account (if mentioned on cheque) and number and posts debit transaction against balance available. Signature verification is of prime importance, because this is the authority by which the customer’s account is debited.
  - Teller confirms beneficiary account name and number and posts credit in the customers account.

- The entries in excess of Teller’s limit will require supervision.
  - The Teller affixes Transfer and branch stamp, signs and delivers receipt to the depositor.
  - The Teller affixes bank crossing stamp on the face of the cheque and endorsement stamp "Payee s account credited” on the reverse. The endorsement is signed by the Supervisor.

For debit/credit to customer account with remote Online branch, system controls / conditions will apply and system will be used for confirming title of account, acxoun: number, signature verification and balance confirmation.

Procedure tor payment of cheque in inward

clearing Procedure:

The cheques and other instruments drawn on the same branch are received from NIFT / Clearing Cell along with forwarding schedule showing number and amount of instruments enclosed.

- Cheques and other instruments are handed over to the respective departments to scrutinize cheques for any discrepancy such as:

  -Validity (stale / post dated).

  -Amount in words and figure agree.

  -Cheque is properly endorsed by beneficiary and bank.

  -Bears presenting bank's clearing and crossing stamps.

  -Addition / alteration / cutting, if any, on cheque(s) and other instrument(s), is authenticated.

- If cheques are found to be in order, signature(s) are verified against Unibank system. Signature verification is of prime importance, because this is the authority by which the customer's account is debited.

- The cheques are posted in the respective accounts in the system against available balance through the financial transaction option of the Clearing.

- The branch will ensure that total number and amount of cheques / instruments received through NIFT / Clearing Cell agrees with the amount shown on NIFT / Clearing Cell forwarding schedule.

  Dishonored cheques / instruments are returned along with the cheque returning memo (showing specific reason of return) duly signed and after entry in the Cheque Returned Register.

- The cheque returning charges are recovered as per schedule of charges.

- The paying (drawee) branch issues Inter Branch Credit Advice for the cheques / instrument paid, i.e. total value of instruments received less the amount of dishonored cheques delivered to Clearing Cell / NIFT.

- The NIFT / Clearing Cell responds to the advice received and disburses funds to cheque presenting banks / branches.

- The returned cheques are returned to the cheque presenting banks / branches along with the cheque returning memo.

Ambiguous reasons for returning cheques

The reason (s) for which a cheque is returned must be clear and self- explanatory. Vague terms must be strictly avoided, such as "refer to drawer", "effects not dear, may be presented again' etc. Returning cheques **against ambiguous reasons is liaMe to incur a penalty.**

Wrongful dishonor means failure to pay a or properly endorsed and presented for payment. A rightful dishonor means that a bank may return a check with a missing signature, altered date, balance is not sufficient to Day the cheque etc, without penalty.

If, however, the (the person presenting the cheque) suffers financially because of the bank's refusal to an otherwise payable cheque, the bank may be liable to its customer for damages. The customer must still be able to prove any financial loss he/she has suffered. Liability is limited to actual damages proved and may include potential consequential damages.

Part Five

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Negotiable Instruments and Endorsements

Crossings on Cheques

Learning Outcome

By the end of this chapter you should be able to: State the objective

of crossing ■ List and discuss the types of crossing

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Crossing of Cheques

When two parallel transverse lines, with or without any words, are drawn, on the left hand top corner of the cheque, this is called crossing. A crossed cheque does not affect the negotiability of the instrument. It can be negotiated in the same way as any other negotiable instrument. A crossed cheque is payable only through a collecting bank and not directly at the counter of the bank. Crossing is done for the security of the payee, as only the collecting banker can collect the proceeds for the account of the payee or the endorsee of the instrument.

Types of Crossing:

- General Crossing
- Special ㇾ rossing
- Account Payee or Restrictive Crossing
- Not Negotiable Crossing 1• General Crossing

General crossing of a cheque means that it bears across its face two parallel transverse lines without any words like ‘and company’ or ‘& *Co*' written in between them.

Section 123 of the Negotiable Instrument Act 1881 says that:

“Where a cheque bears across its face addition of the words ‘& company* or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the word not ‘negotiable’, that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally•”

If a cheque is crossed generally, it cannot be paid at the counter in cash. It has to be first deposited in the bank account and then cash can be withdmwn by the customer.

2. Special Crossing

When a cheque bears across its face an addition of the name of the bank, either with or without two parallel lines, this is called special crossing. Where a cheque is crossed specially, the banker on whom it is drawn will pay it to the banker to *whom* it is crossed or his agent for collection. According to section 124 of the Negotiable Instrument Act 1881:

“Where a cheque bears across its face an addition of the name of a banker, either with or without the words not negotiable’ , that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker.”

The drawer of a negotiable instrument can cross it generally or specially. After crossing, it becomes a material part of the instrument and only the drawer can cancel it under his / her full signatures.

3. Cheque crossed “Account payee”

When a cheque is crossed “A/C payee”, the collecting bank is supposed to credit the proceeds of the cheque to the account of the payee mentioned in the cheque. This type of crossing enhances the liability of the collecting bank. In a case where the collecting bank credits the proceeds of the cheque in the account of any person other than the payee, it will lose its protection available under the law for the collecting banker.

Section 123A of the Negotiable Instrument Act 1881 says that:

1. “Where a cheque crossed generally bears across its face an addition of the words 'account payee* between the two parallel transverse lines constituting the general crossing, the cheque, beside being crossed generally, is said to be crossed ‘account payee’ , , .
2. When a cheque is crossed “account payee” .
   (a) “It shall cease to be negotiable; and
   (b) It shall be duty of the banker collecting payment of the cheque to credit the proceeds thereof only to the account of the payee named in the cheque.”

Dealing officers sitting at bank counters should invariably compare title of account with the payee mentioned in the cheque/ instrument. If they are found negligent, they will lose legal protection available under section 131 of the Negotiable Instrument Act 1881 (Protection to the Collecting Banker).

4. Not Negotiable crossing

A “Not Negotiable” crossing is a very safe crossing, as it means the transferee of a cheque cannot get better title than the transferor (cannot become a holder in due course). The words “Not Negotiable” can be added to a general as well as a special crossing, though the instrument still remains transferable.

The Negotiable Instrument Act 1881 section 130 says that:

“A person taking a cheque crossed generally or specially, bearing in either case the words Xot negotiable* shall not have, and shall not be capable of giving, better title to the cheque than that which the person from **whom he to^k it had•’**

Rules for crossing

- ***Where*** a ***cheque*** is uncrossed, ***the holder*** may cross it ***generally*** or specially.
- Where a ***cheque*** is crossed generally, the ***holder*** may ***cross*** it specially.
- Where a cheque is crossed ***generally*** or specially, the holder may add the words “not negotiable”.
- Where a cheque is crossed specially, the banker to whom it is crossed may again cross it especially to another banker as his agent for collection.
- If a cheque *I* instrument is in the favor of the bank, a special crossing stamp is not required.

Specimens of Crossing

1. General ㄴ rossing

&C0

.Payee A/C only

Negotiable

Not

- Payee A/C only

Not Negotiable

Special Crossing

United Bank Limited

National Bank of Pakistan

Rart Five

Gii&pter 5

teaffling Outcome

Negotiable Instruments and Endorsements

Clearing Services

By the end of this chapter you should be able to:

思 State the ***clearing*** services offered by banks 後 State the role of SBP in ***clearing ® Describe*** the role of NIFT in the ***clearing*** system 嫌 Define ***Real*** Time Gross Settlement system (RTGSj in clearing

Clearing means presenting a cheque, pay order, draft or any other negotiable instrument through the banking procedure / channel for its ultimate oavment through a clearing house by the drawee bank.

In everyday business, financial transactions are settled through cheques from different banks. These cheques are deposited by the customers of the banks in their accounts. As such, every day, thousands of cheques are transported from various banks and financial institutions to reach the branches where the accounts are maintained (on which the cheques are drawn). The massive number of cheque-based transactions makes sorting a formidable task. For instance, in Karachi alone over one hundred thousand cheques come for clearance on a daily basis, from within the city and inter-city.

In order to handle a task of such great magnitude, an independent body is required. SBP authorises NIFT (National Institutional Facilitation Technologies) to handle clearing processes in big cities.

A clearing house is a place where representatives from member banks get together with the objective of exchanging cheques and other negotiable instruments drawn upon their respective banks and to settle the claims.

NIFT is a private body, which has been providing clearing house facilities to all member banks since 1996. Their services are now extended to over 140 cities covering more than 5000 branches of the country. Its responsibility, on behalf of SBP, is to supervise the functions of clearing houses in major cities and to coordinate with Clearing Member Banks ***and SBP in settlement of their claims. The services provided by NIFT*** cover functions pertaining to the main overnight clearing, same-day ***clearing, intercity clearing and US $ clearing.***

NIFT is a joint venture between a consortium of six major financial institutions, responsible for ***establishing*** and managing automated clearing house facilities in P^kisiarL XIFT is actively involved in the modernization of oavment systems in PakisiaD ***and*** implementing coordination of clearing results across the ***nation...*** The ***clearing*** services are now web-based so that Treasury ***Managers and*** the ***branches*** are able to access data and images through NIFTs clearing portal.Through this system all reports and data are made available more quickly than through the physical delivery of the reports and only preauthorized users can get access to the services.

From August 2007 SBP initiated the process of implementing a Real Time Gross Settlement (RTGS) system with the aim of settling interbank funds transfer on a real time basis. Under this system, instead of providing individual nets of each SBP center, NIFT collects nets from all automated centers and provides a countrywide net position of debit or credit to banks' current accounts maintained with SBP in Karachi. Local SBP offices and main branches of the banks, in different cities, now get all reports even earlier, allowing them better control and faster reconciliation at bank level.

Nowadays, banks of developed countries are opting for technology called M ***image-based clearing" that allows banks to clear cheques very quickly.*** In an image-based cheque clearing system, the cheque's image is captured using a scanner at the collecting branch, which is transmitted electronically to the paying branch where a system continuously receives and processes this information. The paying institution returns an image of the cheque to the presenting bank, avoiding any physical handling and transportation of the instrument, and therefore saving considerable time and allowing services to be deployed in other areas more effectively.

We in Pakistan are also moving towards an image-based clearing system where soft files of the cheques presented for clearing will be auto posted in the drawee branch's account. The dealing officer will give clearance regarding signature, clear balance and apparent-tenor of the instrument. Upon successful implementation, the work load in branches will be considerably reduced.

Standard items for NIFT clearing

NIFT has given standard items handling in per details below: Document size Width Weight	Minimum 6" or 15.24 cm 3" or 7.62 cm 0.1 to 0.15 mm 80-90 GMS	details of for clearing as given Length Thickness	Maximum 8.5" or 21.59 cm 4.5" o 11.43 cm 0.1 to 0.15 mm 80-90 GMS

MICR Specification

Magnetic readable characters were introduced in the banking industry in America in 1950. The magnetic characters, 8 epic *I* character / inch, printed in a special font, are placed at the bottom of the instrument for auto processing. Exact placement of these characters is restricted to 0.48 cm from the bottom edge of the instrument, while the top of the code line is set at 0.62 cm from the edge of the instrument.
Cheques *I* instruments should be printed on specified CBI-1 paper, providing protection against: alteration and should have chemical sensitivity.

Documents which are not according to the specifications given by the NIFT are treated **as non-standard and** extra charges are recovered front banks and DFls for processing such documents.

Procedure for outward / inward clearing *1.Outward clearing*

Counter staff will receive deposit slips and cheques drawn on other banks in the city and should scrutinize pay-in slips / cheques for the following:

- The details of the cheques are correctly filled in.
- Cheque is not stale/ post dated/ mutilated.
- Any crossing / clearing stamp previously affixed by any other bank is cancelled.
- Any cutting on oay-in-slip is authenticated by the depositor.
- The date of deposit slip is of the same day, otherwise it should be corrected.
- Officer/ teller receiving the cheques should affix crossing and (next working day) clearing stamp on the cheques / instruments and should affix endorsement stamp on reverse of the cheque instrument. Signatures on the endorsement should be made by the authorized staff.

The counterfoil of the deposit slip will be delivered back to the depositor after affixing the clearing stamp and putting signatures by the bank's counter staff.

Cheques / instruments should be entered in the clearing system / register, the bank's clearing schedule should be prepared and claims should be *lodged through NIFT I clearing cell.*

Funds against the cheques I instruments should be made available to the customers on the same day or next working day, keeping in view the nature of clearing, i.e. special clearing or normal clearing.

2. Inward clearing

On receipt of clearing cheques/ instruments from NIFT/ clearing cell drawn on the same branch, along with forwarding schedule, the total *amount of cheques / instruments received for payment should be balanced* with the total of NIFT/ clearing cell forwarding schedule. The staff *concerned should scrutinize the cheques / instruments for any discrepancy,* such as:

- Instrument bearing presenting bank's crossing / clearing stamp.
- Instrument is not stale or post-dated.
- Endorsement is given by the presenting bank.
- Cutting *I* alteration, if any, is authenticated,
- Amount of the cheque in words and figures is the same.
- Reasons for cheques returned should not be ambiguous; otherwise SBP can penalize the branch.

After checking the above-mentioned discrepancies, signatures of the cheques / instruments should be verified. The cheques/ instruments will be posted in the respective accounts / ledgers against clear balance. Dishonored cheques / instruments should be returned along with cheque returning memo duly signed and recorded in the cheque return register. The reason(s) for cheque return should be clear and specific. The paying branch should issue a credit advice for the cheques / instruments paid to the clearing cell / NIFT.

Clearing House Inter-bank Payments System (CHIPS)

CHIPS is a system for paying and receiving funds through the use of electronic terminals located at banks who are members or associates of CHIPS System, New York, USA.

The associate members, including many foreign banks, must select a correspondent from one of the member banks through which daily CHIPS transactions are settled. At the end of each business day, the clearing house notifies the net credit or debit positions of each member. The net position of associate members is adjusted by debiting / crediting their account with the corresponding banks, which are members of Federal Reserve Bank, settling their own and their associate member's net position through the balance maintained with Federal Reserve Bank, New York.

For more than 37 years, CHIPS has been delivering highly effective and efficient wire transfer payments, in real time, with almost 100 % accuracy. During this time, CHIPS has maintained a reputation for reliability, efficiency and innovation, processing over 95% of the USD cross-border payments and an increasing volume of U.S. domestic payments. Leading banks, their correspondents and customers around the world count on CHIPS to process more than $2 trillion each day.

CHIPS is operated by The Clearing House, which also encompasses Automated Clearing House (ACH), paper cheque exchange and cheque image exchange for financial institutions of all sizes around the world.

Differences between cheque and bill of exchange:

Cheque	Bill of Exchange
It is drawn on a banker.	It may be drawn on any party or individual.
It has three parties - the drawer, the drawee, and payee.	There are three parties - the drawer, the drawee, and the payee.
It is seldom drawn in sets.	Foreign bills are drawn in sets.
It does not require acceptance by the drawee.	It must be accepted by the drawee before he can be made liable to pay the bill.
Days of grace are not allowed to a banker.	Three days of grace are always allowed to the drawee.
No stamp duty is payable on cheques.	Stamp duty has to be paid on bills of exchange.
It is usually drawn on the printed fofm.	it may be drawn in any paper and need not necessarily be printed.
A cheque is either crossed or uncrossed.	There is no such requirement in a bill of exchange.
In the case of a "bounced" cheque,, notice of dishonor is not necessary.	It is a must in the case of a bill of exchange.
You can stop payment in the case of a cheque	K is not possible in the case of a bill of exchange.

A Promissory Note

A promissory note is a written, dated and signed two-party instrument containing an unconditional promise by the originator to pay a definite sum of money to a payee on demand or at a specified future date. When a bank is the originator promising to repay money it has received plus interest, the promissory note is called a Certificate of Deposit (CD) (for the legal definition of a promissory note, please refer to Section 4 of the Negotiable Instrument Act 1881).

Difference between promissory note and bill of exchange:
A promissory note differs from a bill of exchange in the following points:

Promissory Note	**Bill** of Exchange
It is a promise to	**It is an order to pay.**
There are only two parties -the drawer and the payee.	**There are three parties - the drawer, the drawee, and the payee.**
There is no necessity of	**It must be accepted.**
The maker is primarily liable.	**The drawer is not primarily liable.**
It is never drawn in sets.	**Foreign bills are specially drawn in sets.**
Protesting is not necessary after dishonor.	**A foreign bill must be protested upon dishonor.**

part Five_Negotiaole Instruments and Endorsements

iJiapter 6 Endorsements

Learning Outcome By the end of this chapter you should be able to:

逝 Define the concept of endorsements

忿 State the various classifications of endorsements

Explain the principles of endorsement and discuss specimens of endorsements made by different types of payees

® Discuss what is meant by liability of the endorser

Endorsement

Endorsement means putting signature, instructions, etc. on the reverse of a commercial document, for the purpose of assigning the interest therein to another.

Endorsement of any negotiable instrument (bill of exchange, bill of lading, delivery order, or other document of title) means the:

1. Endorser guarantees that he or she is the lawful owner of the instrument.
2. Knows of no defect in it.
3. He / she has received it in good faith for value received.
4. He/she is legally capable of endorsing.

Endorsement can also limit further negotiability of a negotiable instrument. For example, the words “account payee only” on the face (in Pakistan, India and UK) or “For deposit only” on the back (in the US) of a cheque, block its cashing over the counter and (generally) endorsement to another party. §3-204 of the UCC makes it clear that a complete endorsement of whatever type includes the holder's signature. Simplv placing "for deposit only" on the back of a cheque doesn't make for an endorsement, and it's only our sometimes overly relaxed attitude about endorsements that permits this kind of sloppiness. Of course, a signature is whatever the customer and bank agrees will be a signature, so that a rubber-stamped endorsement with the name of the depositor is fine.

There are three types of endorsements:

- Blank endorsement - person merely signs his or her name on the back.
- Restrictive endorsement – limits further negotiation of the cheque.
- Special endorsement - names a third party who can cash the cheque.

1. Blank endorsement: Simplest endorsement, consisting of only the holder's signature. It generally converts order” paper to "bearer" form.

2. Restrictive endorsement: In addition to holder's signature, includes a restriction on how the paper may be used by transferee. Most common wording is "For Deposit Only." The transferee bank must aoDlv the cheque to the holder's deposit account.

3. Special endorsement: This endorsement names the next holder and requires his/her/its endorsement for further negotiation. Usual wording is "Pay to [the order of] TRANSFEREE NAME." There is a combination of the restrictive and special endorsement that bankers see in their daily business from their customers. It usually reads something like "Pay to the order of ABC Rank, for deposit only, (signature)."

4. Qualified endorsement: Endorsement that add certain which limit, qualify, or restrain the endorsers liability. For example, adding the term “without recourse” to a negotiable instrument signifies that the endorser not be if the instrument is dishonored.

   If a banker receives a negotiable instrument: with a qualified endorsement, it is an attempt by the endorser to escape from liability if the negotiable instrument is dishonored. Wording might include the words "without recourse". There is a legitimate purpose for this form, but if you see it on a cheque deposited by your customer, you should check with management before accepting the deposit.

   If an insurance settlement draft is issued payable jointly to an automobile owner and the lien holder, the lien holder may use a qualified endorsement to permit negotiation, but insulate itself from liability if the draft is “bounced”.

Many banks include in their deposit contracts a provision that the bank is entitled to its customer's unqualified endorsement, and may provide same if the customer fails or refuses to give it.

Principles of Endorsement

Endorsement is a French word; it refers to transfer of a cheque or bill to a third party. Sometimes the holder of the bill/ cheque finds it difficult to take the amount from the drawee so he/she may endorse the bill to the third party by signing on the back of the bill. By doing so the third party may find the authority to get the bill discounted from the bank.

Endorsement is required for an order instrument.

For a bearer instrument endorsement is not required, as ownership is transferred by delivery.

If a cheque is crossed “payee’s account only” then this cheque cannot be endorsed.

If the payee of an order instrument has signed in blank on the reverse of the cheque then anybody can take payment as now it is payable to bearer.

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Banks endorsement on collecrioa of endorsed cheque

First payee endorsement confirm

Second payee's
account will be
credited

On realization

For XYZ Bank Limited

Officer

For cheque sent for collection (other cities)

(Bank's endorsement in 1 case)

Payee A/c will be
credited on realization

For XYZ Bank Limited

Officer

Bank's endorsement of bill of lading

Deliver to the order of-----------------

For XYZ Bank Limited ABC Branch

Officer

Manager

Bank’s endorsement on bill of exchange

Pay to the order of........................ ....

For XYZ Bank Limited ABC Branch

Officer Manager

Negotiable Instruments and Endorsements

Collection Services and Foreign Payment Arrangements

to me

By the end of this chapter you should be able to: en

Discuss the concept of Inward/outward collection ® Discuss the concept of local and foreign collection (clean)

® Describe the correspondent bank as a settlement network ® Discuss the concept of correspondent banks for in-country payments 摘 Define ‘Nostro’ and ‘Vostro’ accounts

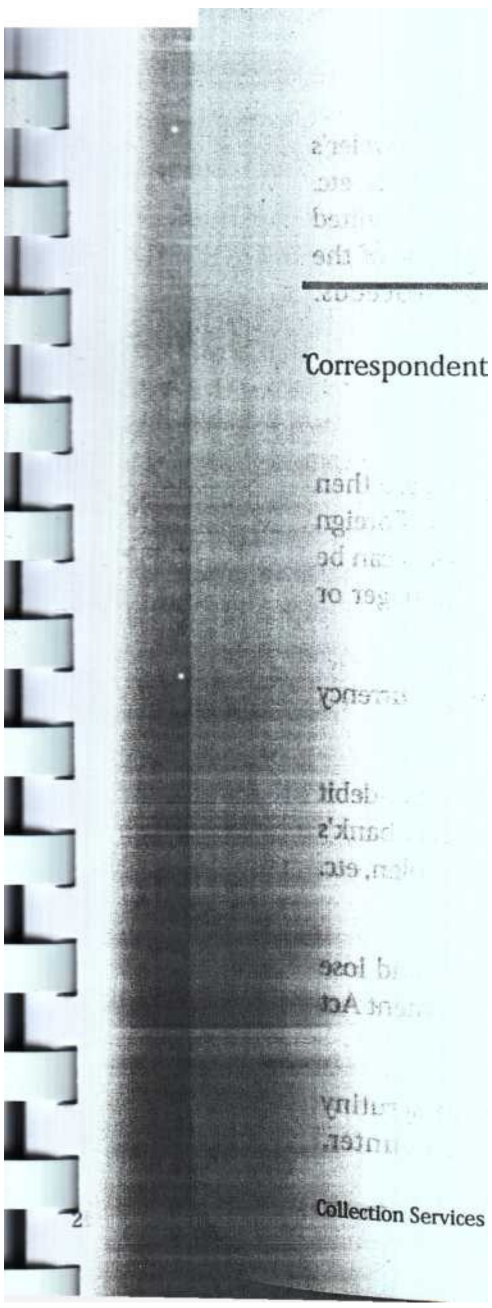
* Discuss the procedure for correspondent banking arrangements with banks when dealing with foreign payments

» Define “Clean Foreign Bill”

箱 Discuss the procedure for selecting the collecting bank

s Discuss the procedural details and charges during lodgment of cheques and bills in outward collection

® Discuss the legal obligations of the collecting office on re-claiming payments against defective cheques



Correspondent Banks

- The adequacy of the other financial institution's controls and internal compliance practices in relation to AML/CDD.
- The ownership, control and ***management*** structures of the other financial institution and any parent company.
- Whether a politically exposed person has ownership or control of the other financial institution or any parent company.
- The other financial institution's financial position.
- The reputation and history of the other financial institution.
- The reputation and history of any parent company of the other financial institution.
- Whether the other financial institution has been the subject of an investigation, or any criminal or civil proceedings relating to money laundering or terrorism financing.

Once these conditions are satisfied, an account can be opened as the correspondent bank's account.

Clean Foreign Bills

Purchase or collection of foreign financial instruments such as Traveler's Cheque, Draft and Cashier's Cheque, ordinary Cheque, Money Order, etc. is an arrangement by which the value of the instrument can be credited to the payee's deposit account; if purchased, prior to the result of the ***clearing process and if collection, on receipt of proceeds.***

Foreign Bills Purchased Clean (FBP)

In FBP, foreign currency cheques are purchased; instruments are then issued against value received, such as FC Traveler's Cheques, FC Foreign Demand Draft, FC Foreign Money orders, etc. These instruments can be purchased at the counter after approval from the Branch Manager or Operations Manager.

Extra care and skill should be exercised when purchasing Foreign Currency instruments because:

- According to the law of some of the foreign countries, they can re-debit the account up to six years from the date of credit of the local bank's account with them if the instrument is proved to be fake or stolen, etc. (US and most of the western countries law).

  In the case of FBP, the local banks act as holder for value and lose protection available under SEC 131 of the Negotiable Instrument Act **1881.**

For FBP Clean other than TC the normal process of cheque scrutiny would apply upon receipt of the instrument over the counter.

Cash Payment

Procedure:

- Customer presents FC instruments at the counter for payment either in Pak Rupees or for credit to his/her FC Account.
- Original passport and, in the case of FC Travelers Cheques, a sale receipt should also be obtained for checking the identity and authenticity of the customer.
- Signature of customer should be obtained on the lower line of the TCs intended for this purpose.
- If the signature of the customer reasonably matches the signature on record, and the first signature on TCs or passport, the instruments may be accepted for encashment.

. A f t e r completing the above steps, FBP Clean is be debited on a Debit cash voucher at OD Buying Rate, charges will be recovered as per effective S O C, and then payment can be made.

- Posting is in banking financial transaction Dr. FBP Clean and credit cash.
- FBP Clean schedule is prepared and details of TCs are entered in *FBP register. Schedule and instruments are sent for collection**
- On realization, a credit confirmation memo is received and the entry is reversed by debiting HO and crediting FBP Account.

Credit to Foreign Currency Account

Procedure:

- Customer completes a Pay-in slip, instruments are received in normal course, a Collection schedule is prepared, details of F C instrument is entered in the FBC register Schedule and it is then sent for collection-
- Photocopy of Passport, Sale receipt, and instruments are retained in branch along with the Collection schedule.

On realization, a credit confirmation memo is received by collecting branch who will respond the entry by debiting HO A/G and crediting FBP A/C.

- Schedule and TCs are sent to APC for collection.
- Transactions are reported on monthly exchange returns.

Foreign Bills for Collection (FBC)

Cheques drawn in foreign currency and on branches either in Pakistan
or in foreign countries are collected in FBC (Foreign Bills for Collection).
Procedure for Lodgmenn

. C a s h Officer or Teller receives foreign currency cheque along with a completed pay*in slip signed by the depositor.

The cheque should be carefully scrutinized and the title of the account compared with the payee mentioned on the cheque (if it is A/C payee only).

If all is satisfactory, a “Received for collection” stamp is affixed on both parts of the pay-in slip, signed, and the counterfoil returned to the customer.

- Bank crossing ***stamp*** should be affixed on the cheque and endorsement on the reverse of the cheque.
- The dealing officer enters details of the cheque in the FBC Register which is maintained in serial number order.

. Each year the FBC numbering system starts from Number One (Number-Year), for example, (001-2011).

. FBC number is noted on the bank s portion of the pay-in slip and on the cheque under small FBC stamp.

.Photocopies of the instrument (both sides) should always be taken and kept on record. This is necessary in case the instrument is lost in transit. Follow up after 15 days and copy to be placed on file.

- Covering schedule is prepared giving full details of the cheque and then dispatch it.

.On the covering schedule / letter for foreign currency US $ cheques drawn within the country, a local FBC should be written.

Procedure for Realization of FBC:

- On realization of FBC a credit confirmation memo is received from APC
- Credit confirmation memo has columns: Br Ref, FC Bill Amount, Amount Realized, and Value Date.
- If cheque was drawn in a foreign country, HO debit advice will be received giving details of FBC No, Value Date, F C realized, Pak Rupees

Amount (@ TT clean buying rate).

HO A/C	Debit	
Customer’s A/C		Credit
Income A/c Commission		Credit

If FBC in U S $ was drawn on local Br.:

Ho A/C local collection US	**Debit**	
Customers A/C		**Credit**
Income *AfC*		**Credit**

(For currencies other then U S $ normal procedure is adopted) Transactions should be *r^poned* in SBP Return J O -3.

Collection of cheques

All cheques and other negotiable instruments payable locally are presented through the clearing system prevailing in the city.

Cheques drawn on other banks at other cities are collected through bank branches in those cities. Where the bank does not have a branch of its own, the instrument should be sent directly for collection at the drawee bank or collected through a correspondent bank.

In order to automate and centralize a collection process for cheques, the major banks in Pakistan have created Auto Processing Centers (APC) for collection of cheques. Following are the benefits:

- Branches do not have to deal with collection issues so they can focus on other core business.

. The branches mail APC all their collection cheques (local ana roreign).

- On receipt of the cheques APC processes them in batches.

.Processing time and cost of collection are saved.

- Automated reimbursement.
- Processing through specialized personnel and automated system improves chance of collection.

. B a n k forwards returned items directly to the processing center; hence ***chances of loss of the instrument are minimized.***

Following are the main processes handled at APC:

1- Outward Bill for Collection

2- Inward Bill for Collection

3- Outward FCY Bill for Local Collection

4- Inward FCY Bill for Local Collection

5- Outward FCY Bill for Foreign Collection

6- Inward FCY Bill for Foreign Collection

All inward mail in the department should be time stamped, evidencing receipt of delivery. Once received, the mail is sorted according to its **relative area, i.e. LCY/FCY or IBC/OBC.**

Outward Bills for Collection (OBC) Procedure At Brancn:

- Teller receives out station cheque, with completed pay-in slip, signed by the depositor.

Teller scrutinizes the instruments for discrepancies, including, but not limited to, ensuring that the title of the account matches the payee mentioned on the instrument (if it is marked as a/c payee).

Upon confirmation of correct details , the teller should stamp the deposit slip and sign the same, and the customer's copy is handed over to the customer.

Teller then proceeds to place a crossing stamp on the front of the instrument and an OBC stamp on the reverse, and the OBC number should be written on the cheque.

- The OBC number is system generated for branches where the OBC system is available. For branches which do not have the OBC system, a manual register should be maintained.
- Branch passes a contra voucher.
- Branch then passes the entry, the OBC collection schedule is then verified and checked against the physical instruments.
- The authorized signatory at the branch /authorized staff authenticate all cuttings and over writings on the schedule, whether they are system generated or manually produced.
- Before dispatching, the branch should ensure that the number of instruments and the amounts are as per the schedule. Upon realization, the branch should receive the funds via head office advice.
- Returned instruments should be received at branches via courier.
- All applicable charges should be recovered by the branch.

At CPU

The following steps are involved in the OBC process:

- The OBC covering schedule received from branches should be matched with the amount and number of cheques stated on the covering schedule. Discrepancies, if any, should be notified to the originating branch.
- At the time of recording cheque details through the APC system, the processor should scrutinize the instrument for discrepancies.

  Crossing stamp is placed on the front and OBC stamp on the reverse.

.In cases of discrepancies the instrument should be returned to the branch.

- The cheques should be sorted according to area and sent to the relevant branches of the bank.
- If no branch of own bank exists, the cheque is sent to the bank on whom it is drawn.

- In cases where realized ***funds are*** not received after three working days, a reminder should be sent and continuously followed-up until settlement of OBC. AH reminders should be copied to the originating ***branch.***

. Upon realization of funds the entries are transferred to the branch which has sent the instrument.

Inward Bill for Collection (IBC) Procedure

At Branch

- On receipt of inward bill for collection, the teller should scrutinize the instruments for discrepancies, such as valid date, amount in words and figure is the same, collecting banker's stamps are correctly made.
- The instrument is entered in IBC register.
- The IBC number is system generated for ***branches*** where IBC system is available.
- The title of ***account*** should match the payee ***mentioned*** on the instrument.

. Upon confirmation of correct details, the teller verifies signature.

- The teller then posts ***against*** clear balance in the account.
- After posting, credit is given to sending branch or AP as appropriate.

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FCY Cheque for Local Collection - USD Outward ***At Branch***

. Local clearing is done twice a week, i.e. on Mondays and Thursdays.

- The teller receives USD cheque with completed pay-in slip, signed by the depositor.
- ***The teller should scrutinize the instruments for discrepancies, including*** but not limited to, valid date, amount in words and figure the same, collecting banker's stamps correctly made.

  The title of account should match the payee mentioned on the ***instrument (if it is marked as a/c payee).***
- Upon confirmation of correct details, the teller should stamp the deposit slip and sign the same.

  The customer copy is handed over to the customer.

  The branch should retain a photocopy of the cheque.
- The teller affixes a crossing stamp on the face of the instrument.
- Along with the cowEring schedule, these instruments are then forwarded to APC.

- Upon realization, the branch receives a Credit Intimation letter via courier or scanned e-mail.
- The branch then credits the customers account.
- Returned instruments should be received at the branch via the main designated branches.

At CPU

- Local clearing is done twice a week, i.e. on Mondays and Thursdays.
- The FBC covering schedule sent by the branch should match the amount and number of cheques stated in the enclosed summary.
- The processor records the details of the cheque in the register (maintained . on Excel) and scrutinizes the cheque for discrepancies, such as valid date, amount in words and figure is the same, collecting bankers stamps are correctly made.

.In cases of discrepancies, the instrument will be returned to the branch.

- APC affixes the bank's discharge stamp and clearing stamp on the face of the cheque
- Add-list items are prepared arid filed in the Bundle Cover and Summary Delivery Receipt in triplicate, including number and amount of instruments for onward collection by NIFT representative.
- Notice of the instruments should be received through NIFT on the next clearing day.
- Upon realization, the branch should be advised through a Credit Intimation Letter.

FCY Cheque for Local Collection - USD Inward At Branch

- Upon receipt of instruments the teller should scrutinize them for discrepancies.
- Verification of customers signature.

Clearing and endorsement stamp affixed.

The branch debits the customer's account, issues HO advice and forwards same to APC depL

If not returned it is assumed that the instruments have been accepted for payment.

At CPU

- Cheques drawn on UBL branches country wide are presented centrally by NIFT to the APC department on local USD clearing days, i.e. Mondays and Thursdays.
- The processor records the details of the cheque in the register (maintained on Excel) and scrutinizes the cheque for discrepancies, such as endorsement by presenting bank being complete. Bank's discharge stamp and clearing stamp are affixed.
- Cheques received are sorted according to branch and sent to the relevant branches, along with a Collection Memo Letter advising the branch to send an advice (if cleared) or the physical instrument (if returned) to APC, before next clearing day.
- Upon receipt of advice for paid items, the same should be delivered to Treasury Back Office and marked as paid in the register.

.In cases where the instrument is being returned, upon receipt of the same at APC it should be forwarded to NIFT.

- Nostro [1] and 'Vostro' accounts

A Vostro account is a foreign bank's account with a reporting bank, while
a Nostro account is the reporting bank's account in a foreign bank.
In other words, it is an arrangement by which two correspondent banks
in different countries keep a local currency account for one another.

Part 6: Payment Methods

Chapter 1:Banker's Cheques and Travelers Cheques Cashier cheque / banker's cheque

Pay Orders and Demand Draft

Traveler's Cheque

1 In cases of discrepancies, these should be returned, along with a signed return memo clearly stating the reasons for return, to the designated main branch for onward deli、ぇ ry to APC before the next settlement date.

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Part Six

Chapter

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Banker's Cheques and Traveler's Cheques

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Learning Outcome

By the end of this chapter you should be able to:

級 Define banker's cheque/cashier cheque: pay order and demand draft

愁 Discuss why a bankers cheque is a guaranteed and secure form of payment

像 Discuss the procedure for issuing banker's / cashier cheque

播 Discuss the role of agency arrangements in the orocess of issuing demand drafts on other banks

State the risk mitigation measures that need to be undertaken when a banker's cheque is cancelled

Explain the concept of Traveler s cheques (TC)

r cheque /
's cheque

A cashier cheque is a kind of a draft drawn by a branch on its Head Office or Main Office. Cashier cheques are a guaranteed form of payment. This is an order instrument that can be paid when presented at the counter, but generally issued as a crossed cheque. This is a very customer-friendly instrument as it serves the purpose of both a demand draft and a pay order. A pay order is issued and paid by the same branch, and a demand draft is paid by the branch on which it is drawn, whereas a cashier cheque can be paid at any branch of the bank. Any customer, including a walk-in customer, can order a cashier cheque from any bank simply by handing them the money over the counter, although if he/she has an account with the bank, it is sometimes cheaper.

In western countries such as the UK, cashier cheques are issued with special characteristics, such as:

- Generally issued with enhanced security features, including special bond paper.
- These are designed to decrease the vulnerability to counterfeit items.
- The cheque is generally signed

by one or two bank employees; however, some banks issue cashier cheques featuring a signature of the bank's or other senior official.

A cashier cheque includes the name of the issuing branch and its code, instrument number, date, drawn on main office and amount in words and figures. It can be issued for any amount and requires the signatures of two authorized officers -

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Issuance

.Application for issuance of a cashier cheque should be submitted on *the standard form or can be issued against the customer’s written* instructions.

.Customer’s name, address and telephone number should be included on the application form.

.If the purchaser is a walk-in customer, a copy of CNIC should be obtained, along with original for attestation. This is SBP’s minimum requirement for walk-in customers.

- If a cashier cheque has to be issued against cash, then the cash should be counted and “Received Cash” stamp should be affixed on the application.
- If a cheque is tendered along with an application, it should be posted in the customer's account and a transfer stamp should be affixed on both the cheque and the application form.
- A cashier cheque of the required amount should be issued under full signature and attorney number.
- Post the details of the cashier cheque in the system; details of the instrument can then be updated at the Head Office record online and on a real time basis.
- After posting in the system, the instrument may be delivered to the customer.
- Dispatch related credit advice to the cashier cheque cell.

Encashment

Cashier cheque can be paid in cash, transfer or clearing.

Before encashment, dealing officer should verify signatures on the instrument.

It is advisable that, before encashment, a list of lost instruments should be referred to.

For walk-in **customers, a copy of** CNIC should be obtained.

In the case where **a lost instrument** is presented for payment, it should be marked as **“Reported Lost”** and returned to the presenter.

The dealing officer, **after verifvlng** the authenticity of the instrument, should cancel it in **the same manner** as other instruments are cancelled

Ystem.

and post the same

The holder **should be** (cas **paid in the mode it** was presented for payment **anda** transfer, **clearing)**

Pay Orders and Demand Drafts 1.Pay order (PO) /

Cashier cheque

A pay order is an order to pay a certain amount of money mentioned in the instrument on demand or to the endorsee on behalf of the payee. The bank is discharged by payment in due course. A pay order is generally used for making local payments and the same is done by the branch that *issues it. This is an order instrument and transferred through negotiation.* This is like a banker's cheque but issued locally for local payments. This *is different from a demand draft which is payable for outstations and is generally used for outstation payments.*

Issuance

.Request is received on standard application form or on customer's *written request.*

- In the case of a walk-in customer, the necessary KYC (Know Your Customer) procedures should be completed, such as address of the purchaser, telephone number(s) and a photocopy of the CNIC for due diligence. Check that all required information on the application is filled in and that it is duly signed.
- If pay order is to be issued against cash, then the same needs to be collected along with charges and a cash-received stamp is affixed on the pay order application.
- If the pay order is to be issued against a cheque, then it should be posted in the account. Service charges, if not collected in cash, will have to be posted in the customer's account through a debit voucher. A transfer stamp needs to be affixed on the voucher and the pay order before issuing it either manually or through the system.

Issuance of Pay order / Cashier cheque

Customer approaches the bank for issuance of PO/CC

Request will be received either or standard application form or customer's written request

case of walk-in customer required KYC to be completed such as : Address & telephone number(s) of the purchaser. Photocopy of CNiC & its comparison with original for due diligence. Purpose of refruttance.

De^kig omcer must check that all required information in the application form is filed n and it is signed

PO CC ts to be issued against cash, then same to be collected along v. サ charges and cash received stamp to be affixed on application form

*■ s 13 c»e issued against cheque, it shall be posted in the account. If crrarges are not iiduded in the cheque, a separate debit voucher shall be prepare-: and charges shall be recovered

sfxelled and transfer stamp must be affixed on all

Duplicate copy to be hande over to the customer

k m cheque to be prepared as per details in the application atrer or trroogh system.
I t De sicjne-ご' the maker and counter-signed by the checker.

Payment

When a pay order is presented for payment , the banker should check the following:

.Issued by the same branch and duly signed by authorized officers.

- There is no ***alteration*** on the instrument.
- If presented in clearing, special crossing and clearing stamp are affixed ***and endorsement is made on back of the instrument.***
- Pay order date should not be more than six months old, otherwise it ***will require revalidation.***

After checking all the above points, the pay order should be posted in the register / system and should be marked as paid.

Duplicate issuance

- The purchaser of the pay order should submit an application for loss ***of the pay order and issuance of a duplicate.***
- ***Signature*** of the ***purchaser*** should be verified from the original application ***form.***
- Prescribed indemnity on required value of stamp paper should be ***obtained; signed by the purchaser and duly witnessed.***
- Approval from competent authorities of the bank for issuance should be obtained.
- Duplicate pay order should be issued and new numbers of the duplicate ***pay order should be written on PO application form.***

Cancellation

Application from the purchaser, along with original instrument, requesting cancellation of pay order is required.

The banker should verify the signature of the purchaser from the pay order application form.

If pay order was issued other than in a personal name, clearance / discharge from beneficiary must be obtained.

Pay order should be marked as cancelled and the signature portion **of the pay order should be tom out.**

Cancellation should be marked in the PO register / system.

Proceeds of the pay order should be credited in customer’s account after recovering cancellation charges,

If pay order was issued for a walk-in customer, another pay order in the name of the purchaser should be issued.

1. Demand Draft (DD)

A demand draft is a value-received instrument issued by a bank. It is issued in order to pay money drawn by one branch of a bank upon another branch of the same bank or its correspondent. Since this is an order instrument, the drawee bank is discharged by payment in due course and the instrument is transferred through negotiation. DDs are generally drawn on other cities with an objective of making payments there.

Issuance

- Request should be received on standard application form or on customer's written request ***I*** instruction.
- In the case of a walk-in customer, the necessary KYC (Know Your Customer) procedures should be completed, such as address of the purchaser, telephone humber(s) and a photocopy of the CNIC for due diligence.

. C h e c k that all required information on the application is filled in and that it is duly signed.

- If DD is to be issued against cash, then the same needs to be collected along with charges and a cash-received stamp is affixed on the pay order application.
- If DD is to be issued against a cheque, then it should be posted in the account. Service charges, if not collected in cash, will have to be posted in the customer's account through a debit voucher. A transfer ***stamp needs to be affixed on the voucher and the DD before issuing*** it either manually or through the system.
- DD should be prepared according to the draft application form, signed by two authorized officers and should be delivered to the purchaser.
- Relative credit advice should be prepared and dispatched to the drawees branch.

Payment

When a draft is presented for payment, the banker should check the following:-

- If presented in clearing, ***special crossing and clearing*** stamp are affixed and endorsement is made on the back of the instrument.

.DD date should not be more than six months old, otherwise it will require re-validation.

After checking all the above points, the DD should be posted in the register / system and should be marked as paid.

Duplicate issuance

- The purchaser of the draft should submit application for loss of the demand draft and issuance of duplicate.
- Signature of the purchaser should be verified from the original application form.
- Drawee branch should be informed of the loss of the draft, with request to mark caution for its payment.

.On receipt of confirmation that draft is outstanding, prescribed indemnity on required value of stamp paper should be obtained, signed by the purchaser and duly witnessed.

.Duplicate demand draft should be issued with a note: "duplicate draft ***is issued in lieu of original draft no___________________________________dated***

A Traveler's Cheque is a value received instrument, in local as well as foreign currencies, issued to the bank’s regular customers as well as walk- in customers. Each travelers cheque has a space for

Part 7: Control Policies and Compliance

customers to sign at the time of receiving it and another space for signing in the presence of the paying agent / bank officer at time of payment.

Rupee Traveler's Cheques (TC)

Cheques issued in Pak rupees by the banks to their customers who wish to travel within the country are called Rupee Traveler's Cheques. Each cheque has a space for the customer to sign immediately on receipt of the cheque and another space to sign in the presence of the paying banker at the time of encashment.

Issuance

- Application for issue of Rupee traveler's cheques should be submitted only on the standard form.

.Customer's name, address and telephone number should be included on the application form.

- If purchaser is a walk-in customer, a copy of CNIC should be obtained along with the original for attestation.

- If TCs have to be issued against cash, then the same should be counted and a "Received Cash Stamp" should be affixed on the application.

- If a cheque is tendered along with the application, it should be posted in the customer's account and a transfer stamp should be affixed on both the cheque and the application form.

Chapter 1:Policies and Compliance Internal

Control Process Major Elements

of Internal Control Process

Management Oversight and the

Control Culture Roles and

Responsibilities of External

Auditors Lessons learned from

Internal Control Failures

Importance of Compliance

Role of management in improving

Internal Controls Audit

Compliance Officer

Training

Non Compliance

Pan Seven

Cliaoter

Control Policies and Compliance

Policies and Compliance

Learning Outcome

By the end of this chapter you should be able to:

- Discuss the internal control policies and compliance in banking operations
- Explain the importance of compliance as a collective responsibility
- Discuss the role of the management in inculcating the sense of responsibility in employees
- List the risks of non-compliance
- Discuss the critical areas of compliance:
  - -Account opening and subsequent relationship management
  - -Observance of safeguards against money laundering
  - -Internal safety and security
  - -Internal and regulatory reporting
- Recall the SBP Regulations with respect to compliance

Internal Control Process

Internal control is a process affected by the board of directors, senior management and all levels of personnel. It is not a procedure or policy that is implemented solely at a certain point in time, but rather it should be continually in operation at all levels within the bank. The board of directors and senior management are responsible for establishing the appropriate culture to facilitate an effective internal control process and for continuously monitoring its effectiveness; however, each individual within an organization must participate in the process.

The main objectives of the internal control process can be categorized as follows:

1. Efficiency and effectiveness of operations (operational objectives).
2. Reliability and completeness of financial and management information (information objectives).

3. Compliance with applicable laws and regulations (compliance objectives).

Operational objectives

For internal control these pertain to the effectiveness and efficiency of the bank in using its assets and other resources and protecting the bank from loss. The internal control process seeks to ensure that personnel throughout the organization are working ***to achieve*** its objectives in a straightforward manner, without unintended ***or*** excessive ***cost*** or placing other interests (such as those of an employee, ***supplier*** or customer) before those of the bank.

Information objectives

These address the preparation of timely, reliable reports required for decision-making within the banking organization. They also address the need for reliable annual accounts, other financial statements and other financial-related disclosures, including those for regulatory reporting and other external uses. The information received by management, the board of directors, shareholders and supervisors should be of sufficient quality and integrity that recipients can rely on the information in making ***decisions. The term "reliable" , as it relates to financial statements, refers*** to the preparation of statements that are presented fairly and based on comprehensive and well-defined accounting principles and rules.

Compliance objectives

These entail ensuring that all banking business is conducted in compliance with applicable laws and regulations, supervisory requirements, and internal policies and procedures. These objectives must be met in order to protect the bank's franchise and reputation.

The Major Elements of an Internal Control Process

The internal control process, which historically has been a mechanism for reducing instances of fraud, misappropriation and errors, has recently become more extensive, addressing all the various risks faced by banking organizations. It is now recognized that a sound internal control process ***is critical to a bank's ability to meet its established goals and objectives, and to maintain its financial viability.***

Internal control consists of five interrelated elements:

1. Management oversight and the control culture
2. Risk assessment
3. Control activities
4. Information and communication
5. Monitoring activities

The problems observed in recent large losses at banks can be aligned with these five elements. The effective functioning of these elements is essential to achieving a bank's operational, information, and compliance objectives.

Board of directors t? = '

Principle 1:The board of directors should have responsibility for approving strategies and policies; understanding the risks run by the bank; setting acceptaole levels *for* these risks and ensuring that *senior* management takes the steps necessaxy to identify, monitor and control these risks; approving the organizational structure; and ensuring that senior management is monitoring the effectiveness of the internal control system.

The board of directors provides governance, guidance and oversight to senior management. It is responsible for setting the broad strategies and major policies of the organization and approving the overall organizational structure. The board of directors has the ultimate responsibility for ensuring that an adequate system of internal controls is established and maintained. Effective board members are objective, capable, and inquisitive, with knowledge of the activities and risks run by the bank. A strong, active board, particularly when coupled with effective upward communication channels and capable financial, legal, and internal audit functions, is often best able to ensure the correction of problems that may diminish the effectiveness of the internal control system.

The board of directors should include in its activities:

1. Periodic discussions with management concerning the effectiveness of the internal control system.
2. A timely review of evaluations of internal controls made by management, internal auditors, and external auditors.
3. Periodic efforts to ensure that management has appropriately followed up on recommendations and concerns expressed by auditors and supervisory authorities on internal control weaknesses.

One option used by banks in many countries is the establishment of an independent audit committee to assist the board in carrying out its responsibilities. The establishment of such a committee allows fbr detailecl examination of information and reports without the need to take up the time of all directors and ensures that the particular questions concerned receive proper attention. The audit committee is typically responsible for overseeing the financial reporting process and the internal control system. As part of this responsibility, the audit committee typically oversees the operations of, and serves as a direct contact for, the bank’s internal audit department and engages and serves as the primary contact for the external auditors.

In those countries where it is an option, the committee should be composed entirely of outside directors (i.e., members of the board that are not employed by the bank or any of its affiliates) who have knowledge of financial reporting and internal controls. It should be noted that in no case should the creation of an audit committee amount to a transfer of .duties away from the full board , which alone is legally empowered to take decisions.

Senior management

Principle 2: Senior management should have responsibility for implementing strategies approved by the board; setting appropriate internal control policies; and monitoring the effectiveness of the internal control system.

Senior management is responsible for carrying out directives approved by the board of directors, including the implementation of strategies and policies and the establishment of an effective system of internal control. Members of senior management typically delegate responsibility for establishing more specific internal control policies and procedures to those responsible for a particular unit's activities or functions. Consequently, it is important for senior management to ensure that the managers to whom they have delegated these responsibilities develop and enforce appropriate policies and procedures.

Compliance with an established internal control system is heavily dependent on a well-documented and communicated organizational structure that clearly shows lines of reporting responsibility and authority and provides for effective communication throughout the organization. The allocation of duties and responsibilities should ensure that there are no gaps in reporting lines and that an effective level of management control is extended to all levels of the bank and its various activities.

It is important that senior management takes steps to ensure that activities are conducted by qualified staff with the necessary experience and technical capabilities. Staff should be properly compensated and their training and skills periodically updated. Senior management should institute compensation and promotion policies that reward appropriate behaviors and minimize incentives for staff to ignore or override internal control mechanisms.

Control culture

Principle 3: The board of directors and senior management are responsible for promoting high ethical and integrity standards, and for establishing a culture within the organization that emphasizes and demonstrates to all levels of personnel the importance of internal controls. All levels of personnel in a banking organization need to understand their role in the internal controls process and be fully engaged in the process.

An essential element of an effective system of internal control is a strong control culture. It is the responsibility of the board of directors and senior management to emphasize the importance of internal control through their actions and words. This includes the ethical values management displays in their business dealings, both inside and outside the organization. The words, attitudes and actions of the board of directors and senior management affect the integrity, ethics and other aspects of the bank's control culture.

In varying degrees, internal control is tbe responsibility of everyone in a bank. Almost all employees produce information used in the internal element of a strong internal control system is the recognition by eve”” employee of the need to carry out their responsibilities effectively and to communicate to the appropriate level of management any problems in operations, instances of non-compliance with the code of conduct or other policy violations or illegal actions that are noticed. This can best be achieved when operational procedures are contained in clearly written documentation that is made available to all relevant personnel. It is essential that all personnel within the bank understand the importance of internal control and are actively engaged in the process.

In reinforcing ethical values, banking organizations should avoid policies and practices that may inadvertently provide incentives or temptations for inappropriate activities. Examples of such policies and practices include ***undue emphasis on performance targets or other operational results,*** particularly short-term ones ; high performance-dependent compensation rewards; ineffective segregation of duties or other controls that may offer temptations to misuse resources or conceal poor performance; and insignificant or overly onerous penalties for improper behaviors.

While having a strong internal control culture does not guarantee that an organization will reach its goals, the lack of such a culture provides greater opportunities for errors to go undetected or for improprieties to ***occur.***

Risk Assessment

From an internal control perspective, risk assessment should identify and ***evaluate the internal and external factors that could adversely affect the*** achievement of the banking organization’s operational, information and ***compliance objectives. This should cover such risks as credit, market,*** liquidity and operational risk (which include the risk of fraud, misappropriation of assets, and unreliable financial information). There is a significant difference between risk assessment in the context of the internal control process and the broader concept of the "risk management" of a bank's overall business. For example, the risk management^process ***in a banking organization consists of setting organizational goals and*** objectives (such as profitability targets) and identifying, measuring and setting limits on the risk exposures that the bank will accept in order to achieve its objectives. The internal control process then works to ensure ***that objectives and policies are communicated and implemented, that*** compliance with limits is monitored, and that deviations are corrected in accordance with management's policies. Thus, the concept of risk management includes, but is not limited to, both risk assessment and the setting of operational objectives as those terms are defined for internal control purposes.

Principle 4: Senior management should ensure that the internal and external factors that could adversely affect the achievement of the bank's objectives are being identified and evaluated. This assessment should cover all the various risks facing the bank (for example, credit risk, country and transfer risk, market nsk, interest rate risk, liquidity risk, operational risk, legal risk and reputational risk).

Effective risk assessment identifies and considers internal factors (such as the nature of the bank's activities, the quality ***of*** personnel, organizational changes and employee turnover) as well as external factors (such as fluctuating economic conditions, changes in the industry and technological advances) that could adversely affect the achievement of the bank's objectives. This risk assessment should be conducted at the level of individual businesses and across the wide spectrum of activities and subsidiaries of the consolidated banking organization. This can be accomplished through various methods. Effective risk assessment addresses both measurable risks (such as credit, market and liquidity risk) and non- measurable risks (such as operational, legal and reputational risk).

The risk assessment process also includes evaluating the risks to determine which are controllable by the bank and which are not. For those risks that are controllable, the bank must assess whether to accept those risks or whether to mitigate the risk through control procedures. For those risks that cannot be controlled, the bank must decide whether to accept these risks or to withdraw from or reduce the level of business activity concerned.

Principle 5: Senior management should ensure that the risks affecting the achievement of the bank's strategies and objectives are continually being evaluated. Internal controls may need to be revised to appropriately address any new or previously uncontrolled risks.

In order for risk assessment, and therefore the system of internal control, to remain effective, senior management needs to continually evaluate the risks affecting the achievement of its goals and react to changing circumstances and conditions. Internal controls may need to be revised to appropriately address any new or previously uncontrolled risks. Often these risks can be best understood when considering how various scenarios ***(economic and otherwise) affect the cash flows and earnings of*** financial instruments and transactions. Thoughtful consideration of the ***full range of possible problems, from customer misunderstanding to operational failure, will point to important control considerations.***

Control Activities

Principle 6: Control activities should be an integral part of the daily operations of a bank. Senior management must set up an appropriate control structure to ensure effective internal controls, defining the control activities at every business level. These should include: top level reviews; appropriate activity controls for different departments or divisions; physical controls; periodic checking for compliance with exposure limits; a system of approvals and authorizations; and a system of verification and reconciliation. Senior management must periodically ensure that all areas of the bank is in compliance with established policies and procedures.

Control activities are designed and implemented to address the risks that the bank identified through the risk assessment process described above. Control activities involve **three steps:**

1. The establishment of policies
2. The performance of procedures in accordance with those policies

Control activities involve all levels of personnel in the bank, including senior management as well as front line personnel. Examples of control activities include:

•Top level reviews - Boards of directors and senior management often request presentations and performance reports that enable them to review the bank's progress toward its goals. For example, senior management may review reports showing actual financial results to date versus the budget. Questions that senior management generate as a result of this review and the ensuing responses prepared by lower levels of management represent a control activity which may detect problems such as control weaknesses, errors in financial reporting or fraudulent activities.

•Activity controls - Department or division level management receives and reviews standard performance and exception reports on a daily, weekly or monthly basis. Functional reviews occur more frequently than top level reviews and usually are more detailed. For instance, a manager of commercial lending may review weekly reports on delinquencies, payments received, and interest income earned on the portfolio, while the senior credit officer may review similar reports on a monthly basis and in a more summarized form that includes all lending areas. Like the top level review, the questions that are generated as a result of reviewing the reports and the responses to those questions represent the control activity.

•Physical controls - Physical controls generally focus on restricting access to physical assets, including securities and other financial assets. Control activities include physical limitations, dual custody, and periodic inventories.

•Compliance with exposure limits - The establishment of prudent limits on risk exposures is an important aspect of risk management. For example, compliance with limits for borrowers and other counterparties reduces the bank's concentration of credit risk and helps to diversify its risk profile. Consequently, an important aspect of internal controls is the periodic review of compliance with such limits.

•Approvals and authorizations - Requiring approval and authorization for transactions over certain limits ensures that an appropriate level of management is aware of the transaction or situation, and helps to establish accountability.

•Verifications and reconciliations • Verifications of transaction details and activities and the output of risk management models used by the bank are important control activities. Periodic reconciliations, such as those comparing cash flows to account records and statements, may identify activities and records that need correction. Consequently, the results of these verifications should be periodically reported to the appropriate levels of management.

Control activities are mast rfFective when they are viewed by management and all other personnet as an int^ral part of, rather than an addition to, the daily operations of the bank. When controls are viewed as an addition ***to the day-to-day operations, they are often seen as less important and*** may not be performed in situations where individuals feel pressured to complete activities in a limited amount of time. In addition, controls that are an integral part of the daily operations enable quick responses to changing conditions and avoid unnecessary costs. As part of fostering the appropriate control culture within the bank , senior management shouia ensure that adequate control activities are an integral part of the daily functions of all relevant personnel.

It is not sufficient for senior management to simply establish appropriate policies and procedures for the various activities and divisions of the bank. They must periodically ensure that all areas of the bank are in compliance with such policies and procedures and also determine that existing policies and procedures remain adequate. This function is usually carried out as part of the internal audit department.

Principle 7: Senior management should ensure that there is appropriate segregation of duties and those personnel are not assigned conflicting responsibilities. Areas of potential conflicts of interest should be identified, minimized, and carefully monitored.

In reviewing major banking losses caused by poor internal controls, supervisors typically find that one of the major causes of such losses is the lack of adequate segregation of duties. Assigning conflicting duties to one individual (for example, responsibility for both the front and back offices of a trading function) gives that person access to assets of value and the ability to manipulate financial data for personal gain or to conceal ***losses. Consequently, certain duties within a bank should be split among various individuals in order to reduce the risk of manipulation of hnancial data or misappropriation of assets.***

Segregation of duties is not limited to situations involving simultaneous front and back office control by one individual. It can also result in serious problems when there are no appropriate controls in those instances where an individual has responsibility for:

- Approval of the disbursement of funds and the actual disbursement

- Customer and proprietary accounts
- Transactions in both the "banking" and "trading" books
  - Informally providing information to customers about their positions while marketing to the same customers
  - Assessing the adequacy of loan documentation and monitoring the borrower after loan origination
  - Any other area where significant conflict of interest emerges and the same is not mitigated by any other factor.

Areas of potential conflict should be identified, minimized, and carefully monitored. There should also be p»iodic reviews of the responsibilities and functions of key individuals to ensure that they are not in a position to conceal inappropriate actions.

Information and Communication

Principle 8: Senior management should ensure that there are adequate and comprehensive internal financial, operational and compliance data, as well as external market information about events and conditions that are relevant to decision making. Information should be reliable, timely, accessible, and provided in a consistent format.

Adequate information and effective communication are essential to the proper functioning of a system of internal control. From the bank's perspective, in order for information to be useful, it must be relevant, reliable, timely, accessible, and provided in a consistent format. Information includes internal financial, operational and compliance data, as well as external market information about events and conditions that are relevant to decision making. Internal information is part of a record-keeping process that should include established procedures for record retention.

Principle 9: Senior management should establish effective channels of communication to ensure that all staff are fully aware of policies and procedures affecting their duties and responsibilities and that other relevant information is reaching the appropriate personnel.

Without effective communication, information is useless. Senior management of banks need to establish effective paths of communication in order to ensure that the necessary information is reaching the appropriate people. This information relates both to the operational policies and procedures of the bank as well as information regarding the actual operational performance of the organization.

The organizational structure of the bank should facilitate a complete flow of information - upward, downward and across the organization. A structure that facilitates this flow ensures that information flows upward so that the board of directors and senior management are aware of the business risks and the operating performance of the bank. Information flowing down through an organization ensures that the bank's objectives, strategies, and expectations, as well as its established policies and procedures, are communicated to lower level management and operations personnel. This communication is essential to achieve a unified effort by all bank employees to meet the bank's objectives. Finally, communication across the organization is necessary to ensure that information with one division or department can be shared with other affected divisions or departments.

Principle 10: Senior management must ensure that there are appropriate information svstems in place that cover all activities of the bank. These systems, including those that hold and use data in an electronic form, must be secure and periodically tested.

A critical component of a bank's operations is the establishment and maintenance of management information systems that cover the full range of its activities. This information is usually provided through both electronic and non electronic means. Banks must be particularly aware of the organizational and internal control requirements related to processing information in an electronic form.

Electronic information **systems** and the use of information technology have risks that must **be effectively** controlled by banks in order to avoid

disruptions to business and potential losses. Controls over information systems and technology should include both general and application controls. General controls are controls over the computer system (i.e., mainframe and end-user terminals) and ensure its continued, proper operation. For example, general controls include back-up and recovery procedures, software development and acquisition policies, maintenance procedures, and access security controls.

Application controls are computerized steps within software applications and other manual procedures that control the processing of transactions. Application controls include, for example, edit checks and computer matching. Without adequate controls over information systems and technology, including systems that are under development, banks could experience the loss of data and programs due to inadequate physical and electronic security arrangements, equipment or systems failures, and inadequate backup and recovery procedures. Management decisionmaking could be adversely affected by unreliable or misleading information provided by systems that are poorly designed and controlled. Information processing could be curtailed or fail entirely if alternate compatible facilities are not available in the event of prolonged equipment failure. In extreme cases, such problems could cause serious difficulties for banks and even jeopardize their ability to conduct key business activities.

Monitoring

Principle 11:Senior management should continually monitor the overall effectiveness of the bank's internal controls in helping to achieve the organization's objectives. Monitoring of key risks should be part of the daily operations of the bank and should include separate evaluations as required.

Banking is a dynamic, rapidly evolving industry. Banks must continually monitor and evaluate their internal control systems in light of changing internal and external conditions, and must enhance these systems as necessary to maintain their effectiveness.

Monitoring the effectiveness of internal controls should be part of the daily operations of the bank but also include separate periodic evaluations of the overall internal control process. The frequency of monitoring different activities of a bank should be determined by considering the risks involved and the frequency and nature of changes occurring in the operating environment. Ongoing monitoring activities can offer the advantage of quickly detecting and correcting deficiencies in the system of internal control. Such monitoring is most effective when the system of internal control is integrated into the operating environment and produces regular reports for review. Examples of ongoing monitoring include the review and approval of journal entries, and management review and approval of exception reports.

In contrast, separate evaluations typically detect problems only after the fact; however, separate evaluations allow an organization to take a fresh, comprehensive look **at the effectiveness** of the internal control system and specifically at the effectiveness of the monitoring activities. Separate evaluations of the internal control system often take the form of self- assessments when persons responsible for a particular function determine the effectiveness of controls for their activities. The documentation and the results of the evaluations are then reviewed by senior management. All levels of review should be adequately documented and reported on a timely basis to the appropriate level of management.

Principle 12: There should be an effective and comprehensive internal audit of the internal control system carried out by appropriately trained and competent staff. The internal audit function, as part of the monitoring of the system of internal controls, should report directly to the board of directors or its audit committee, and to senior management.

The internal audit function is an important part of the ongoing monitoring of the system of internal controls because it provides an independent assessment of the adequacy of, and compliance with, the established controls. By reporting directly to the board of directors or its audit committee, and to senior management, the internal auditors provide unbiased information about line activities. Due to the important nature of this function, internal audit must be staffed with competent, well- trained individuals who have a clear understanding of their roles and responsibilities. The frequency and extent of internal audit review and testing of the internal controls within a bank should be consistent with the nature, complexity, and risk of the organization's activities. In all cases, it is critical that the internal audit function is independent from the day- to-day functioning of the bank and that it has access to all activities conducted by the banking organization.

It is important that the internal audit function reports directly to the highest levels of the banking organization, typically the board of directors or its audit committee, and to senior management. This allows for the proper functioning of corporate governance by giving the board information that is unaltered in any way by the levels of management that the reports cover. The board should also reinforce the independence of the internal auditors by having such matters as their compensation or budgeted resources determined by the board or the highest levels of management rather than by managers who are affected by the work of the internal auditors.

Principle 13: Identified internal control deficiencies should be reported in a timely manner to the appropriate management level and addressed promptly. Material internal control deficiencies should be reported to senior management and the board of directors.

Internal control deficiencies, or ineffective policies or procedures, should be reported to the appropriate person(s) as soon as they are identified, with serious matters reported to senior management and the board of directors. Once deficiencies or ineffective policies or procedures are reported, it is important that management corrects the deficiencies on a timely basis. The internal auditors should conduct follow-up reviews and immediately inform senior management or the board of any uncorrected deficiencies. In order to ensure that all deficiencies are addressed in a timely manner, management should establish a system to track internal control weaknesses and actions taken to rectify them.

Evaluation of Internal Control Systems by Supervisory Authorities

Principle 14: Supervisors should require that all banks, regardless of size, have an effective system of internal controls that is consistent with the nature, complexity, and risk of their on- and off-balance-sheet activities and that responds to changes in the banks environment and conditions. In those instances where supervisors determine that a bank's internal control system is not adequate (for example, does not cover all of the principles contained in this document), they should take action against the bank to ensure that the internal control system is improved immediately.

Although the board of directors and senior management bear the ultimate responsibility for an effective system of internal controls, supervisors should assess the internal control system in place at individual banks as part of their ongoing supervisory activities. The supervisors should also determine whether individual bank management gives prompt attention to any problems that are detected through the internal,control process.

Supervisors should require the banks they supervise to have strong control cultures and should take a risk-focused approach in their supervisory activities. This includes a review of the adequacy of internal controls. It is important that supervisors not only assess the effectiveness of the overall system of internal controls, but also evaluate the controls over high-risk areas (e.g., areas with characteristics such as unusual profitability, rapid growth, or new business activity). Bank supervisors should place special emphasis on written policies and procedures as a key communication mechanism.

Supervisors, in evaluating the internal control systems of banks, may choose to direct special attention to activities or situations that historically have been associated with internal control breakdowns leading to substantial losses. Certain changes in a bank's environment should be the subject of special consideration to see whether accompanying revisions are needed in the internal control system. These changes include:(1)a changed operating environment; (2) new personnel;(3) new or revamped information systems; (4) areas/activities experiencing rapid growth; (5) new technology; (6) new lines, products, activities (particularly complex ones); (7) corporate restructurings, mergers and acquisitions; and (8) expansion or acquisition of foreign operations (including the impact of changes in the related economic and regulatory environments).

To evaluate the quality of internal controls, supervisors can take a number of approaches. Supervisors can evaluate the work of the internal audit department of the bank through review of its work papers, including the risk assessment methodology used. If satisfied with the quality of the internal audit department's work, supervisors can use the reports of internal auditors as a primary mechanism for identifying control problems in the bank, or for identifying areas of potential risk that the auditors have not recently reviewed. Some supervisors may use a self-assessment process based on which management reviews the internal controls on a business-by-business basis and certifies to the supervisor that its controls are adequate for its business. Other supervisors may require periodic external audits of key areas, where the supervisor defines the scope. And finally, supervisors may combine one or more of the above techniques with their own on-site reviews or examinations of internal controls.

Supervisors in many countries conduct on-site examinations and a review of internal controls is an integral p2rt of such examinations. An on-site review could include both a review of the business process and a reasonable level of transaction testing in order to obtain an independent verification of the bank's own internal control processes.

An appropriate level of transaction testing should be performed to verify:

- the adequacy of, and adherence to, internal policies, procedures and limits
- the accuracy and completeness of management reports and financial records
- the reliability (i.e., whether it functions as management intends) of specific controls identified as key to the internal control element being assessed.

In order to evaluate the effectiveness of the five internal control elements of a banking organization (or a unit/activity thereof) supervisors should:

- ***identify the internal control objectives that are relevant to the*** organization, unit or activity under review (e.g., lending, investing, accounting)
- evaluate the effectiveness of the internal control elements, not just by reviewing policies and procedures, but also by reviewing documentation, discussing operations with various levels of bank personnel, observing the operating environment, and testing transactions
- share supervisory concerns about internal controls and recommendations for their improvement with the board of directors and management on a timely basis
- determine that, where deficiencies are noted, corrective action is taken in a timely manner.

Banking supervisory authorities that do not conduct routine on-site examinations typically make use of the work of external auditors. In those instances, the external auditors should be performing the review of the business process and the transaction testing described above.

In all instances, bank supervisors should review the external auditors' observations and recommendations regarding the effectiveness of internal controls and determine that bank management and the board of directors have addressed the concerns and recommendations expressed by the external auditors. The level and nature of control problems found by auditors should be factored into supervisors' evaluation of the effectiveness of a bank's internal controls.

Supervisors should also encourage bank external auditors to plan and conduct their audits in ways that appropriately consider the possibility of misstatement of banks financial statements due to fraud. Any fraud found by external auditors, regardless of materiality, should be communicated to the a^jropriate level of management. Fraud involving senior management and fraud that is material to the entity should be reported to the board of directors and/or audit committee. External auditors may be expected to disclose fraud to certain supervisory authorities or others outside the bank in certain circumstances (subject to national requirements) •

In reviewing the adequacy of the internal control process at individual banking organizations, supervisors should also determine that the process is effective across business lines and subsidiaries. It is important that supervisors evaluate the internal control process not only at the level of individual businesses or legal entities, but also across the wide spectrum of activities and subsidiaries within the consolidated banking organization.

Roles and Responsibilities of External Auditors

Although external auditors are not, by definition, part of a banking organization and therefore, are not part of its internal control system, they have an important impact on the quality of internal controls through their audit activities, including discussions with management and recommendations for improvement to internal controls. The external auditors provide important feedback on the effectiveness of the internal control system.

While the primary purpose of the external audit function is to give an opinion on, or to certify, the annual accounts of a bank, the external auditor must choose whether to rely oh the effectiveness of the bank's internal control system. For this reason, the external auditors have to conduct an evaluation of the internal control system in order to assess ***the extent to which they can rely on the system in determining the nature, timing and scope of their own audit procedures.***

The exact role of external auditors and the processes they use vary from country to country, Professional auditing standards in many countries require that audits be planned and performed to obtain reasonable assurance that financial statements are free of material misstatement. Auditors also examine, on a test basis, underlying transactions and records supporting financial statement balances and disclosures. An auditor assesses the significant estimates made by management, accounting principles used and also evaluates the overall financial statement presentation. In some countries, external auditors are required by the supervisory authorities to provide a specific assessment of the scope, adequacy and effectiveness of a bank's internal control system, including the internal audit system.

One consistency among countries, however, is the expectation that external auditors will gain an understanding of a bank's internal control process. The extent of attention given to the internal control system varies by auditor and by bank; however , it is generally expected that the auditor would identify significant weaknesses that exist at a bank and report material weaknesses to managemait cxsSy or in confidential management letters and, in many countries, to the supervisoiy authority. Furthermore, external auditors may be subject to 平edal supervisory requirements that specify the way that they evaluate and report on internal controls.

Many internal control failures that resulted in significant losses for banks could have been substantially lessened or even avoided if the board and senior management of the organizations had established strong control cultures. Weak control cultures often had two common elements. First, senior management failed to emphasize the importance of a strong system of internal control through their words and actions, and most importantly, through the criteria used to determine compensation and promotion. Second, senior management failed to ensure that the organizational structure and managerial accountabilities were well-defined. For example, senior management failed to require adequate supervision of key decisionmakers and reporting of the nature and conduct of business activities in a timely manner.

Senior management may weaken the control culture by promoting and rewarding managers who are successful in generating profits but fail to implement internal control policies or address problems identified by internal audit. Such actions send a message to others in the organization that internal control is considered secondary to other goals in the organization, and thus diminish the commitment to and quality of the control culture.

Some banks with control problems had organizational structures in which accountabilities were not clearly defined. As a result, a division of the bank was not directly accountable to anyone in senior management. This meant that no senior manager monitored the performance of these activities closely enough to notice unusual activities, financial and otherwise, and no senior manager had a comprehensive understanding of the operations and how profits were being generated. If management ***had understood the operations of the division, they may have been able to recognize warning signs (such as an unusual relationship of profit to levels of risk), investigate the operations and take steps to reduce the eventual losses.***

These problems could also have been avoided if line management had reviewed transactions and management information reports and held discussions with appropriate personnel about the nature of business transacted. Such approaches provide line management with an objective look at how decisions are made and ensure that key personnel are operating within the parameters set by the bank and within the internal control framework.

In the recent past, inadequate risk assessrhent has contributed to some organizations' internal control problems and related losses. In some cases, the potential high yields associated with certain loans, investments, and derivative instruments distracted management from the need to thoroughly assess the risks associated with the transactions and devote sufficient resources to the continual monitoring and review of risk exposures. Losses have also been caused when management has failed to update the risk assessment process as the ofganizations operating environment changed. For example, as more complex or sophisticated products within a business line are developed, internal controls may not be enhanced to address the more complex products. A second example involves entry into a new business activity without a full, objective assessment of the

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As discussed above, banking organizations will set objectives for operational efficiency and effectiveness, reliability in financial reporting and compliance with laws and regulations. Risk assessment entails the identification and evaluation of the risks involved in meeting those objectives. This process helps to ensure that the bank's internal controls are consistent with the nature, complexity and risk of the bank's on- and off-balance sheet activities.

In reviewing major banking losses caused by poor internal control, supervisors typically find that these banks failed to observe certain key internal control principles. Of these, segregation of duties, one of the pillars of sound internal control systems, was most frequently overlooked by banks that experienced significant losses from internal control problems.

Often, senior management assigned a highly regarded individual responsibility for supervising two or more areas with conflicting interests. For example, in several cases, one individual supervised both the front and back offices of a trading desk. This permitted the individual to control transaction initiation (e.g., buying and selling securities or derivatives) as well as the related bookkeeping function. Assigning such conflicting duties to one individual gives that person the ability to manipulate financial data for personal gain or to conceal losses.

Segregation of duties is not limited to situations involving simultaneous front and back office control by one individual. It can also result in serious problems when an individual has responsibility for:

- Approval of the disbursement of funds and the actual disbursement
- Customer and proprietary accounts
- Transactions in both the "banking" and "trading" books
  - Informally providing information to customers about their positions ***while marketing to the same customers***
  - Assessing the adequacy of loan documentation and monitoring the borrower after loan origination
  - Any other areas where significant conflicts of interest emerge and are not mitigated by other factors.

Shortcomings in control activities, however, reflect the failure of a variety of efforts to determine that business is being conducted in the expected manner, from high-level reviews to maintenance of specific checks and balances in a business process. For example, in several cases management did not appropriately respond to information they were receiving. This information took the form of periodic reports on the results of operations for all divisions of the organization that informed management of each divisions progress in meeting objectives, and allowed them to ask questions if the results were different from their expectations. Often the divisions that later report significant losses after reporting profits -far in excess of expectations for the apparent level of risk - should concern senior management. Had thorough top level reviews occurred, senior management may have investigated the anomalous results and found and addressed some of the problems, thus limiting or preventing the losses that occurred. However, because the deviations from their expectations were positive (i.e. profits), questions were not asked and investigations were not started until the problems had grown to unmanageable proportions.

Some banks have experienced losses because information in the organization was not reliable or complete and because communication within the organization was not effective. Financial information may be misreported internally; incorrect data series from outside sources may be used to value financial positions; and small, but high-risk activities may not be reflected in management reports. In some cases, banks failed to adequately communicate employees , duties and control responsibilities or disseminated policies through channels, such as electronic mail, that did not ensure that the policy was read and retained. As a result, for long periods of time, major management policies were not carried out. In other cases, adequate lines of communication did not exist for the reporting of suspected improprieties by employees. If channels had been established for communication of problems upward through the organizational levels, management would have been able to identify and correct the improprieties much sooner.

To illustrate a potential conflict of interest that is mitigated by other controls, an independent loan review, through its monitoring activities of a bank's credit grading system, may compensate for the potential conflict of interest that arises when a person who is responsible for assessing the adequacy of loan documentation also monitors the creditworthiness of the borrower after loan origination.

Many banks that have experienced losses from internal control problems did not effectively monitor their internal control systems. Often the systems did not have the necessary built-in ongoing monitoring processes and the separate evaluations performecl were either not adequate or were not acted upon appropriately by management.

In some cases, the absence of monitoring began with a failure to consider and react to day-to-day information provided to line management and other personnel indicating unusual activity, such as exceeded exposure limits/customer accounts in proprietary business activities, or lack of current financial statements from borrowers. In one bank, losses associated with trading activities were being concealed in a fictitious customer account. If the organization had a procedure in place that required statements of accounts to be mailed to customers on a monthly basis and that customer accounts be periodically confirmed, the concealed losses would likely have been noticed long before they were large enough to cause the failure of the bank.

In several other cases, the organization's division or activity that caused massive losses had numerous characteristics indicating a heightened level of risk such as unusual profitability for the perceived level of risk and rapid growth in a new business activity that was geographically distant from the parent oiganizaticm. However, due to inadequate risk assessment, the organizations did not provide sufficient additional resources to control or monitor the higjvrisk activities In fact in some instances, the high risk activities were operating with less oversight than activities with much lower risk profiles - several warnings from the internal and external auditors regarding the activities of the division were not acted upon by management.

While internal audit can be an effective source of separate evaluations, it was not effective in many problem banking organizations. A combination of three factors contributed to these inadequacies: the performance of piecemeal audits, the lack of a thorough understanding of the business processes, and inadequate follow-up when problems were noted.

The fragmented audit approach resulted primarily because the internal audit programs were structured as a series of discrete audits of specific activities within the same division or department, within geographic areas, or within legal entities. Because the audit process was fragmented, the business processes were not fully understood by internal audit personnel. An audit approach that would have allowed the auditors to follow processes and functions through from beginning to end (i.e., follow a single transaction through from the point of transaction initiation to financial reporting phase) would have enabled them to gain a better understanding. Moreover, it would have provided the opportunity to verify and test the adequacy of controls at every step of the process.

In some cases, inadequate knowledge and training of internal audit staff in trading products and markets, electronic information systems, and other highly sophisticated areas also contributed to internal audit problems. Because the staff did not have the necessary expertise, they were often hesitant to ask questions when they suspected problems, and when questions were asked, they were more likely to accept an answer than to challenge it.

Internal audit may also be rendered ineffective when management does not appropriately follow-up on problems identified by auditors. The delays may have occurreci because of a lack of acceptance by management of the role and impbrtance of internal audit. In addition, the effectiveness of internal audit is impaired when senior management and members of the board of directors (or audit committee, as appropriate) failed to receive timely and regular tracking reports that indicate critical issues and the subsequent corrective actions taken by management. This type of periodic tracking device can help senior management confront important issues in a timely manner.

Importance of compliance

The purpose of compliance is to review the bank's written policies, procedures, and processes and implementation of central banks' policies and regulations with special reference to the adequacy of customer due diligence (CDD) and Anti Money laundering (AML) policies and programs and their implementation, as well as to determine whether the bank has developed, administered, and maintained an effective program for compliance with the KYC requirement as per prudential regulations. If necessary, an inspection period will be required to support the overall 'conclusions regarding the adequacy of the compliance program. The findings of such an inspection should be discussed with the bank's management, and ***significant*** findings must be included in the report of examination or ***supervisory*** correspondence.

The compliance ***program must provide*** for the following minimum requirements:

.A system of internal controls to ensure ongoing compliance.

- Independent testing of ***CDD/AML*** compliance.
- Designate an individual(s) responsible for managing compliance task ***(compliance officer).***
- Training for appropriate personnel.

If the compliance department is vigilant, performing its duties with full responsibility, the audit result will improve and the bank's overall operational rating on the basis of the central bank's inspection will be better.

Role of management in improving internal controls

- The board of directors, acting through senior management, is ultimately responsible for ensuring that the bank maintains an effective internal control structure, including suspicious activity monitoring and reporting.
- Internal controls are the bank's policies, procedures, and processes designed to limit and control risks and to achieve compliance with ***central bank regulations.***
- The level of sophistication of the internal controls should be in accordance with the size, structure, risks, and complexity of the bank.
- Large complex banks are required to implement departmental internal controls for compliance. Departmental internal controls typically address risks and compliance requirements unique to a particular line of business or department and should be part of a comprehensive compliance program.
- To identify banking operations of products, services, customers, entities, and geographic locations which are more vulnerable to abuse by money launderers and criminals.
- Provide for periodic updates to the bank's risk profile; the compliance program should be tailored to manage risks.
- Inform senior management of compliance initiatives, and of identified compliance deficiencies.

Identify persons responsible for KYC/CDD/AML compliance.

- Meet all regulatory record keeping and reporting requirements, and provide for timely updates in response to changes in regulations.

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.Provide for dual controls and the segregation of duties to the maximum extent possible.

- Provide sufficient controls and monitoring systems for timely detection and reporting of suspicious activity.
- Provide for adequate supervision of employees who handle currency transactions, complete reports, grant exemptions, monitor for suspicious activity, or engage in any other activity covered under granting of waivers and AML implementing regulations.

. T r a i n employees to be aware of their responsibilities under central banks policies / regulations and internal policy guidelines.

Audit

An independent audit should be conducted by the internal audit department, external auditors, consultants, or other qualified independent parties. This should be risk-based and evaluate the quality of risk management for all banking operations, departments, and subsidiaries. Risk-based audit programs vary depending on the bank’s size, complexity, scope of activities, risk profile, quality of control functions, geographic diversity, and use ot technology.

The testing should assist the board of directors and management in:

- Identifying areas of weakness or areas where there is a need for enhancements or stronger controls.

- An assessment of the integrity and accuracy of MIS used in the compliance program. MIS includes reports,used to identify currency transactions, aggregate daily currency transactions, funds transfer transactions, monetary instrument sales transactions, and analytical and trend reports.

Compliance Officer

The bank's board of directors must designate a qualified individual to serve as the compliance officer.

The compliance officer is responsible for coordinating and monitoring day-to-day regulatory and internal policies compliance. The compliance officer is also charged with managing all aspects of the compliance program and with managing the bank's adherence to the implementation regulations.

The compliance officer should be fully aware of the central bank's policies, rules and regulations.

The compliance officer should also understand the bank's products, services, customers, entities, and geographic locations, and the potential money laundering and terrorist financing risks associated with those activities.

The appointment of a compliance officer is not sufficient to meet the regulatory requirement if that person does not have the expertise, authority, or time to satisfactorily complete the required job.

Training

Banks must ensure that appropriate personnel are trained in applicable aspects of the prudential regulations. Training should include regulatory requirements and the bank's internal CDD/AML policies, procedures, and processes.

Non-compliance

Banks / DFIs are advised by SBP, as the central bank of the country, to ensure circulation of all rules, regulations, policies related to banking operations and risk, to all their offices / branches for meticulous compliance in letter and in spirit. Non-compliance with the Prudential Regulations will lead to punitive action under the relevant provisions of Law. Transactions structured in a manner to avoid these Prudential Regulations are treated equally with violations of the Prudential Regulations and are penalized more severely.

Account opening, maintenance and monitoring, with critical areas of compliance

With the view to preserving the integrity and safety of the financial system, it is essential to prevent the possible use of the banking sector for money laundering and terrorist financing. As per Prudential

Regulation M 1. Banks/DFIs should undertake customer due diligence measures when:

a) Establishing a business relationship, i.e. new account opening.
b) Customer conducting occasional ***transactions*** above rupees one million whether carried out in a single operation or in multiple operations that appear to be linked.
c) Carrying out occasional wire transfers (domestic/cross border) regardless of any threshold.
d) There is suspicion of money laundering/terrorist financing.
e) There is a doubt about the veracity or adequacy of available ***identification data on the customer.***

Banks/DFIs shall undertake at least the following customer due diligence measures:

a) Banks/DFIs should not open and maintain anonymous accounts or accounts in the name of fictitious persons.
b) All reasonable efforts shall be made to determine the identity of every prospective customer. For this purpose, there is a minimum set of documents to be obtained by the banks/DFIs from various types of customers/account holder (s).
c) Banks/DFIs shall identify the beneficial ownership of accounts/ transactions by taking all reasonable measures.
d) For all customers, banks/DFIs should determine whether the customer is acting on behalf of another person, and should then take reasonable steps to obtain sufficient identification data to verify the identity of that other person.
e) ***For customers who are legal persons or for legal arrangements,*** banks/DFIs are required to take reasonable measures to (i) understand the ownership and control structure of the customer (ii) determine that the natural persons who ultimately own or control the customer. This includes thoSe persons who exercise ultimate effective control over a legal person or arrangement.
f) ***Government accounts should not be opened in the personal*** names of anygovemment official (s). Any such account, which is to be operated by an officer of the Federal/Provincial/Local ***Government in his/her official capacity, shall be opened only*** on production of a special resolution/authority from the appropriate administrative department, duly endorsed by the Ministry of Finance or Finance Department of the Government concerned.

Verification is an integral part of CDD/KYC measures for which banks/DFIs shall ensure that:

a) Copies of CNIC wherever required in Annexure-VIII are invariably verified, before opening the account, from NADRA through utilizing an on-line fecility, or, where the banks/DFIs or their branches do not have such facility, from the regional office (s) of NADRA.

b) The identification of the beneficial owner is verified using reliable information/ satisfactory sources.
c) ***Cost of verification of CNIC from NADRA should not be*** passed on to the account holder(s) (either existing or prospective).

Banks/DFIs shall note that:

a) For customers/clients whose accounts are either dormant as per bank's own policy or an attested copy of account holders Computerized National Identity Card (CNIC) is not available in bank's /DFFs record, bank/DFIs may allow credit entries in such accounts. Debit transactions/ withdrawals shall not be allowed until the account holder produces an attested copy of his/her CNIC and fulfills all other formalities for activation of the account. However, transactions, e.g. debits under the recovery of loans and markup etc., any permissible bank charges, government duties or levies and instruction issued under any law or from the court will not be subject to debit or withdrawal restriction.

b) For all other customers/clients, including depositors and borrowers, banks/DFIs shall obtain the attested copies of CNICs. Banks/DFIs shall block accounts without CNIC (after serving one month prior notice) for all debit transactions/withdrawals, irrespective of mode of payment, until the regulatory requirement is fulfilled. However, debit block from the accounts shall be removed upon submission of copy of CNIC. Banks/DFIs are also advised that CDD/KYC is not a one-time exercise to be conducted at the time of entering into a formal relationship with the customer/account holder. This is an on-going process for prudent banking practices. To this end, banks/DFIs are required to:

a) Set up a compliance unit with a full time Head.
b) Put in place a system to monitor the accounts and transactions on a regular basis.
c) Update customer information and records, if any, at reasonable intervals.
d) Install an effective MIS to monitor the activity of the customers* accounts.
e) Chalk out plan of imparting suitable training to the staff of bank/DFI periodically.
f) Maintain proper records of customer identifications and clearly indicate, in writing, if any exception is made in fulfilling the CDD/KYC measures.

Banks/DFIs shall conduct enhanced due diligence when:

a) dealing with high-risk customers, a business relationship or transaction including the following;
   i. non-resident customers
   ii. private banking customers
   iii. legal persons or arrangements including nongovernmental organizations (NGOs)/not-for-profit organizations (NPOs) and trusts/charities
   iv. customers belonging to countries where CDD/KYC and anti-money laundering regulations are lax

v. customers with links to offshore tax havens
vi. customers in cash-based businesses
vii. high net worth customers with no clearly identifiable source of income
viii. customers with high-value items, etc.

b) There is reason to believe that the customer has been refused banking facilities by another bank/DFI.
c) Opening correspondent banks' accounts.
d) Dealing with non-face-to-face/on-line customers. Adequate measures in this regard should be put in place, e.g. independent verification by a reliable third party, client report from the previous bank/DFI of the customer, etc.
e) Establishing business relationship or transactions with counterparts from or in countries not sufficiently applying FATF recommendations.
f) Dealing with politically exposed persons or customers holding public or high profile positions.

For politically exposed persons or holders of public or high profile positions, enhanced due diligence should include the following:

a) Relationship should be established and/ or maintained with the approval of senior management including when an existing customer becomes a holder of public office or a high profile position.
b) Appropriate risk management systems to determine whether a potential customer, a customer or the beneficial owner is a politically exposed person/ holder of public or high profile position and sources of wealth / funds of customers, beneficial ***owners for ongoing monitoring on regular basis.***

Where there are low risks and information on the identity of the customer and the beneficial owner of a customer is publicly available, or where adequate checks and controls exist, banks/DFIs may apply simplified or reduced CDD/KYC measures. The following cases may be considered for application of simplified or reduced CDD/KYC:

a) Financial institutions provided they are subject to requirements to combat money laundering and terrorist financing consistent with the FATF recommendations and are supervised tor compliance with those requirements.
b) Public companies that are subject to regulatory disclosure requirements and such companies are listed on a stock exchange or similar situations.
c) Government administrations or entities.

Reduced CDD/KYC measures shall not be applied where there is risk of money laundering or terrorist financing or when a customer resides in a country which does not comply with FATF recommendations.

In the case of banks/DFIs not being able to satisfactorily complete required CDD/KYC measures including identity, beneficial ownership or information on purpose and intended nature of business relationship,

an account should not be opened nor any service provided, and instead reporting of a suspicious transaction should be considered. Similarly, relationships with existing customers should be terminated and reporting of suspicious transactions be considered if CDD/KYC is found to be unsatisfactory.

State Bank of Pakistan, during the course of inspection, would particularly check the efficacy of the CDD/KYC policies and system of the banks/DFIs and compliance by all the branches and the staff members. Appropriate action shall be taken against the bank/DFI and the relevant staff members for non-compliance and negligence in this area, under the provisions of Banking Companies Ordinance, 1962.

Pan Seven

Control Policies and Compliance

Money Laundering

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feaimiing Outcome

By the end of this chapter you should be able to:

® Define the concept of Money Laundering

理 Discuss the circumstances and conditions that encourage Money Laundering

» Discuss the Early Warning Signals

s Recall the SBP regulation with respect to AML

What is money lamoderin^?

The goal of a large number of criminals is to generate profit for the individual or group that carries out the illegal activities. Money laundering is the processing of these criminal proceeds to cover their illegal origin. This process is of vital importance, as it enables the criminal to enjoy these profits without jeopardizing their source. As money laundering is aEconsequence of almost all profit-generating crime, it can occur anywhere in the world. Generally, money launderers have a tendency to look for countries or sectorsEin which there is a low risk of detection due to weak or ineffective anti-money laundering programs. Because the objective of money laundering is to get the illegal funds back to the individual who generated them, launderers prefer to move funds through a stable financial system.

How money laundering takes place

In the initial stage of money laundering, the launderer introduces the illegal profits into the financial system. This is done by:

- Breaking up large amounts of cash into less noticeable or smaller sums that are then deposited directly into a bank account.

.Purchasing a series of monetary instruments such as cashier cheques, pay orders, demand drafts, etc that are then collected and deposited into accounts at another location.

After the funds have entered the financial system, the second stage takes place. In this phase, the launderer engages in a series of movements of the funds to distance them from their source. Sometimes funds are channeled through the purchase and sales of investment instruments or the launderer simply wires the funds through a series of accounts at various banks across the world.

Large-scale money laundering schemes always contain cross-border elements.

Since money laundering is ail ***international*** problem , international cooperation is a serious ***necessity in the fight*** against it. A number of initiatives have been implemented to attempt to deal effectively with the problem at international level. ***International*** organizations, such as the United Nations or the Bank ***for International*** Settlements, the European Union, Council of Europe, have established anti-money laundering standards for their ***member countries.*** The Caribbean, Asia, and Latin America have also taken steps to combat money laundering and to address the problem.

In Pakistan, SBP, as regulator, has issued PR (M2). In this PR, banks/DFIs are advised to follow the following guidelines to safeguard themselves against their involvement in money-laundering activities, and other unlawful trades. These will add to or reinforce the existing precautions that banks/DFIs may have been taking on their own in this regard:

a) Banks/DFIs shall ensure that their business is conducted in conformity with high ethical standards and that banking laws and regulations are adhered to. It is accepted that banks/DFIs normally do not have effective means of knowing whether a transaction stems from or forms part of wrongful activity. Similarly, in an international context, it may be difficult to ensure that cross-border transactions on behalf of customers are in compliance with the regulations of another country. Nevertheless, banks/DFIs should not set out to offer services or provide active assistance in transactions, which, in their opinion, are associated with money derived from illegal activities.

b) Specific procedures should be established for ascertaining the customer's status and his source of earnings, for monitoring of accounts on a regular basis, for checking identities of remitters and beneficiaries, for retaining internal records of transactions for future reference. Any transactions which are inconsistent with the history, pattern, or normal operation of the account, involving heavy deposits/withdrawals/transfers, should be viewed with suspicion and properly investigated.

c) Banks/ DFIs are required to include accurate and meaningful originator information (name, address and account number) on funds transfers, including wire transfers and related messages that are sent, and the information should remain with the transfer or related message throughout the payment chain. However, banks/ DFIs may, if satisfied, substitute the requirement of mentioning address with CNIC, Passport, Driving license or similar identification number for this purpose.

d) Beneficiary financial institutions shall adopt effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information. Wire transfers with incomplete originator information may be seen with suspicion which may require reporting to FMU or termination of the transaction. Banks/ DFIs should be wary of those financial institutions which do not comply with the aforesaid requirements and limit or terminate the business relationship.

e) Banks/DFIs shall not allow personal accounts to be used for business purposes except proprietorships, small businesses and professions where constituent documents are not available but where the banks/DFIs are satisfied with the KYC profile of the account holder, purpose of relationship and expected turnover of the account, keeping in view the financial status and nature of business of that customer.

f) For effective implementation of banks'/DFIs' policy and procedures relating to anti money laundering/other unlawful trades , suitable training requires to be imparted to members of staff and that they be informed of their responsibility in this regard.

Keeping in view the above principles, banks/DFIs shall issue the necessary instructions for guidance and implementation by all concerned.

Part Seven

Control Policies and Compliance

Banking Mohtasib

Chapter

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learning Outcome By the end of this chapter you should be able to:

« State who is a Banking Mohtasib

»s Discuss the powers and authorities of Banking Mohtasib

Banking Mohtasib / Ombudsman

Ombudsman means a commissioner appointed by the Government to investigate any complaints against the body concerned. In Pakistan, ombudsman is called Mohtasib. For the banking sector, government has appointed a separate Mohtasib who is aopointed for a period of three years and is not be eligible for any extension.

The office of the Banking Mohtasib (BM) was established under banking companies ordinance 1962 by inserting seven sections from 82-A to 82- G on 2nd June, 1997 through the banking companies amendment Act 1997. The purpose of the establishment of Banking Mohtasib is to resolve any complaints from customers against their banks and those of scheduled banks against another bank. This is a free service for the public which covers all banking services.

Powers of Banking Mohtasib

a) BM can entertain complaints from, customers, borrower, utility bill depositors, banks or from anybody or organization.
b) Banking Mohtasib can award compensation for actual loss suffered and grant of reasonable expenses can be considered by the banking Mohtasib.
c) Banking Mohtasib cannot award damages against the bank. Facilitate amicable settlement of the complaints.
d) Banking Mohtasib shall not entertain any complaint already disposed of by SBP or any court or law.
e) Banking Mohtasib cannot issue a stay order to entertain any complaint, if the matter is pending before any court of law.

Authorities of Banking Mohtasib

Banking Mohtasib is authorized to entertain complaints of the following nature:

- Banks failure to act according to the banking laws and regulation. Delays or frauds in relation to the payments, collection of instruments or fund transfer.

.Fraudulent or unauthorized debit entries in the account.

.Complaints from exporters or importers relating to the banking services.

.Conipiaints from holders of foreign currency accounts whether resident or non r^ident.

- bii^thorized operation of lockers.

Complaints related to foreign remittances.

-• Complaint in relation to the mark-up based on the ground of violation ***of an agreement or SBP directives.***

v、 ハ
> • Complaints relating to the utility bills.

Banking Mohtasib shall not pass any order against bank without giving notice and opportunity of hewing.

Before filing a complaint with the Mohtasib, the complainant should intimate bank in writing about the intention of doing so. If case of no reply or unsatisfactory reply, the complainant can send complaint to banking Mohtasib within 45 day.

The complaint should he made in writing under solemn affirmation or oath, narrating full details of the case *I* transactions disputed, and also name and address of the complainant.

The Mohtasib can adopt any procedure, he considers appropriate for investigating the complaint.

Banking Mohtasib has the power for the purpose of disposing a case, to require any information documents from banks which are relevant for the purpose of deciding a complaint, subject to the following conditions:

- Maintain confidentiality as per banking laws and procedure.
- The documents shall not be provided which may compromise banks position in relation to the other customers account.
- If banks do not provide information / documents, the bank Mohtasib can add adverse comments in his finding regarding non provision of information/ documents.

Mohtasib will try for an amicable settlement if satisfied with the genuiness of the complaint. In case of failure it may direct concerned bank to:

- Reconsider the matter.
- Modify earlier decision
- To pay compensation fixed by Mohtasib.
- To take steps to improve efficiency of the bank.
- Recommend SBP to initiate inquiry against the bank for violation of la 平 regulations etc.

In no case Mohtasib will direct bank to provide finance/ loan to any complainant.

If any bank or its official or complainant is not satisfied with the decision of Mohtasib, he may file an appeal with the Governor of the State Bank of Pakistan within 30 days of passing the order by the Mohtasib. The governor shall decide appeal within 30 days.

Finding of the Mohtasib should be implemented within 40 days of the decision or finalization of appeal from the Governor SBP as the case may be.

If no appeal is filed, the decision of Mohtasib shall be treated as final. If decision of the Mohtasib is not implemented by the concerned bank, SBP may penalize it or may ask for disciplinary action against its officials.

Banking Mohtasib can ask the bank to disclose any information required for disposing the case, ensuring confidentiality as per requirement of law.

Part Eight

?art 8: Cash Monitorin

Chapter 1

> a.p:er 1:Cash Monitoring

SBP Cash Monitoring Policy

Cash Monitoriri|

Cash Monitoring

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Learning Outcome

By the end of this chapter you should be able to:

® Recall the salient features of SBP cash monitoring policy with special emphasis on sorting and handling ***of*** soiled notes

SBP Cash Monitoring Policy

A currency note, being a legal and acceptable medium of ***exchange,*** represents the image of its country. It is the medium ***by*** which ***purchases*** and sales are made. It is therefore essential to take measures ***to keep*** currency notes in the best possible condition.

In order to achieve this objective, teams of cash examiners of SBP Services Banking curraicv Corporation (SBP BSC) conduct on-site examination of notes and coins and also issue circulars, which are expected to be complied with, with respect to cash monitoring. Teams visiting branches of commercial banks ensure that these circulars are being paid attention to. Branches that do not implement the instructions issued by SBP BSC are heavily penalized and their banker's account maintained with SBP is debited with a penalty amount.

In order to assist branches we have given below relevant parts of SBP Cash Monitoring Circulars, which should be implemented in **brandies** in order to avoid imposition of penalties by SBP.

Points to be implemented:-

Maintenance of prescribed Proforma of closing cash balances in the following format:

If above Proforma is not maintained, SBP cash examiners can imposepenalties of Rs.5,*000/-* per instance, plus Rs.500/- per day during which the default continues,__________—_______

Soiled notes are those which remain in circulation for quite a long time, lose their color and become soft. Defective notes are those which are torn or have spots of ink, etc.

- Maintenance of minimum sorted balance of issuable / re-issuable notes for one day, in accordance with the average daily cash payment requirements.
- Packets / bundles should be sorted into issuable / non-issuable bank notes over the payment counters.

.Unsorted / non-issuable currency notes of any denomination, if caught being pushed into circulation, will be penalized.

- Sorted stamp should be affixed on band used for making packets of all sorted cash.
- If "sorted" stamp is not affixed on the packets of bank notes, along with the name of the bank, branch and date of sorting, a fine/ penalty will be imposed.

.Non-acceptance of small denomination bank notes and / or cut soiled/ mutilated and defective notes of other denominations.

.Usage of staple pins on the packets of any denomination notes instead of properly banding them, even in re-issuable form.

- Cash in safe should also be kept according to the Proforma above, i.e. unsorted cash should be kept separate.
  - Sorted cash should also be kept separately as issuable and soiled / defective.

In addition to the above requirements, SBP has also instructed through BPRD circulars that banks and DFIs should take the following steps to combat counterfeit notes:

1. Cash examiner can write a true picture of the cash position.
2. Installation of equipment / machinery for the detection of fake currency notes for their own use and for the use of the public.
3. **Educate customers about the security features of currency notes.** Forewarning to the public regarding counterfeiting and the consequences of committing such crime.
4. Maintain close liaison with law enforcement agencies.
5. Encourage members of the public to hand over counterfeit notes to SBP BSC or nearest bank branch and reporting of the incidents to law enforcement agencies.

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chapter 1:Alternate Delivery Cliannels Branch-less

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Regclatory Permissible Branch-less

Banking Models Permissible Branch-less

Banking Activities Agent-Assisted Branch-

less Banking Risk-Basɔd customer Due

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B— Alternate Delivery Channels

Gbifmr I

By the end of this chapter you should be able to:

« Define branch-less banking

e List the permissible activities in branch-less banking

ifl List the agents associated with branch-less banking

s Discuss the importance of change in the nature and functions of a branch due to addition of alternate delivery channels such as ATM, phone banking, e-banking and mobile banking

ii Explain the concept of downtime/uptime in an ATM operation

- Define cash retract timeline
- Explain how a cash retraction is handled

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Branch-less banking is a new delivery channel by which to offer banking services in a cost-effective manner, at the customer's office, residence or at point of sale (POS).

SBP, as regulator, has issued regulations regarding branch-less banking. According to these regulations, only authorized Financial Institutions (FIs) can provide branch-less banking services.

The bank/FI is required to prepare policies and procedure manuals, and strengthen existing risk management and audit functions as required by the regulator. They should also maintain close liaison with partners, service providers and agents, as branch less banking is not possible without the help of other market players such as telecoms companies, technology service providers, agents, etc.

Mobile phone banking constitutes a large part of branch-less banking. Activities include opening and maintenance of a Branch-less Banking Account, account-to-account fund transfer, person-to-person fund transfers, cash-in and cash-out, bills payment, merchant payments, loan disbursement/repayment and remittances.

SBP has also formulated regulations regarding consumer protection and consumer awareness, both of which should be an essential part of branchless banking policies. Customer protection against risk of fraud, as wellas loss of privacy, should also be covered in policy manuals because the consumer's trust/confidence is the basic requirement for the growth of branch-less banking.

SBP has issued a policy paper on a regulatory framework for branch-less banking in Pakistan which stipulates SBP's strategy for promoting branchless banking in Pakistan. These regulations are issued with the purpose of creating a regulatory environment and to promote a bank-led model of branch-less banking. These regulations are applicable to financial institutions (Commercial Banks, Islamic Banks and Microfinance Banks) willing to undertake branch-less banking.

Only authorized Financial Institutions can provide branch less banking services as stipulated in these regulations. Before applying for such an authorization, FIs should thoroughly prepare themselves in the light of these regulations. The process should start from a top-level strategic decision to enter into branch-less banking activities. Once the decision is made, preparation of the necessary policies and procedure manuals, strengthening of existing risk management and audit functions as required, and identification of partners, service providers and agents should be carried out. The FI may then approach SBP for a formal authorization to conduct BB, attaching all required documents.

Terms used in Branch-less Banking Regulations

A Branch-less Banking account, or BB account, means an account maintained by a consumer in a financial institution in which credits and debits may be affected by virtue of Electronic Funds Transfer and which is used to conduct branch-less banking activities.

A Branch-less Banking Agent means an agent providing basic banking services to the customers of a financial institution under a valid agemy agreement.

Electronic Funds means money transferred through an Electronic Terminal, ATM, Telephone instrument, Computer, Magnetic medium or any electronic device so as to order, instruct or authorize a financial institution or any other company or person to debit or credit any account.

Electronic Funds Transfer means any transfer of funds, other than a transaction originated by cheque, draft, or a similar paper instrument which is initiated through an Electronic terminal, Telephone instrument, point of sale, Terminal, stored value card Terminal, debit card, ATM, computer magnetic tape or any other electronic device so as to order, instruct or authorize a Financial Institution or any other company or person to debit or credit an account.

Electronic Money indudes monetary value as represented by a claim on the issuer which is stored in an electronic device or payment instrument, issued on receipt of funds of an amount not less in value than the monetary value issued, accepted as means of payment by undertakings other than issuer and includes electronic store of money value on a electronic device that may be used for making payments or as may be prescribed by State Bank of Pakistan.

Mobile payment or m-payment is not by itself a new payment instrument but an access method to activate an existing means of payment for financial transactions processed by banks between bank customers. An e-payment involves a wireless device that is used and trusted by the customer. M- payment may be card based or non card based, in both the real and the virtual world.

Permissible Branch-less Banking Models

In any one financial institution, a customer can have only one branchless banking account. Only the bank-led model of branch less banking is allowed at present, which may be implemented in different ways. Firstly, it can be implemented either by using agency arrangements or by creating a JV between the bank and Telco/non-bank. Further, mobile phone banking, which makes up a large part of branch less banking, can be implemented by using one-to-one, one-to-many and many-to-many models.

1. One-to-one (1-1) Model: In this model one bank offers mobile phone banking services in collaboration with a specific Telco. As a consequence, the services may only be offered to customers using the mobile connection of that specific Telco. This model can be JV-based or implemented through specific agency agreements between the Telco and ***the bank. It offers greater customization, good service standards, and the possibility of co-branding and co-marketing. On the other hand, it lacks in outreach as it is limited to the customers of one Telco only.***

One bank can have several one-to-one arrangements with many Telco's or alternately, one Telco can have several one-to-one arrangements with many banks.

2. Many-to-many: In this model many banks and many Telco's join together to offer services to virtually all bankable customers. Under this system, a central transaction processing system (TPS) is necessitated, which must be controlled by an FI; or by a subsidiary owned and controlled by an FI or a group of FIs; or by a third party service provider under a proper agency agreement with a bank.

3. Alternate Channels: Branch less banking can also be done using agents other then Telco's (like fuel distribution companies, Pakistan Post, chain stores, etc.) and using technologies not limited to mobile phone (like GPRS, POS terminals, etc.). The three sub models explained above (one-to-one, one-to-many and many-to-many) can also be applied to this type of branch less banking (i.e. one FI may join together with one super- agent [1-1], one FI with many agents or many FIs and many super-agents may join together to provide BB services). Provided the complexities of each model are understood, the operating procedures are documented and the risks are identified and taken care o£ FIs may devise an arrangement

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which does not fall exactly under one of the above models. Such arrangements may be allowed on a case-by-case basis.

Permissible Branch- less Banking Activities

Under branch-less banking regulations, the following products/services may be offered:

1. Opening and maintaining a BB Account: A BB account can be opened and operated by a customer with a bank through use of BB channels. Banks may associate such account to a particular branch or to a centralized branch-less banking unit. Account capabilities/limits are commensurate with the level of customer due diligence (COD) and KYC procedures the customer has undergone.
2. Account-to-account Fund Transfer: Customers may transfer funds to/from their BB account from/to their other pre-registered accounts (current/saving bank accounts, loan limit accounts, credit card acxounis, etc.)
3. Person-to-person Fund Transfers: Customer can transfer funds from/co their BB or regular account to/from BB or regular accounts of same or some other bank (depending on the model capabilities) or to mobile numbers of other non-BB account holders.
4. Cash-in and Cash-out: Customers may deposit and withdraw funds to/from their BB account using a variety of options including bank- branch counters, ATM machines and authorized agent locations.
5. Bill Payments: A BB account can also be used to pay utility bills (e_g» gas, electricity, phone, etc.)
6. Merchant Payments: Customers can use a BB account to make paymoils for purchases of goods and/or services.
7. Loan Disbursement/Repayment: FIs, particularly MFBs, may use BB accounts as a means to disburse small loan amounts to their borrowers who have BB accounts. The same accounts may be used by custome to repay their loan installments.
8. Remittances: BB accounts may be used to send *I* receive remittances subject to existing regulations.

Agent-Assisted Branch less Banking

The true power of branch less banking cannot be unleashed until some trusted third parties are involved in performing some of the activities that are traditionally performed in bank branches by bank staff. Use of the word “agent” in this context does not include third party service providers who provide certain technical services to banks, such as provision of a transaction processing system. However, there is no restriction on a third party technology service provider becoming a branch-less banking agent provided that it meets the criteria for becoming an agent.

Agents may perform any or all of the following functions depending on the agency agreement and agent type:

1. Opening of BB Accounts (Level1 accounts only).
2. Cash in / Cash out for BB accounts.
3. Bills Payments (both from registered BB customers as well as from walk-in customers (through cash) of any utility company).

4. Loan disbursement/ Repayment Collection (without involving loan marketing/ approval functions).

Risk-Based Customer Due Diligence

To optimize the gains of branch-less banking and to extend financial services outreach to the unbanked areas of society without compromising the requirements of AML/CDD, a risk-based approach to customer due diligence is outlined here. This approach is specific to BB accounts and does not apply to regular full service banking accounts. Under the risk - based CDD approach, BB accounts have been categorized into three levels. The KYC requirements, transactional limits and minimum technological security requirements applicable to each type of account have been described by SBP. It may be noted that a level1 BB account is for individuals only, a level 2 account can be opened by individuals as well as by firms, entities, trusts, not-for-profit organizations, legal persons, etc, and a level 3 BB account is for businesses only.

Despite the above relaxations in the KYC requirements for a l^vel1 account holder, banks and financial institutions must adhere *to* the requirements of other relevant prudential regulations (like PR M2 & M5).

Banks and financial institutions must ensure that their transaction processing system is capable of:

- Imposing the above limits to avoid any breach.
- Sending alerts to the users if they are close to a limit (these regulations do not suggest that the banks must send such alerts; however, the capability needs to be there).
- Analyzing transaction history to identify those level1 and level 2 users who need to move to the next higher account level after fulfilling additional KYC requirements.
- Identifying abnormal/ suspicious transactions and to report the same to the FI's compliance set-up for further necessary action.

Minors may open a level 1 of level 2 account provided they submit a written undertaking by their parent/guardian to accept any liability arising ***out of the action(s) of the minors.***

Further, the requirement of sending biannually, statements of account to the account holders does not apply to BB accounts.

Account-holders should have an option to view at least the last 10 transactions using BB channels (e.g. mobile phone) free of cost and they ***may also demand a printed statement of account (for a period not more than the past 12 months) by paying a fee as specified by the FI.***

Other Electronic Products Auto Teller

Machines (ATM)

ATMs are one of the most important e-banking delivery channels in Pakistan. Through ATMs, account holders have 24/7 facilities to withdraw cash, inquire about account balance and transfer funds throughout the year.

Banks and Financial Institutions are free to install ATMs to serve their customers on site (within branch premises) as well as off-site locations. Banks and DFIs can also operate Mobile ATMs or use third party ATMs to serve their customers. Banks are required to inform SBP three days before the ATM becomes operational. At the end of each quarter, banks should also submit a statement, to the payment systems department of the SBP, indicating details of on-site, dff-site, mobile and third party ATMs for their information and record. Banks should ensure proper security at ATMs to avoid any incidents of snatching, robbery, dacoity, etc.

ATM Operations

SBP payment systems department issues instructions / guidelines regarding ATM service and operations, in order to reduce inconvenience to the banks' customers, the details of which are given below:

- Banks and DFIs are instructed to ensure proper maintenance of *fi^TMs* and the network. For this purpose a comprehensive SLA should be signed with the vendors.

- Un interrupted delivery of service should be ensured 24/7.

- Cash should be checked / fed regularly into the ATM.

- Install CCTV cameras in ATM vicinity for proper surveillance. Proper security should be ensured by providing ample lighting and a locking arrangement.

- 24/7 help lines ^uxitd be introduced to resolve d^-to-day operational issues.

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- Complaint / suggestion boxes should be placed at ATM bootns and should be checked on a daily basis.

All branches are required to carry out reconciliation on ATM cash balancing, and fixed time, every working day at a not be done at peak hours. but this should

Actual cash should be balanced with the journal provided in the ATM. Vouchers for difference, if any, should be passed by debiting the relevant head of account. Individual transactions should be checked and where customer's accounts have been debited without cash disbursement, the customer's account should be auto credited after verification as per the following:

1. Same bank same branch, next working/ business day.
2. Same bank different branch of the same city, three business days.
3. Same bank different branch different cities, four business days.
4. Different banks same city same switch, six business days.
5. Different bank different cities same switch, six business days.
6. Different bank different switch same city, seven business days.
7. Different bank different cities different switch, seven business days.

- Branches must report to their card facilitation center (CFC) details of outstanding as well as settled claims on a daily basis.
- All banks are required to nominate at least two key persons with addresses, phone numbers, fax numbers and e-mail addresses to deal with customer queries.
- Customers should be informed in writing, after crediting his/her account.
- No minimum balance penalty shall be recovered from those customers whose account has been debited but no cash is disbursed till the time it remains payable.

ATM Uptime/Downtime:

ATM Uptime is a term used as a measure of a machine's reliability or stability. This time represents the time an ATM can be left unattended without crashing, or needing to be rebooted for administrative or maintenance purposes.

The term 'ATM downtime[1] is used to refer to periods when the machine is unavailable for service. Downtime duration refers to a period of time during which the ATM fails to provide the expected level of services and/ or its primary functions.

ATM uptime is crucial for both revenue generation and maintaining customer loyalty. ATM downtime is rendered unacceptable by the SBP as an ATM is expected to deliver un interrupted services 24/7.

Cash Retract Timeline:

• ***Cash retract timeline' is the amount of time an ATM customer is given*** to withdraw the physical notes of his transaction, once presented by the ***machine. It is the timeframe between cash presentation by the machine*** and the machine's note retraction feature being triggered. Usually this time frame is set to 5 to 7 seconds by the ATM service provider as a security feature to prevent unattended note theft.

When the machine senses that the notes are lying on the dispenser unattended for more than the specified amount of seconds, the ATM software instructs the machine for cash retraction. These notes get sucked/retracted back in the machine to a separate compartment called the purge or the retraction bin.

Handling Cash retraction

At day end (ATM closing) the net ATM cash transactions are reconciled by the ATM operator. The opening and closing balance of physical cash count must tally with the debit/credit net effect in the ATM general ledger. In case of excessive debit to the ledger account and less cash handed over to the customer, excessive currency will be identified during reconciliation. This is an indicator that cash retraction occurred. Identification of the customer account that was debited more than what was received by the customer is then carried out manually.

• Form A-7 is required to be completed in respect of all debit and credit transactions.

Cash Retract
Timeline:

• Relative credit advice should be prepared and dispatched to the drawee's branch.

Payment

When a draft is presented for payment, the banker should check the following:-

- Draft is drawn on the branch where it is presented for payment.
- Signed by authorized officers with attorney number.
- Signature should be verified from power of attorney book.
- There is no alteration on the instrument and it is in order in all respects.

In the case of any alteration, the same should be duly authenticated under joint signatures.

• Cancellation should be marked in the DD issue register / system.

• If beneficiary's account is in another branch, TT receipt should be issued in the name of the beneficiary and paid in normal clearing.

• A cashier cheque of the required amount should be issued under full signature and attorney number.

• If TCs have to be issued against cash, then the same should be counted and a " Received Cash Stamp" should be affixed onto the application.

Cash Retract
Timeline:

- Key shall be handed over to the Licensee and he / she shall be asked to sign locker attendance register to check the locker allotted. Details of the locker allotted shall be recorded in the Locker Allotment Register, including Name, Address, Date Rented, Locker No, Key No, Key Deposit, details of the rent deposited with initials.

Commercial banks generally deal with deposits and loans from corporations or large businesses. Retail banking , on the other hand, refers to banking in which banking institutions execute transactions directly with customers/consumers, rather than with corporations or other banks. Retail banking clients are offered a wide range of personal banking services, including savings and transactional accounts, mortgages, personal loans, debit cards, credit cards, highly networked ATMs, one-click-away online banking services, 24/7 call support and IVRs and other associated services.

Bank Loan Products

1. Credit Cards

A credit card system operates through cards issued to users by the issuing bank for use in retail transactions at merchant outlets and / or cash advance transactions (at ATMs). These transaction amounts are paid to the merchant by the bank on the next day, whereas the card user has the facility to pay later to the issuing bank, according to the terms and conditions specified by the issuing bank on the credit agreement. Most

Cash Retract
Timeline:

credit cards issued are of the same shape and size, as specified by the standard.

Credit cards are issued against the customer's application on a standard form, duly signed , and approved by the bank after the necessary formalities. Once a card is approved and issued , the cardholder activates it through a phone call and can then start using it for making purchases. Outlets accepting credit cards can be identified by stickers at their doors and counters reading "credit cards accepted here". According to SBP's Consumer Prudential Regulations, regarding cards, a member can be assigned a purchase limit facility of up to Rs.2 (M).

Electronic verification systems through EDC terminals allow merchants to verify that:

- the credit card is valid
- the customer has sufficient credit to cover the purchase
- data from the card is obtained at point of sale.
  - Any sum to be deposited in the account should be accompanied by a duly completed deposit slip showing the name and number of the

Cash Retract
Timeline:

account to be credited and the depositor's signature. Such deposits must be entered at cash counter only.

- Foreign Currencies in US Dollar, Japanese Yen, Euro, British Pound, Swiss Franc, and UAE Dirham should be surrendered through SBP Nostro account. Deposits and instruments in other Foreign Currencies shall be surrendered by converting the same into US Dollars. Frozen Foreign Currency Deposits shall be surrendered equaling Pak Rupees.
- Attested copy of the CNIC of the claimant should be attached. Certificate for refund of unclaimed deposit as per annexure "c" of BPD Circular No. 7 dated 21st July, 2006.
- Where assets are held jointly by a person who is liable to pay Zakat and another person who is not liable to pay Zakat or gets exemption on compulsory deduction of Zakat and share is specified, Zakat shall be recovered in respect of the first person. Where share is not pre-specified, Zakat shall be deduced on the whole asset.

Walk-in customers are those who just walk into branch premises to open an account or make use of other banking services. The priorities of walk-in customers may be that:

- the branch is convenient for them
- the customer service of the branch is better than other branches or other banks

Cash Retract
Timeline:

- the branch premises are better than other branches or other banks and are equipped with modern facilities

- the size and reputation of the bank is good
- The charges are less than other banks.

Solicited customers are those who are contacted by the bank staff with the purpose of establishing a business relationship. Generally these are customers whose credentials are well established and who enjoy a good reputation in the market.

An account is opened by completing an account opening form. This document is the means by which the banker-customer relationship is established. All the requirements of account opening apply to both the customer and the documentation depending on the type of account being opened in the bank.

- When dealing with any Legal Person (companies, trusts, societies, NGOs, Non-profit Organizations, etc) information must be obtained and verified about the ownership and control structure of the account and about the person(s) who ultimately own(s) or controls) the account/ customer.

Enhanced Due Diligence (EDD)

Cash Retract
Timeline:

Enhanced due diligence should be exercised when dealing with High Risk customers such as:

a) Non-residence customers

b) Private banking companies

c) Legal persons

d) Customers belonging to countries where KYC, CDD, AML regulations are non-existent/not applied

e) Customers in cash-based business

f) Customers whose source of income is not clearly defined

- Chief Justice of High Courts and judges of Supreme Courts; senior leaders of political parties

- Senior journalists of electronic and print media etc

- Diplomats, Ambassadors and Counsel Generals serving abroad and Foreign Ambassadors and Counsel Generals of Increased Risk Countries

Cash Retract
Timeline:

- Heads of Armed Forces (Army, Navy, Air Force, Joint Chiefs of Staff)

- Persons responsible for looking after the public interest at large. This list is only indicative and not exhaustive and is also based on subjective criteria Just to give an idea of PEPs/ public figures. You may be able to think of other examples from your own experience of dealing with such customers.

Private Non-Resident Rupee Account

Accounts of individuals, firms or companies resident in countries outside Pakistan are designated as Non-resident accounts. All Pakistani nationals

Correspondent bank services are used by local banks in order to service transactions originating in foreign countries, where domestic banks do not have any branches. In fact, correspondent banks act as agents for domestic banks abroad. This is necessary because the domestic bankEmay haveElimited access to international financial markets, and cannot service its customers' needs without opening up a branch in another country. In order to establish a correspondent banking relationship, a formal agreement with other banks is required, and this should be signed at Head Office level.

Cash Retract
Timeline:

The level and scope of due diligence that is required regarding a correspondent banking 'client should include the following points:

- The nature of the other financial institution's business, including its product and customer base.
- Where the financial institution is established and its size.

.Address of any parent company of the other financial institution.

- The existence and qiiality of any AML/CDD regulation in the other financial institution s country of domicile.
- Draft is drawn on the branch where it is presented for payment. Signed by authorized officers with attorney number.
- Signature should be verified from power of attorney book.
  There is no alteration on the instrument and it is in order in all respects. In the case of any alteration (s), the same should be duly authenticated under joim signatures.
- New number of the duplicate draft should be written on draft application form.
- No fresh credit advice should be issued.

Cash Retract
Timeline:

.If purchaser wants his/her money back, drawee branch should be asked to remit back money by debiting their DD payable account and by issuing a credit advice.

- On receipt of funds, the same should be credited to customer's account.

Cancellation

- Application from purchaser along with original instrument requesting cancellation of the demand draft.

. The banker should verify signature of the purchaser from the draft application form.

- If demand draft was issued on other than a personal name, clearance/discharge from beneficiary must be obtained.

Draft should be marked as cancelled and signature portion of draft should be torn out.

Cancellation should be marked in the DD issue register / system.

.Proceeds of the draft should be paid by debiting suspense account and crediting customer's accounts respectively.

On receipt of credit advice the suspense account created in lieu of the cancelled DD should be re\'ersed within a maximum of 30 days.

- TCs of the required denomination should be issued under full signature and attorney number, in the name of the beneficiary, the details of whom should be

Cash Retract
Timeline:

written on the application form. TCs should be issued after first obtaining a signature on each TC and pn the purchase receipt.

- Related credit advice should be dispatched to the TC cell. Encashment

- TCs can be presented for payment either in cash, transfer or in clearing.
- Authenticity Qf the TC should be checked by verification of the signature on the TC and the signature of the purchaser on the purchase receipt.

.Customer should be asked to put his/her signature in the second space. . For

walk-in customers a copy of CNIC should be obtained.

- After verification of signature and CNIC, payment can be made.

- If presented in clearing, crossing, clearing, discharge on the reverse should be verified and if everything is in order, the cheque should be marked as cancelled and related credit advice should be issued.
- Implement risk-based CDD policies, procedures, and processes.
- Evaluation of the overall adequacy and effectiveness of the KYC/CDD/AML compliance program.
- Testing of appropriate risk-based transactions to verify the bank's adherence to central bank recordkeeping and reporting requirements.

- A review of staff training for adequacy, accuracy, and completeness.

Cash Retract
Timeline:

A review of the effectiveness of suspicious activity monitoring systems (manual, automated, or a combination) used for BSA/AML compliance.

Related reports may include, but are not limited to:

a) Suspicious activity monitoring reports.
b) Large currency aggregation reports.
c) Monetary instrument records.
d) Funds transfer records.
e) Non-sufficient funds (NSF) reports.
f) Large balance fluctuation reports.
g) Account relationship reports.