

Journal of The Institute of

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April - June 2016

**STRENGTHENING BANK SUPERVISION:
THE NEED FOR FORWARD-LOOKING,
INTRUSIVE SUPERVISION AND
A SUPPORTIVE SUPERVISORY
CULTURE**

LIQUIDITY RISK MANAGEMENT

INTRODUCING BASEL 4



Automated Teller Machines

ATMs:

Countering Risks and Frauds

IBP

commerce mobilized



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20 years of customers' trust with card and payment systems
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2015 was a rewarding year for the economy and the banking sector of Pakistan. While year-on-year inflation rose from 1.3 percent in September 2015 to 3.9 percent in March 2016, average inflation marked at 2.6 percent and the expected outlook of inflationary measures remains controlled. The upward movement in inflationary pressures depicts a boost in aggregate demand led by the improved security and energy situations.

As a result, a general increase in demand has been observed in the services sector, and this coupled with the lower interest rates, have driven an increase in the flow of credit to the private sector – a positive development that bodes well for economic growth in the near future. The large scale manufacturing sector grew by an improved 4.1 percent between July 2015 and January 2016.

The PKR/USD parity remained stable in spite of growth in oil and machinery imports, and declining exports. The exchange rate was supported by the continued augmentation in remittances and foreign direct investment; the external account was provided reprieve in the form of depressed oil prices. Moreover, contained expenditures and a promising increase in tax revenues enhanced fiscal discipline.

While weakened global trade activity constricted Pakistan's export demand, the headway made on the China Pakistan Economic Corridor (CPEC) front has revived bilateral economic prospects and paved way for sustained economic growth prospects. The CPEC will bring a promised \$46 billion worth of Chinese investment to Pakistan, with \$11 billion being utilized for infrastructure development and \$35 billion being channeled into energy ventures, which are expected to spur growth of industrial zones. The Corridor will also facilitate Pakistan's trade with the Central Asian republics. The banking sector also remains poised to optimally capitalize upon the financial intermediation opportunities presented by the China Pakistan Economic Corridor.

Branchless banking is another aspect which holds significant potential for the financial sector in the near future. Digital finance will work towards the implementation of National Financial Inclusion Strategy (NFIS) - a roadmap to achieve financial inclusion goals. The National Financial Inclusion Strategy, which was launched last year, aims to achieve universal financial access, with a target of expanding formal financial access to at least 50 percent of adults and increasing SME

lending of financial institutions. The NFIS currently focuses on promoting digital transaction accounts, increasing scale of payments, diversifying access points, improving capacity of financial service providers and increasing levels of financial awareness and capability.

The State Bank of Pakistan continues to promote the branchless banking segment while enhancing its framework and regulatory dynamics further. The Regulator and the PTA's more recent efforts towards the same include their directives on the inter-operability of the mobile banking industry participants including banks, mobile network operators and technology service providers. The recently introduced Third Party Service Provider (TPSP) model will offer optimal outreach and connectivity and provide banks and telecoms further access to each other's customers.

Formal transaction accounts open regulated access to a host of financial services including savings, payments, insurance and credit, which not only enable the masses to manage their finances better and become financially independent, but also benefit banks through financial penetration and growing customer base. The aggregate network of branchless banking agents reached almost 300,000 across Pakistan in December 2015.

The remaining half of 2016 and 2017 will be a period of interest as it will set the foundation of the growth trajectory for this new era of economic progress.



Sirajuddin Aziz
Editor-in-Chief

IBP WELCOMES NEW CHIEF EXECUTIVE



Mr. Husain Lawai has recently joined The Institute of Bankers Pakistan as Chief Executive. He was previously the President and CEO of Summit Bank Ltd.

Mr. Lawai has succeeded Mr. Muhammad Haroon Rasheed who had been serving the Institute for the past two years.

Mr. Lawai is currently a member on the Board of Glaxo Smith Kline Pakistan, Wyeth Pakistan Limited and The Searle Company Limited.

He carries an experience of more than 40 years in the banking and financial services industry and has also served as President and Chief Executive Officer at MCB Bank, Director, Security Investment and Finance Limited (UK). He established Faysal Islamic Bank, Pakistan Branches, the first Islamic Sharia Compliant Bank (now known as Faysal Bank Limited) in Pakistan and was the General Manager, Emirates NBD Bank for Pakistan and Far East.

Mr. Lawai is also on the Board of Governors of Karachi Grammar School & Virtual University of Pakistan.

He holds a Master's Degree in Business Administration from Institute of Business Administration, Karachi.



Muhammad Subtain Raza is a banker having expertise in financial compliance with MBA, M.Sc (Hons.), and Junior Associateship of The Institute of Bankers Pakistan. He writes for various national & international financial



Syed Danish Ali is a consultant at SIR consultants, a leading actuarial consultancy in the Middle East and South Asia. He is also a graduate of University of London and Career Ambassador of Institute and Faculty of Actuaries (IFoA UK). He has contributed 16 publications across a range of international platforms and is a regular contributor to various research activities in IFoA and International Actuarial Association including the ASTIN journal which is a leading journal for actuaries in Non-Life insurance.

Andrew Stone is a business journalist

Michael J. Zamorski has an extensive experience in financial institution supervision and has monitored prudential and conduct of business supervision for 5,200 U.S. banks. He has also worked on managing supervisory responsibility for banks, reinsurers, collective investment fund operators, other financial services providers, accountants and auditors. He was a member of the Basel Committee from 2000-2006 and was the Basel Consultative Group member from 2009 - 2010.

Ian Henderson is a business journalist



Dr. S. Sabir Ali Jaffery is an MBA (IBA - Gold Medalist); M.Phil (KASBIT - Gold Medalist); PhD (Business Management), a veteran banker of more than fifty years standing with international exposure as Country General Manager and a versatile academic Professor, teaching MBAs and M.Coms. at different universities.



Fahim Adil is an MBA from Concordia University Wisconsin, U.S.A and M.Sc in Economics from Quaid-e-Azam University, Islamabad. He carries intense knowledge on Risk Management, Economy, Management Information Systems, Finance & Banking.

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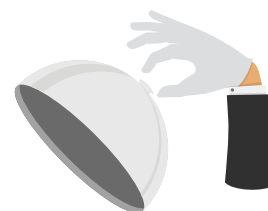
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The Institute of Bankers Pakistan
Moulvi Tamizuddin Khan Road
Karachi 74200, Pakistan
Tel: +92 (21) 111-000-IBP (427)
Fax: +92 (21) 3568 3805
www.ibp.org.pk

Editor-in-Chief:

Sirajuddin Aziz

Deputy Editor-in-Chief

Khawlah Usman

Publications

Fizza Rizvi
Ext: 539
publications@ibp.org.pk

Advertising

Muhammad Akram
+92 (21) 3562 1339, 35277511
m.akram@ibp.org.pk

Design:

Jahangir Ishaq

Potential contributors are requested to contact the Publications Manager on the email address above (or) write to IBP at its mailing address.

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LEAD 2016

A World Inspired

On 3rd February 2016, The Institute of Bankers Pakistan in collaboration with Knowledge Now broadcasted the live simulcast of LEAD 2016 from Nashville, Tennessee, USA. This mega event was attended by various senior officials from the banking and financial sector, governing bodies, media and academia personnel's.

Mr. Saeed Ahmad - Deputy Governor (FM, IB & SIs) at State Bank of Pakistan graced the occasion with his valuable presence as the Guest of Honor.

The panel speakers consisted of both locally and globally recognized personalities, in which Mr. Amanullah Khan,

Mr. Shahid Zaki, Dr. Abdul Bari Khan were from Pakistan and Sister Helen Prejean, Bonnie St. John, Stephen M. R. Covey and Arthur Bloom were international speakers who shared their experiences about the concept of building global leaders.

This one of its kind, technologically advanced event was sponsored by HBL Pakistan (Gold sponsor), Bank Alfalah (Silver sponsor) and Habib Insurance (Bronze sponsor). The audience were truly lured by this knowledgeable platform and appreciated the efforts of IBP in engaging the financial industry in such a productive event.



Launch Ceremony of



Pakistan Banking Awards

DAWN with IBP

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The Institute of Bankers Pakistan launched Pakistan Banking Awards 2016 on February 29, 2016. Honorable Governor, State Bank of Pakistan – Mr. Ashraf Wathra chaired the event.

Addressing the audience, Mr. Wathra appreciated the launching of banking awards and said that such awards for the banking Industry on a continuous basis would encourage banks to improve their performances and will bring forward their assessment to the public.

The ceremony was attended by financial industry experts and stakeholders including the Presidents and CEOs of the local and

international banks/ financial institutions of Pakistan.

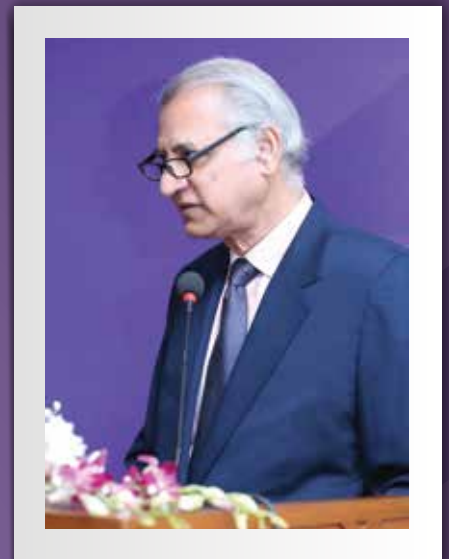
Governor - SBP commended the initiative and efforts put in by The Institute of Bankers Pakistan (IBP), DAWN Media Group and A. F. Ferguson (AFF) for setting the stage to encourage the top performers. He said that he was extremely delighted to see the list of jury members as each one of them is an institution in themselves and holds the repute and wisdom to make the whole process credible and respected. He encouraged the banks to participate and make this event a success.

Earlier, Mr. Muhammad Haroon Rasheed, Chief Executive

of IBP, welcomed the guests. He apprised the audience that Pakistan Banking Awards would be a series of annual awards to be given to individual banks, based on their performance in specific developmental, customer and service related and financial categories. Mr. Shabbar Zaidi from AFF shared the Award Categories & Evaluation Mechanism at length. Mr. Ali Hassan, GM Marketing – DAWN Media Group, thanked all participants.

The event was well-received by the banks and financial sector. The audience appreciated the brilliant initiative and arrangements made at the launch ceremony.

“Governor - SBP commended the initiative and efforts put in by The Institute of Bankers Pakistan (IBP), DAWN Media Group and A. F. Ferguson (AFF) for setting the stage to encourage the top performers”



“The event was well-received by the banks and financial sector”



BASEL III



Highlighting the importance of Basel III an internationally acclaimed training, The Institute of Bankers Pakistan invited Mr. Peter Buerger - Managing Partner at Risk & More Consulting and Training (Germany) to educate the audience about comprehensive set of reform measures, to strengthen the regulation, supervision and risk management of the banking sector.

Almost 70 participants, attended the two day training in Karachi & Lahore on 16th-17th February 2016. Bankers mainly from Risk and Credit division, Taxation department, Capital Markets, Compliance Division and Financial Analysts attended the event wholeheartedly, appraising the efforts of The Institute of Bankers Pakistan (IBP) in organising this event.



Automated Teller Machines **ATMs:** Countering Risks and Frauds



By Subtain Raza

The introduction of Automated Teller Machines (ATMs) has proven a technological development that has revolutionized the financial sector by providing financial services to their customers with 24/7 service. According to an estimate by Retail Banking Research, there are more than 2.2 million ATMs deployed worldwide and projected. This is a figure forecasted to exceed 3 million by 2016. The ATM options keep the customers at their ease with respect to access their cash and transfer transaction where-ever required. This article highlights some key techniques adopted by criminals and their groups to exploit ATM interfaces and counter measures which may prevent major financial losses across the world.

Crime perpetrators have also exploited the advancement in technology for their illicit objectives. They devise better plans and techniques via devices, and actions regarding ATM frauds. The availability of card, PIN numbers, skimming devices and ease in counterfeiting make ATM cards more attractive for criminal rings. The most common techniques of ATM fraud are detailed hereunder:

CARD SKIMMING

Card skimming involves the attachment of an additional front, device or instrument to the internal side of a card reader of the ATM, which captures the card number and transmits the information to criminals. They may also tactically place another object -- possibly a leaflet holder with a camera to record PIN or a fake keyboard that is in fact a PIN recorder. The criminals use the card number to generate a cloned card using mobile top-up cards and with the PIN code they can drain the victim's account. The most prevalent type of fraud in Asia is card skimming.

Typically, criminals design skimming devices to be undetectable by consumers. The following are three kinds of card skimming attacks that can occur:

- External Card Skimming – placing a device over the card reader slot (motorized or dip) to capture consumer data from the magnetic stripe on the card during a transaction. This is the most common form of card skimming.
- Internal Card Skimming – gaining access to the top hat of the ATM to modify the card reader or replace the original card reader with an already modified one for the purpose of obtaining consumer card data during a transaction.
- Vestibule Card Skimming – in locations where the ATM is located within a vestibule, skimmers are placed on the vestibule door card access reader to capture cardholder data from the stripe where the card is read when an unwary consumer inserts their card.

PHISHING

Phishing is a term used to describe forged e-mails, the criminal hackers send to clients to capture the passwords, credit card numbers or other personal information. Hackers will use this data to access personal accounts, financial information and identities that they will then use for fraudulent purposes. Generally, e-mails are sent to customers from false email addresses (similar to company's e-mails) pretending to seek credentials from their financial institutions.

SPOOFING

This term describes Phishing that request and guide you to supply, confirm, or update personal information or other credentials by clicking on a link furnished in the e-mail. The link will connect to a web page or log-in that masquerades as belonging to the company mentioned in the e-mail. Such emails often mislead the recipient to and if a customer enters personal data, the hackers will capture that information.

SOCIAL ENGINEERING

Social engineering is used to collect requisite information for illicit transactions. The prey is trapped in such a way to easily reveal his/her authentication codes. Electronic means e.g. rogue websites are set up by the criminal rings to collect authentication information from un-suspecting customers in the name of necessary updates or changes being carried out by their 'Bankers'. The user ends up divulging his card sensitive data to the rogue site.

CARD SWAPPING

Card swapping occurs when a customer's ATM card is being swapped for another card without their knowledge while the customer is performing an ATM transaction.

SHOULDER SURFING

Shoulder surfing involves tracking or observing ATM PIN while the customer enters PIN on ATM PIN pad. Generally, criminals position themselves close to legitimate ATM customers to observe covertly as the customer enters his or her PIN. Miniature video cameras, installed

in hidden locations are also used for shoulder surfing.

CARD JAMMING/TRAPPING

ATM card reader is tampered so, that a customer's card will be held in the card reader and cannot be removed from the machine. The criminal removes the card once the customer leaves.

DISPENSER MANIPULATION

In this case, the ATM is set up to dispense big denominations as smaller ones, thereby giving out more money than should be dispensed with. This is possible by an insider's help or remote commandeering.

PHYSICAL ATTACKS

Where an ATM is physically attacked with the intention of removing the cash content. Use of electric/gas cutters, explosions and vehicle hits etc. are common ways in physical attacks.

MUGGING

Mugging is a scenario in which a client is attacked while conducting a transaction at an ATM.

CASH TRAPPING

In this attack method, fraudsters attempt to gain access to cash by attaching a fraudulent device to the cash-dispensing slot, causing notes to be stuck inside the ATM. The perpetrator then returns later to remove the cash from inside the dispenser.

MALWARE AND HACKING

With any computer system, the purpose of installing malicious software (malware) is to violate the confidentiality, integrity and/or authenticity of data on that computer system. Designed to collect cardholder data and/or dispense cash, malware and hacking can occur both locally or remotely. Local attacks operate by accessing the top hat and downloading the malware using a USB drive or attaching a USB sniffing device to intercept communication between the card reader and the ATM's computer. Remote attacks on an ATM network occur at some point in the communica-

tion with the host or at the backend infrastructure. Typically, these sophisticated attacks are carried out by well-funded criminal organizations.

THE TOP HAT

Perpetrators attempt to access the top hat or upper portion of the ATM because they mistakenly believe it is a way to get to the safe or other cash or because they want to steal components of the ATM such as the hard drive. Fraudsters also try to access the ATM via the top hat to attach an internal skimmer or download malware.

Following precautions should be used by ATM users and financial institutions to protect themselves against ATM frauds:

MEASURES FOR ATM USERS

- Activate E-alerts via e-mail or SMS so as to notify the account owner of movement on his/her account, especially debits.
- Keep in mind that no financial institution sends emails or SMS asking to enter financial credentials. Avoid such illegitimate e-mails.
- Regularly track your transactions by asking statements or e-statements.
- To prevent phishing attacks, always use a network with phishing filters.
- Keep a stronger and easy to remember password and regularly change it.
- To avoid shoulder surfing, protect the PIN by covering pad or covertly entering passwords.
- Observe for any unusual changes in physical stature of ATM, new gadgets, devices and happenings around.
- Check balances of your accounts on regular basis. This will bring to notice any irregular or unauthorized transaction.
- Do not use ATMs with excessive signage or warnings posted on the machine.
- Report any unusual activity to concerned security authorities.

- Passwords and access codes should be kept secret and changed periodically. Financial institutions will never ask for your username and password.
- After using Internet banking, practice to exit the browser after completing the Internet session, and have measures to keep your computer free of viruses and spyware that could be used to capture password keystrokes.

MEASURES FOR FINANCIAL INSTITUTIONS

- Suggest ATM locations in highly visible, well-travelled and busy areas.
- Consumer education should be disseminated on national and international level.
- ATM monitoring services are the best ways to prevent the application of fraudulent equipment such as skimming devices on or near legitimate ATMs.
- Foreign object detection technology can also play a role in identifying fake equipment. Hidden from view, this type of technology actively monitors the ATM's fascia.
- Physical Security arrangements should be managed to resist physical security risks.
- Build and maintain a secure network and maintain an information security policy.
- Devise better fascia design, weather and vandal-resistant construction materials, shutters and other devices designed to protect and ensure the integrity of ATM components and cardholder data.
- Prefer to hire remote diagnostics measures.
- To prevent PIN interception, use encrypted PIN pad technology.
- Arrangements for mirrors, better lighting, and CCTV cameras for video surveillance should be made.

“Crime perpetrators have also exploited the advancement in technology for their illicit objectives. They devise better plans and techniques via devices, and actions regarding ATM frauds”

CONCLUSION:

Financial institutions have practiced many strategies and actions to upgrade the security arrangements which reduce the scope of ATM frauds. These include safe locations for ATM, remote monitoring, surveillance video cameras, foreign object detection, anti-skimming card solutions, enhanced consumer awareness and public service messages from government authorities. But criminal rings have evolved their reactive counter actions to withstand against all preventive strategies. There is a need of a more effective, tolerant and enduring strategy which assures zero ATM fraud ratio. The use of biometric features for security measures is a practical approach.

Biometrics features like fingerprint verification, iris analysis, hand geometry-vein patterns, ear recognition, odor detection, DNA pattern analysis and sweat pores analysis, handwritten signature verification, keystroke analysis and speech analysis may be utilized as medium of identifying and authenticating account owners at the Automated Teller Machine interfaces. Biometric identification helps to verify a person's identity by measuring digitally certain human characteristics and comparing those measurements with those that have been stored in a template for that same person. Templates can be stored at the biometric device, the institution's database or in a user's smart card.



By Danish Ali

With a flurry of revisions given by the Basel Committee on Banking Supervision (BCBS or Basel) in recent times, the banking industry faces a crossroad to call these revisions 'Basel 4' or merely revisions to Basel 3. Most bankers conclude that the revisions are so significant holistically that it constitutes a new 'Basel 4' on its own. These regulatory updates collated as Basel 4 have deep implications for banks across the world and are considered in this article. This article sheds light on major themes of Basel 4. A holistic journey is undertaken so as to separate the various elements comprising Basel 4 in order to reach a correct synthesis.

CRTICISMS ON BCBS IN RECENT TIMES

Recent Basel studies evaluated the calculations undertaken to determine capital levels by different large banks. The result was that risk charges vary widely across banks, even for similar risks. This was a great source of concern because it reduces comparability across different banks and so is detrimental to regulators' efficacy. The main reason for variations in credit risk charges were due to different estimations of Probability of Default (PD) and Loss Given Default (LGD), differences in adjusting for cyclical effects, and different translations of external ratings to internal ratings, among others.

Moreover, Basel's evaluation of capital adequacy for banks found out that banks are engaged in unacceptable levels of 'risk-weighted-assets optimization' which means that the capital held are insufficient to meet adverse conditions.

BCBS is also concerned that low probability of default in banks' internal modeling exercises are creating an artificial level of comfort for the banks because of prolonged period of low interest rates which means that many defaults are being avoided, only to potentially resurface in times of higher interest rates. The banks should not be sitting on a 'stochastic time bomb' (Nassim Nicholas Taleb) to rely on counter-cyclical buffers and rather should diffuse the situation before it reaches a tipping point.

Basel is also uncomfortable at the level of sophistication and complexity adopted in the internal modeling exercises undertaken by the banks because they reduce market transparency as well as create 'black boxes' where it is difficult to know exactly why the numbers derived from these models as risk charges are appropriate or not.

There is an increasing realization across the world by the likes of Paul Wilmott, Emmanuel Derman (see 'The Financial Modelers' Manifesto'), Nassim Nicholas Taleb as well as many policy-makers and other stakeholders that modeling in finance can only produce limited answers. Taking this into account, BCBS recognizes that in a

world riddled by cataclysmic risk, uncertainty and incompleteness (see Mandelbrot's application of fractal geometry to finance), it may be a better route to follow simple rules that have reasonable predictive power than making models that try to replicate reality in all of its complexities. These complexities can be counter productive when their underlying core assumptions and relations break down as it does in stressed economic conditions.

Recent developments that are not due to Basel 4 but heavily interlinked with Basel 4 are:

- Ever since Basel 3, Leverage ratio has become the most discussed ratio for the banking industry. Many countries now call for greater than the 3% minimum leverage ratio as required by Basel 3. In USA, the Federal Reserve is proposing 5% minimum leverage ratio for systematically important banks to be applied from 2018. 'Systematically important banks' is recognition on a global scale that not all banks contribute to the same extent to a financial contagion and that large banks induce far greater systemic risk explosions than their smaller counterparts.
- Loss absorbency capacity is different across instruments and banks, especially the systematically important ones by regulators.
- Regarding stress testing, many regulators like the US, UK, Ireland are adopting a front line of defense approach for stress testing rather than stress testing being reserved for worst cases only, as now a bank is required to

Moreover, Basel's evaluation of capital adequacy for banks found out that banks are engaged in unacceptable levels of 'risk-weighted-assets optimization' which means that the capital held are insufficient to meet adverse conditions.

meet minimum capital ratios even in the stressed scenarios and not just in the normal baseline scenarios. In particular, UK's Prudent Regulation Authority (PRA) is assessing the capital adequacy of large banks for meeting at least 3% leverage ratios based on Core Tier 1 capital with a different, narrower definition of total tier 1 than as per Basel 3.

MAJOR CHANGES IN BASEL 4

Standardized approach in Basel 3 revised

Based on criticisms highlighted previously, BCBS has proposed revisions in the relationship between the standardized approach and internal modeling of the banks. A floor is to be imposed on risk weights to ensure that risk weightage optimization does not reduce capital. These floors will lead to increase in capital requirements to be held by the banks. The implication is using floors in standardized approach for regulatory reporting whereas internal modeling to feature more in internal risk management and pricing exercises.

CREDIT RISK

For credit risk mitigation, the following proposals are on the table currently:

- Banks would not be allowed to reach their own estimates of haircuts or to use Value at Risk (VaR) models for certain secured financial transactions or use other internal model methods for collateralized OTC derivative transactions.
- There is presently an exemption to national supervisors from applying 20% risk weight floor for certain repo-style and OTC derivative transactions. This exemption should be eliminated.
- Risk weights and amounts for supervisory haircuts are to be recalibrated for 'supervisory haircuts for issuers other than sovereigns and securitizations'.

VaR faced too many criticisms in the wake of the financial crisis of 2008 notably for being blind to tail risk which is what happens in extreme scenarios. That is why BCBS now recommends

expected shortfall to calculate risk charges and abolishes VaR in most cases.

COUNTER - PARTY CREDIT

Under the revised Standardized approach, risk weights will be applied on calculations but only risk weights of a small number of significant risk drivers. For exposure to various asset classes, credit risk has the following risk drivers:

- Banks; substitute external ratings with capital adequacy ratio and an asset quality ratio
- Corporate exposures; replace external credit ratings with the revenue and leverage of the borrower
- Commercial real estate; preferred method is to see the loan-to-value ratio
- Residential mortgages; Utilize loan-to-value and debt-service coverage ratios as risk drivers

OPERATIONAL RISK

BCBS identified that banks using the standardized and basic approaches to operational risk, underestimate it by as much as 50%, leading to a new approach of 'Business indicator' as metric to calculate charge for operational risk. The Business Indicator is essentially the aggregation of net interest income, fee income and expenses, other operating income and expenses and the absolute values of banking book and trading book Profit and Loss. Instead of flat coefficients for all banks, coefficients now increase non-linearly as the size of banks increase to reflect the empirical observation that operational risk increases as size of bank increases.

TRADING BOOK

While reviewing the trading book, BCBS has proposed a simpler method for adopting liquidity horizons in the internal models approach supplement. Treatment of internal transfers of credit risks should be complemented by treatment of internal risk transfers of interest rate risk and equity risk. This sensitivity based approach to reviewing trading book would also require banks to utilize price and rate sensitivities as

inputs to guide the treatment of different asset classes in order to capture more complex or microscopic risks in the trading book.

ENHANCED DATA COLLECTION AND REPORTING

BCBS encourages banks to apply the recommendations of the 'Enhanced Disclosure Task Force' into practice. These recommendations attempt to shed further light into the black boxes of internal modeling regimes across banks and to align them in a more reasonable manner to the Basel ecosystem. Banks have to apply their models to hypothetical portfolios, disclose results of both internal models and the standardized calculations and explain the reasons for their differences and publish additional useful metrics that the investor can use to get better insight such as historical volatility of profits, leverage ratios based on revenues, capital ratios using market value for equities and so on.

IMPACT OF BASEL 4

Based on our review above, the main impact of Basel 4 is expected to be in the following areas:

BCBS identified that banks using the standardized and basic approaches to operational risk, underestimate it by as much as 50%, leading to a new approach of 'Business indicator' as metric to calculate charge for operational risk

- Lower reliance on internal models; decrease in sophistication of calculations for capital charges
- More detailed data collection and reporting; more comprehensive risk reporting
- Lower reliance on credit rating agencies
- Increase in capital charge requirements
- Changes in customer targeting and selection

In particular, KPMG projected in 2013 that major UK banks might need an additional £50 billion of CET1 capital (an increase of around 25 percent) to comply with the regulatory requirements for Basel 4, or alternatively to make a corresponding lessening in risk weighted assets. In practice, between June 2013 and June 2015 these banks have enlarged their CET1 capital by £20 billion (and could have attained twice this amount in the absence of large conduct-related fines and redress payments), and reduced their risk weighted assets by £350 billion, thus

increasing their CET1 capital ratios from 9.4% to 12.0%.

LIMITATIONS OF BASEL 4

Internal Criticisms

It must be noted that conversions of input parameters into Risk Weighted Assets is done using the Base2 IRB risk weight functions which were prescribed by BCBS. Rather than BCBS changing input parameters like PD, LGD, EAD and Expected Maturity, the transformation process of these into Risk Weighted Assets could be transformed instead.

The floors on parameters are likely to undermine risk based approaches and reduce incentives for prudent risk management of economic risks. This is most felt in specialized lending and low default portfolios. Moreover, the linkage between economic risk and capital charge is weak in the revised standardized approach due to limited risk drivers and floors on their percentages. Banks focus on managing the drivers of capital in an attempt to reduce their capital charge and hence also reduce their underlying economic risk. Due to weak linkage, banks are likely to focus more on drivers of capital instead of true drivers of economic risks. For instance, secured lending is where the banks work in riskier industries and so emphasize on loan structuring, collateral management and other good underwriting practices which are not recognized under the Standardized Approach.

Some of the metrics chosen are also inherently pro-cyclical. CET1 and revenue both tend to fall in times of crisis. Non-performing asset ratios naturally increase as default occurs more in times of crisis. Connecting the two pieces together, let's assume there are two banks; Bank A and Bank B. If Bank A faces increased losses, its NPA ratios will increase. This will lead Bank B to increase its risk weightage to Bank A which will in turn increase CET1 of Bank A. Increase in CET1 of Bank A will lead Bank B to increase its risk weightage to Bank A and so on in a self-fulfilling prophecy cascading manner.

External Limitations

Financial regulation seems to be still stuck in the industrial age. Major techno-

logical overhauls like big data, massive parallel computing, smartphones, cloud computing and so on have led to an explosion of alternative ways to access finance. Crypto currencies like bitcoin pose another challenge as these are not regulated and neither is peer-to-peer lending model of business. Regulation is less effective when money diverts from mainstream into other channels afforded by advancements in technology.

Regulation is far from perfect and many things slip from the cracks of the structures. A profound insight in this regard is quoted; *"Modern finance may well be making the tails fatter,"* says Daron Acemoglu, an economist at MIT. "When you trade away all sorts of specific risk, in foreign exchange, interest rates and so forth, you make your portfolio

In the backdrop of all technicalities, lie the stark human psychology and sociology running the financial markets. There are limitations to safeguards and regulations because while they are essential in policing lenders on an individual basis, these tend to 'feed greed in greedy times and fear in fearful ones'. How do we tackle the 'animal spirits' as Keynes called to handle busts? Animal spirits highlight a paradox that individual rationality in times of busts lead to collective madness. How do we persuade and convince an individual to ignore his rationality in times of crisis when everyone else is herding in the same manic direction?

Recommendation and Conclusion

One potential suggestion would be to not construct various elements of the

“In conclusion, it is indeed an open question as to how will Basel 4 fare against external criticisms of technological and psychological nature as well as internal shortcomings. A key factor to answer this will be sustainability of banks over the future as risk management is ultimately about survival and not profits or losses”

seem safer. But you are in fact swapping everyday risk for the exceptional risk that the worst will happen and your insurer will fail-as AIG did. Even as the predictable center of the distribution appears less risky, the unobserved tail risk has grown. Your traders and managers will look as if they are earning good returns on lower risk when part of the true risk is hidden. They will want to be paid for their skill when in fact their risk-weighted returns may have fallen”.

So, the question arises that what is Basel 4 doing that reduces this feature of swapping specific risk for systematic risk only to wait until drop by drop increase in water collapses the whole dam.

regulatory capital framework in pieces, such as new standardized credit risk, operational risk and capital floors, without allowing for full implementation of previous changes. This is because holistic understanding and calibration of framework is potentially better than the individual piece by piece regulation.

In conclusion, it is indeed an open question as to how will Basel 4 fare against external criticisms of technological and psychological nature as well as internal shortcomings. A key factor to answer this will be sustainability of banks over the future as risk management is ultimately about survival and not profits or losses.



By Michael J. Zamorski

STRENGTHENING BANK SUPERVISION:

*The Need for Forward-Looking, Intrusive Supervision
and a Supportive Supervisory Culture*

BACKGROUND & INTRODUCTION

Effective bank supervision is a critical part of maintaining financial stability by promoting sound, stable and resilient banks positioned to meet the productive credit needs of their customers, which is necessary to achieve sustainable economic growth. Reliable access to bank credit and risk intermediation services is especially important in emerging economies where capital markets are still developing.

The U.S./Eurozone Crisis of 2008-2009 (the Crisis) was the most significant period of global financial instability since the start of the U.S. Great Depression, nearly 80 years earlier. Studies of the Crisis have identified a long list of contributing causal factors. Many problems originated outside of the banking system. However, there were many bank risk management practices and risk cultures that did not provide effective checks and balances on excessive

risk taking in the years immediately preceding the Crisis. Governmental policies also created incentives for excessive risk taking. Unfortunately, it is also evident that ineffective financial sector regulation and supervision contributed to the onset and severity of the Crisis.

In the aftermath of the Crisis, global bank regulators and standards-setters have pursued an extensive regulatory

reform agenda. While these efforts are very important, they do not guarantee supervisory effectiveness. This article explores some of the root causes of the Crisis and other episodes of banking system stress, and discusses qualitative considerations that are important to ensuring the future effectiveness of prudential supervision.

PRIMARY PRUDENTIAL SUPERVISORY FACTORS CONTRIBUTING TO THE CRISIS

Analyses of the Crisis have been made by the Basel Committee, the Financial Stability Board, the IMF, and various national bank supervisory authorities. Some frequently cited causal factors related to bank supervision methods and practices include:

- Failing to conduct on-site supervisory inspections or examinations at reasonable intervals and in sufficient depth.
- Use of off-site surveillance systems as a substitute for on-site examinations.
- Overemphasizing institutions' historic operating results and static financial conditions in assessing risk, not sufficiently stress testing potential vulnerabilities.
- Failing to identify ineffective bank risk management methods and governance structures, as well as other shortcomings in bank risk cultures.
- Failing to take timely and appropriate supervisory follow-up/remedial actions.
- Improper implementation of the concept of risk-based supervision.
- Allowing banks to operate with excessive leverage.
- Failing to consider that a build-up of macroeconomic risks and vulnerabilities could adversely impact a number of banks simultaneously, posing systemic risk.

Some expert industry observers and current and former regulators have also carefully studied the Crisis in an effort to get past its symptoms and focus on its root causes and their implications. In that regard, some noteworthy comments

appeared last year in Seacen's Journal in an article by William M. Isaac, a former Chairman of the U.S. Federal Deposit Insurance Corporation. Mr. Isaac was a bank regulator during periods of significant banking system stress in the U.S. In his article he states: "None of these crises occurred because of lack of regulatory authority but rather the failure of regulators to use their authority effectively to rein in excessive speculation by financial institutions." He then pointedly asks "What regulatory authority did U.S. financial regulators not have to rein in the risks taken by financial institutions that precipitated the latest crisis? I cannot think of any."

Thomas J. Curry is the current U.S. Comptroller of the Currency, overseeing the U.S. Office of the Comptroller of the Currency (OCC), an independent bureau of the U.S. Department of the Treasury. The OCC charters, regulates and supervises more than 1,600 national banks and federal saving associations, and federal branches and agencies of foreign banks, comprising about two-thirds of the assets of the U.S. commercial banking system.

In 2013, Comptroller Curry commissioned an external study of the effectiveness of OCC's supervisory program preceding the Crisis. The study group that conducted this high-level process review was headed by Jonathan Fiechter, former Deputy Director, Monetary and Capital Markets at the IMF, and former Senior Deputy Comptroller for International and Economic Affairs at the OCC. Other study group members included highly respected current and former bank supervisors from the Australian Prudential Regulatory Authority, the Canadian Office of Superintendent of Financial Institutions, and the Monetary Authority of Singapore. The study group's report, entitled "An International Review of OCC's Supervision of Large and Midsize Institutions: Recommendations to Improve Supervisory Effectiveness," was issued December 4, 2013. Observations and conclusions that apply to other regulators include:

- "The team noted instances of a material lag between the identification of an emerging risk and the issuance of guidance or rules to address the risk. This puts the onus on examiners on the ground to try and contain the risks at the institution level."

- The OCC had teams of examiners resident in some of the largest banking organizations. The study group recommended that this arrangement be changed, where practicable, to have examination teams move out of the banks and be co-located in OCC offices. This would allow for better information and experience-sharing by OCC experts on common risk issues and allow specialists to more efficiently perform work on multiple institutions.
- Some OCC examination staff below the Examiner in Charge was assigned to the same institution for many years. "Examiners may get stale and become too familiar with the (middle) management of the institution, giving rise to perceptions of regulatory capture. Supervisory effectiveness may be hampered as a result of lack of comparative experience in other institutions—examiners, lacking good comparators, may simply assume an institution's controls are adequate."

A thought-provoking analysis of Crisis lessons learned related to bank supervisory practices was published by the IMF in a 2010 Staff Discussion Note entitled "The Making of Good Supervision: Learning to Say 'No.'" The paper provides valuable insights on what it terms "the essential elements of good supervision." I believe it should be "required reading" for all bank supervisors. Key points made in the paper include:

- To be effective, supervision must be "intrusive, skeptical, proactive, comprehensive, adaptive, and conclusive." "For this to happen, the policy and institutional environment (of the regulatory authority) must support both the supervisory will and ability to act."
- Intrusiveness: "...supervisors must be willing and empowered to take timely and effective action, to intrude on decision-making, to question common wisdom, and to take unpopular decisions."
- "Supervisors are expected to stand out from the rest of society and not be affected by the collective myopia and consequent underestimation of risks associated with the good times. In this role, society and governments too

must support this approach and stand by their supervisors as they perform this unpopular role.”

The following commentary provides my personal observations on achieving supervisory effectiveness from having been a senior banking supervisor during several banking crises.

CRITICAL IMPORTANCE OF ON-SITE SUPERVISION

The onset of the U.S./Eurozone Crisis in those jurisdictions most directly affected was characterized by an extended period of seemingly benign economic conditions. These circumstances induced complacency among some bankers and regulators, allowing less stringent bank risk management and supervisory practices to proliferate over time. Bank credit underwriting standards became relaxed, tending to overemphasize escalating collateral values (mostly real estate) and not focusing sufficient attention on assessing borrower repayment capacity under changing circumstances (sometimes dismissing the possibility that collateral values could level-off or fall). Some banks’ compensation schemes became tied to improper incentives, such as loan portfolio growth, without proper qualitative considerations, inducing imprudent risk-taking.

The primary way to proactively detect potentially unsafe and unsound practices and conditions is through a sufficiently intrusive on-site examination process that is “forward-looking.” “Intrusive” means that on-site examiners conduct in depth, on-site reviews of bank records and documentation. These reviews form the basis for detailed discussions with senior executives and other personnel to clearly understand strategies, policies, and transactions, and the level and trend of the bank’s overall risk profile. These close personal interactions provide important insights on the capabilities of the executive management team and the board of directors in managing risk, including the ability to cope with less favorable external circumstances such as an economic downturn. Policies and procedures may look good on paper, but their effectiveness is best determined by experienced bank supervisors who evaluate bank practices and condition by direct interaction and dialogue with bank management, through a “lens” of healthy skepticism.

PRIORITY, FREQUENCY AND SCOPE OF BANK EXAMINATIONS

There are no universally applicable standards or guidelines pertaining to the priority, frequency and scope of on-site examinations. Practices vary among jurisdictions, but an annual, full-scope on-site examination seems to be a frequency that is generally regarded as reasonable.

Pre-Crisis, regulators in some jurisdictions lengthened their minimum on-site examination frequency to a much longer interval, or cut back on the scope of on-site examinations, believing that such action was justified by the extended period of favorable economic conditions that showed no signs of ending. De-emphasis of on-site examinations was motivated in some cases by budgetary pressures, with regulators reducing the size of their supervisory staff. This was a false economy as the cost of a properly resourced examination function is a small fraction of the direct and indirect costs of even a small banking crisis. The time for bank supervisors to be most vigilant is during “good times” when banking practices may become lax, leading to excessive risk in less favorable economic circumstances.

Post-Crisis, bank supervisors in some jurisdictions, in an effort to be “ahead of the curve” and be more proactive, have supplemented their regular bank examination programs by conducting “thematic reviews.” This entails selecting a sample of banks and conducting on-site reviews focusing on a specific risk area or issue. For example, a thematic review could be conducted assessing commercial real estate lending risk. Bank examiners review each sampled bank’s practices. Institution-specific issues requiring supervisory follow-up are handled in the same way as a regular examination. Common concerns emanating from all of the reviews may form the basis for industry alerts or policy guidance from the regulators to try and control these risks proactively, since many banks might not be scheduled to receive a near-term examination.

ADEQUACY OF EXAMINATION STAFF RESOURCES

Inadequate examination staff resourcing is a problem that usually cannot be remedied quickly. Bank examiners typically develop

their unique skills proficiency through a three to five year training program, which emphasizes on-the-job experiences supplemented by formal training. Basic skills proficiency includes a working knowledge of banking law, commercial and transactions law, accounting and auditing techniques, and “soft skills” such as interviewing techniques and the ability to effectively articulate and present examination findings to bank management and obtain commitments for remedial action. It is difficult to hire people in the employment market who possess all of these skills. Hiring entry-level, trainee bank examiners immediately preceding or during a crisis does not provide subject matter experts who can effectively assist in dealing with the crisis. If fact, they may impose a heavy training burden on an already over-extended staff operating under the pressure of simultaneously addressing many urgent problems and priorities. Therefore, supervisory authorities need to anticipate their longer-term human resource needs and plan accordingly.

Over the past twenty years, bank supervisors have adjusted their on-site supervision methods to engage in “risk-based supervision,” which generally means that finite supervisory resources are prioritized by allocating/targeting them to the greatest areas of perceived risk, both in individual banks and in the banking system. Pre-examination planning is done with the clear understanding that the scope of examinations can be expanded if there are “red flags” detected or matters surfaced which require further analysis. Unfortunately, in the period preceding the Crisis, some bank supervisors’ risk-based supervision programs failed to allow scope expansion when necessary, resulting in failure to detect and curtail the build-up of excessive risk. Also, some risk-based supervision programs became oriented toward reducing banking industry regulatory burden, rather than as a resource prioritization tool. This approach, characterized by some as “light touch” supervision, in some cases prevented the timely detection and remediation of excessive risk, even contributing to institutional failures.

OFF-SITE SURVEILLANCE

Off-site analysis can be a valuable screening tool for detecting “red flags” and outliers among supervised institutions.

However, it is not a substitute for on-site examinations and the transaction testing and management interactions they provide. Financial data is usually submitted on a lagged basis and is based on bank management's self-reporting. Erroneous or overly-optimistic reporting (such as in loan loss provisioning or assumption-based asset valuations) can undermine its integrity and reliability. Also, periodic reporting provides very limited insight as to the soundness of bank risk management practices and corporate governance. However, off-site monitoring is a very valuable complement to the on-site examination process in influencing the timing and intensity of on-site supervision. Combining bank reported data with market surveillance/environmental scanning and management reviews can sharpen risk profiling and support more targeted examination risk-scoping.

ACHIEVING PROACTIVE SUPERVISION

Supervisory effectiveness is greatly improved by reducing the time between risk identification and supervisory response, allowing "proactive" versus "reactive" supervision. Understanding the changing risk environment, financial industry innovation, and actual bank practices as close to "real time" as possible:

- allows earlier supervisory detection of abnormal risks at individual banks, enabling faster regulatory risk mitigation efforts;
- accelerates regulatory policy development related to emerging issues and changing risks;
- reduces the opportunity for regulatory arbitrage; and
- helps to prevent the proliferation of unsound practices or inappropriate risk selection that can destabilize individual institutions and the financial system.

What are some of the supervisory approaches that bank supervisors can employ to accelerate detection of abnormal risk or emerging policy and supervisory issues, as close to "real time" as possible?

- Conducting thematic or cross-sectional reviews of emerging or higher risk areas, to obtain actionable intelligence

for related policy development or to issue industry risk alerts to influence bank risk-taking.

- Developing organizational feedback mechanisms to raise awareness of increasing institutional and industry risk and emerging issues. For example, some regulators have established regular interactions between their leadership and senior on-site supervisors to discuss emerging issues and risks, greatly accelerating any needed policy changes, issuance of industry risk alerts and consideration of new or revised regulations.
- Regular dissemination of information on emerging policy and risk issues to front-line supervisors.
- Conducting periodic industry forums to discuss current conditions and emerging issues and related regulatory expectations with the industry.
- Ensuring that bank regulatory risk rating systems are "forward looking" and consider institutional practices, and do not overemphasize current financial condition.

CHALLENGES IN ASIA PACIFIC: ENSURING EFFECTIVE CONSOLIDATED SUPERVISION

Asia Pacific jurisdictions are both home and host supervisors for large, geographically dispersed banking organizations that are part of financial conglomerates operating across the region. Some of these conglomerates operate systemically important banks in more than one jurisdiction. Also, global banking organizations operate extensive regional banking networks. The region has increasing financial integration and many close inter-linkages have developed over the last decade. Countries' sound implementation of consolidated supervision is, therefore, an important part of promoting regional financial stability, especially timely and effective cross-border information-sharing among supervisors.

Prior to the Crisis, some bank regulators focused on a "top down" consolidated view of risks within banking conglomerates, which included multiple bank subsidiaries. These banking organizations' risk management and reporting protocols

provided consolidated information on bank subsidiaries' condition and performance. However, this approach can be problematic. A consolidated view of banks' risks may, for example, reflect adequate capital and liquidity, even if some subsidiary banks have weaknesses or problems on a stand-alone basis. This analytical approach also implicitly assumes that capital and liquidity within a banking group is "fungible," that is, it can be reallocated among the various subsidiaries at will. This is not the case. There are frequently legal restrictions on transactions with affiliates.

CONCLUSION

The Crisis clearly demonstrated that there is no substitute for a regular program of on-site inspections/examinations at reasonable intervals, conducted by seasoned, professional bank supervisors, performing an appropriate level of transaction-testing.

Supervisors need to take timely action to curtail and remedy objectionable and undesirable practices and/or conditions to control financial stability risk. They need to be supported by their organizations in the proper exercise of those actions. Bank examiners sometimes need to deliver constructive feedback and, at times, criticism to senior bank officials and boards of directors. This type of interaction, a necessary part of effective bank supervision, is not always well received, and occasionally generates complaints against examiners who are properly fulfilling their duties. Bank examiners need to know that they will be backed-up by their senior management when they receive bank management criticism and push-back in reaction to the proper exercise of their supervisory responsibilities.

Banking crises usually produce substantial new laws and regulations that attempt to address the perceived root causes of the crisis. While such reform efforts are important, no amount of new legislation can guarantee supervisory effectiveness without a supportive supervisory culture and effective supervisory methods. Supervisory authorities need to candidly assess whether their actual supervisory methods used are sufficiently robust and intrusive, and are effective in proactively detecting excessive risks or imprudent practices at their incipient stages.



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The perfect **STORM WARNING**

UK banks, with the lion's share of the European credit card market, will be hardest hit by the new EC rules limiting transaction fees, reports ANDREW STONE.

In a bid to reduce debit and credit card transaction costs for European retailers and consumers, the European Commission this April introduced regulations capping interchange fees.

The move is also designed to encourage competition and make it easier for new entrants to join the market, with new payment products. A more transparent payments process, says the EC, will help consumers make more informed choices.

But some doubt there will be such positive outcomes for consumers or the credit and debit card issuers. They warn that the UK will be disproportionately hit by measures that radically reshape the market. Some predict that this is part of a perfect storm of negative trends set to hit the profitability of the issuers.

Richard Koch, Head of Policy at the UK Cards Association, estimates the cost of lost interchange fees to the banks from retailers will be around £1bn a year. He warns that, for very little consumer benefit, the regulations as currently drafted pose major risks for consumers in the long-term.

A SHIFT IN COSTS

"If retailers stop making a fair contribution to card payments, consumers will be left to pick up a disproportionate share of these costs," says Koch. "This shift in costs directly onto consumers through interest or charges will create an additional burden on the most vulnerable consumers who can least afford it, while the benefit of the redistribution will not be felt by the average

consumer who will save five pence on a £45 transaction. That's not going to be a detectable saving."

Some consumers will benefit "very marginally", but those with credit cards will have a more adverse outcome. For banks, this raises questions about the sustainability of their credit cards. "The interchange fee ensures that retailers make a fair contribution to the operation of the card payments system, in return for which they benefit through guaranteed payments, security from fraud and the ability to accept payments online."

The radical reshaping of the debit and credit card markets may result in less investment, says Koch. "We may see a sector with potentially less to invest in fraud prevention, innovation and competitive offers to consumers," he says. And the UK, with about 70% of the European credit card market, will be most heavily affected by the new rules. "European legislators have

**"SHIFTING COSTS DIRECTLY
ONTO CONSUMERS
THROUGH INTEREST OR
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THOSE WHO CAN LEAST
AFFORD IT."**

enacted this legislation but to some extent they don't have much skin in the game."

The move will hamper sector innovation and competition, warns Koch. "There's an assumption that issuing credit cards is hugely lucrative and highly profitable, but in fact there's fierce competition. Around 40% of balances are non-interest bearing at the moment and, in many cases, issuers are only making money from the retailer interchange contribution."

Specialist monoline credit card lenders and issuers like Bank of America and MBNA may be hit more than the large banks which can cross-subsidise product lines from other parts of their business. All the same, says Koch: "It will have a massive impact on how people shape the product. The structure of the market will change considerably over time. There will be some consolidation as people increasingly use only one card."

"With Apple Pay coming in too, we'll see less revenue for the banks. And, with the Financial Conduct Authority now in the midst of a market study into credit cards, further regulatory challenge may lie ahead. These are difficult times – we're talking about conditions for a perfect storm."

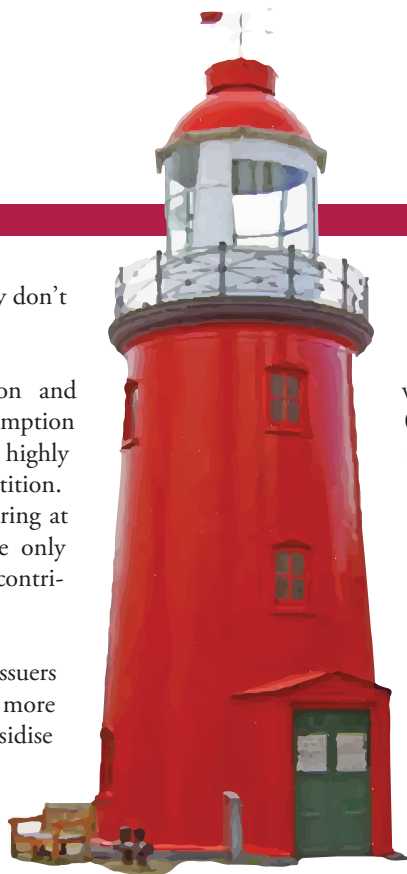
"The credit card industry has benefited from a low base rate with low delinquency rates and low credit impairment, but inevitably that won't last forever. This all makes it very difficult to operate on the current model. The banks and credit card issuers will need to re-engineer products but it's difficult to know how that's done at the moment."

"The challenge is to be innovative and provide something of value that the consumer might have to pay something for. All our work suggests people are not broadly clued up about the cost of credit and how different products might be better for them."

"Debit card growth has been enormous and we may also see people start to migrate further towards the use of their debit card. That might benefit those with a foot in both the credit card and debit card markets."

THOSE INTERCHANGE FEES

Simply put, an interchange fee is paid by the retailer's card acceptance provider (acquirer) to the card issuer when a card payment transaction occurs. It ultimately pays for a reliable global card acceptance system that's secure from fraud and guarantees payments will be made. Interchange fees vary depending on the types of card, transaction, associated risk and where the transaction takes place.



"WE MAY SEE A SECTOR WITH POTENTIALLY LESS TO INVEST IN FRAUD PREVENTION, INNOVATION AND COMPETITIVE OFFERS TO CONSUMERS."

The EC's regulation proposes to cap interchange fees at 0.2% of the transaction value for consumer debit card transactions and 0.3% for consumer credit card transactions. It aims to limit upward pressure on interchange fees where card schemes compete to attract issuers by offering high interchange fees – ultimately, in its view, protecting consumers from higher retail prices.

Opponents claim consumers won't benefit from reduced retail prices because evidence shows that retailers tend not to pass any cost savings to consumers. They say the Commission's proposals will result in less competition, restricting consumer access to credit, while increasing its cost.

THE FUTURE IS MOBILE

Meanwhile, the industry must also look at the changing consumer and technological landscape, warns Stephen Hart, CEO and founder of Cardswitcher.co.uk.

In the short term, high street banks should continue to dominate in card payments owing to their strong distribution network. But the marketplace is changing, he warns, and banks have already made the mistake of selling off their merchant acquiring businesses and opening the door to competitors.

"They misjudged the value of that product particularly to SME merchants. They took the view that they're banks, not technology firms. That was the mantra five years ago: don't invest in technology, outsource it. Barclays is the only one to retain its own in-house offering."

Now they face competition with the likes of World Pay threatening to compete on core banking products such as money transfer and treasury services. And mobile products are emerging such as Zapp which facilitate bank-to-bank transfers via mobile.

"I could see a scenario in a few years when debit cards come under serious threat from these direct bank-to-bank technologies," he says. "Look at generation Y and those to come. It will be all about mobile technology. No-one in the future will be interested in physical credit/debit cards. That's not to say that Visa/Mastercard won't be well represented in that new world, but competition from new disruptive technologies can only weaken their existing franchises."

This article was first published in Chartered Banker, the magazine of the Chartered Banker Institute

p2p

SALE

Peer-to-peer (P2P) finance is doubling every year. It appeals to SMEs and consumers that some existing lenders can't reach. Some major players are moving in. Ian Henderson asks whether it's time banks took notice.

THE NEW LORDS OF LENDING?



“P2P does seem to represent real competition in what has been a closed market for a very long time.”

wrappers, even a tiny fraction of the £2tn invested would accelerate growth still faster.

Sam Ridler of the Peer-to-Peer Finance Association, which represents providers, adds that a number of convergent trends are powering growth: the British public are increasingly eager to transact online round the clock; ‘big data’ has removed the banks’ information advantage and the need for expensive infrastructure; current low interest rates have raised the profile of alternative investments; and P2P providers are able to provide a better customer experience than banks are able to offer.

CHANGING LENDING LANDSCAPE

Led by the UK, US and China, P2P is still only a small part of the global banking landscape. But that won’t be true for much longer – the UK sector reached £1.74bn in 2014 and conservative predictions show over £4.4bn in 2015.

P2P was pioneered in the UK back in 2005 by Zopa, but is now showing its fastest growth as an industry with two additional established platforms – RateSetter and Funding Circle. According to a research report published in December 2014 by Nesta (with PwC and ACCA), 2012-14 saw growth of 108% in P2P consumer lending and 250% growth in P2P business lending.

That accounted for over £1bn of financing for more than 7,000 businesses in 2014, or 2.4% of cross-national lending to SMEs, through sites like

Funding Circle and Thin Cats. Credit is by far the largest part of the UK alternative finance sector, although invoice trading and especially equity crowdfunding (at a staggering 410% a year) are also

growing fast. Peer-to-peer, non-banking finance is simply too big to ignore any longer – which is why Nesta’s research report makes interesting reading.

For example, although 44% of SMEs surveyed were familiar with some sort of alternative finance, less than 10% had approached one of the platforms. Those who have like the better interest rates, speed, ease of use and higher levels of customer service they get from alternative finance providers. More than half of P2P business investors intend to lend more next year, and 86% of borrowers would look to P2P finance first, even if a bank were to offer funding on similar terms.

So, it seems that, beyond the rational decision, people actually prefer peer-to-peer lending. Giles Andrews, CEO of Zopa, says the banking industry has “forgotten who its customers are.” He claims that, like other disruptors, firms like his “take a product (lending), and we simply do it better”.

BANKS IN ON THE ACT

Richard Woolhouse of the British Bankers’ Association accepts that not all SMEs are suited to bank finance and that P2P providers are answering a need. However, he points out that the sector is relatively untested and not yet subject to the same regulatory and competitive forces.

He sees the link-up in SME lending between Santander and Funding Circle (RBS is talking about a similar partnership) as one mutually beneficial way forward where banks work alongside P2P lenders to provide “the right finance at the right stage in a company’s growth”. In the medium term, he and Sam Ridler agree there is room for different models to co-exist – although longer term, Ridler sees banks becoming “more like P2P lenders than vice versa”.

Zopa’s Giles Andrews believes existing banks “need to identify what is really important to their customers and

S Shopping. Listening to music. Finding a taxi. The list of ways in which the internet continues to change all our lives grows daily. We can do things faster, cheaper, better – wherever we are, whatever we’re doing. And businesses which can’t keep up simply get left behind. Could banks be next, joining the angry shopkeepers, record company honchos and cabbies who have seen their livelihoods threatened seemingly overnight by Amazon, Spotify and Uber?

The most basic functions of a bank – taking in funds and lending them out again with interest – can now be done directly from lenders to borrowers “about 60% more efficiently” through peer-to-peer (P2P) websites compared to conventional banks, according to fintech analyst Cormac Leech at investment bank Liberum. Growth is already exponential – and he sees that as the UK Government brings P2P inside ISA and SIPP tax

“For investors, P2P providers can offer better returns than conventional banks, but do carry more risk. The platform itself carries no risk, so capital requirements are much lower.”

simplify their businesses accordingly". Encouragingly for him and other 'disruptors', many users would consider peer-to-peer services that aren't yet available – like currency exchange, insurance and even mortgages – so banks can't even assume the threat is limited to what P2P currently offers.

If there is some reassurance, most of their customers are still either unaware of peer-to-peer finance or say they would be unwilling to use it without significantly better returns or some form of guarantee that their money was safe. Quite a few (31%) worry that P2P is more 'risky' than a bank – but to a similar number (28%) P2P feels more 'socially responsible'.

The Nesta report shows most SME P2P borrowers (79%) had already tried a bank before turning to a platform like Funding Circle or ThinCats, but only 23% had been made an offer of funding. The borrowing was usually for expansion or working capital, and 95% reported that their business had performed better since the funding – suggesting relatively low risk.

On the consumer, side, arguably Zopa (established 2005) and RateSetter (2010) have been around long enough to get their algorithm-driven lending criteria right – rejection rates are still high (up to 90%) and default rates extremely low (under 1%). Although it produces some very satisfied customers (both borrowers and lenders) this cherry-picking approach may suggest a limit to P2P lending growth as it will eventually need to attract higher-risk borrowers.

FUTURE OF LENDING?

Some major players clearly think P2P is here to stay, especially in the USA. Lending Club, the biggest of them all with \$6bn lent so far and a spectacularly successful IPO last December, quotes Larry Summers (ex-Secretary to the Treasury and Lending Club board member, along with Morgan Stanley's John Mack), as saying: "Lending Club's platform has the potential to profoundly transform traditional banking over the next decade."



“P2P finance does fulfil a real consumer desire to which the banking industry will soon have to respond.”

For investors, shares in P2P providers can look a better bet than conventional banks: the lender carries no risk itself if its loans go bad and capital requirements are much lower. As with any newly disrupted sector, growth will be uneven and there will be reverses – we can safely predict media coverage turning more negative, and more regulation as the sector expands.

Sam Ridler reckons: "The sustainability of P2P platforms depends on their ability to effectively assess credit risk. If investors start seeing that they are not making money due to bad debt levels... then they will find other places for their money." Cormac Leech thinks the long-term growth of the P2P sector is assured, but agrees robust credit checks are essential alongside continued transparency and keeping margins low.

He also believes platforms should have 'skin in the game' to align their objectives with those of users; without the right incentives he predicts "some blow-ups" as the sector expands. There may be

significant threats for the banking industry from other disruptors (FaceBook's widely rumoured 'FaceBank', for example), but P2P does seem to represent real competition in what has been a closed market for a very long time. So far, the industry's response has been described by the Financial Times as "laid-back" – perhaps in the expectation that the P2P audience will be limited to its current small pool of credit-worthy 'super-prime' borrowers. So far there's no sign of the copycat platforms, legal challenges or buyouts that disruptors in other markets have faced. It may also be that the shrinking tenure of the average bank CEO means they don't expect to be in the job long enough for P2P to matter.

What's clear is that P2P finance does fulfil a real consumer desire to which the banking industry will soon have to respond. Or, like those shopkeepers, record execs and cabbies, risk getting left behind.

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LIQUIDITY

RISK MANAGEMENT

By Dr. Sabir Ali Jaffery

Liquidity Risk, as defined by the State Bank of Pakistan, is the shortage of liquid assets of an organization to meet its obligations. In other words, it is the potential for loss to an organization arising from its inability to meet its obligations.

When short of liquidity, an organization has to meet its business objectives at a comparatively higher cost, thereby causing either loss to the organization or reduction in its earnings.

The Rise Of Liquidity Risk

Liquidity Risk may arise due to all or any of the following reasons:

- ❑ Undue reliance on corporate deposits. Generally speaking, such deposits are in heavy amounts. Their withdrawals are also made in large sums. A sudden withdrawal may, therefore, cause a severe blow to the liquidity position of a bank.

- ❑ Undue concentration of assets, particularly of fixed assets.
- ❑ A large loan default or sudden change in interest rate.
- ❑ Negative trend of return in any area of operation.
- ❑ As a consequence of rise in other financial risks.
- ❑ Large size of Off-balance sheet exposure.
- ❑ Decline in the quality of credit portfolio.
- ❑ Changes in interest rate.

Liquidity Risk Management Strategy

The strategy should embody specific policies on various aspects of liquidity risk management, such as:

- An optimum mix of assets and liabilities vis-à-vis the desired level of liquidity.
- Funding sources split as under:

- ❑ Permanent --- that would stay with the organization under all the circumstances.
- ❑ Semi-permanent --- that would part with in phases in problematic situation.
- ❑ Temporal --- that would quit at the first sign of problem.

- Approach to inter-bank market. Since it is difficult and costly to approach the inter-bank market in problematic situation, the strategy should take this into account.

The strategy and the policies devised there should be communicated down the line throughout the organization. These should be reviewed and revised periodically matching with the current position.

Once the policies have been devised, operational methodologies should be worked out to put these policies into action.

Organizational Structure

The structure embodies the Board of Directors, Senior Management, Investment Committee, and Asset-Liability Committee (ALCO). Experienced and competent staff, fool-proof systems and procedures are other requisites of an effective liquidity risk management team.

Board of Directors / Senior Management

The Head of the Planning and Development Department, or the department performing the same function under any different nomenclature, shall collect data, and based upon it, prepare the draft strategy of liquidity-risk management, and submit it to the Board of Directors (BoD) for approval. The BoD, after due scrutiny, shall approve the strategy and send it back for implementation to the department which had initiated it.

After the BoD approves the strategy, the senior management assumes the

responsibility of transforming it into procedural methodology and ensures its proper implementation.

This function of the senior management shall include, but not restricted to; ensuring adherence by all concerned to the prescribed policy and procedure of liquidity-risk management.

It will also be the responsibility of the senior management to establish an effective built-in control system that would measure, monitor, and control liquidity-risk of the organization, and shall identify well in advance any untoward lapse or deficiency.

Risk Management Committee

It is a high-powered committee constituted to supervise overall risk management functions of the organization, which primarily include controlling and monitoring of the integrated risk management comprising various risk exposures of the organization including the liquidity risk.

“The structure embodies the Board of Directors, senior management, Investment Committee, & Asset-Liability Committee (ALCO)”



"Cash position may also be determined on a day-to-day basis through 'maturity ladder' device"

Strength and structural components of this committee vary from organization to organization, depending upon the size and complexity of the business an organization undertakes.

Asset-Liability Committee (ALCO)

State Bank of Pakistan has recommended formation of an Asset-Liability Committee. Functions proposed for this committee, commonly known as ALCO, are almost identical to those of Risk-Management Committee. However, in a large size organization with different levels of hierarchy and with multiple level organizational set-up, ALCO may also be established to monitor and oversee the performance of Liquidity-risk Management functions. By its very nature, ALCO is assumed to have the powers of reviewing and revising the overall Liquidity Management Strategy of the organization in the context of various other risks the organization is exposed to.

This is a committee that is formed to manage overall liquidity of the bank. Ideally, an ALCO should comprise of senior management. ALCO members are expected to have relevant expertise and a good understanding of all the issues related to liquidity.

Liquidity Risk Management Process

An effective liquidity risk management system features identifying, measuring, monitoring, and controlling both existing as well as future risk an institution may be exposed too. To acquit itself creditably with this assignment, the system should have support of a self-contained Management Information System (MIS)

Liquidity Measurement Techniques

Some of the techniques commonly used by banks are:

- Contingency Funding Plan (CFP)

- Cash Flow Projections
- Liquidity Ratios and Limits

Contingency Funding Plan

It is a set of policies and procedures that suggest a way out in stressful situations. It is a projection of future cash flows and funding sources in the wake of aggressive asset growth and / or liability erosion. It is an extension of ongoing liquidity management techniques. Its utility is well-judged in situation of sudden liquidity stress. Since such situations require spontaneous action, banks with an organized plan to deal with such situations address the problem more effectively.

No outline of the scope and operational mechanism of CFP can be exhaustive. It has to cope with the volume and the complexity of the business a bank undertakes and is therefore variable in nature.

Cash Flow Projections

A cash flow projection shows the difference between cash inflows and outflows, thus determining surplus or deficit over a period of time. Cash position may also be determined on a day-to-day basis through 'maturity ladder' device.

"An effective liquidity risk management system features identifying, measuring, monitoring, and controlling both existing as well as future risk an institution may be exposed too"

For short term, inflows and outflows of funds can be estimated more accurately. Such estimates carry great practical

values since based on them immediate actions are taken. It, however, does not mean that distant period estimates are of no avail. These estimates provide ample opportunity to the banks to ascertain their cash need sufficiently in advance before the crises knocks at the door. Some cash flows are seasonal or cyclical. These need to be taken care of in their true perspective.

Liquidity Ratios and Limits

Liquidity may be quantified with the help of a variety of ratios, which may also be used to create limits for liquidity management. Ratios should invariably be used in corroboration with qualitative information about funds movement, such as the probability of increased requests for early withdrawals, reduction in credit lines, or reduction in the volume of term deposits.

Cash Flow Ratios and Limits:

A great threat is posed by unarranged-for maturing liability. Cash flow ratios and limits provide before hand warning of maturing liability.

Liability Concentration Ratios:

These ratios and limits help prevent a bank from relying too much on a few selected sources of funds.

Periodical Review

Effective and meaningful control of procedures and policies demand that these should be periodically reviewed and updated. Truly speaking, utility of policies and procedures lies in their constant review, matching the current situation and forecasts. Officials not related to funding areas should undertake such reviews as a regular business activity.

Monitoring and Reporting Risk Exposures:

Senior management and the Board should receive with frequent intervals, reports on the level and trends of the liquidity which would help them ascertain how much liquidity risk. The bank is in a position to assume. With the help of these reports, risk-tolerance level is quantified for further purposeful exercises.

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COMMERCIAL BANKING

Problems and Solutions

By Dr. Sabir Ali Jaffery



How would you handle the following situations?

(a) An illiterate person approaches you to open an account at your branch.

(b) A person with raw handwriting and signing in vernacular wants to open an account with you.

Ans. (a) There is no bar in opening the account by an illiterate person. However, certain precautions, are needed:

The illiterate person will be required to provide his latest photograph which will be attached on the account opening form and verified by the bank official under his full signature. Preferably, one copy of the photograph will also be pasted on the specimen signature card and attested by the bank officer conducting the account opening process.

Thumb impressions of the person on account opening form and on specimen signature card will be affixed in presence

of the bank official and will be attested by him (bank officer).

Moreover, every time when he would be issuing a cheque he would put his thumb impression on the cheque in presence of a bank officer who would attest it.

(b) All the precautions as mentioned in (a) above will be taken while allowing opening and operating the account.



The accountant of one of your accountholders, a partnership firm, approaches you with a request apparently signed by a partner of the firm authorised to operate the account of the firm singly to issue a cheque book stating that the previous cheque book containing the requisitioning memo was with another partner of the firm who was out of the country. How would you deal with the request?

Ans. After verifying the signature on the letter, a call will be made to the partner who had signed the letter. On

getting confirmation to your satisfaction that the letter was signed by him and that the partner who was out of the country was not expected to return in the near future, the cheque book may be issued but instead of delivering it to the accountant, the same will be sent on firm's address by courier service.

The fact of conversation with the partner should be recorded on the letter of request with time and date. Moreover, a copy of the delivery memo of the courier company should also be obtained and kept on record.



A well reputed public limited company maintains a highly valuable account with you for quite some time. The account is running with your full satisfaction. The company now requests you to deliver back to them the paid cheques at the end of each month. Normally, a large number of cheques are presented and paid during the month as a normal business practice. How would you deal with the situation?

Ans. The request may be acceded to after taking the following precautionary measures:

(a) Copies of all the cheques may be preserved carefully.

(b) Admittance as to the correctness of the Statement of account incorporating debit entries pertaining to the cheques being delivered back should be obtained from the company.

(c) An acknowledgement of having received the paid cheques stating serial numbers and amounts of each cheque may be obtained from the company. This should also bear an undertaking that all or any of these cheques will be presented as and when called for.

(d) An indemnity should be obtained from the company that the bank shall be indemnified for any loss accrued to it

due to any transaction covered by all or any of these cheques.

(e) All expenses relating to this service shall be borne by the company.



One elderly lady wants to open an account with you on the following terms and conditions:

(i) The account shall be operated by her son;

(ii) On her death the balance in the account should be paid to the son without further legal formalities; and

(iii) If the relations between mother and son are strained, the son should not be allowed to operate the account. How would you meet the needs of the lady to her satisfaction?

Ans. The account will be opened in the name of the lady and she will be advised to execute mandate in favour of her son to operate the account. She will be within her right to revoke the authority, if her relations with her son are strained at any future stage.

A nomination from the lady in favour of her son may entitle the son to draw the balance of the account after her death. Such nomination should be attested by a magistrate.

It would, however, be impracticable for her to withdraw the nomination in view of her strained relation with the son. The situation may be tactfully explained to the lady and made her agree that the balance of her account on her death would be made available to her legal heirs on production of Succession Certificate.



DEALING WITH DISTRESSED ENTERPRISES IN PAKISTAN

*A take in the 2016 rehabilitation bill
“old wine in new bottle”*

By Fahim Adil



On New Year's night, working on debt bailout proposal for a distressed asset, I began to ponder the fiduciary duty of banks and the discretion banks exercise with the accompanying usual rhetoric of deliberations and considerations. The idea herewith in the commentary is simple: the restructuring of non-performing banking assets needs a regulatory framework instead of statutory intervention through a bill to ensure timely and transparent procedures. State Bank of Pakistan (SBP) has to come up with two tier policy in the light of current economic conditions for settlement and restructuring. Minimizing the subjectivity associated with willful default and providing a platform through collective and coordinated efforts to rescue a firm in distress will result in better returns to banks and in general to our economy. Absence of such a mechanism forces firms into formal insolvency and

benefit from it at the expense of creditors. In case a relief package is offered to a genuinely distressed firm, there is little holding the sponsors of the concern to the promises vital for turnarounds.

A person is said to commit an offence of willful default under NAB Ordinance, if he does not pay the amount to the financial institution (unless the accused was unable to pay). Their character is compared with their capacity to pay. The over-simplistic assumption here is that they are mutually exclusive. This simplistic interpretation leaves a lot of political discretion for the banks to play with ambiguity arising from failure of the existing insolvency and recovery laws. Banks have double digit Return on Equity (RoE) and less than 2% Return on Asset (RoA) in Pakistan, illustrating that the banks have a high equity multiplier, that is, a low ratio of assets to equity, and thus,

are quite vulnerable. The underlying thought here is that many loans in general are restructured with the pretext to clean balance sheet temporarily and not with the bona fides intended to rehabilitate or help the distressed borrower. The recurring restructurings have no financial benefit to the economy and to the lenders. SBP with regulatory mandate can spell out the difference between character and capacity. Therefore, a mechanism is needed to establish that either a corporation is a willful defaulter requiring punitive actions or financially distressed entity needing relief. The requisite mechanism becomes absolutely essential in the case of multiple lenders involving large sums of money.

Assume that there is a company, which has an outstanding debt with multiple lenders that it *cannot* service for genuine reasons. What options does the company

have? The company can replace high cost debt with low cost debt, or it can opt for equity market. The distressed company will not be in a position to service the debt even at marginally lower interest rates compared to previously high rates. Moreover, it would not be able to raise the desired money from equity and bond market due to this paradoxical situation from which the company cannot escape. Due to the absence of any incentive to declare the firm as sick and subsequently eligible for statutory relief, whose merits are, in any case, questionable, the company can cease its operations, undergo winding up, or go for distress sale. Another option could be for the company to devise a structured plan to re-negotiate the terms of its current debt with the lenders. This will give much needed breathing space to the company, provided these lenders form a significant portion of the creditors who agree to the terms. In the absence of such a mechanism, the bargaining power rests with the debtor seeking financial relief from lender without addressing the impending issues. Resulting Restructuring fetches low returns to lenders and is **counter economic**.

The above stated opinion challenges many successful restructuring done by lenders, denies the importance of restructuring as instrument for the lenders, and aids the transformation of otherwise bad loans into possible productive assets. Crucially, it also helps us understand the inherent weakness and drawbacks of a process lacking inter-creditor mechanisms and the supervision of central bank. This problem is not unique to lenders in Pakistan. Corporate restructuring programs in countries such as the UK, Thailand, Malaysia and South Korea were similarly instituted during the economic crisis of the early 1990s.

Not surprisingly, the Pakistan banking sector has the highest infection ratio among comparable countries such as Bangladesh, India, Sri Lanka, Philippines, and Malaysia. None of them crosses the 10% line except Pakistan. Corporate is the front runner sector with 67% allocation of the advances granted by the banks. The issue becomes more pressing with the fact that 14% of corporate loans are infected. To have to predict exactly how far a restructuring mechanism can go to prevent insolvency is like having to predict the unpredictable. The restructuring

mechanism, however, should be implemented for the right reasons, appropriate time and specific milestones. In 1997, the State Bank of Pakistan announced a scheme for the recovery of loans in default. Main concerns of the borrowers at that time were that the collaterals valued more or less than what they were required to pay under the scheme and what would constitute the principal and mark-up amount. The scheme made no difference between those debtors who used wrong means with no intention to pay back, compared to those borrowers who failed to meet their obligations for genuine reasons. The answer to forgoing at that time was Corporate and Industrial Restructuring Corporation (CIRC) whose statutory life expired on 22 September, 2006; CIRC was alleged for not reorganization and restructuring businesses.

Present Macroeconomic conditions and an escalation in non-performing asset warrant that in order to safeguard the interest of depositors and to ensure the safety, transparency, and soundness of the bank system, a regulatory framework/prudential regulation should be issued that provide a detailed framework for the restructuring of corporate debts of viable entities facing problems. The Policy coordination will have significant role for both the borrowers who are otherwise viable business concerns and the lenders. PPP's Senator Saleem Mandviwala presented Corporate Rehabilitation Bill 2015. This Corporate Restructuring bill is being perceived as pro-borrower & court-driven by creditors, contradictory to present laws of the country that are pro-creditor. On March 4, 2016 the Standing Committee of the National Assembly on Finance and Revenue approved the draft of the Corporate Restructuring Companies Bill, 2016 that is propagation of aforementioned legislation. Corporate Restructuring Companies Bill, 2016. As per SECP Press Release dated March 4, 2016 the bill will provide basic set up for the rehabilitation mechanism of sick units in the country and to put the corporate economy on fast track. It is noticed by, The Standing Committee of the National Assembly on Finance that there is a need to introduce a comprehensive legal framework to address the rehabilitation issues of distressed businesses in Pakistan, develop and promulgate a comprehensive corporate rehabilitation regime.

“Present laws do not differentiate between a willful default and a circumstantial default”

The training of the judges as the interpreter of the law and in absence of comprehensive legal framework, the corporate rehabilitation through court or out of court “Administration” would not bear fruit and its fate would not be much different than previous attempts. Corporate Restructuring Companies Bill, 2016 is *old wine in a new bottle*.

In the present scenario, a statutory corporate rehabilitation process would make the recovery of distressed concerns even more difficult. Present laws do not differentiate between a willful default and a circumstantial default, revocation of section 31-D of NAB ordinance has made the issue more complex. A statutory intervention through a bill is neither supported by debtors nor by creditors for different reasons. However, a regulatory framework, as I have been discussing here, will inspire a broader creditor agreement for rehabilitation /restructuring. This framework will not only make rehabilitation process transparent and viable but also give leverage to creditors in recovery.

Rehabilitation and Restructuring of Corporate Entities Bill of 2015 might be the object of a leverage game between debtors and creditors, but the losing parties will surely be the depositors and the common people who will be denied the much needed economic activity. Each non-performing loan in the financial sector is viewed as an obverse mirror image of an ailing unprofitable enterprise. From this point of view, the eradication of non-performing loans is a necessary condition to improve the economic status.

Joris Luyendijk, an investigative journalist, knew as much about banking as the average person: almost nothing. Bankers, he thought, were ruthless, competitive, bonus-obsessed sharks, irrelevant to his life. And then he was assigned to investigate the financial sector. Joris immersed himself in the City for a few years, speaking to over 200 people - from the competitive investment bankers and elite hedge-fund managers to downtrodden back-office staff, reviled HR managers and those made redundant in the regular 'culls'.

Breaking the strictly imposed code of secrecy and silence, these insiders talked to Joris about what they actually do all day, how they see themselves and what makes them tick. They opened up about the toxic hiring and firing culture. They confessed to being overwhelmed by technological and mathematical opacity. They admitted that when Lehman Brothers went down in 2008 they hoarded food, put their money in gold and prepared to evacuate their children to the countryside. They agreed that nothing has changed since the crash. Joris had a chilling realisation. What if the bankers themselves aren't the real enemy? What if the truth about global finance is more sinister than that?

MAJOR AREAS COVERED

- ❑ Behind the Wall of Silence
- ❑ Planet Finance and the Crash

- ❑ Going Native
- ❑ Other People's Money
- ❑ When the Call Comes
- ❑ Every Man for Himself
- ❑ Islands in the Fog
- ❑ And Now for Some Good News?
- ❑ Godverdomme
- ❑ Masters of the Universe
- ❑ Life in the Bubble
- ❑ Nobody Likes A Prophet of Doom'
- ❑ The Empty Cockpit

REVIEWS

- ❑ Luyendijk dives deep into the most important social pocket in the world: among the elite financiers who nearly killed the global economy a few years ago - and who are right now carrying on as before in a system that's as shaky as ever. All this is described not with spleen, but with an attentive empathy - and the book is all the more terrifying for it. (Aditya Chakraborty)
- ❑ An exploration of the inner workings of banking that's both enormously entertaining and utterly terrifying. Proceeding in his fair-minded, unsensationalist way, Joris Luyendijk ends up

showing how the financial system has evolved to offer all the wrong psychological rewards for all the worst behaviour - and how we may be teetering on the brink of a greater crisis than those we've already seen. It's not (mainly) that bankers are bad people. It's far scarier than that. (Oliver Burkeman)

❑ Based on interviews with bankers, Joris Luyendijk's *Swimming with Sharks* argues that the problem in banking is systematic rather than with individuals. While suggesting another crash is inevitable, Luyendijk also achieves the near-impossible: making you pity these "masters of the universe". (*Evening Standard*)

❑ It is his willingness to see the good in his subjects that gives his final conclusion greater force. (Jonathan Ford *Financial Times*)

❑ A fascinating anthropologist's study of financial system's culture. (George Cooper *The Origin of Financial Crises*)

❑ Terrifying ... Luyendijk avoids banker bashing and clichés which makes this portrait all the more devastating. (*De Volkskrant*)

ABOUT THE AUTHORS

Joris Luyendijk is a writer, journalist and author of *Hello Everybody! One Journalist's Search for Truth in the Middle East*. Follow him on @JLbankingblog.

(This book is available in IBP Library)



Overcome ERM implementation challenges by taking cues from leading global organizations

Implementing Enterprise Risk Management is a practical guide to establishing an effective ERM system by applying best practices at a granular level. Case studies of leading organizations including Mars, Statoil, LEGO, British Columbia Lottery Corporation, and Astro illustrate the real-world implementation of ERM on a macro level, while also addressing how ERM informs the response to specific incidents. Readers will learn how top companies are effectively constructing ERM systems to positively drive financial growth and manage operational and outside risk factors. By addressing the challenges of adopting ERM in large organizations with different functioning silos and well-established processes, this guide provides expert insight into fitting the new framework into cultures resistant to change.

Enterprise risk management covers accidental losses as well as financial, strategic, operational, and other risks. Recent economic and financial market volatility has fueled a heightened interest in ERM, and regulators and investors have begun to scrutinize companies' risk-management policies and procedures. *Implementing Enterprise Risk Management* provides clear, demonstrative instruction on establishing a strong, effective system. Readers will learn to:

- ❑ Put the right people in the right places to build a strong ERM framework

- ❑ Establish an ERM system in the face of cultural, logistical, and historical challenges

- ❑ Create a common language and reporting system for communicating key risk indicators

- ❑ Create a risk-aware culture without discouraging beneficial risk-taking behaviors

ERM is a complex endeavor, requiring expert planning, organization, and leadership, with the goal of steering a company's activities in a direction that minimizes the effects of risk on financial value and performance. Corporate boards are increasingly required to review and report on the adequacy of ERM in the organizations they administer, and *Implementing Enterprise Risk Management* offers operative guidance for creating a program that will pass muster.

REVIEWS

"This book should be an extremely valuable source of knowledge for anyone interested in the emerging and evolving field of risk management." —Robert S. Kaplan, Senior Fellow, Marvin Bower Professor of Leadership Development, Emeritus, Harvard University

"It will provide a much needed resource to students and practitioners for many years to come and should become a well used reference on the desk of every manager of risk." - Kevin W. Knight, AM, Chairman, ISO/TC 262 Risk Management

"I commend the editors and contributors for making a significant contribution to ERM by sharing their experiences." —James Lam, President, James Lam & Associates; Director and Risk Oversight Committee Chairman, E*TRADE Financial Corporation; author of *Enterprise Risk Management: From Incentives to Controls*

"The broad collection of practices is insightful for students, academics, and executives, as well as seasoned risk management professionals." —Carol Fox, ARM, Director of Strategic & Enterprise Risk Practice, RIMS

ABOUT THE AUTHORS

JOHN R.S. FRASER is the Senior Vice President of Internal Audit and former Chief Risk Officer of Hydro One Networks Inc. He holds several auditing and accounting certifications and has over 30 years of experience in the risk and control field.

BETTY J. SIMKINS is the Williams Chair and Professor of Finance at Oklahoma State University's Spears School of Business, where she teaches enterprise risk management and other courses. She has published award-winning research on risk management in academic and professional outlets.

KRISTINA NARVAEZ is President and CEO of ERM Strategies. Her work in risk management has been recognized with accolades and awards from numerous organizations, including the Risk and Insurance Management Society

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An Analytical Framework for Understanding Financial Markets

The Economics of Money, Banking and Financial Markets brings a fresh perspective to today's major questions surrounding financial policy. Influenced by his term as Governor of the Federal Reserve, Frederic Mishkin offers students a unique viewpoint and informed insight into the monetary policy process, the regulation and supervision of the financial system, and the internationalization of financial markets.

Continuing to set the standard for money and banking courses, the Eleventh Edition provides a unifying, analytic framework for learning that fits a wide variety of syllabi. Core economic principles organize students' thinking, while current real-world examples keep them engaged and motivated.

FEATURES

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- An applications-oriented perspective with numerous applications and special-topic boxes increases students' interest by showing them how to apply theory to real-world examples in the Pearson e-text.

- NEW! Real-time data analysis. Problems marked with the RTDA logo require that students download data from the Federal Reserve Bank of St. Louis FRED website, and then use the data to answer questions about current issues in macroeconomics.
- Offers a no-fuss solution for instructors who want to make the most recent data a central part of their macroeconomics course. Real-time data analysis exercises will not only help students to understand macroeconomics better, but will enable them to see the real world relevance of their study of macroeconomics.

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The text also allows instructors to cover the most important issues in monetary theory without having to do a detailed development of the IS, MP, and AD curves in Chapters 21 and 22. Instructors who want to teach a more complete treatment of monetary theory would make use of these chapters.

ABOUT THE AUTHOR

Frederic S. Mishkin is the Alfred Lerner Professor of Banking and Financial Institutions at the Graduate School of Business, Columbia University.

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INTERESTING QUOTES ON BANKERS

“It is well enough that people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before tomorrow morning.” - *Henry Ford*

“When a government is dependent upon bankers for money, they and not the leaders of the government control the situation, since the hand that gives is above the hand that takes.” - *Napoleon Bonaparte*

“When people rob Banks, they go to jail. When Banks rob people, they get bonuses.” - *Anonymous*

BANKERS JOKES

A man visits his bank manager and says:

"How do I start a small business?"

The manager replies, "Start a large one and wait six months."

~~A Man Was Sleeping In His House.~~

Suddenly Death Angel Appeared & Said "Go Out & Enjoy, Nothing Will Happen To You For The Nxt 10 yrs"

He Did So & Met With An Accident & Died In Heaven,

He Asked Angel:
Why You Lied To Me?

Angel Replied:
Sorry Son, Month End..
Had 2 Achieve Targets"

~~"Little Johnny, what do you want to be when you grow up?"~~

"I'm gonna follow in my dad's footsteps and be a cop."

"Is your dad a cop?"

"No, he's a bank robber."

IN MEMORY OF SHAHEED MOHTARMA BENAZIR BHUTTO



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