

Journal of The Institute of

**Bankers**

P a k i s t a n

Volume 82 | Issue # 3

July/September 2015

**E-Banking Current State of Play –  
Impact, Issues, Risks & Security**

**Placing Ethics at the Top  
in Governance**

**Should Your Business Pay the Price  
for Bank Fraud**

**Management in Banking:  
Risk Management-I;  
Credit Risk Management**

**SUKUK MARKET IN ASIA**  
Set for a Take-off

# ISQ

Become A  
Certified Banker

**Accredited by  
Chartered Banker UK,**

ISQ is the only professional banking  
qualification in Pakistan.

## **Fast Track Your Career in Banking**

**Get Yourself Enrolled Now**

### **What is ISQ?**

- Internationally recognized professional banking qualification, also recognized by the State Bank of Pakistan and the banking industry.
- 3-level self study program.
- Specially designed to impart technical skills and knowledge to become well-rounded banking professionals.
- Exams are held in April and October each Year.

### **Program Cost and Schedule**

One time Registration Cost Pak Rs. 15,000  
Per subject Exam cost: Pak Rs. 1,500

### **For More Information**

Call us at: 111-IBP-ISQ (111-427-477) or  
Visit us at : [www.ibp.org.pk](http://www.ibp.org.pk)



**IBP Superior  
Qualification**

**Chartered Banker**  
Leading financial professionalism



**The Institute of Bankers  
Pakistan**

Up till 2013, the SBP had kept its monetary policy tight; since then it has loosened the same by reducing the policy rate repeatedly. In doing so, it reduced the interest rate by 350 basis points between November 2014 and September 2015. In its most recent decision, the Regulator cut the policy rate down further by 50 basis points to 6 percent – a rate that stands at a 42 year low.

However, the effects of the loosened monetary stance have yet not transpired in the flow of credit to the private sector. The flow of credit increased by Rs 208.7 billion during FY15, compared to Rs 371.4 billion in FY14. This restricted flow of credit can be attributed primarily to dampened domestic and international demand, structural bottlenecks, low commodity prices and government borrowing from the banking system.

In contrast to FY14, when ample foreign inflows provided financing for the fiscal deficit, the government relied heavily on the banking system for its financing needs in FY15 when foreign inflows dried up. A record borrowing of Rs. 1,339 billion was conducted from the scheduled banks, with most of the funds being used to retire the SBP's debt. The expectations of monetary easing and the loosened monetary stance implemented by Regulator further facilitated the government in meeting its financing requirements.

Real lending rates have marked at around 4 percent since mid-FY15 due to declining inflation. Hence, while monetary conditions appear to have loosened, they still remain tight in real terms. However, the credit flow to the private sector is expected to pick up in the near future, with the expectation of increased productivity heralded by an increase in fixed investment loans by energy generation and distribution, chemicals and services sectors. Credit for long term investment purposes was recorded at an increased Rs. 126.9 billion in FY15 as opposed to Rs. 71.4 billion in FY14.

To be noted is the fact that excluding the exceptional credit demand in FY14, and when comparing with the average of the past 3 years' credit uptake of Rs113 billion, the credit directed to the private sector in FY15 does not seem to be on an actual declining trend.

As per projections, a lagged impact of the eased monetary stance of FY15 will be witnessed in the upcoming credit cycle of the first half of FY16. Higher credit utilization in construction and real estate sectors depict that going

forward in 2016, these sectors are likely to exhibit increased productivity and credit demand. Agriculture credit, too, is expected to grow broadly as per its stable trend while the outlook in the textile sector remains lackluster due to the projections of low cotton prices in the medium term. The energy sector also holds promise depending on the early actualization of energy projects under China Pakistan Economic Corridor (CPEC).

Bolstered investor confidence as a result of positive IMF reviews, political stability, improved law and order situation and the prospects offered by the CPEC are further strengthening the expectations of an impending increase in flow of private sector credit.



**Sirajuddin Aziz**  
Editor-in-Chief



# GLOBAL REACH LOCAL EXPERTISE



■ Banks ■ Telecom Operators ■ Payment Processors ■ Central Bank ■ National Switch Providers

■ Abu Dhabi ■ Afghanistan ■ Algeria ■ Bahrain ■ Bangladesh ■ Brunei ■ Burkina Faso ■ Cameroon ■ Congo  
■ Egypt ■ France ■ Ivory Coast ■ Jordan ■ Kuwait ■ Lebanon ■ Libya ■ Malaysia ■ Maldives ■ Mauritius ■ Morocco  
■ Oman ■ **Pakistan** ■ Qatar ■ Saudi Arabia ■ Sudan ■ Togo ■ Tunisia ■ Turkey ■ UAE ■ UK ■ Yemen

 IRIS Enterprise Switch	 Moneta Sanitization Processing System	 IRIS PCMS	 UBPS Electronic Bill Payments	 Payaxis Payment Gateway	 PRISM Internet Banking
Multi Channel Enterprise Switch	Cross Border Remittance	Prepaid Card Management	Bill Collection Management	Digital Commerce	Direct Banking



TPS Middle East FZ LLC | TPS Pakistan(Pvt.)Ltd.  
Office 1204, Aurora Tower, DIC, | TPS Tower, A-43, Block 7/8,  
P.O. Box: 502785, Dubai, U.A.E | K.C.H.S., Karachi 75350, Pakistan  
[www.tpsonline.com](http://www.tpsonline.com)



**Dr. Salman Sheikh** is currently pursuing PhD in Economics and has done MS in Finance. He is a known author with 11 indexed research papers published in local and abroad journals along with more than 150 research articles written in more than two dozen different magazines worldwide.

**Sehba Ehsan** carries a massive experience of 20 years in Commercial banking covering Relationship Management – Corporate / Consumer and also Compliance and Anti – Money Laundering activities in Bank. She holds an MBA degree from IBA.



**Mahboob Ahmed** has a professional experience of 8 years as Relationship Manager - Branch Banking and Asst. Manager Documentation and Review in Credit Administration Department. He has done M.Com (Finance Specialization) from University of Punjab, Lahore and is JAIBP qualified.



**Dr. S. Sabir Ali Jaffery** is 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.



**Danish Ali** Since 2009, he has been working as an actuarial consultant in a leading firm. He has done Bachelors in Sociology from University of London. He is a member of "400 club" and is a career ambassador for the IFoA (Institute and Faculty of Actuaries UK). He is also engaged in various international bodies.



**Mujahid Abbas** has successfully completed JAIBP, MBA (Finance) and CPA (F). Since 2008, he is actively engaged in teaching Accountancy, Economics and Banking. Corporate training is his passion.



**Athar Hussain** is an Emeritus Professor of International University of Chabahar, Iran. He is a senior management and governance professional, a fellow member of the Institute of Chartered Accountants in Pakistan, a Public Finance Accountant from UK and Australia & Fellow of Corporate Governance Body of Secretaries in Pakistan.

## 06

COVER STORY



## SUKUK MARKET IN ASIA

### Set for a Take-off

### Cover Story

**06** Sukuk Market in Asia  
Set for a Take-off

### Global Perspective

**12** Money Laundering –  
A Global Review

**16** E-Banking Current State  
of Play – Impact, Issues,  
Risks & Security

### Banking

**24** Commercial Banking  
Problems & Solutions

**26** Management in Banking:  
Risk Management-I;  
Credit Risk Management

**29** Humanizing the Enterprise  
Risk Dialogue

## 09

## List of Successful Candidates



## Opinion

**30** Should Your Business Pay the Price for Bank Fraud

**36** Humor and Quotes

## Personal & Professional Development

**34** Placing Ethics at the Top in Governance



### Published by:

The Institute of Bankers Pakistan  
Moulvi Tamizuddin Khan Road  
Karachi 74200, Pakistan  
Tel: +92 (21) 3568 0783  
Fax: +92 (21) 3568 3805  
www.ibp.org.pk  
publications@ibp.org.pk

### Editor-in-Chief:

Sirajuddin Aziz

### Deputy Editor-in-Chief

Rizwan Nizami

### Publications

Fizza Rizvi  
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.

### Copyright



The Institute of  
Bankers Pakistan

All rights reserved. The material appearing in this journal may not be reproduced in any form without prior permission of The Institute of Bankers Pakistan.

### General Disclaimer:

IBP Journal is based on contributions from individuals and information obtained from local and international print and electronic media. IBP has not verified this information and no warranty, expressed or implied, is made that such information is accurate, complete or should be relied upon as such. In no circumstances IBP and its team members would be liable for any incidental or consequential damage that may occur from the use of information contained in IBP publication(s).



HABIBMETRO



SPENDING HAS  
ITS REWARDS.



0800 HABIB (42242)  
[www.habibmetro.com](http://www.habibmetro.com)

STAY AHEAD

TERMS AND CONDITIONS APPLY



# SUKUK MARKET IN ASIA

## Set for a Take-off

*By Salman Ahmed Shaikh*

Sukuk is an alternative Islamic finance instrument for conventional bonds. Sukuk is a certificate that represents ownership in underlying real asset(s). Islamic law does not permit interest and hence conventional coupon paying bonds are impermissible as per Islamic law.



**T**he financial crisis of 2007-2009 and ongoing sovereign debt crisis in Europe has created a lot of questions and provided some key lessons. Some of the contributing factors for the crisis included:

- Massive levels of debt
- Consumption beyond means
- Speedy financial innovation with lax regulations

In US, the share of total corporate profits generated in the financial sector grew from 10% in the early 1980s to 40% in 2006. These earnings are transaction costs for the productive sector.

Financial institutions that were just supposed to be playing a supportive role to the productive economy got much bigger and unregulated through shadow banking practices. Nevertheless, financial intermediation has a useful function to efficiently match savers and investors.

A new paradigm is needed that can:

- Put the focus back on productive enterprise
- Bring economic recovery with job creation
- Limit and regulate speculative financial instruments
- Improve corporate governance by influencing the incentives

The two most important problems identified in a post-financial crisis look back are perverse incentives and de-linking of financial sector growth and activities with the real sector of the economy. Islamic finance principles by basing all financial products with real assets fill the gap and this feature alone is a very important risk management tool inbuilt into the system. The Islamic finance industry has demonstrated its potential with steady 15-20% growth during the last two decades.

During the last decade and half, the Islamic financial industry has seen tremendous growth even when the conventional financial institutions went into a deep crisis. Not only Muslim major-

ity countries but non-Muslim majority countries are also taking interest in using Islamic finance instruments to finance government projects. In recent years, UK, Luxembourg and Hong Kong have issued Shari'ah compliant securities.

Islamic law allows sale and lease of real assets and the resulting income in the form of profit on sale or rental income stream on lease of assets. Holders of Sukuk share in the lease or profit income generated from the ownership of real assets that the Sukuk certificate represents.

Sukuk is a useful device to access funds on long term basis for the purchase of lumpy assets. By way of issuing Sukuk, the issuer gets required amount of funds externally from a wide range of investors who are looking for stable income source. Sukuk is a standardized instrument in Islamic finance that can provide stable income stream for a long term. The standardized nature of the instrument and the listing at the exchange provides liquidity in the instrument that is a useful attribute for investors looking to restructure their portfolios in changing scenarios.

For firms, Sukuk based financing is often the only alternative for long term and large amount of financing requirements since the banks have a short term maturity of deposit liabilities and cannot place large amount of funds for too long. Moreover, small Islamic banks are sometimes hampered by prudential regulations issued by central banks to restrict huge exposure to a single client. Hence, in such cases, Sukuk turns out to be a very useful instrument for syndicate financing.

Sukuk issuance globally reached \$117 billion in 2013 from a total of 811 issues, of which 175 were based on the Ijarah structure. A typical Ijarah Sukuk would work like this. For instance, if a manufacturer requires industrial equipment, it will issue Sukuk that can be purchased by institutional and/or retail investors. From the proceeds of Sukuk, the industrial equipment is purchased and is leased to the manufacturer. During the period of lease, the manufacturer will pay rents and that will generate income stream for the Sukuk holders who had invested in Sukuk. After the lease period is over, the manufacturer will purchase the asset in a separate contract

and this will enable the Sukuk holders to be able to redeem their investment.

Sukuk could turn out to be an instrument of choice after the current financial crisis. Not only Muslim countries but non-Muslim majority countries are also taking interest in it. UK treasury issued a Sukuk worth £200 million. It became the first sovereign state outside the Muslim world to issue an Islamic bond. Furthermore, Hong Kong and Luxembourg also issued Sukuk recently.

Globally, Malaysia remains the leader in the international Sukuk market. Among other regional countries, Indonesia in last few years has issued three sovereign Sukuk of \$1 billion to \$1.5 billion each. Turkish issuers including the government have also issued Sukuk worth \$4 billion internationally.

In Pakistan, 78 Sukuk have been issued so far for an amount of \$6.7 billion. Out of the total 78 issued, 32 Sukuk for an amount of \$1.1 billion had been fully redeemed. Government of Pakistan had issued Ijarah Sukuk on numerous occasions in the past to meet its escalating borrowing requirements. Government sector companies like Water & Power Development Authority (WAPDA) and Sui Southern Gas Company Limited (SSGC) have also issued Sukuk in past. Karachi Shipyard issued an Ijarah Sukuk in 2007.

Sukuk are debt instruments, which must be backed by a particular asset – this means that they are ideally suited to serve large-scale project financing needs. By issuing sovereign Sukuk to scale up infrastructure investment, the governments can attract foreign direct investment by improving their public infrastructure. Projects to build toll ways, railways or even schools and hospitals, which generate revenues from tangible assets, are consistent with the Islamic finance rules of creating economic value and so are particularly appropriate for Sukuk financing.

Some of the potential projects that can be financed using Sukuk include:

- Low cost public transportation
- Solar parks

- Wind farms
- Dams
- Dry and Sea Ports
- Highways etc

In most developing countries, the governments pay more than 50% of their tax revenues in servicing debt and spend very little in development. Often, these governments trim development spending to cover other non-discretionary current expenditures. Islamic banks can finance the governments for the purchase of infrastructure that can be used in development projects. These Sukuk can deepen Islamic money market and provide more investment alternatives to Islamic banks' treasuries.

### Challenges for Growth of Sukuk in Development Finance

Currently, differences of opinions among Shari'ah scholars can occur even within a single jurisdiction. Some years back, a respected scholar Mufti Taqi Usmani commented that as much as 80% of the Sukuk issued globally does not fulfill Shari'ah compliance criteria. There is a need for standardization and issuance of more commonly accepted structures like Ijarah, Istisna and Musharakah which will be more conducive and have less reputational risk. Many Sukuk also involve multiple transfers of an asset, which can make underlying assets subject to repeated instances of taxation.

Debt financing of infrastructure projects would be an entirely new and unfamiliar asset class for most capital market investors. As a result, intermediaries will need to engage in considerable marketing efforts to generate interest among capital market investors in infrastructure.

The current low oil price may change the servicing capacity of the oil-rich governments and change their respective Sukuk ratings. Geopolitical crisis may also affect ratings of sovereign Sukuk. MYR in which most Sukuk are denominated has undergone steep depreciation. This increases the currency risk and hence premium on MYR denominated Sukuk if the trend persists. One of the solutions could be multi-currency Sukuk, but it comes at a higher cost of incomplete hedging.

"Islamic law allows sale and lease of real assets and the resulting income in the form of profit on sale or rental income stream on lease of assets. Holders of Sukuk share in the lease or profit income generated from the ownership of real assets that the Sukuk certificate represents."

The small secondary market for green bonds and the buy-and-hold nature of regional investors suggests that when the green Sukuk market does develop, it may suffer from liquidity constraints. All sovereign Sukuk issued are for infrastructural assets but are not necessarily used for infrastructure projects. For any investor who wants to ensure that the funds raised for the infrastructure projects are actually used for such projects, it is important that an appropriate structure is used for the chosen Sukuk. Musharakah based Sukuk and those based on the principle of Istisna may in fact ensure that the investors have real exposure to the underlying infrastructure project.

### What Lies Ahead for Sukuk Market?

Going forward, more Sukuk issuance can increase the investment choices for Islamic banks and also enable them to have a wider market of firms looking for expansionary investment in long term fixed assets. Sovereign Ijarah Sukuk issued by the governments have been structured in such a way that it allows the government to mobilize funds.

The Sukuk holders are also able to earn Shari'ah compliant income. It also facilitates Islamic banks to manage their liquidity as well as meet statutory liquidity requirement stipulated by the central banks. Through issuance of more Sukuk, the investment class assets universe will expand. This will enable the Islamic-conscious individual and institutional investors to effectively diversify their portfolios. Treasuries of Islamic banks will also have an expanded set of investment avenues.

It will increase the liquidity of these Sukuk and generate wider interest among all investors in the economy to consider investing in these investment vehicles. Islamic banks face liquidity risk in countries where Commodity Murabaha is not practiced. The surplus liquidity can be used by the governments by issuing sovereign Sukuk. This will enable the

government to avoid crowding out by using excess liquidity available with banks.

In some jurisdictions, there are fiscal responsibility acts to contain public debt. For instance, in Pakistan, the fiscal responsibility act sets a limit of 60%. Such limits shall be revised to accommodate real asset backed infrastructure financing from Sukuk.

ADB is increasing its efforts to assist member countries to use Islamic finance in areas such as infrastructure financing, ranging from technical assistance to providing credit guarantees. Recently, the G20 group of nations' decision to examine the use of Sukuk to finance infrastructure investment could eventually spur a big increase in the size of the market.

However, more needs to be done on the regulatory framework and to engage Development Finance Institutions (DFIs) to promote Sukuk based development finance in place of conventional fixed term loans. It can be explored to have DFIs acting as servicing agents and guarantors for infrastructure projects to establish trust and confidence of investors. Long term Sukuk can be issued to establish socially important institutions like microfinance to provide seed capital for establishing these institutions on the basis of Musharakah Mutanaqisa.

Convertible Sukuk can also be offered to provide seed capital for socially conducive projects and then repackaged as equity once these projects mature and become less risky. It is estimated that energy deficit eats up 1% to 2% of potential GDP in countries like Pakistan, India and Afghanistan. Hence, Sukuk in energy infrastructure can enable the Islamic financial institutions to contribute directly in economic growth and sustainable development. Likewise, there is abundant potential to help finance health and education infrastructure to create immense improvement in human capital.

# CONGRATULATIONS!!!

## To All Successful Candidates

### JAIBP Summer 2015

#### Allied Bank Ltd

E-5752	Abdul Malik
E-25472	Ali Raza
E-25592	Kalsoom Akhtar
E-24234	Muhammad Adnan Ali
E-21627	Muhammad Nauman Yousaf
E-23939	Nadeem Ahmed
E-13629	Saima Tufail
E-21488	Shahzad Hassan
E-14854	Shehzad Murtaza Qamar
E-14920	Sohaib Raheel
E-23520	Toseef Ahmed
E-26305	Umer Shahzad

#### ASKARI BANK LIMITED

E-26738	Junaid Tahir
E-9209	Kamran Ameer
E-12553	Muhammad Faisal
E-22926	Sania Ishtiaq
E-12227	Zainab Aziz
E-26475	Zia Ahmed Siddiqui

#### BANK ALFALAH LIMITED

E-24244	Arman Asif
E-25305	Bilal Ahmed
E-26889	Faiza Raza
E-3744	Hassan Abbas Siddiqui
E-23867	Muhammad Irfan
E-26589	Nadeem Ahmad
E-2281	Nasir Mehmood
E-13432	Tajammul Ilyas
E-4203	Umair Shabbir

#### BANK AL HABIB LIMITED

E-24676	Abdullah Taimoor Khan
E-9567	Adnan Sadda

E-25542	Arsalan Qazi
E-5317	Asif Saeed
E-25550	Bilal Ahmed Saleem
E-25981	Bilal Hamid
E-26847	Ghafeer Shahid
E-21725	Hassan Abbas Malik
E-6200	Imran Ali Alvi
E-22235	Imran Manzoor Malik
E-26858	Jahanzeb Khalid
E-7563	Kamran Younas
E-25016	Khaqan Zeb
E-14151	Mir Sajid Ali
E-23880	Muddassar Munir
E-3446	Muhammad Adnan Haider
E-23659	Muhammad Adnan Masoud
E-23735	Muhammad Ali
E-13261	Muhammad Ashraf Javed
E-25264	Muhammad Haroon Sohail
E-23038	Muhammad Mustaqeem
E-26886	Muhammad Rehan
E-13548	Muhammad Suhail Akhtar
E-24908	Muhammad Taimoor Saeed
E-25036	Muhammad Zain Saeed
E-26920	Saad Khalid
E-8658	Shahid Hanif
E-23678	Shahid Nawaz Khan
E-11328	Syed Muhammad Ali Rizvi
E-21731	Tayyab Raza
E-1028	Waseem Abbas
E-23305	Yasir Abbas
E-23554	Zahid Hussain

#### BANKING MOHTASIB PAKISTAN

E-22761	Muhammad Shafaqat Ali
---------	-----------------------

#### BURJ BANK LIMITED

E-23138	Faisal Ahmed
E-11240	Muhammad Shakir Ali

#### FAYSAL BANK LIMITED

E-14992	Abdul Rahim Dar
---------	-----------------

#### FIRST WOMEN BANK LIMITED

E-11971	Rozia Bibi
E-2974	Saima Naz
E-2880	Uzma Sadia Shafi

#### HABIB BANK LIMITED

E-25041	Khurshid Ahmad
E-22906	Muhammad Hamza
E-22336	Muhammad Haroon Sahi
E-12829	Muhammad Ramiz Riaz
E-9345	Uzma Hina

#### HABIB METROPOLITAN BANK LIMITED

E-24849	Ahmer Riaz
E-8839	Ali Abbas
E-24568	Fahad Jabbar Khan
E-25510	Qirat Swaba
E-22414	Syed Taha Mohiuddin

#### MCB BANK LIMITED

E-13808	Abid Pervaiz Gill
E-6833	Adnan Zafar
E-1470	Amber Shabbir
E-26369	Ameet Kumar
E-26440	Ameet Kumar
E-21631	Atif Saeed
E-26223	Faizan Ilahi Malik
E-22039	Ghulam Mujtaba
E-22752	Hassan Iftikhar
E-22030	Hira Aftab Khan Lodhi
E-21467	Imran Shakoor
E-23252	Khurram Shahzad
E-26176	Kulsoom Fatima



# CONGRATULATIONS!!!

## To All Successful Candidates

E-26425 Maliha Ali  
E-26098 Mazhar Iqbal  
E-23791 Muhammad Amir  
E-23790 Muhammad Atif Ur Rehman  
E-22055 Muhammad Azam  
E-13346 Muhammad Bilal Ashraf  
E-24312 Muhammad Farooq  
E-26089 Muhammad Hamid  
E-9895 Muhammad Umair  
E-26173 Muhammad Usman Virk  
E-22900 Muhammad Yahiya Farooq  
E-24306 Shakeel Ahmad  
E-22459 Shakeel Akhtar  
E-26097 Sidra Zahid  
E-10188 Wajiha Nazir  
E-22630 Waqas Bashir  
E-6199 Yasir Amin Khatri  
E-22589 Zaheer Ullah Khan

### MEEZAN BANK LIMITED

E-4350 Mehboob Ahmad  
E-24183 Salma Bashir  
E-23583 Tamoor Ahmed

### NATIONAL BANK OF PAKISTAN

E-11778 Abdul Qayyum  
E-2249 Abdul Samee  
E-24197 Abid Irshad  
E-6594 Afzal Mushtaq  
E-14425 Amin Khan Khattak  
E-11292 Aneela Talpur  
E-21565 Aqsa Nisar  
E-21131 Asif Mahmood  
E-14105 Asif Raza  
E-21482 Asif Zawar  
E-12600 Ayesha Tariq  
E-14475 Babar Khushk  
E-5242 Bano Fakhra Batool  
E-11668 Faiza Ikram  
E-7868 Farheen Zehra  
E-21524 Farrukh Abbas

E-13118 Fatimah Kalsoom  
E-3351 Hasan Amin Khan  
E-22773 Haseeb Ahmed  
E-11984 Humaira Anila  
E-21666 Ihsan Ullah  
E-6920 Ijaz Ahmed  
E-11761 Imran Khan  
E-11002 Imtiaz Elahi  
E-14715 Iqra Shaheen  
E-6140 Jalil Ahmed Tariq  
E-12999 Jamil Ahmad  
E-14848 Kashif Raheem Noonari  
E-21754 Khalid Nabi  
E-12630 Majid Ali  
E-24457 Momna Mansoor  
E-25212 Mudassar Anwar  
E-14223 Muhammad Sheraz  
E-22921 Muhammad Ali Muqaddas Mian  
E-21082 Muhammad Farhan Ashraf  
E-14971 Muhammad Imran  
E-23624 Muhammad Imran  
E-14236 Muhammad Mudassar Shahid  
E-8957 Muhammad Umar  
E-13300 Muhammad Wasim Aslam  
E-14851 Muhammad Zeshan  
E-13152 Mukhtar Ahmad  
E-12390 Muzzamil Hussain  
E-23111 Nighat Erum  
E-11823 Omar Shaukat Qureshi  
E-13862 Rabia Rafiq  
E-13696 Rameez Ali  
E-7784 Sana Yousuf  
E-11178 Sarika  
E-24509 Shahid Jamil  
E-8783 Shahid Khan  
E-12122 Sohaib Iftikhar  
E-13425 Sophia Pervez  
E-24742 Sumair Zaman  
E-13495 Syed Asgher Ali Kazim  
E-13448 Syed Zeeshan Akhtar Gilani  
E-11820 Umar Sultan  
E-9101 Ummeha Anum

E-22514 Yasir Ilyas Malik  
E-21059 Zakir Ullah Khan  
E-22762 Zubair Amin

### SINDH BANK LIMITED

E-25009 Angela Kumari  
E-24668 Maqsood Ali  
E-25642 Muhammad Jaffar

### SONERI BANK LIMITED

E-14773 Ashir Nazir Gill  
E-26735 Salman Sheikh  
E-7673 Sumsam-Ud-Din

### STANDARD CHARTERED BANK (PAKISTAN) LIMITED

E-22446 Jawad Sabir

### STATE BANK OF PAKISTAN

E-23952 Adnan Asghar  
E-14687 Hafiz Asim Mushtaq  
E-14247 Inzar Gul  
E-9829 Rabiya Yaqoob Khan  
E-3056 Waqas Hamid

### SUMMIT BANK LIMITED

E-21153 Atif Majeed

### THE BANK OF KHYBER

E-24117 Adil Sher  
E-25101 Athar Ramzan  
E-5878 Bashir Ahmad  
E-26028 Irfan Ullah  
E-2358 Kashif Zia  
E-25082 Malik Asim Ali  
E-11649 Muhammad Aamir  
E-7151 Muhammad Saqib Zeeshan  
E-25623 Qaiser Khan  
E-8549 Rehman-UI-Haq Afridi

# CONGRATULATIONS!!!

## To All Successful Candidates

E-22826 Salman Haider Khan  
E-14479 Umbreen Sharif  
E-3654 Usman Waheed  
E-22754 Zakir Ali

### THE BANK OF PUNJAB

E-26485 Muhammad Moazzam  
E-25794 Muhammad Uzair  
E-10657 Wasim Ahmed Bhatti

### THE PUNJAB PROVINCIAL CO-OPERATIVE BANK LIMITED

E-21590 Awais Khalid  
E-15017 Muhammad Ali Hasnain Khan

### UNITED BANK LIMITED

E-12090 Almas Shakoor  
E-25570 Fahad Ahmed Khan  
E-26483 Muhammad Salman Baig  
E-1625 Noureeb Basharat Cheema  
E-26187 Saqib Hassan Minhas

### WASEELA MICROFINANCE BANK

E-11981 Muhammad Taloot

E-14590 Amir Walayat Kharal

E-23334 Farah F. Khan  
E-23358 Muhammad Osama  
E-21023 Naheed Ashraf  
E-12285 Tehmina Zia  
E-11315 Yasin Ali  
E-21550 Amna Mahmood  
E-11249 Hina Ghaffar  
E-11789 Imran Ali Kazmi  
E-26498 Muhammad Zohaib  
E-22480 Shabeena Amin

### AIBP Summer 2015

#### MCB BANK LIMITED

E-22086 Saad Zikar Jangda

#### NATIONAL BANK OF PAKISTAN

E-7000 Fahad Nazir  
E-8988 Faizan Razi  
E-21642 Humaira Anwar  
E-12291 Mansoor Ahmed Abbasi  
E-6943 Mohsan Khan  
E-6783 Shahzad Iqbal  
E-4035 Sultan Mahmood

#### THE BANK OF KHYBER

E-23129 Riaz Hussain  
E-22000 Tariq Pervez

#### THE BANK OF PUNJAB

E-2530 Atif Arif

#### UNITED BANK LIMITED

E-11192 Syed Abbas Raza

E-2043 Shabana Kamal



The Institute of Bankers  
Pakistan

**Chartered Banker**

Leading financial professionalism

# MONEY

# LAUNDERING

## *A Global Review*

By Sehba Ehsan

**A1 Capone:** The known American mobster was at the forefront of the birth of modern money laundering schemes. It is estimated that he laundered \$1 billion through various business ventures. His first business was infact Laundromats, which being cash operated was very helpful in hiding and disguising illegal gains. The fact that Capone made use of the laundry trade is frequently given as the origin for the phrase: "laundering" – however this is still subject to debate. Capone was eventually indicated in 1931 for a different financial crime: tax evasion.

**Ferdinand Marcos,** an ex - lawyer was President of the Philippines from 1965 to 1986 before being removed from power by a popular uprising. During his reign he laundered billions of dollars of stolen public funds through Banks in the US and Switzerland. It took the Philippines a massive operation, known as "Operation Big Bird" to retrieve the money (estimated US\$ 7.5 bn).





The funds may be split into multiple smaller amounts and then whisked away to various Banks and Financial Institutions – to be placed as deposits. This process is known as "smurfing".

**T**he United Nations office of Drug Control and Crime Prevention defines money laundering as, 'the process to eliminate Criminals who wish to benefit from the proceeds of large scale crime, thus disguising their illegal profits without compromising themselves'.

It is the process by which individuals conceal and legitimize the proceeds of illegal activities. The criminal is endeavoring to 'wash away' any signs of the direct origin of the funds.

In essence, Money Laundering can be described in three classic cases. In the first stage, '**Placement**', the illegally obtained assets are introduced into the legal financial system to make it appear 'Kosher' — with the intention of disguising their original source. The idea, is to circumvent any 'suspicion' regarding the deposit. The funds may be split into multiple smaller amounts and then whisked away to various Banks and Financial Institutions — to be placed as deposits. This process is known as "smurfing".

The second stage is called '**Layering**' in which the source of illegally obtained funds is obscured through a succession of transfers and multiple transactions so as to diffuse the paper trail. This can be achieved through the involvement of entities, charitable organizations, religious institutions, charitable of any financial organization that can serve as a concealment tool or mechanism.

The third stage is "**Integration**" when funds can eventually be mixed into some legitimate business and be invested in avenues as bonds, stocks, property, jewellery or guarantees etc. Again, the idea being to completely diffuse the trail — it becomes tougher and tougher to trace the trail of funds.

As per the 1999 United Nations International Convention for the suppression of the Financing of Terrorism, the crime of terrorist financing is defined as the offense committed by "any person" who by "any means", directly or indirectly, unlawfully and willfully, provides or collects funds with the intention that they

should be used in full or in part, in order to carry out "an act intended to cause death or serious bodily injury to a civilian or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act".

Terrorist financing came into limelight in the US after the 9/11 subsequent to which the US government passed the USA PATRIOT ACT to attempt, to thwart the financing of terrorism and anti money laundering ensuring adequate focus by financial institutions. This Act also has extra territorial impact and non US Banks had to upgrade their AML/CFT processes as well.

#### **Global Efforts to Fight Money Laundering and Terrorist Financing:**

The AML/CFT regime is a young one and is still evolving — being a tall order, this global regime requires ongoing fine tuning.

The UN convention against Illicit Traffic in Vienna, known as Vienna Convention Narcotics Drugs and Psychotropic Substance established the offense of Money Laundering forming the basis for the international AML regime. This effort was given further boost by the creation of an international standard setting body the Financial Action Task Force (FATF). Also, the initiative taken by the UN Security Council regarding AML and CFT, has hugely impacted states to ratify the international convention for the suppression of the Financing of Terrorism.

The Vienna convention was the first international instrument to address the proceeds of crime and to require states to establish Money Laundering as a criminal offense. The International Convention against Transactional Organized Crime (UNTOC) viz., the Palermo Convention came into force in 2003 — it urges member states to co-operate with one another in the detection, investigation & prosecution of Money Laundering. In December 2005, the UN convention against Corruption (UNCAC) came into force.

The IMF and the World Bank have also intensified efforts to steer nations along the lines of good conduct to ensure adherence to global standards in AML and CFT.

#### **Financial Action Task Force - Efforts to Establish and Implement AML Standards:**

Formed in 1989 by the G7 countries, the FATF is an inter government body whose purpose is to develop and promote an international response to combat Money Laundering and Terrorist Financing. The FATF secretariat is housed in OECD in Paris.

FATF, a policy making body which brings together legal, financial and law enforcement experts to achieve national legislation & regulatory AML & CFT reforms. As per 2014, its membership consisted of 36 countries & territories and two regional organizations.

FATF has developed 40 recommendations on Money Laundering and 9 special recommendations regarding Terrorist Financing — it assesses member states against these recommendation in published reports. Countries not sufficiently compliant with these recommendations are subjected to financial sanctions.

Besides setting international standards for AML & CFT, the FATF assesses & monitors compliance to standards, conducts typologies studies of Money Laundering & Terrorist Financing methods, trends & techniques and responds to new & emerging threats as proliferation financing.

The FATF relies on a strong network of FATF Style Regional Bodies FSRBs, in addition to its own members to achieve the global implementation of the recommendations. These FSRBs include the Asia Pacific Group, Caribbean Financial Action Task Force, Eurasian AML Group, West Africa Money Laundering Group GIABA, MENA Middle East and North Africa FATF, Latin America AML Group GAFILAT and Moneyval Council of Europe AML Group.

Formed in 1989 by the G7 countries, the FATF is an inter government body whose purpose is to develop and promote an international response to combat Money Laundering and Terrorist Financing.

#### **Recommendations Developed by FATF – Anti Money Laundering AML and Combating Terrorist Financing CFT:**

The recommendations have been drawn up as an initiative to combat the abuse of financial system by elements laundering money and financing terrorism. It is a comprehensive framework of measures; recognizing that countries have diverse legal and financial systems, these are minimum standards to be implemented according to particular circumstances and constitutional set ups.

##### **A. Legal Systems Anti-Money Laundering AML - Scope of Criminal Offense of Money Laundering:**

Countries to criminalize Money Laundering on the basis of the Vienna Convention and to make it an offense punishable by imprisonment.

- Provincial Measures and confiscations: to adopt legislative measures so that competent authorities can confiscate property laundered.
- B. Measures to be taken by Financial Institutions and Businesses & Professional to Prevent Money Laundering:**
- Customer Due Diligence and Record Keeping.
- Reporting of Suspicious Transactions and Compliance.
- Other Measures to deter Money Laundering and Terrorist Financing.

- Measures to be taken with respect to countries that do not comply with FATF.

- Regulation and supervision.

##### **C. Institutional and other Measures necessary in systems to combat Money Laundering and Terrorist Financing**

- Competent Authorities, their Powers and Resources.
- Transparency of legal persons and arrangements.

##### **D. International Co-operation**

- Mutual Legal Assistance and Extradition.
- Other forms of co-operation.

#### **Combating Terrorist Financing CTF :**

The following nine recommendations, along with the forty AML ones set the basic framework to detect, prevent and suppress the financing of terrorism and terrorist acts.

- International Cooperation: Countries to have amongst themselves, to the extent possible mechanisms for mutual legal assistance or information exchange etc.
- Alternative Remittances: Money transfers, should be effected through a system or network that is licensed or registered.

- Wire Transfers: Accurate and meaningful originator information should be included in the fund transfer messages.
- Non- profit Organizations: These should be reviewed for regulations as these may be entities that could be particularly vulnerable by organizations for financing terrorism.
- Cash Couriers: A declaration system or any disclosure obligation to be in place to monitor the physical cross border transportation of currency.
- Ratification and implementation of UN Instruments: The UN International Convention for the suppression of Financing of Terrorism should be ratified and implemented.
- Criminalizing the Financing of terrorism and associated Money Laundering: The financing of terrorism and terrorist acts should be treated as a predicate offence & criminalized.
- Freezing and Confiscating Terrorist Assets: Measures to be in place to freeze without delay funds or other assets of terrorists as per the UN resolutions regarding prevention & suppression of financing of terrorism acts.
- Reporting Suspicious Transactions Related to Terrorism: Suspicions regarding funds in any way linked to or are to be used for terrorism should be reported promptly to competent authorities.





# E-BANKING

## Current State Of Play *impact, issues, risks & security*

By Mahboob Ahmed

The banking and financial industry (BFI) is transforming itself, powered in an important way by advances in information technology. Since the 1980s, commercial banking has continuously innovated through technology-enhanced products and services, such as multi-function ATM, tele-banking, electronic transfers, and electronic cash cards. Over the past decade, the Internet has clearly played a critical role in providing online services and giving rise to a completely new channel. In the Internet age, the extension of commercial banking to cyberspace is an inevitable development. Both researchers and practitioners in the BFI have highlighted the need for banks to broaden their branch-based delivery channels by embracing electronic banking (e-banking).



**E** - banking creates unprecedented opportunities for the banks in ways they organize financial product development, delivery and marketing via the Internet. While it offers new opportunities to banks, it also poses many challenges such as the innovation of IT applications, the blurring of market boundaries, the breaching of industrial barriers, the entrance of new competitors and the emergence of new business models. Now, the speed and scale of the challenge are rapidly increasing with the pervasiveness of the

Internet and the extension of information economy.

However, to successfully cope with the challenge of the e-banking innovation, the incumbent banks must understand the nature of the change and capability barriers that it presents. Without this understanding, attempts to migrate to e-banking may be doomed to failure. Banks that are equipped with a good grasp of the e-banking phenomenon will be more able to make informed decisions on how to transform them into e-banks and to exploit e-banking to survive in the new economy. Given that e-banking is a financial innovation, the change may render the organizational capabilities of the traditional banks obsolete. From the resource-based view in such a context, the banks must constantly reconfigure, renew, or gain organizational capabilities and resources to meet the demands of the dynamic environment. Developing core capabilities can help the banks redeploy their resources and renew their competences to sustain competitive advantages and to achieve congruence with the shifting business environment.

#### **Growth in Internet Banking:**

Numerous factors including competitive cost, customer service, and demographic considerations — are motivating banks to evaluate their technology and assess their electronic commerce and Internet banking strategies. Many researchers expect rapid growth in customers using online banking products and services. Marketing strategies will vary as banks seek to expand their markets and employ lower cost delivery channels. Examiners will need to understand the strategies used and technologies employed on a bank-by-bank basis to assess the risk. Evaluating a bank's data on the use of their web sites may help examiners determine the bank's strategic objectives, how well the bank is meeting its Internet banking product plan and whether the business is expected to be profitable.

#### **Market Factors that May Drive a Bank's Strategy for E-Banking:**

##### **Competition:**

Studies show that competitive pressure is the chief driving force behind increasing

use of Internet banking technology, ranking ahead of cost reduction and revenue enhancement, in second and third place respectively. Banks see Internet banking as a way to keep existing customers and attract new ones to the bank.

##### **Cost Efficiencies:**

Banks can deliver banking services on the Internet at transaction costs far lower than traditional brick-and-mortar branches. The actual costs to execute a transaction will vary depending on the delivery channel used. The cost to deliver manual transactions at a branch was typically more than ATM, call center and internet transactions. These costs are expected to continue to decline. Banks have significant reasons to develop the technologies that will help them deliver banking products and services by the most cost-effective channels. Management should include in their decision making the development and ongoing costs associated with a new product or service, including the technology, marketing, maintenance, and customer support functions. This will help management exercise due diligence, make more informed decisions and measure the success of their business venture.

##### **Geographical Reach:**

Internet banking allows expanded customer contact through increased geographical reach and lower cost delivery channels. In fact, some banks are doing business exclusively via the Internet — they do not have traditional banking offices and only reach their customers online. Other financial institutions are using the Internet as an alternative delivery channel to reach existing customers and attract new customers.

##### **Branding:**

Relationship building is a strategic priority for many banks. Internet banking technology and products can provide means for banks to develop and maintain an ongoing relationship with their customers by offering easy access to a broad array of products and services. By capitalizing on brand identification and by providing a broad array of financial services, banks hope to build customer loyalty, cross-sell and enhance repeat business.

## Customer Demographics:

Internet banking allows banks to offer a wide array of options to their banking customers. Some customers will rely on traditional branches to conduct their banking business. For many, this is the most comfortable way for them to transact their banking business. Those customers place a premium on person-to-person contact. Other customers are early adopters of new technologies that arrive in the market place. These customers were the first to obtain PCs and the first to employ them in conducting their banking business. The demographics of banking customers will continue to change. The challenge to banks is to understand their customer base and find the right mix of delivery channels to deliver products and services profitably to their various market segments.

## Types of Internet Banking:

Understanding the various types of Internet banking products will help examiners assess the risks involved. Currently, the following three basic kinds of Internet banking are being employed in the market place:-

### Informational:

This is the basic level of Internet banking. Typically, the bank has marketing information about the bank's products and services on a stand-alone server. The risk is relatively low, as informational systems typically have no path between the server and the bank's internal network. This level of Internet banking can be provided by the bank or outsourced. While the risk to a bank is relatively low, the server or web site may be vulnerable to the alteration. Appropriate controls therefore must be in place to prevent unauthorized alterations to the bank's server or web site.

### Communicative:

This type of Internet banking system allows some interaction between the bank's systems and the customer. The interaction may be limited to electronic mail; account inquiry, loan applications, or static file updates (name and address changes). Because these servers may have a path to the bank's internal networks, the risk is higher with this configuration than with informational systems. Appropriate

controls need to be in place to prevent, monitor and alert management of any unauthorized attempt to access the bank's internal networks and computer systems. Virus controls also become much more critical in this environment.

### Transactional:

This level of Internet banking allows customers to execute transactions. Since a path typically exists between the server and the bank's or outsourcer's internal network, this is the highest risk architecture and must have the strongest controls. Customer transactions can include accessing accounts, paying bills, transferring funds etc.

### Meeting Today's Customer Needs in Internet Banking:

- Multi-year statement history
- Consolidated bill payment
- Expedited payment services
- Inter-institution account transfers
- Enhanced e-mail alerts
- Personal financial management

Internet banking has come a long way since first-generation solutions were introduced. Typically, these older solutions merely allow customers to view their statements online, conduct transfers between accounts and pay bills to utility providers, telephone companies and financial institutions. Over time, online bankers have started demanding more from their Internet Banking Solution—especially younger customers who are used to instant access to information. Fortunately, there are now comprehensive, secure, high-performance Internet Banking Solutions available that meet their many financial needs—reducing the costly risk of losing online bankers to the competition.

Customers are looking for added functionality in multiple areas. Enhancing customer access to statement history is critical. Three of the top online banking institutions supply seven full years of statement history access within 48 hours. Easy access to online statements enables customers to research transaction history

and also help deliver peace of mind required to migrate to paper statement suppression—a key cost benefit to banks.

## Impact of E-banking on Traditional Services:

One of the issues currently being addressed is the impact of e-banking on traditional banking players. After all, if there are risks inherent in going into e-banking there are other risks in not doing so. It is too early to have a firm view on this yet. Even to practitioners the future of e-banking and its implications are unclear. It might be convenient nevertheless to outline briefly two views that are prevalent in the market. The view that the Internet is a revolution that will sweep away the old order holds much sway. Arguments in favor are as follows:

- E-banking transactions are much cheaper than branch or even phone transactions. This could turn yesterday's competitive advantage - a large branch network, into a comparative disadvantage, allowing e-banks to undercut bricks-and-mortar banks. This is commonly known as the "beached dinosaur" theory.
- E-banks are easy to set up so plenty of new entrants will arrive. 'Old-world' systems, cultures and structures will not encumber these new entrants. Instead, they will be adaptable and responsive. E-banking gives consumers much more choice. Consumers will be less inclined to remain loyal.
- E-banking will lead to an erosion of the 'endowment effect' currently enjoyed by the major banks. Deposits will go elsewhere with the consequence that these banks will have to fight to regain and retain their customer base. This will increase their cost of funds, possibly making their business less viable. Lost revenue may even result in these banks taking more risks to breach the gap.

## Risks Involved in Internet Banking:

### Credit Risk:

Credit risk is the risk to earnings or capital arising from an obligor's failure to meet the terms of any contract with the bank or otherwise to perform as agreed. Credit



risk is found in all activities where success depends on counterparty, issuer or borrower performance. It arises any time bank funds are extended, committed, invested or otherwise exposed through actual or implied contractual agreements, whether on or off the bank's balance sheet. Internet banking provides the opportunity for banks to expand their geographic range. Customers can reach a given institution from literally anywhere in the world. In dealing with customers over the Internet, without any personal contact, it is challenging for institutions to verify the bonafides of their customers, which is an important element in making sound credit decisions. Verifying collateral and perfecting security agreements also can be challenging with out-of-area borrowers. Unless properly managed, Internet banking could lead to a concentration in out-of-area credits or credits within a single industry. Moreover, the question of which state's or country's laws control an Internet relationship is still developing. Effective management of a portfolio of loans obtained through the Internet requires that the board and management understand and control the bank's lending risk profile and credit culture. They must assure that effective policies, processes and practices are in place to control the risk associated with such loans.

#### Interest Rate Risk:

Interest rate risk is the risk to earnings or capital arising from movements in interest rates. From an economic perspective, a

bank focuses on the sensitivity of the value of its assets, liabilities and revenues to changes in interest rates. Interest rate risk arises from differences between the timing of rate changes and the timing of cash flows (re-pricing risk); from changing rate relationships among different yield curves affecting bank activities (basis risk); from changing rate relationships across the spectrum of maturities (yield curve risk); and from interest-related options embedded in bank products (options risk). Evaluation of interest rate risk must consider the impact of complex, illiquid hedging strategies or products, and also the potential impact that changes in interest rates will have on fee income. In those situations where trading is separately managed, this refers to structural positions and not trading portfolios. Internet banking can attract deposits, loans, and other relationships from a larger pool of possible customers than other forms of marketing. Greater access to customers who primarily seek the best rate or term reinforces the need for managers to maintain appropriate asset/liability management systems, including the ability to react quickly to changing market conditions.

#### Liquidity Risk:

Liquidity risk is the risk to earnings or capital arising from a bank's inability to meet its obligations when they come due, without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned changes in funding

sources. Liquidity risk also arises from the failure to recognize or address changes in market conditions affecting the ability of the bank to liquidate assets quickly and with minimal loss in value. Internet banking can increase deposit volatility from customers who maintain accounts solely on the basis of rate or terms. Asset/liability and loan portfolio management systems should be appropriate for products offered through Internet banking. Increased monitoring of liquidity and changes in deposits and loans may be warranted depending on the volume and nature of Internet account activities.

#### Price Risk:

Price risk is the risk to earnings or capital arising from changes in the value of traded portfolios of financial instruments. This risk arises from market making, dealing and position taking in interest rate, foreign exchange, equity, and commodities markets. Banks may be exposed to price risk if they create or expand deposit brokering, loan sales or securitization programs as a result of Internet banking activities. Appropriate management systems should be maintained to monitor, measure and manage price risk if assets are actively traded.

#### Foreign Exchange Risk:

Foreign exchange risk is present when a loan or portfolio of loans is denominated in a foreign currency or is funded by borrowings in another currency. In some

“ Security is an issue in Internet banking systems. Some banks allow for direct dial-in access to their systems over a private network while others provide network access through the Internet. Although the publicly accessible Internet generally may be less secure, both types of connections are vulnerable to interception and alteration ”



cases, banks will enter into multi-currency credit commitments that permit borrowers to select the currency they prefer to use in each rollover period. Foreign exchange risk can be intensified by political, social, or economic developments. The consequences can be unfavorable if one of the currencies involved becomes subject to stringent exchange controls or is subject to wide exchange-rate fluctuations.

#### Transaction Risk:

Transaction risk is the current and prospective risk to earnings and capital arising from fraud, error and the inability to deliver products or services, maintain a competitive position and manage information. Transaction risk is evident in each product and service offered and encompasses product development and delivery, transaction processing, systems development, computing systems, complexity of products and services and the internal control environment. A high level of transaction risk may exist with Internet banking products, particularly if those lines of business are not adequately planned, implemented, and monitored. Banks that offer financial products and services through the Internet must be able to meet their customers' expectations. Banks must also ensure they have the right product mix and capacity to deliver accurate, timely and reliable services to develop a high level of confidence in their brand name. Customers who do business over the Internet are likely to have little tolerance for errors or omissions from financial institutions that do not have sophisticated internal controls to manage their Internet banking business. Likewise, customers will expect continuous availability of the product and Web pages that are easy to navigate. Software to support various Internet banking functions is provided to the customer from a variety of sources. Banks may support customers using customer-acquired or bank-supplied browsers or personal financial manager (PFM) software. Good communications between banks and their customers will help manage expectations on the compatibility of various PFM software products. Attacks or intrusion attempts on banks' computer and network systems are a major concern. Studies show that systems are more vulnerable to internal attacks than external, because internal system users have knowledge of the system and access. Banks should have sound preven-

tive and detective controls to protect their Internet banking systems from exploitation both internally and externally. Contingency and business resumption planning is necessary for banks to be sure that they can deliver products and services in the event of adverse circumstances. Internet banking products connected to a robust network may actually make this easier because back up capabilities can be spread over a wide geographic area. For example, if the main server is inoperable, the network could automatically reroute traffic to a backup server in a different geographical location. Security issues should be considered when the institution develops its contingency and business resumption plans. In such situations, security and internal controls at the backup location should be as sophisticated as those at the primary processing site. High levels of system availability will be a key expectation of customers and will likely differentiate success levels among financial institutions on the Internet. Banks that offer bill presentment and payment will need a process to settle transactions between the bank, its customers, and external parties. In addition to transaction risk, settlement failures could adversely affect reputation, liquidity and credit risk.

#### Compliance Risk:

Compliance risk is the risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices or ethical standards. Compliance risk also arises in situations where the laws or rules governing certain bank products or activities of the bank's clients may be ambiguous or untested. Compliance risk exposes the institution to fines, civil money penalties, payment of damages and the voiding of contracts.

Compliance risk can lead to a diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential and lack of contract enforceability. Most Internet banking customers will continue to use other bank delivery channels. Accordingly, banks will need to make certain that their disclosures on Internet banking channels, including web sites, remain synchronized with other delivery channels to ensure the delivery of a consistent and accurate message to customers.

#### Strategic Risk:

Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. This risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory and other environmental changes. Management must understand the risks associated with Internet banking before they make a decision to develop a particular class of business. In some cases, banks may offer new products and services via the Internet. It is important that management understands the risks and ramifications of these decisions. Sufficient levels of technology and MIS are necessary to support such a business venture. Because many banks will compete with financial institutions beyond their existing trade area, those engaging in Internet banking must have a strong link between the technology employed and the bank's strategic planning process.

Before introducing an Internet banking product, management should consider whether the product and technology are consistent with tangible business objectives in the bank's strategic plan. The bank also should consider whether adequate expertise and resources are available to identify, monitor, and control risk in the Internet banking business. The planning and decision making process should focus on how a specific business need is being met by the Internet banking product, rather than focusing on the product as an independent objective. The bank's technology experts, along with its marketing and operational executives, should contribute to the decision making and planning process. They should ensure that the plan is consistent with the overall business objectives of the bank and is within the bank's risk tolerance. New technologies, especially the Internet, could bring about rapid changes in competitive forces. Accordingly, the strategic vision should

determine the way the Internet banking product line is designed, implemented, and monitored.

#### Reputation Risk:

Reputation risk is the current and prospective impact on earnings and capital arising from negative public opinion. This affects the institution's ability to establish new relationships or services or continue servicing existing relationships. This risk may expose the institution to litigation, financial loss or a decline in its customer base. Reputation risk exposure is present throughout the organization and includes the responsibility to exercise an abundance of caution in dealing with customers and the community. A bank's reputation can suffer if it fails to deliver on marketing claims or to provide accurate, timely services. This can include failing to adequately meet customer credit needs, providing unreliable or inefficient delivery systems, untimely responses to customer inquiries, or violations of customer privacy expectations. A bank's reputation can be damaged by Internet banking services that are poorly executed or otherwise alienate customers and the public. Well designed marketing, including disclosures, is one way to educate potential customers and help limit reputation risk. Customers must understand what they can reasonably expect from a product or service and what special risks and benefits they incur when using the system. As such, marketing concepts need to be coordinated closely with adequate disclosure statements. A bank should not market the bank's Internet banking system based on features or attributes the system does not have. The marketing program must present the product fairly and accurately.

“ A bank's reputation can suffer if it fails to deliver on marketing claims or to provide accurate, timely services. This can include failing to adequately meet customer credit needs, providing unreliable or inefficient delivery systems, untimely responses to customer inquiries, or violations of customer privacy expectations”

Banks should carefully consider how connections to third parties are presented on their web sites. Hypertext links are often used to enable a customer to link to a third party. Such links may reflect an endorsement of the third party's products or services in the eyes of the customer. It should be clear to the customer when they have left the bank's Web site so that there is no confusion about the provider of the specific products and services offered or the security and privacy standards that apply. Similarly, adequate disclosures must be made so that customers can distinguish between insured and noninsured products. Banks need to be sure that their business continuity plans include the Internet banking business. Regular testing of the business continuity plan, including communications strategies with the press and public, will help the bank ensure it can respond effectively and promptly to any adverse customer or media reactions.

#### Issues in Internet Banking:

Financial institutions, their card associations, and vendors are working to develop an Internet payment infrastructure to help make electronic commerce secure. Many in the banking industry expect significant growth in the use of the Internet for the purchase of goods and services and electronic data interchange. The banking industry also recognizes that the Internet must be secure to achieve a high level of confidence with both consumers and businesses. Sound management of banking products and services, especially those provided over the Internet, is fundamental to maintaining a high level of public confidence not only in the individual bank and its brand name but also in the banking system as a



whole. Key components that will help maintain a high level of public confidence in an open network environment include:

#### Security:

Security is an issue in Internet banking systems. Some banks allow for direct dial-in access to their systems over a private network while others provide network access through the Internet. Although the publicly accessible Internet generally may be less secure, both types of connections are vulnerable to interception and alteration. For example, hardware or software “sniffers” can obtain passwords, account numbers, credit card numbers, etc. without regard to the means of access.

Banks therefore must have a sound system of internal controls to protect against security breaches for all forms of electronic access. A sound system of preventive, detective, and corrective controls will help assure the integrity of the network and the information it handles. Firewalls are frequently used on Internet banking systems as a security measure to protect internal systems and should be considered for any system connected to an outside network. Firewalls are a combination of hardware and software placed between two networks through which all traffic must pass, regardless of the direction of flow.



“ A certificate authority is a trusted third party that verifies identities in cyberspace. Some people think of the certificate authority functioning like an online notary. The basic concept is that a bank, or other third party, uses its good name to validate parties in transactions”

They provide a gateway to guard against unauthorized individuals gaining access to the bank's network. The mere presence of a firewall does not assure logical security. Firewalls are not impenetrable and must be configured to meet a specific operating environment. They also must be evaluated and maintained on a regular basis to assure their effectiveness and efficiency. Individuals who are technically competent must perform the installation, configuration, evaluation and maintenance of firewalls. The specific risks involved may require a broad range of security controls.

#### Trust:

Trust is another issue in Internet banking systems. As noted in the previous discussion, public and private key cryptographic systems can be used to secure information and authenticate parties in transactions in cyberspace. A trusted third party is a necessary part of the process. That third party is the certificate authority.

A certificate authority is a trusted third party that verifies identities in cyberspace. Some people think of the certificate authority functioning like an online notary. The basic concept is that a bank, or other third party, uses its good name to validate parties in transactions. This is similar to the historic role banks have played with letters of credit, where neither the buyer nor seller knew each other but both parties were known to the bank. Thus the bank uses its good name to facilitate the transaction for a fee.

#### Privacy:

Privacy is a consumer issue of increasing importance. Banks that recognize and respond to privacy issues in a proactive way make this a positive attribute for the bank and a benefit for its customers. Public concerns over the proper versus improper accumulation and use of personal information are likely to increase with the continued growth of electronic commerce and the Internet. Providers who are sensitive to these concerns have an advantage over those who do not.

#### Availability:

This is another component in maintaining a high level of public confidence in a network environment. All of the previous components are of little value if the network is not available and convenient to customers. Users of a network expect access to systems 24 hours per day, seven days a week. Among the considerations associated with system availability are capacity, performance monitoring, redundancy, and business resumption. Banks and their vendors who provide Internet banking products and services need to make certain they have the capacity in terms of hardware and software to consistently deliver a high level of service. In addition, performance monitoring techniques will provide management with information such as the volume of traffic, the duration of transactions, and the amount of time customers must wait for service. Monitoring capacity, downtime, and performance on regular basis will help management assure a high level of

availability for their Internet banking system.

In conclusion e-banking creates issues for banks and regulators alike. For their part, banks should:

- Have a clear and widely disseminated strategy that is driven from the top and takes into account the effects of e-banking, together with an effective process for measuring performance against it.
- Take into account the effect that e-provision will have upon their business risk exposures and manage these accordingly.
- Undertake market research, adopt systems with adequate capacity and scalability, undertake proportional advertising campaigns and ensure that they have adequate staff coverage and a suitable business continuity plan.
- Ensure they have adequate management information in a clear and comprehensible format.
- Take a strategic and proactive approach to information security, maintaining adequate staff expertise, building in best practice controls and testing and updating these as the market develops. Make active use of system based security management and monitoring tools.
- Ensure that crisis management processes are able to cope with Internet related incidents.

# Save today for a brighter tomorrow

Khushhalibank, the largest microfinance bank in Pakistan offers opportunities for investment in our deposit products featuring convenience and competitive returns.

khushhali  
Aamdani  
Certificate

khushhali  
Izafa  
Certificate

Behtrien Bachat  
ACCOUNT

PROFIT UP TO  
**12%**

## Features

- Online banking facility
- Free life / disability insurance\*
- ATM facility
- Profit paid monthly / annually

**Network:** 128 branches across Pakistan

**Rating:** Short term A-1 and Long Term A+

For further information:  
**021-111 222 525**  
[www.khushhalibank.com.pk](http://www.khushhalibank.com.pk)

فوشحالی بینک لمیٹڈ  
khushhalibank limited



# COMMERCIAL BANKING

Problems  
and Solutions

By Dr. S. Sabir A. Jaffery



**Q.1 One of the three directors of a company is adjudged insolvent. How would you deal with the situation?**

**Ans.** A company is in its own right an independent entity. Hence, insolvency of a director will not affect it except that the insolvent director will no more remain a director.

The minimum number of directors required under Companies Act shall be maintained by filling the vacancy caused by relinquishing the office by the insolvent director.

**Q.2 The Juvenile Club wishes to open an account with your branch. What formalities will be observed while acceding to its request?**

**Ans.** The following documents will be acquired before opening the club's account:

The original copy of the bye laws / rules and regulations / constitution will be required along with a photo copy thereof. However, the original will be returned after comparing and attesting the photocopy which shall be retained as a permanent record.

- A resolution passed by the managing committee of the club for opening the account with your bank signed by the secretary and the president of the club.
- The mandate to operate upon the account along with the attested signatures of the official(s) authorised to operate, signed by the secretary and president of the club.
- Account opening form and specimen signature card signed by the authorised office bearers. Preferably, these signatures may be obtained before a bank officer and attested by him.
- If the club is unregistered, extra ordinary care should be exercised in monitoring its operation.
- No advance is to be allowed in an unregistered club. A warning to that effect may be recorded on all the relevant documents.

**Q.3 The Hill Park Apartments Residents' Welfare Association has a current account at your branch which is operated as under:**

**By the finance secretary jointly with the secretary general.**

**(OR)**

**By the finance secretary jointly with the president or the secretary general.**

**The secretary general is reported dead. Later, a cheque signed jointly by the finance secretary and the secretary general is presented in clearing. Will the cheque be paid? Relate your answer in both the situations listed above.**

**Ans.** The cheque will be paid in both the situations as the deceased had signed in the representative capacity and not in his personal capacity.

Nevertheless, in the first situation, operation in the account will be stopped till new incumbent to the slot of secretary general is duly elected or an alternate mandate is received authorizing some other office bearer to operate the account jointly with the finance secretary until the office of secretary general is filled.

In the second situation, however, the account shall run unhampered as the president will be available to operate the account jointly with the finance secretary.

**Q.4 What precautions will be observed while opening and handling a trust account?**

**Ans.** A trust is governed by its trust deed. Hence, the account should be opened and allowed to be operated upon exactly in conformity with the provisions of the trust deed. Should the trust deed be silent as regard opening and operating the account, all the trustees must sign the account opening form and all will be required to operate jointly unless trustees are specifically authorised to delegate such powers.

Objects of the trust must be kept in view. It is advisable that a note to that effect be put on the account opening form and specimen signature card. Any transaction that vividly defeats the objects of the trust should not be allowed. For example, a cheque payable to a wine store drawn on the account of a

trust formed to promote Qur'anic teachings does not warrant payment without alleging bank for negligence.

A certified copy of the trust deed should be preserved in the record. It is advisable that the trust deed should be studied thoroughly by the concerned staff to ensure that no violation takes place at any stage.

**Q.5 How will the bank behave in the following situations?**

- a) A trustee who is authorised to operate the trust account singly draws a cheque payable to himself on the trust account and deposits it in his personal account also maintained with you.
- b) A cheque received from a third party favouring trust account is deposited in the personal account of the sole trustee.
- c) A cheque signed by a deceased trustee is presented for payment after information of his death had been received by the bank.
- d) One of the trustees is reported dead.

**Ans.** (a) and (b) Section 10 of the Negotiable Instruments Act qualifies "payment in due course" as payment made "---without negligence to any person in possession thereof (of the instrument) under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment---".

Payment made in the given situations would be tantamount as having been made with negligence under the circumstances which on the face of it indicated that the person receiving the payment was not entitled to receive it. This section when read with section 85 of the Act would suggest that the bank will not be discharged by making this payment. In both the situations, the bank will not be inclined to make payment.

- c) Since the cheque was signed in the fiduciary capacity and not in the personal capacity by the deceased, it will be paid.
- d) The bank will act according to what was laid down in the trust deed as regard the situation in question.



## Management in Banking: Risk Management-I; **CREDIT RISK MANAGEMENT**

By Dr. S. Sabir A. Jaffery

State Bank of Pakistan has defined risk in BSD Circular # 07 dated 15th August 2013 as *"a possibility that the outcome of an action or event could bring up adverse impacts."* As could be inferred from this definition, credit risk arises when an obligor either due to unwillingness or owing to impaired financial resources fails to meet his obligations.

Given these definitions, every deal or transaction that a bank undertakes has in its fold some risk. This, however, does not mean that a risk is always materialized. It remains simply as a 'probability' with, of course, varying degree of certainty. No sooner it turns up into reality, it remains no more a risk; it becomes an actual loss.

**A** bank that pursues the policy of running without risk soon becomes *asinus ad lyram* – one unsuited for an occupation. The doctrine "no risk, no game" is typical of banking operations. However, a bank that undertakes excessive risks or takes risks without visualizing their magnitude and impact is bound to sustain heavy loss.

Risk is a multifaceted phenomenon and according to the SBP Circular referred above has been categorized as Credit, Market, Liquidity and Operational risk.

### Guiding Principles of Risk Management:

The process of risk management begins well before taking a risk and continues until it is liquidated. Guiding principles prescribed to manage risks include:

- The officials to whom the job of risk management is assigned should be fairly seniors who are expected to be well versed with all aspects of risk such as nature, size net of margin, degree of certainty, current throw-away price of security, credibility and creditwor-

thiness of the principal debtor and the guarantor, if any, validity of documents, legal formalities etc.

- Risk taking decisions should be in line with the business strategy of the bank and should not have been incurred in violation of the policy decisions made by the Board of Directors.
- Overdue debts cases should be handled skillfully lest they are turned into classified advances. Recovery measures should, as far as possible; be commensurate with the practices generally followed by banks and non-banking financial institutions.
- Provision should be made for all bad and doubtful debts. Branches normally apply interest on stuck up advances and credit it to their income account. This is highly irregular. Amount of interest accrued on such accounts should be placed in some office account, such as Sundry Deposits Account and credited to income account only after actual recovery.
- At times, it happens that the borrower is in genuine difficulty for funds. In such a situation, further advance may be tenable to rejuvenate him back in the business to reinforce his repaying capacity. The concerned officials should be experienced and intelligent enough to distinguish between unwillingness and incapacity of the debtor to service his debt.
- In addition to the viable security, adequate margin must be retained against each advance, depending upon the nature of advance and creditworthiness of the debtor. Liabilities such as L.Cs. and guarantees should be covered with adequate margin / counter guarantees.
- More often than not, borrowers resort to multiple borrowings. The banker monitoring the risk management measures should manipulate market intelligence to timely get information of such incidences.
- Most important thing in respect of advances is the creditworthiness and credibility of the borrower which should be thoroughly vetted while processing a proposal. In other words,

the credit operations of a vigilant bank should primarily base on in-depth understanding of its customers.

- Last but not the least the availability of sufficient capital as a buffer to take the risk.

#### Managing Credit Risk

Credit risk arises when a borrower is either unwilling to service his debt as per agreement or when his repaying capacity is impaired.

Generally speaking, advances are the largest and the most probable source of credit risk. However, to have more realistic view of financial health of the bank, in addition to direct accounting losses, credit risk should also be measured in terms of transaction costs, opportunity costs and expenses incurred on maintaining non-performing assets.

Credit risk may sometime accompany other risks. For example, a swelling non-performing credit portfolio may trigger liquidity problem.

Operational methodology of risk management adopted by banks primarily depends upon the size, nature and quality of their credit portfolios. Nevertheless, there are certain requisites of risk management methodology which apply to all financial institutions indiscriminately. These are:

- Action by top brass.
- Operational methodology or management framework.
- Risk Management, an integrated function.
- Risk Measurement.
- Bad and doubtful debts.
- Contingency plan.

#### Top Brass at the Task:

In order to be effective and meaningful, risk management endeavours must start from the top and travel down the line. The Board of Directors (BOD) shall devise policies which will be transformed into procedure and imple-

**“State Bank of Pakistan has defined risk in BSD Circular # 07 dated 15th August 2013 as, “a possibility that the outcome of an action or event could bring up adverse impacts.”**

mented and monitored by senior management.

Mere formulation of policy and procedure shall not yield the desired result. These ought to be communicated upto the lowest level of hierarchy from where it is implemented.

To keep pace with the time, the policies and procedures need to be periodically reviewed by senior management and the BOD and necessary changes should be made as and when deemed necessary.

#### Operational Methodology / Risk Management Framework:

Risk management framework should be self-contained so as to cover the entire spread of risks. It should clearly and precisely define the complete methodology of risk management covering early risk identification, measuring risk magnitude, monitoring risk and reporting to controlling authorities with required frequency. An ideal framework should also be flexible to accommodate any changes in the bank's credit activities.

The framework should also provide for an ongoing review of procedure and policies of risk management. Moreover, the executives responsible for review should be independent of risk-taking units and report directly to top management.

Further, the framework should have in its fold an effective management information system that ensures smooth flow of information from operating point to control level.





“Risk is a multifaceted phenomenon and according to the SBP Circular referred above has been categorized as Credit, Market, Liquidity and Operational risk”

### **Risk Management- An Integrated Function:**

Various types of risks are interrelated. For instance, operational risk tends to create financial risk which, in turn, may incite liquidity risk. The risk management framework should, therefore, be all-pervading, thereby recognizing and reflecting interactions between different categories of risks spread over entire business activities of the bank.

The risk management framework is also expected to provide to senior management, while it (senior management) is assessing and managing risks, an overall view of bank's entire exposure.

### **Measuring the Risks :**

To have effective control over risks, it is desirable to periodically assess, evaluate and measure the quantum and magnitude of risks. A number of qualitative and quantitative techniques to measure risk inherent in credit portfolio have been evolved. A well structured credit rating framework is an important tool for monitoring and controlling risk inherent in individual credits as well as in credit portfolios.

A bank should adopt one that suits it keeping in view its size and nature of portfolio. However, in addition to direct accounting loss, costs such as opportunity costs, transaction costs and expenses associated with non-performing assets should also be viewed as credit risk.

The clear view of overall exposure thus provided will help management make

viable decisions regarding expansion and future development plans of the bank.

In areas of activities where quantification of risk is not practicable, qualitative measures need to be taken to size up the risks involved. This can possibly be done by the staff having ample knowledge and expertise. The staff entrusted with this job should have exhaustive training. Keeping in view the specialty of the task ahead, there should be a separate cadre of risk management staff which like other members of staff should not be subjected to frequent job rotation.

### **Managing Bad and Doubtful Debts:**

If due care is exercised before granting a credit, worthwhile marketable security is obtained retaining adequate margin against the amount advanced, current value of the security is assessed with reasonable intervals, a regular review of the credit is undertaken as an established policy of the bank, a watchful eye is kept on the reputation of the borrower vis-a-vis integrity through market intelligence then there hardly remains any room for the advance going bad or doubtful.

Despite all the necessary precautions taken, an advance may turn out to be problematic. It is, therefore, desirable to set up a mechanism that helps identify a problem loan sufficiently in advance when more remedial options may be available.

Along with other actions matching the situation, following precautionary steps are advised to deal with the problem loans:

### **Personal Contacts:**

- Frequent contacts with the obligor coupled with meaningful negotiation proposing, inter alia, value addition to the security.
- Regular contacts with market leaders to have dependable information about the borrower's integrity and financial health well in time.

### **Effective Follow-up:**

- Rigorous and persistent efforts made at the early stage are most likely to spare the banks from litigations and monetary losses.

### **Alternate Remedial Measures:**

- Restructuring of repayment terms, reduction in mark-up, (some times waiver of even total mark-up is considered feasible to recover the principal), and enhancement in credit limit, although very sparingly, tend to increase obligor's repaying capacity.

### **Contingency Plan:**

Banks should look ahead not only for expansion and development but also for stress situations. There should be a properly organized setup to which the task of looking into future as an ongoing process is assigned. Steps should also be taken by this setup to manage the volatile situation sufficiently in advance under structured plan. This plan should be reviewed regularly and periodically.

# Humanizing the ENTERPRISE RISK DIALOGUE

By Danish Ali

Ever since the world crisis of 2008, Enterprise Risk Management (ERM) occupies a central position in running a financial institution. Banks, especially have chartered entire departments dedicated to ERM. The aim of this article is to shed light on the humanizing aspects of ERM so that a wider range of audience can access the potential of ERM.

It is quite evident that ERM encompasses a myriad of diverse areas within itself. It does bring about a fruitful change in perspective to meet the unprecedented challenges we face today. ERM highlights that while recognizing facts (in form of quantitative analysis), it seems as if we only tend to scratch its surface as data, on its own, highlights results; whereas there are plenty of processes that culminate in data generation in the first place. There is an incredible depth once when we start looking beyond the facts into fact-making itself with fact-making being the human psychology of participants in the markets, our behavioral and cognitive tendencies and the risk mentality we adhere to. ERM has been immensely helpful in shifting the focus from result orientation to process orientation. Process oriented approach allows us to separate efforts from results which are not positively correlated for most of the time. External and complex as well as random factors with their inter-connections continue to dominate the space between efforts and results. That is why many external risks like financial contagion to natural catastrophes can potentially bring ruin in results of companies despite our best efforts.

ERM might be 'perceived' as more technical than it actually is due to communication gaps and barriers within different stakeholders involved. To provide more common ground for mutual understanding, we have to emphasize that ERM is not just a problem to be solved; it is an experience to be lived. That is why we continuously try to nurture a mindset in which balancing of risk and rewards is fused in the very fabric of management decision making. We do recognize that better than many sophis-

ticated terminologies are few explanations that bring about clarification. At the same time, we appreciate that there is more reason in data than many of our opinions. 1+1 is not generally 2 when taken across aggregate of huge data sets. While we can reach generic hunches on market trends, data usually dissects these to separate the wheat from the chaff. It is quite often the case that data reveals a different picture from our expectations. What is true for micro elements (on which we usually base our hunches) is not necessarily true when taken on a macro aggregate level. A case in point is when data orientation of NGOs showed that the poor do not adhere to the stereotypes that society usually pictures them in. They are far more versatile and can change their conditions given the platform.

It is understood that there can be a potential conflict over how the qualitative aspects of ERM and the quantitative implications of ERM are connected with each other. This should be clarified here. A Risk pool of all potential risks is identified through brainstorming, dialogues between management, consultants and various stakeholders. Each risk is mapped accordingly in the capital modeling exercise and the quantitative impact of each risk is measured here. This helps us to select and focus on the top risks to which we are vulnerable. Hence, both the qualitative and quantitative aspects are crucial for an effective ERM implementation because qualitative sets the spectrum of risks and quantitative helps to highlight the important risks which the company is vulnerable to.

Stress testing and preparing for worst case scenarios and what our contingency plans should be in such situations is need of the hour. Despite our emphasis on worst case risk measures, we are not here to sell pessimism to businesses. Too much focus on worst case brings about negativity in the mindset of management of the company which reduces our ability to effectively integrate ERM mindset. What we are here for is guided optimism. Guided optimism is what we mean when we say risk-adjusted performance. Knowing the risks but also the opportunities.

Connecting it all together, unique advantages brought about by ERM on processes are highlighted and shown how it is ever more useful in bridging the communication gap between different stakeholders.





# Should Your Business Pay the Price for **BANK FRAUD**

By Mujahid Abbas

**A**s most businesses choose to do their banking online these days, there is a significant question of who gets the responsibility of keeping it safe and secure. While most businesses rely on vendors to keep their banking transactions and money safe and fix problems, when they arise, who ultimately pays the price when fraud happens? In this digital age, hackers and security breaches are increasing in numbers. Should your business pay the price for bank fraud?

*The answer to the question is most probably not, even though it is perfectly normal for businesses to feel they ought to be held responsible.*

Recent court rulings have suggested that banks need to show they have "reason-

able security measures" to protect their business customers. And this is still not quantifiable, what to speak of our country, even in advanced countries such as America, no US federal standards yet neither exist for online banking security nor is there a federal data breach law that would cover business bank account breaches.

While banks generally reimburse consumers for any theft related to personal credit cards and accounts that is not always or even typically the case with business accounts which don't have the same protections. Online attacks against business are growing, yet there's no clear demarcation line for liability.

But most small firms are convinced a cyber attack would simply never happen

to them, despite the fact they hold higher sums held in their account than individuals, making them a target for criminals.

Two-thirds of companies have internet-connected laptops and half allow IT-enabled mobile and remote working. Vital business data including confidential customer, supplier and financial records as well as IP is stored and processed on computers. In this way hackers do their work.

Ponemon Institute study found that the average cost to a company from a data breach is increasing. While it was \$3.5 million an year ago, the increase compared to the preceding year is 15 percent. "Evidence shows small and medium sized businesses (SMBs) are



more often becoming targets of online fraud because they are perceived as having valuable data and less sophisticated defenses”.

Even if you are using top-brand antivirus and security software for your banks and companies, you are still un-safe. While phishing attacks persist—which happen when an employee clicks on a rogue link in an email disguised as its bank or other trusted vendor and enters login or other sensitive information –the latest breaches are trickier. Say for instance, an employee is innocently surfing the web, encounters an insecure site and clicks on a link, after which a piece of malware is automatically downloaded to his computer. From there, the malware records keystrokes on the infected PC or device and recognizes when an individual is logging onto a financial site. Once the login information is retrieved, hackers sell the data to large online criminal networks that quickly initiate the fraud; wire transfers stealing

#### **Talk to your bank:**

Determine whom<sup>1</sup>q at your bank is well-versed in access-control processes and security measures to protect business accounts. You might have to drill down a few levels to find the right person, but it’s worth the effort to understand exactly what your bank is doing on the security front and how they will help your business in the event of fraud? How do they protect wire transfers and do they use advanced encryption and offer sophisticated multifactor authentication (MFA) tools to thwart hackers? Do they have anti-fraud software to quickly detect suspicious activity and notify customers immediately? Do they ask for customer passwords over the phone, email or text? (They shouldn’t). Consider that a smaller regional bank may have less sophisticated defenses than a major institution such as Standard Chartered, Barclays etc.

**Outsource and have experts do it for you.**

company’s industry and risk profile. Service providers can manage antivirus and other security technology updates, common areas of forgetfulness at small companies. Everything can be taken care of with less cost. Keeping operations in house wouldn’t even run as great as compared to having security experts do it for you.

#### **Use dedicated computing resources to access the bank:**

Accessing online accounts from various computers increases the surface area for some kind of exploit to compromise the banking session. Browsers are hard to secure as users mix business and personal tasks at work and traditional antivirus products are not adept at identifying and thwarting the new class of exploits. But there are new technology solutions that run a dedicated browser within a secure sandbox to keep it separate from the rest of the machine. Some live on the user’s computer, but others run in the cloud and can be accessed from any device.

---

“Two-thirds of companies have internet-connected laptops and half allow IT-enabled mobile and remote working. Vital business data including confidential customer, supplier and financial records as well as IP is stored and processed on computers. In this way hackers do their work”

---

hundreds of thousands of dollars can occur in a few hours or even minutes. “At a small business, if the banking credentials are hacked, by the time somebody notices the fraud, the money is long gone and often can’t be recovered.

#### **So what’s a business to do?**

The first step is to accept that the business is ultimately responsible and that banks will not be there to clean up the mess. Now you can start to systematically think through where vulnerability exists, and what measures you can take to implement security controls and tighten up internal processes. Here are some ideas that will get your organization moving in the right direction.

Do not try to do everything yourself. While business owners can only do so much as to implement tight security measures and restrict access to privileged information, the bottom line is that a company’s security system should have sophisticated, state-of-line defenses.

And while this can be costly before, in this age of cloud computing, small business have no reason to even try to manage its own security systems much less networking and other complex infrastructure components if they can outsource at a lower cost and have higher quality of service.

Qualified security experts will know exactly what you need based on your

#### **Control access to your sensitive data:**

Small companies, especially startups, tend to have an “open door” policy with respect to employees’ use of their information systems. Yet there is no reason why anyone other than the CFO/Controller and the CEO need access to a company’s online financial accounts. Do not allow sharing of credentials (i.e. passwords) and keep employees educated about the latest hacking techniques and safe computing practices.

#### **Purchase insurance:**

Some insurance companies offer network security or privacy loss policies, which can help cover the loss as well as



“Accessing online accounts from various computers increases the surface area for some kind of exploit to compromise the banking session”

related expenses such as notification costs, forensics research to investigate the incident, legal costs, and crisis management/PR costs. Newer crime insurance policy endorsements can also cover digital theft and fraudulent transfers, and can reimburse the company for all or part of any financial loss from a cyber theft incident. Such policies are becoming more popular, and are not prohibitively expensive for small businesses. The insurance carrier might require a company to deploy particular technologies and processes to qualify. For many companies, the costs of insurance will more than offset theft, if cyber criminals are able to siphon hundreds of thousands of dollars from your accounts. As more entities, including banks, ensure against cyber risks, uninsured SMBs may be exposed to “subrogation” claims in which insurers seek to recover costs from third parties whose actions contributed to the loss.

#### Develop a response plan:

Every country or state may have different laws regarding what companies are

required to do in the event of a data breach, loss or privacy violation. For instance, you may have to notify customers within 24 hours of discovering a breach. Get your lawyers, insurance reps, IT contractors, business executives and PR people together to fashion a plan ahead of time, because speed is essential after an attack.

#### Advice to businesses on how to take steps to avoid becoming a victim of remote purchase fraud-

- Ask your bank or card processor about the online protection offered by card schemes, such as Verified by Visa, Secure Code by MasterCard and American Express’ ‘Safe Key’, which help make transactions over the internet safer from the threat of fraud.
- Know your customer: assess a customer’s profile, order and delivery details before accepting a transaction.
- Be wary of high value or unusual orders from customers you do not know,

particularly if the product is easily resalable.

- Use the banking industry’s Address Verification Service, which compares the delivery address provided for the order with the billing address details for the payment card held by the card issuer.

Maintain a record of fraudulent

- accounts and transactions to prevent further breaches – fraudsters will continue to attack businesses until the window of opportunity is close.

#### At the end...The burden is yours

Suffice to say, the burden is largely on the small business owner today to protect their companies from attack and utter destruction by cyber criminals. A prevention program including regularly educating employees, insurance) is the best way to avoid incidents and minimize loss. Even if a bank agrees to reimburse your business for some of the loss, it can take years to see a check. For some companies, that will be too late.

Summit  
**senior**  
**citizen**  
account

FIKR SE  
NAHIN,  
FAKHER  
SE JIYO!

6.5%  
PROFIT PER  
ANNUM.



With Summit Bank Senior Citizen Account, you can live the glory days with your head held high.  
Enjoy 6.5%\* profit per annum with Summit Bank Senior Citizen Account.

Summit Senior Citizen Account features include:



Free  
Cheque Book



Profit  
Payment on  
Monthly Basis



No Minimum  
Balance  
Required



Debit Cards



Mobile  
Banking

\*Terms & conditions apply.

[www.summitbank.com.pk](http://www.summitbank.com.pk), 0800-24365

Summit **S** Bank

Committed to you





# Placing ETHICS at the Top in Governance

By Athar Hussain

In the first decade of the 21st century, many businesses learned firsthand the moral and financial risks of focusing exclusively on short-term financial gains. Just take the example of Lehman Brothers, which, after 158 years of successfully doing business, went bankrupt over the space of just one weekend. The causes: mismanagement and a reckless disregard for moral hazard. The results: the worst global recession in decades.

**T**he Lehman Brothers debacle is just one of a long and growing list of recent business management scandals that now includes Arthur Andersen, Enron, Parmalat and Bernie Madoff. The time has come to shift from short-term gains at any cost, to a deeper, longer view of management ethics view point. The ethics must be taken into account because the whole theory of wealth maximization is about people and community welfare and

dealing with people requires ethics. Business is not a machine; it is first and foremost a human construct. Those who run business are free individuals who cooperate within an organization with common goal and the decisions and actions a manager takes have the potential to benefit or hurt other people. Thus, ethics is not an artificial add-on to business but an intrinsic aspect of good management. Companies should, therefore, resist seeing people as resources or just means for

profit. Ethical management is about recognizing what people are, treating them accordingly and fostering their development.

## Basic Ethical Requirements for Good Management

Ethics are embedded in management: first, through decision making; second, through the ideas that drive the practice of management; and third, through the moral character of the manager him or



“Ethics are embedded in management: first, through decision making; second, through the ideas that drive the practice of management; and third, through the moral character of the manager him or herself”

herself. Making and acting on ethical decisions contribute to good management in many ways, such as helping to humanize business, generating trust, fostering loyalty, encouraging responsibility and helping to develop a strong moral culture.

We may avoid complex philosophical discussions to present a way of thinking about ethics on very basic principles, such as the Golden Rule, which states that one should treat others as one would like to be treated oneself, and the Natural Moral Law which holds that certain rights or values are inherent to human nature and recognizable by human reason. Respect for human dignity is the main principle. Three basic values and their corresponding virtues are upheld as critical to ethical management: justice, truthfulness and intelligent love.

Justice renders to each what is rightfully theirs. Truthfulness refers to the observance of truth in speech and behavior and a disposition to search for the truth. Intelligent love – understood as love driven by true knowledge of the real needs of the other – goes beyond justice and entails care and benevolence.

#### What about Efficiency?

Ethics and efficiency are intertwined. Efficiency depends on many factors,

including technology and production processes but also on the willingness of those in an organization to work toward goals and cooperate with others. Underlying this willingness are trust and morale, which can be jeopardized if stakeholders feel manipulated, overlooked or treated unfairly. Having an ethical sense pushes one to act in the best way for the purpose of efficiency. In turn, firm efficiency contributes to the common good. An efficient use of resources provides material support to human life and makes economic goods more widely accessible.

Through increasing competitiveness, efficiency also contributes to creating and preserving employment, thus helping to provide a livelihood for a greater number of people. The Person, the organisation and the Common Good Business managers always face a trade-off between generating profits and being responsible to their firm's many stakeholders. Shareholders, employees, customers, suppliers and the local community all have a stake in the success or failure, sustainability or loss of the firm. In a nutshell, while making a profit is necessary and important, it is not the sole purpose of business.

The firm contributes to the common good and to sustainable development. It does this by creating wealth and knowledge, by performing as a respon-

sible stakeholder and being a good corporate citizen. This means seeking not only economic results, but also positive impacts on society and the environment. Sustainability should be integrated into all processes, products and activities.

#### Key Moral Competencies for Managers

Moral competencies, including character and virtues, have a particular importance in leadership. Character shapes the vision, goals, strategies, perception and other key dimensions of the leader. It is the character through which leadership is exercised. The most important quality of a good leader is his or her willingness to serve others. This requires concern for other people, helping them to achieve worthy objectives. Other essential moral leadership skills are responsibility, honesty, loyalty, compassion, gratitude, solidarity, courage, patience, constancy and integrity.

While ethics may not be a cure for all the ills affecting the economy, they are absolutely vital if we are one day to move beyond the current crisis to a sustainable recovery. By helping managers choose the best possible alternative in each situation, ethics offer a sure path to better business practice, and even a better world.

## Jokes

### Two bankers are talking:

"How are you?"

"Very bad. Completely ruined. I wanted to commit suicide, but I couldn't do it."

"Why don't you book yourself a contract killer?"

"How do I do that? I went bankrupt. I have no money."

"Don't worry. I will let you borrow."

### A man visits his bank manager and asks:

"How do I start a small business?"

The manager replies:

"Start a large one and wait six months."

**During a bank robbery, the Chief told the Sergeant to cover all exits so that the robbers could not get away. Ten minutes later, the Sergeant reports to the Chief:**

"Sorry sir but they got away."

The chief replies:

"I told you to cover all exits, didn't I?"

"I did but they got away through the entrance."

## Interesting Quotes

"Sometimes your best investments are the ones you don't make" – **Donald Trump**

"The modern banking system manufactures money out of nothing" – **Josiah Stamp**

"The safest way to double your money is to fold it over once and put it in your pocket." – **Frank McKinney Hubbard**

## View on Banker

"Good bankers, like good tea, can only be appreciated when they are in hot water." – **Jaffar Hussein**

"A father is a banker, provided by nature" – **Unknown**





IN MEMORY OF SHAHEED MOHTARMA BENAZIR BHUTTO

  
**SINDH BANK**  
POWER TO THE PEOPLE

**BANKING CONVENIENCE AT ITS BEST  
WITH 225 ON-LINE BRANCHES  
IN 111 CITIES IN 4 YEARS**



**RS 6 BILLION PROFIT**  
UP TO JUNE 30, 2015

**ANOTHER 25 NEW ON-LINE BRANCHES BEING ESTABLISHED IN 2015**

**OTHER SERVICES AND FACILITIES:**

- ISLAMIC BANKING
- MOST ATTRACTIVE DEPOSIT SCHEMES
- COUNTRYWIDE ATM NETWORK
- AGRICULTURE LOANS
- MARKUP FREE STUDENT LOANS
- SME CREDITS
- VISA & UNIONPAY DEBIT CARDS

**KEY FEATURES OF SMS BANKING:**

- BALANCE INQUIRY
- MOBILE TOP UP
- MINI STATEMENT
- UTILITY BILLS PAYMENT
- INTRA AND INTER BANK FUNDS TRANSFER
- SMS AND EMAIL ALERTS

LONG TERM: AA  
SHORT TERM: A-1+  
(JCR-VIS)

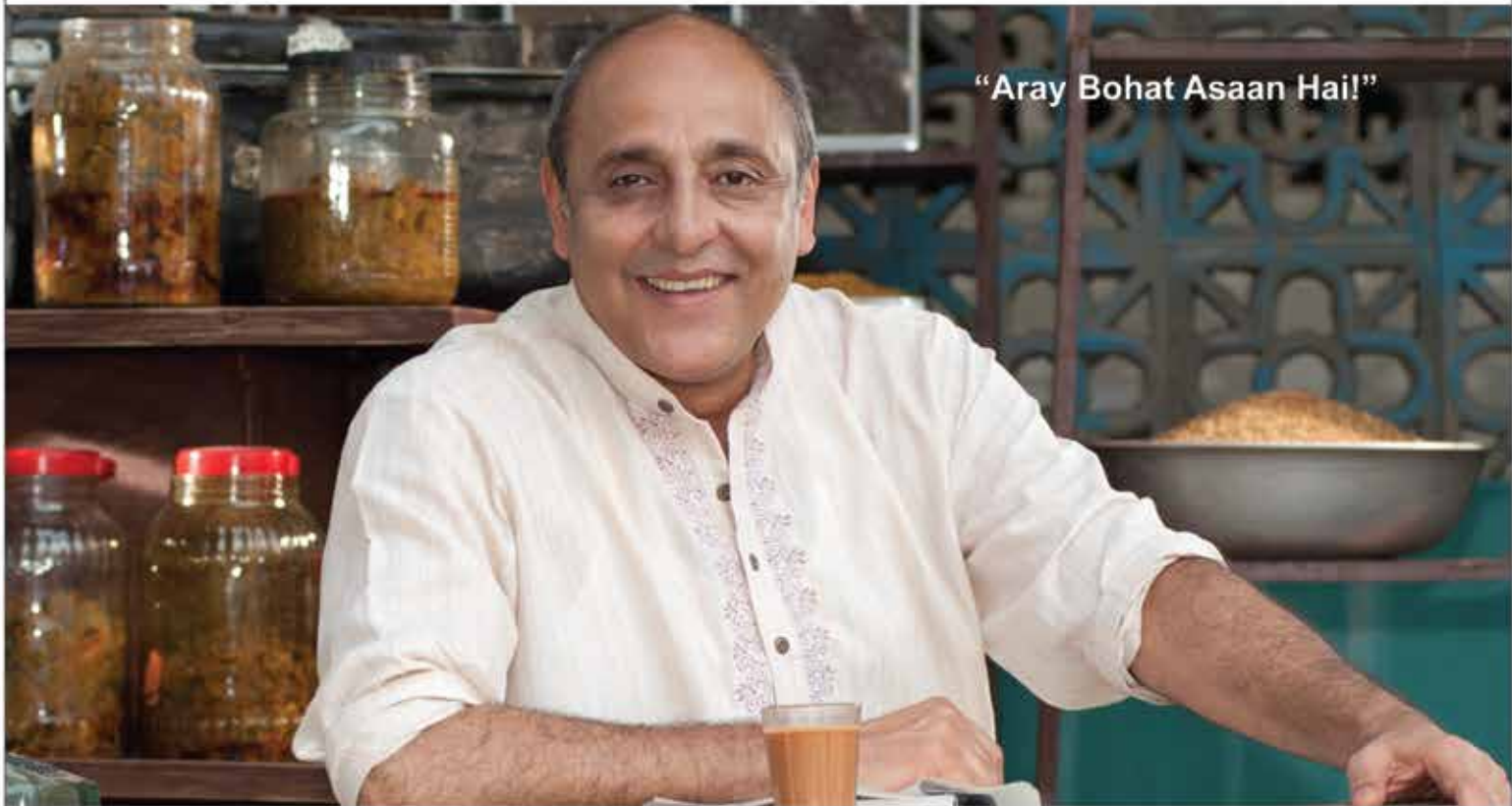


CALL CENTRE: 0800-33322

WWW.SINDBANKLTD.COM

# Banking Mai Asaani Bhi...

## Muft Life Insurance Ka Itmenaan Bhi



“Arey Bohat Asaan Hai!”

### AL Habib

# ASAAN

### CURRENT ACCOUNT

- Free Life Insurance\*
- Account can be opened with Rs. 5/- only
- One Page Account Opening Form
- Free Internet & Mobile Banking
- Free ATM/Debit Card
- Free E-Statements
- Free SMS Alerts

515 branches & sub-branches in 166 cities  
Please call: 111-786-110, 111-014-014  
Visit: [www.bankalhabib.com](http://www.bankalhabib.com) or any of our branches

Rishta Bharosay Ka



Bank AL Habib Limited

\*Conditions apply