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LESSON 1**COURSE MANAGEMENT****Objectives**

This course has been designed with the view to focus special emphasis on the following aspects:

- Developing interpretational skills and clear understanding of the students regarding prevalent banking and ancillary laws in Pakistan.
- Developing professional skills so as to apply these laws in real life situations.
- Enabling them to manage legal requirements pertaining to banks and banking transactions.

Course management:

The entire course would comprise of the following modules, detail of the topics covered under these modules is also given hereunder:

Module 1 It would cover the following topics:

Course Management

Introduction to legal system of Pakistan

Introduction to Banking Laws

Module 2

Financial system and banking: it would cover the following topics/contents:

- Financial institutions
- Financial markets & Financial instruments

Evolution of Banking: it would cover in detail the following topics/contents:

- Historical background
- Nationalization of banks
- The (banks nationalization Act, 1974)

Following topics shall be covered at length in this module:

Direct finance, indirect finance, Foreign exchange market, Stock markets, Bond markets, Financial Intermediaries including: Commercial Banks, Credit Unions, Savings and Loan Associations, Mutual Saving Banks, Mutual Funds, Finance Companies, Pension Funds etc. Key Services Provided by Financial Institutions like Risk Sharing, Liquidity Information services. We shall also discuss concept and scope of Debt and equity markets, Primary Markets and secondary markets, Exchange markets and over-the-counter markets (OTC), including Forward contracts and future markets. money market Instruments and Capital market instruments.

Module 3

Some important statutes regarding banking-- This would cover the following statutes:

Banking Companies Ordinance, 1962: it would comprise the following topics/contents:

- Introduction of the ordinance
- Important statutory definitions
- Forms of business in which banking companies may engage
- Regulations regarding Paid- up capital, Subscribed capital and Authorized capital
- Election of new directors
- Cash reserve
- Powers of State bank to control advances by banking company
- Licensing policy of State Bank of Pakistan
- Guidelines by State Bank
- Accounts & balance sheet
- Power of State Bank to remove directors

- Prosecution of directors, chief executive or other officers
- Transaction of banking business illegally by companies, etc.
- Suspension of business
- Winding-up of banking company
- Special provisions for speedy disposal of winding up proceedings
- Banking Mohtasib
- Procedure for making complaints to Banking Mohtasib
- Penalties
- Power of federal government to make rules
- Banking companies rules, 1963

SBP Act, 1956: it would cover in detail the following topics/contents:

- Establishment and incorporation of the banks
- Management
- Business and functions of banks

SBP Banking Services Corporation, Ordinance, 2001

--Pakistan banking & finance services commission Act, 1992

-- The co-operative societies and co-operative banks (re-payment of loans ordinance, 1966)

-- The establishment of federal bank for co-operative and regulation of co-operative banking Act, 1977

-- Micro finance institutions Ordinance, 2001

-- The corporate and industrial re-structuring corporation Ordinance, 2000

Module 4

Banker - Customer relationships: it would cover in detail the following topics/contents:

- Banker and customer relationship
- Debtor and creditor relationship
- Agency relationship
- Bailor- Bailee relationship
- Mortgagor-Mortgagee Relationship
- Pledger-pledgee relationship

We shall focus special attention on the following topics:

Banker , customer , Rights and Duties of Customer, Duties of the Agent, Rights of the Agent, Duties of Principal, Essentials of Bailment, Duties of Bailee, Rights of Mortgagee, Essentials of a Valid Contract, Classification of Contracts, Termination of Banker- Customer Relationship.

Module 5

Types of Customer's Account: it would cover in detail the following topics/contents:

- Opening of account
- Classified account
- Partnership account
- Account of companies
- Joint accounts
- Trust account
- Accounts of executors/ administrator

Module 6

Law relating to Negotiable instruments: it would cover in detail the following topics/contents:

- Introduction
- Promissory note
- Bill of exchange

- Negotiation of instruments
- Negotiation by delivery
- Negotiation by endorsement
- Holder in due course
- Presentation of instruments
- Payment and interest
- Discharge from liability

Module 7

Principles and Forms of Lending: it would cover in detail the following topics/contents:

- Principles of lending
- Forms of lending
- Over drafts, loans

Securities for Advances: it would cover the following topics/contents:

- Pledge
- Hypothecation
- Mortgage

Module 8

Non-funded facilities: it would cover the following topics/contents:

- **Letter of credit**
- Definition of letter of credit
- Revocable and irrevocable credits
- Types of letter of credit
- Opening of letter of credit
- Negotiation of letter of credit
- Reimbursement of letter of credit
- **Rules regarding Non-funded facilities**
- Uniform customs and practices for documentary credit (UCP 600)
- Uniform Rules for Contract Guarantee URCG-325
- Uniform Rules for Demand Guarantee URDG-458
- **Module 9**

Designing of legal documents: it would cover in detail the following topics/contents:

- Termination of the agreement, Mortgage deed
- Redemption deed
- Redemption of mortgage
- Letter of hypothecation

Module 10

Designing of legal documents: it would cover in detail the following topics/contents:

- Hire- purchase agreement
- Termination of the agreement
- Mortgage deed
- Redemption deed
- Redemption of mortgage
- Letter of hypothecation

Prudential regulations of SBP: it would cover in detail the following topics/contents:

- **Regulations for consumer financing**
 - Statutory Definitions
 - Regulations
 - Classifications
- **For small and medium enterprises financing**
 - Definitions
- Regulations
- Classifications
- **Prudential regulations for corporate/ commercial banking**
 - Definitions
- Risk management
- Corporate governance

Guidelines for banks by SBP: it would cover in detail the following topics/contents:

- Defining risk
- Risk management
- Risk management framework
- **Managing credit risk**
 - Components of credit risk management
 - Managing problem credits
- **Managing market risk**
 - Elements of market risk management
 - Risk management committee
- **Managing liquidity risk**
 - Early warning indicators of liquidity risk
 - Liquidity risk strategy
- **Managing operational risks**
 - Operational risk management principles
 - Risk reporting

Module 11

Financial institutions (Recovery of Finances) Ordinance, 2001:

It would cover in detail the following topics/contents:

- Introduction
- Definitions
- Establishment of banking court
- Power of banking court
- Procedure of banking court
- Leave to defend
- Interim decree
- Power to set aside decree
- Disposal of suit
- Sale of mortgage property
- Attachment before judgment
- Banking documents
- Execution of decree, appeal

Module 12

It would cover the following topics:

- Application of limitation Act, 1908
- Ancillary statutes
- Limitation Act, 1908
- Stamp Act, 1899
- Arbitration Act, 1949
- Contract Act, 1872

Besides text books and reference books, sufficient reading material shall be available in the form of handouts. It is believed that students shall be duly benefited from the multiple resources at their disposal.

LESSON 2**LEGAL SYSTEM OF PAKISTAN**

We know that every body around talks about law according to one's own perception. Before studying the statutory provisions of law, interpretation and significance of law, it is important to know what law is all about. Law in general sense is defined as under:

“The law consists of rules that regulate the conduct of individuals, businesses, and other organizations within society”

Significance of law

Law is to maintain rights, uphold justice and redress wrongs. Law ensures public order, balance, harmony, peace among the persons within the state and inter-states. We can easily conceive that in the absence of law and legal system there would have been disorder, unrest and chaos all around us.

Jurisprudence

For understanding law, we must have preliminary understanding of jurisprudence.

The legal experts term civil law as science of jurisprudence. Some concepts of jurisprudence are given below:

“Jurisprudence means the knowledge of law, or knowledge of just and unjust”

It deals with laws that are enforceable by the courts.

Kinds of Jurisprudence

The jurisprudence has been classified as under:

- Analytical Jurisprudence
- Historical Jurisprudence
- Ethical Jurisprudence

Analytical jurisprudence

It covers the following areas:

It analyses the prevalent law that is the principles of law as exist now. It also studies theory of legislation, precedent and customs and study of different legal concepts such as property, possession, trust, contract, negligence etc

Scope of Analytical jurisprudence

It analyses the basic principles of civil law, it does not pay any attention to the evolutionary process and their ethical aspects that is whether they are good piece of law or otherwise. We can say that analytical jurisprudence does not consider the historical and ethical aspects.

Its scope can be underlined as given below:

- An analysis of the law
- Treatment of a complex idea or concept in its elementary sub-divisions
- Examination of the relations between civil law and other forms of law
- A study of the legal source of law
- An investigation of the theory of legislation, precedent and custom
- Classification of the entire body of law with reasons thereof.
- A treatment of rights, their kinds and classes, their creation, transfer and extinction
- Dealing with legal liability, its kinds, extent and incidence
- To investigate such legal concepts as property, possession, trust, contracts, persons, acts, intention, motive, negligence. etc.

Historical jurisprudence

It studies history of law and evolution of law over a period of time and also amendments, introduction of new principles of law.

Scope of Historical Jurisprudence:

It studies the principles of law in their origin and developments that take place over a period of time. This branch is not the same thing as legal history.

Ethical jurisprudence

It deals with the law that should be in an ideal state. It lays down the different purposes which should be fulfilled in an ideal state. It studies the modifications in the existing law in order to achieve these purposes and objects. The main object of ethical jurisprudence is the attainment of justice.

Scope of Ethical Jurisprudence:

Ethical jurisprudence deals with the law in the ideal state with law as it should be. Law exists to fulfill certain purposes. It is for this branch of jurisprudence to lay down what those purposes are and whether they are fulfilled by the law existing at any given time. It considers the modifications necessary in the existing law so that it may fulfill the objects for which it exists. The other two branches are concerned with an analysis of the law as it is or as has been without being concerned with its adequacy or inadequacy. Ethical jurisprudence has as its object the attainment of justice.

Advantages of study of jurisprudence

The following are the advantages of studying this science:

Jurisprudence is the “grammar of law” and teaches the lawyers and the legislator's proper use of legal terms. It ensures homogeneity and accuracy in legal phraseology.

A person who has studied jurisprudence will be able to study foreign laws intelligently if need be,

Concepts/ Definition of Law

Some of the definitions/concepts from the writings of eminent jurists are given below:

According to Blackstone:--

“Law signifies a rule of action, and is applied indiscriminately to all kinds of action”.

According to Holland:--

“Law refers to a general rule of action, taking cognizance only of external acts enforced by a determinate authority, which authority is human, and among human authorities is that which is permanent in a political society”.

According to Hobbs

“The commands of him and them that have coercive power”

According to Austin

“A law is a rule of conduct imposed and enforced by the sovereign”

According to Salmond

“Law is the body of principles recognized and applied by the State in the administration of justice”

According to John Erskine

“Law is the command of a sovereign, containing a common rule of life for his subjects and obliging them to obedience”.

According to De Montmorency

“Coercion is a weapon of law which law has forged, but it is not the basis of law.”

According to Pound

“Law is the body of principles recognized or enforced by public and regular tribunals in the administration of justice”

According to Wilson

“Law is that portion of the established thought and habit which has gained distinct and formal recognition in the shape of uniform rules backed by the authority and power of Government.”

According to Green

“Law is the system of rights and obligations which the state enforces.”

According to Lord Radcliff

“You will not mistake my meaning or suppose that I depreciate one of the great human studies if I say that we cannot learn Law by learning Law. If it is to be anything more than just a technique it is to be so much more than itself; a part of history and sociology, a part of ethics and a philosophy of life

Classification of Law

The law is classified into the following branches:

Imperative Law

- Physical or Scientific Law
- Natural or Moral Law

Imperative Law

The three ingredients of imperative law are explained in detail

Imperative law is a general rule

It is a rule of general application as distinguished from particular application. A rule which applies only to one individual or one set of circumstances at a given time but never afterwards will not be a rule of imperative law. The rules of conduct laid down by a father for the guidance of his son; or by a master for his servant, though laid down by a superior and enforced by physical force, are not imperative law, because they are not of general application.

On the other hand, ‘general’ does not mean absolutely general, or applicable to all. Thus traffic rules, though applicable to drivers of vehicles only, are imperative law, for they apply generally to all drivers. The rules requiring ministers or the President to take an oath on entering upon office, though applicable to a few or even one individual form part of imperative law for the oath is to be taken by President after President, Minister after Minister, etc. thus “General” here signifies the fact that wherever a particular set of circumstances comes into existence, the rule should be invariably applicable, with exception –though the one affected may be an individual (the Minister) or to class of persons (the drivers of vehicles).

Imperative law has some authority behind it:

It is given by some superior, may be human or divine. Every rule of imperative law is given by some authority –whether divine or religious or political.

Imperative law is enforced by superior power:

There must be some punishment on breach of imperative law. Rules of imperative law are enforced by some superior power, and the punishment takes such form as bodily or mental suffering. The superior

enforces it by either physical force or any other form of compulsion, such as ridicule, contempt or censure. Those subject to imperative law are bound to follow it; thus compulsion is necessary. A rule which people may or may not observe cannot form a part of imperative law.

Illustrations

Divine law is imperative law on the following basis:

- (i) It is laid down by a superior authority (God);
- (ii) It is followed compulsorily;
- (iii) Its breach constitutes a sin and is punished with divine wrath.

Civil law (the law of the land) is also a form of imperative law on the following basis;

--The superior power is the sovereign

--the compulsion is fear of punishment by the state.

--it is enforced by the physical force of the state. Civil law decides whether an act is innocent or criminal.

International Law

International law has been differently defined by different jurists.

Salmond takes it as “those rules which govern sovereign states in their relations and conduct towards each other”. Other definitions are:

“the body of rules which by custom or treaty civilized states regard as binding upon themselves in their relations with one another, and whose violation gives the injured party a legal right to redress”; (Wheaton),

“The aggregate of rules to which nations have agreed to conform in their conduct towards one another”; (Lord Russell).

Sources of law

According to Salmond, following are the main sources:

- **Formal sources**
- **Material sources**

Formal Sources

Formal sources are comprised of statutes and decision of the courts.

Material sources

Material sources are comprised of legal sources and historical sources. Legal sources are comprised of the following:

- Legislation
- Precedent
- Customs
- Agreement

The main instruments under the legal sources are legislation and precedent.

First of all Precedent is explained.

Precedent or Case Law:

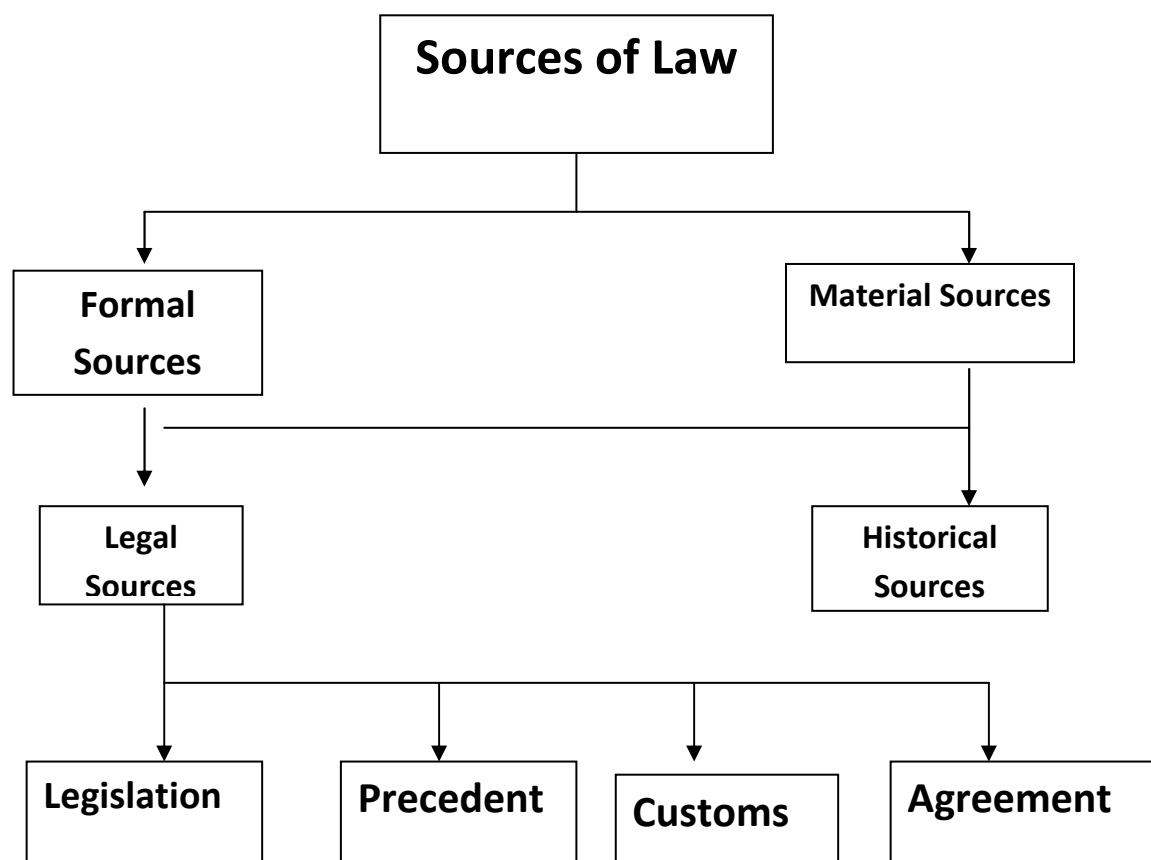
The decisions made by superior judiciary contain interpretation of law are called case law or precedents. The decisions can be relied upon/cited as precedents in future at the time of adjudication of the cases.

Principles of binding precedent are underlined below

- The decision relied upon must be based upon the interpretation of law.

-The precedent must have nexus to the central point of the case.

- The facts of the precedent being cited and the case being adjudicated upon must be the similar.



Process of legislation

Parliament: Law/ statutes are made by the parliament.

It is also called legislature and consists of, National Assembly, Senate and President of Pakistan.

Process of legislation—Explained

Parliament/federal legislature has been given powers to make laws by the constitution of Pakistan (1973) 4th schedule in two lists that is:

A bill can be presented in either house whether national assembly or senate and after being passed by simple majority shall be transmitted to other house. When the bill is passed by both houses of the parliament, it is then presented to the president for assent.

If the bill presented to President is not given assent or sent back to the parliament for any amendments, it will be considered in the joint sitting of the both houses of the parliament and if passed shall be again presented to the President for his assent. Now the bill will become the act of parliament and president does not have powers to withhold assent.

The bill when passed by the parliament is called an **Act**.

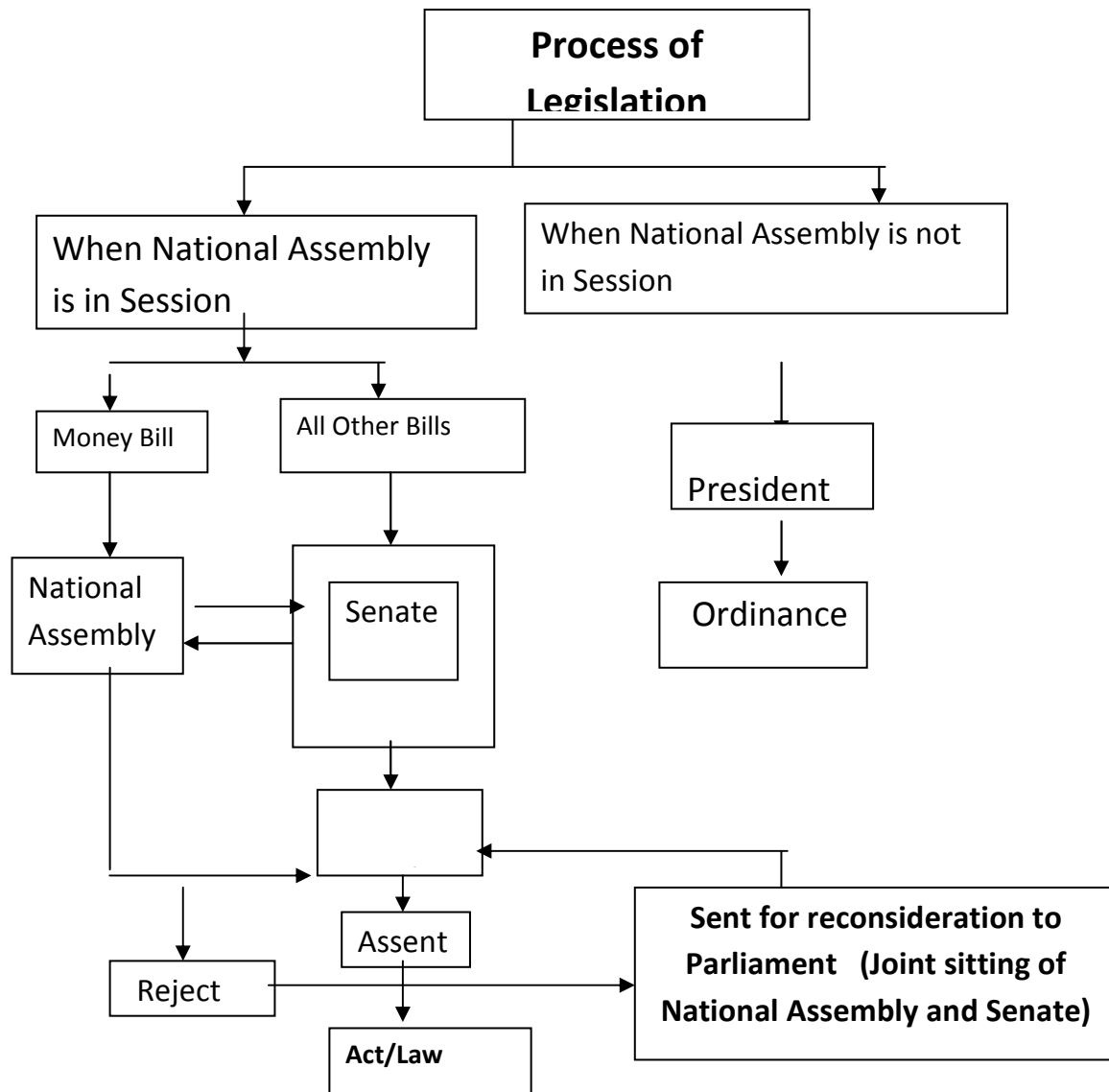
Money Bills

Money bill shall originate in the national assembly and after being passed shall be presented to the president for assent. Money bill shall not be presented to the senate. The rest of the procedure is the same as explained above.

Ordinance

Under the constitution of Pakistan, the President can promulgate an ordinance, if any house of parliament is not in session. The ordinance shall stand repealed after one hundred twenty days, if it is not presented or passed by the parliament.

The process of legislation has also been explained through a figure on next page.



LESSON 3**FINANCIAL SYSTEM & BANKING****Financial System**

Complete and complex ever changing set of rules, regulations, procedures, practices policies, conducts; role of institutions (financial institution), Governments, Policy makers and central bank taken together may be called financial system.

The financial system does have its impacts on individuals, businesses, corporations and governments alike. At times in your life, you will be a saver and at other times, you may be a borrower. The financial system channels funds from savers to borrowers and makes it possible for both to achieve their objectives. When the financial system works efficiently, it leads to better health of the economy.

Purpose of the financial system

Most of us at one time or another may need more funds than you have on hand for one purpose or another. At the same time, others spend less than their incomes. Those who have surplus funds may be willing to let someone else use their savings if they are compensated for doing so.

The mismatch of income and spending for individuals and organizations / creates an opportunity to trade. The investor can use the funds saved by different classes of people. The investor would be better off by earning a profit from investing funds in a new venture and savers who have lent their money would be better off by receiving the return that the investor pays them for lending their funds.

Now we can easily understand the functions provided by the financial system in an economy. It moves funds from those who want to spend less than they have available to those who have a desire to purchase durable goods or those who have productive investment opportunities. This matching process increases the economy's ability to produce goods and services. In addition, it makes households and businesses better off by allowing them to time purchases according to their needs and desires. A smoothly functioning financial system thus improves the economy's efficiency and people's economic welfare.

The financial system provides channels to transfer funds from individuals and groups who have saved money to individuals and groups who want to borrow money. Savers (or lenders) are suppliers of funds, providing funds to borrowers in return for promises of repayment of even more funds in the future.

The financial system brings together savers and borrowers in following two ways.

Direct Finance In direct finance, individual savers through financial markets hold the claims issued by individual borrowers.

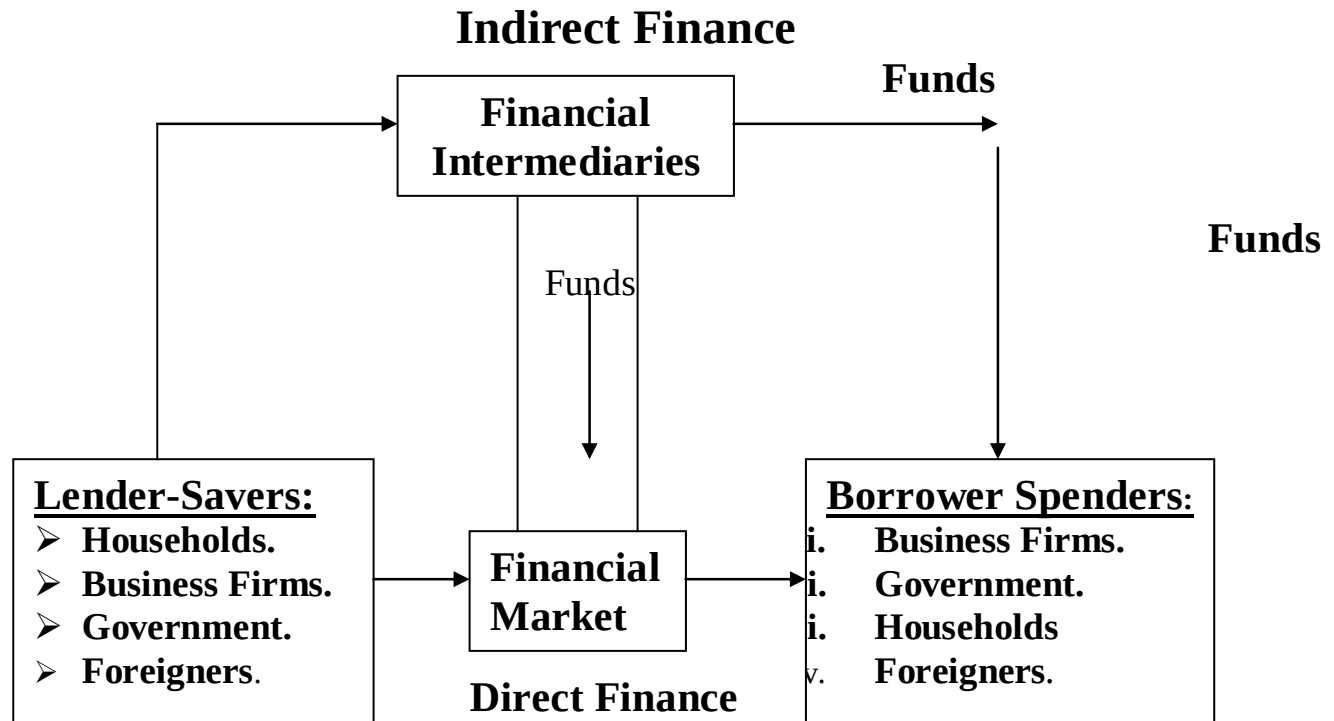
Indirect Finance In indirect finance individual savers through financial intermediaries hold claims over the portfolio of assets of the borrowers.

Financial markets provide a play field to the financial instruments. Financial instruments are traded by household, business firms, government and foreigners in wide variety of financial markets or markets for financial instruments.

Financial market can at preliminary stage be termed as market for bonds and stock markets.

Functions of Financial Markets and Financial Intermediaries

The function is explained through the following figure:



Those who have saved and lending funds, the Lender Savers are at the left side & those who must borrow funds to finance their spending, the Borrower-Spenders are at the right. The arrows show that Funds flow from lender savers to Borrower – spenders via two routes i.e.; through financial markets (Direct Finance) and through Financial intermediaries i.e. Banks etc. (Indirect Finance)

In direct finance borrowers borrow funds directly from lenders in financial markets by selling them securities or bonds which are claim on borrowers' future income or assets.

Types of Financial Markets

Financial markets are divided as under:

1. Foreign exchange market.
2. Stock market.
3. Bond market.

Financial markets are one arena in which savers' surpluses are transferred to borrowers. Savers can buy stocks and Bonds and Business borrowers can obtain funds by issuing stocks and Bonds

Financial Institutions: (Global Perspective)

Financial institutions are also called Financial Intermediaries, these include the following:

Commercial Banks
Credit Unions
Savings and Loan Associations
Mutual Saving Banks
Mutual Funds
Finance Companies
Pension Funds etc.

The role of Financial Institution is to act as Financial Intermediary or to provide function of Financial Intermediation, role of go-between for savers and borrowers.

Banks are the largest financial intermediaries. Banks lend to many sectors of the economy. However, banks and other financial institutions compete with one another and this competition has advantage for savers, borrowers and system as a whole.

Key Services Provided by Financial Institutions

In addition to matching individuals who have excess funds with those who need them, the financial system provides three key services for savers and borrowers. These services are *risk sharing*, *liquidity*, and *information*. Financial markets and financial intermediaries provide these services in different ways, making various financial assets and financial liabilities more attractive to individual savers and borrowers. Many financial decisions made by savers and borrowers are shaped by the availability of these services.

Risk Sharing

One advantage of using the financial system to match individual savers and borrowers is that it allows the sharing of risks. *Risk* is the chance that the value of financial assets will change relative to what you expect. Most individual savers are not gamblers and would like to seek a steady return on their assets rather than erratic swings between high and low earnings. Indeed, individuals prefer stable returns on the collection of assets they hold. A collection of assets is called a portfolio. For example, you might hold some government treasury securities, some shares of stock, and some shares in a mutual fund. Although one asset or set of assets may perform well and another may not perform as well, but overall returns tend to average out. This splitting of wealth into many assets is known as diversification. As long as the individual returns do not vary in the same way, the risk of severe fluctuations in a portfolio's value will be reduced. The financial system provides risk sharing by allowing savers to hold many assets.

Liquidity

The second service, the financial system offers to savers and borrowers is liquidity, which is the ease with which an asset can be exchanged for money to purchase other assets or exchanged for goods and services. Savers view the liquidity of financial assets as a benefit. When they need their assets for their own consumption or investment, they can exchange them easily. In general, the more liquid an asset, the easier it is to exchange the asset for something else. You can easily exchange the currency notes for purchasing a book or anything else because it is highly liquid. You can also cash a check within a short period of time to buy clothes. However, selling a car would take more time because personal property is not very liquid. By holding financial claims (such as stock or bonds) on a factory, individual investors have more liquid savings than they would if they owned the machines in the factory. The reason is that the investor can more easily sell the claim than a specific machine in order to buy other assets or goods. Liquid assets allow an individual or firm to respond quickly to new opportunities or unexpected events. Financial assets created by the financial system, such as stocks, bonds, or checking accounts, are more liquid than cars, machinery, or real estate.

Financial markets and intermediaries provide trading systems for making financial assets more liquid. In addition to creating financial assets, the financial system provides mechanism for increasing the liquidity of financial assets. Investors can readily sell their holdings in government securities and stocks and bonds of large corporations, making those assets very liquid. During the past two decades, the financial system has made many other assets liquid besides stocks and bonds. One measure of the efficiency of the financial system is the extent to which it can transform illiquid assets into the liquid claims that savers want.

Information

A third service of the financial system is the collection and communication of information, or facts about borrowers and expectations about returns on financial assets. The first informational role the financial system plays is to *gather* information. That includes finding out about prospective borrowers and what they will do with borrowed funds. Obtaining such information would be costly and time-consuming for savers, who of course want all the facts before lending their money. Working through the financial system, a prospective investor is likely to learn more about the borrower than he would if he tried to make the investment on his own.

Another problem that exists in most transactions is asymmetric information. This means that borrowers possess information about their opportunities or activities that they don't disclose to lenders or creditors

and can take advantage of this information. Sometimes, financial arrangements have to be structured so that borrowers do not take advantage of asymmetric information at the expense of lenders.

The financial system specializes in information gathering and monitoring, and arrangements exist for solving problems of asymmetric information."

The second informational role the financial system plays is **communication of information**.

Savers and borrowers receive the benefits of information from the financial system by looking at asset returns. As long as financial market participants are informed, the information works its way into asset returns and prices. Information is communicated to borrowers as well as to savers. The incorporation of available information in asset returns is the distinguishing feature of well-functioning financial markets.

Structure of Financial Market

Financial markets are categorized as under:

- Debt and equity markets.
- Primary Markets and secondary markets.
- Exchange markets and over-the-counter market. (OTC)
- Forward contracts and future markets.

Debt and Equity Markets

Debt instruments such as issuing bonds. These may be short term (Maturity less than one year), long-term (maturity ten year or longer) and intermediate term (maturity between one and ten years). Second method of raising funds is by issuing equities

Primary Market and Secondary Markets

Primary Market is a financial market in which new issues of a security such as Bonds or stocks are sold to initial buyers whereas in secondary Markets there is further sale of already issued securities.

Exchange and Over-the-Counter Markets

Secondary Markets can be organized in the following ways:

Through organizing/establishing Stock Exchange through Over-the-Counter (OTC) markets, (Dealers in these markets are in computer contact and know the prices set by one another, OTC markets are very competitive.

Money Market and Capital Market

Money Market is a financial market which deals in short term debt instruments. Capital market deals in long term debt instruments

Forward Contracts and Futures Market

Under Forward Contract, buyers and/sellers agree to trade certain quantity of commodity for a specific price at a specified date in future, contracts are formally made in commodities exchange markets.

Financial Regulations

Respective Governments regulate financial markets and financial institutions around the world, which is necessary for the maintenance of financial stability, build confidence of all stake holders in the system.

There are also international norms, practices and protocols which are required to be observed by all participants, trading across the borders such as Uniform customs and practices for documentary credits (UCP 600)

LESSON 4**FINANCIAL INSTRUMENTS & BANKING LAWS & PRACTICES****Financial Instruments**

We have discussed financial system and financial institutions, now shall move on to financial instruments. Financial instruments are the vehicles by which financial markets channel funds from savers to borrowers and provide returns to savers. We shall discuss major instruments or securities, traded in the financial system. For convenience, we analyze money market and capital market instruments separately. Both money market and capital market assets are actively traded in financial markets.

Money Market Instruments

The short maturity of money market assets doesn't allow much time for their returns to vary. Therefore these instruments are safe investments for short-term surplus funds of households and firms. However, in making investment decisions, savers must still consider the possibility of default—the chance that the borrower will be unable to repay the entire amount borrowed plus interest at maturity.

Government Treasury Bills

Government Treasury securities are short-term debt obligations of the government. They are also the most liquid money market instrument because they have the largest trading volume. The federal government can raise taxes and issue currency to repay the amount borrowed, so there is virtually no risk of default. Treasury securities with maturities of less than one year are called Treasury bills (T-bills). Although individuals can hold them, the largest holders of T-bills are commercial banks, followed by other financial intermediaries, businesses, and foreign investors.

Bill of exchange and other Commercial Papers

Commercial paper provides a liquid, short-term investment for savers and a source of funds for corporations. High-quality, well-known firms and financial institutions use commercial paper to raise funds. Because these borrowers are generally the most creditworthy, the default risk is small, but the interest rate is higher than that on Treasury bills. The growth in the commercial paper market during the past two decades is part of a shift by many corporations toward direct finance (and away from bank loans).

Bill of exchange Defined and Explained

It is an important form of a negotiable instrument and has been defined in section 5 of the Negotiable Instruments Act, 1881 the said definition is reproduced below:

“A bill of exchange is an instrument in writing containing an unconditional order, signed by maker, directing a certain person, to pay on demand or at fixed or determinable future time a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument”.

The following are the ingredients of a bill of exchange:

1. It must be in writing
2. It must contain an order to pay and addressed to some person
3. The order must be unconditional
4. The order must be signed by the maker
5. The order must direct to pay on demand or at a fixed or determinable future time.
6. The sum ordered to be paid must be certain.
7. The payment should be ordered to be paid to a certain person, or to his order, or to the bearer.

Explanation of different features of a bill of exchange

A promise or order to pay is not “conditional, within the meaning of this section and section 4, by reason of the time for payment of the amount or any installment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain.

The sum payable may be “certain” within the meaning of this section and section 4, although it includes future interest or return in any other form or is payable at an indicated rate of exchange, or is payable at the current rate of exchange and although it is to be paid in stated installments and contains a provision that on default of payment of one or more installments or interest. Or return in any other form the whole or the unpaid balance shall become due.

A promise order to pay is not ‘conditional’ nor is the sum payable uncertain within the meaning of this section or section 4 by reason of the sum payable being subject to adjustment for profit or loss, as the case may be of the business of the maker.

Where the person intended can reasonably be ascertained from the promissory note or the bill of exchange; he is a ‘certain person’ within the meaning of this section and section 4, although he is misnamed or designated by description only.

An order to pay out of a particular fund is not unconditional within the meaning of this section; but an unqualified order to pay, coupled with—

- (a) an indication of a particular fund out of which the drawee is to reimburse himself or a particular account to be debited to the amount, or \
- (b) a statement of the transaction which gives rise to the note or bill, in unconditional

An essential character of a bill of exchange is that it shall contain an order to accept or to pay and that acceptor should accept it, in the absence of such a direction to pay the document will not be a bill of exchange or a hundi.

Bankers' Acceptances

These instruments are designed to facilitate international trade, bankers' acceptances are instruments that establish credit between parties who do not know each other. A banker's acceptance is a check like promise that the bank will pay the amount of funds indicated to the recipient. It is issued by a firm (usually an importer) and is payable on a date indicated. The bank that marks the draft "accepted" guarantees the payment to the recipient (usually an exporter or its representing bank). The issuing firm is required to deposit funds in the bank sufficient to cover the draft; if it does not do so, the bank is still obligated to make good on the draft. The bank's good name is likely to enable an importer to buy goods from an overseas exporter that lacks knowledge about whether the importer will be able to pay. In recent years, acceptances have generally been resold in Secondary markets and held by other banks, households, and businesses.

Repurchase Agreements,

Repurchase agreements, also known as repos or RPs, are used for cash management by large corporations. They are very short-term loans, typically with maturities of less than two weeks. In many cases, a firm gives money as loan to a bank overnight. For example, if a large company has idle cash, it purchases T-bills from a bank that agrees to buy them back the next morning at a higher price, reflecting the accumulated interest. The T-bills serve as collateral; that is, if the borrower defaults, the lender receives the T-bills.

Federal (Fed) Funds (in U.S Perspective)

Federal funds instruments represent overnight loans between banks of their deposits with the Federal Reserve System (the U.S. central bank). Banking regulations require that banks deposit a percentage of their deposits as reserves with the Fed. If a bank is temporarily low on reserves, it can borrow funds from another bank that has reserves greater than the required level. The federal funds market reflects the credit needs of commercial banks, so money market analysts watch the federal funds rate (the interest rate charged on these overnight loans) closely. When it is high, banks need additional funds; when it is low, banks have low credit needs

Eurodollars

Eurodollars are U.S. dollars deposited in foreign branches of U.S. banks or in foreign banks outside the United States (not necessarily in Europe). Rather than being converted into the currency of the foreign country, the deposits remain denominated in dollars. U.S. banks can then borrow these funds. Eurodollar funds raised abroad have become an important source of funds for U.S. banks.

Negotiable Bank Certificates of Deposit

A certificate of deposit (CD) is a fixed-maturity instrument sold by a bank to depositors; it pays principal and interest to the certificate holders. This is an American terminology for term deposits.

Capital Market Instruments

Since capital market instruments have longer maturities than money market instruments, they are subject to greater fluctuations in their returns. For this reason, borrowers who seek to use funds for a long period of time and savers with long investment horizons invest in them. All capital market debt instruments contain some risk of default; however, since government securities are backed by sovereign undertaking hence carry little risk.

Government Treasury Securities

Securities and bonds are issued by the government to finance budget deficits such as Federal Investment Bonds issued by Govt. of Pakistan with maturity of 5 to 10 years. These are traded through Stock Exchange, hence liquidity is ensured.

U.S. Government Agency Securities (In U.S Perspective)

U.S. government agency securities are intermediate-term or long-term bonds issued by the federal government or government-sponsored agencies. For example, the Farm Credit System issue bonds to raise money to finance agricultural activities, and the Government National Mortgage Association (GNMA) issues bonds to finance home mortgages. Many such securities are officially guaranteed by the government (with a pledge of the government's "full faith and credit"); others, are implicitly guaranteed, so the default risk is still low.

State and Local Government Bonds issued in United States

State and local government bonds (often called municipal bonds) are intermediate-term or long-term bonds issued by municipalities and state governments. These governmental units use the funds borrowed to build schools, roads, and other large capital projects. The bonds are exempt from federal income taxation (and also income taxation by the issuing state). These bonds are often held by high-tax-bracket households, commercial banks, and life insurance companies.

Stocks

Stocks are issued as equity claims by corporations and represent the largest single category of capital market assets.

Corporate Bonds

Corporate bonds are intermediate-term and long-term obligations issued by large, high-quality corporations to finance plant and equipment spending. Typically, corporate bonds pay interest twice a year and repay the principal amount borrowed at maturity. There are many variations, however. Convertible bonds, for example, allow the holder to convert the debt into equity (for a specified number of shares). By using such variations, firms can sometimes lower their borrowing costs by giving bond buyers an extra return if the firm does exceptionally well. Corporate bonds are not as liquid as government securities because they are less widely traded. Corporate bonds have greater default risk than government bonds, but they generally fluctuate less in price than corporate equities.

Although the corporate bond market is smaller than the stock market in the United States, it is more important for raising funds because corporations issue new shares infrequently. Most funds raised through financial markets take the form of corporate bonds. Investors in corporate bonds are a diverse group, including households, life insurance companies, and pension funds.

Mortgages

Mortgages are loans (usually long-term) to households or businesses to purchase buildings or land, with the underlying asset (house, plant, or piece of land) serving as collateral. Residential mortgages are issued by commercial banks. Mortgage loans for industrial and agricultural borrowers are made by life insurance companies and commercial banks.

Commercial Bank Loans

Commercial bank loans include loans to businesses and consumers made by banks and finance companies. Secondary markets for commercial bank loans are not as well developed as those for other capital market instruments, so loans are less liquid than mortgages.

WAPDA Bond

It is an instrument of capital market in Pakistan. It serves as source of funds to this institution. Bonds in general are issued as equity claims on corporations and represent largest single category of capital market assets.

Debentures: (Corporate Bonds) --- Global Perspective

Through debentures intermediate-term and long-term loans are raised by the company of strong credit rating.

An Overview of Banking Laws & Practices

There are different laws/ statutes promulgated by the legislature. There are also laws/ statutes relating to banks and banking business. Some of the statutes relating to banking and other fields are stated below for reference purposes:

- Banking Companies Ordinance
- Negotiable Instrument Act
- Limitation Act
- Arbitration Act
- Criminal Procedure Code. (CrPC)
- Civil Procedure Code (CPC)
- Contract Act.
- Sales Tax Act

What is banking practice?

A banking practice refers to 'normal banking practice' carried on over a long period of time. Such normal banking practices carry the sanctity of law and courts do recognize such practices while deciding cases. Banking practices are complimentary to law not contradictory to law.

Some of Banking Practices

Secrecy concerning customer's affairs:

A banker is required to maintain secrecy of its customers account however under special circumstances; banker may produce statement of account under some statutory requirements to a court of law or to authorized persons/ department.

Exchange of inter-bank credit reports is one of the global banking practices.

Banker's Right of Set-Off:

Law entitles banks to set—off its claims from customer credit balances. However, courts have formulated rules, which require business norms to be followed as well.

Safe-Custody Services (Lockers Facility)

This relationship is governed by the law of bailment. (Legal relationship of Bailer and Bailee is established between the customer and the banker while availing lockers facility). Courts while adjudicating cases also pay due consideration to normal banking practices.

Banking Practice of Closing a Customer's Account under Following Circumstances:

- Frequently drawing cheques without sufficient balance in the drawer's account.
- Depositing cheques for collection which are frequently returned uncollected.
- Issue cheques and then issue stop-payment instruction to the bank.

Banks may close account of such customers after issuing reasonable notice.

From the above discussion, we can conclude that in banking statutory provisions and banking practices move side by side. It is important to understand that banking practices are complimentary to law these are in no case contradictory to law. Law shall always prevail over practices.

LESSON 5**EVOLUTION OF BANKING****Historical Overview of Banking**

Before we move on to evolution of banking in Pakistan, it would be quite interesting to have a glimpse of historical evolution of banking over a period of time.

Today, we look around us chain of banks rendering host of services to their customers. These banks cater to the commercial and industrial needs of all countries which include die highly developed and industrialized countries, the less developed countries and the countries which are at the take-off stage. Thus there are the industrial banks, the commercial banks, the joint stock banks, the co-operative banks, the agricultural banks, rural development banks, lead banks and so many other types of banks and credit institutions which are functioning. They not only meet the requirements on a national basis, but also on an international basis and what may be called as an ever expanding advancement in banking. The Banks now-a-days are performing so many functions that it would not be a misnomer to suggest that they have become the custodian of the monetary economies of the world. When we talk of great scientific developments and inventions, banking as it stands today is also a wonder of the world.

Banking as we see today is the result of evolutionary development during the course of centuries. It would also be necessary to see how Banking has come to its present stage. There has been all round development in the world and the banking today is not what it was in the earlier rudimentary form. To develop true perception, we need to know as to in what manner Banking today has come to be what it is and in what manner this transition has taken place.

The banking system, as it exists today, is the product of a number of centuries and is not the development of any particular period. In all the countries of the world. Banking has been in existence in one form or the other. So far as the present system is concerned, the word, *bank* is said to be of Germanic origin, cognate with the French word *banque* and the Italian word, *banca*, both meaning *bench*. In fact, this word may have derived its meaning from the practice of Jewish money-changers of Lombardy, a District in North Italy, who, in the middle ages, used to do business sitting on Benches in the market place. In case such an interpretation is provided, then it *also* finds support from a number of other derivations of the word such as the French word, *Bancue Route* and the Italian word, *Banka Rotta*, both of which mean Broken Bench. This practice can be understood if we analyze the situation when a money-changer failed and his bench was broken as a result of his failure.

Macleod, however, does not agree with this view and says, "*The Italian money-changers as such were never called Benchieri in the middle ages*". It may be more correct to say that the word bank is derived from the German word *back* which means a Joint Stock Fund, which was Italianized into *Banco*, when the Germans were me masters of a major part of Italy. *Professor Ram Chandran Rao* has said: "whatever be the origin of the word *bank*, it would trace the history of banking in Europe from the middle ages

When we come to the Roman age, the State Banks were not functioning but there were private banks duly regulated by the Government. *Aristotle* stated that:

"Charging of interest on money was unnatural and immoral and on this account, banking could not develop for sometime."

We should also remember that in ancient times, commercial banking was associated with the business of money-changing. They also met the financial requirements of the ruling government. *Adam Smith* has stated as under:

"The earliest banks of Italy, where the name began, were finance companies..... to make loans to and float loans for the government of cities in which they were formed.... After these banks had been long established, they began to do what we call banking business, but at first they never thought of it.

It was only in the 12th century that the Banks, in the modern sense of the term, were established in Venice and Geneva, which were doing the business of receiving deposits and lending money, and were not only

money-lenders. In Florence alone, there were about 80 bankers known to the whole of Europe such as Bardi, Medici, Peruzzi and others of great repute. The Bank of Venice founded in 1157, was the first Public Banking Institution. The Bank of Barcelona and the Bank of Geneva were established in 1401 and 1407 respectively and the Bank of the Venice and the Bank of Geneva continued to operate until the end of the 18th Century. The private banking houses such as the famous house of Fuggers and Augsburg enjoyed more eminence than Peruzzi and Bardi in the 14th Century and the Medici in the 15th Century in Italy. The bankers of Lombardy settled in the locality which is now known as the famous Lombard Street in London and to them belonged the credit of planting the seed of modern banking in England. Public banks like the famous Bank of Amsterdam was established in 1609 and these banks helped in the development of trade and commerce. These banks received heterogeneous metallic money and credited deposits in their books which were transferable through bank cheques. Thus, the mercantile payments now began to be settled by means of payment through cheques.

In Britain, people used to deposit their cash and bullion at the Royal Mint having faith in the King and the royal family as an institution.

Edward III exchanged various foreign coins and provided foreign exchange to the travelers and also supplied British money.

This faith was betrayed by *Charles I* in 1640 A.D. by capturing a very big amount of £1, 30,000 bullion left for safe custody with the Royal Mint. The merchants then started entrusting their valuables and cash to their cashiers, who also misappropriated them, and the merchants took resort to goldsmiths for keeping custody of valuables in their strong rooms. These goldsmiths used to give receipts which were known as Goldsmith's Note, which was made payable to the bearer and on demand which transformed the said receipt into the position of a bank-note which gained circulation and currency in due course of time. These notes with the passage of time became payable to the bearer on demand and enjoyed circulation. Thus, we can say that the goldsmiths became the precursor of the modern, bank-note and the fore-runners of the modern banking institutions.

Thus the development of banking in England was greatly helped by the activities of the London goldsmiths during the age of Queen Elizabeth I. For sometime, the deposits were made without interest. Later on, the goldsmiths started lending these amounts to others like that of Dutch Bankers and when it was found profitable by them, they started giving interest on this money to their customers instead of charging any fee for safeguarding their money. The goldsmiths started giving loans for long duration and some money was kept by them for daily payments. The trouble arose when *Charles II* under the Cabal Ministry borrowed heavily from them and repudiated all debts there by the goldsmiths as well as English Banking received a rude setback.

Walter Bagehot has stated that the government perpetrated one of those monstrous frauds which are likewise gross blunders. *Charles II* set up the Exchequer. He would pay to none and as has been stated by *Geoffrey Crowther* the goldsmiths were ruined. As a result of this, there was the growth of private banks which finally led to the establishment of the Bank of England in 1694. It is again interesting to refer to *Geoffrey Crowther* to trace the history of modern English banking, who has stated as under:

"The present-day banker has three ancestors of a particular note. One we have already met; the merchant, whose high and widespread reputation or credit enables him to issue documents that will be taken all over the known world as titles to money. To this day the title of "merchant banker" is reserved by usage to the older cosmopolitan and more exclusive private banking firms, nearly every one of which can trace its ancestor to a trader in commodities, more tangible (though hardly more profitable) than money. The banker's two other ancestors are the money-lenders and the goldsmiths. Lending and borrowing are almost as old as money itself and the village money-lender is found even in quite primitive communities. He is not usually regarded as a very lovely object; usurer is one of the oldest terms of abuse. But the services he performs are undoubtedly useful and necessary, even though the reward he extracts in return may usually be rapacious..... The goldsmith ancestor of the modern bank is purely an English affair.

The goldsmiths were losing their faith and earned a bad reputation for sometime and people doubted their *bona fides*. However, they started a new system of having current account with them and the borrowers could withdraw money at any time. This was the stage which gave birth later on to the present banking system. Till then, there was no public bank: The Bank of England was started in 1694 A.D. with its monopoly of issue of notes. There were joint stock companies doing banking business- and they were flourishing in London. These companies introduced deposit banking and cheque currency and many other services which a bank can offer.

So far as the Bank of Amsterdam is concerned, it was one of the greatest banks of the 17th century and its position was not less than the position which was held by the Bank of England. In fact, it had importance in the international world as a whole and one can get a good reference about the working of these banks from *Alfred Marshall* who in his book, "Money, Credit and Commerce, 1923", has stated that these famous banks besides, acting as the fiscal agents for the government, were also responsible for the counterpart of such of the work of the modern stock exchanges. In fact, these banks acted as go-between the lenders and borrowers of funds and also as the holders of cash and old securities. In this connection, it would be interesting to refer to *Adam Smith* who in his famous book, "Wealth of Nations", published in 1776, has described the main function of the Bank of Amsterdam as under:

"This bank received both foreign coin, and light and worn coin of the country at its intrinsic value in the gold standard money of the country, deducting only so much as necessary for defraying the expense of coinage, and the other necessary expense of management. For the value which remained, after this deduction was made, it gave a credit in its books. This credit was called bank money which, as it represented money exactly according to the standard of the mint, was always of the same real value, and intrinsically worth more than current money...., it could be paid away by a simple transfer, without the trouble of counting or the risk of transporting it from one place to another.

We have already seen that the Bank of England was started in 1694 as a result of the actions of *Charles II* who had borrowed very heavily from the goldsmiths and like his father had repudiated his debts. The Bank of England was also started on account of the financial difficulties of *William III* who was at war with France. Patterson suggested a way out of difficulties and offered to rise of £1,200,000 which he was prepared to loan to the government if certain concessions including the right to issue notes were given to the proposed institution. For this purpose the Tonnage Act was passed. In the year 1708 another important Act was passed which prohibited any other bank with more than six partners from issuing promissory notes and bank-notes. This Act gave the monopoly of note issue to the Bank of England, so far as the Joint Stock Banks were concerned, but left private banks having not more than six partners free to issue notes. These banks however, thought that the business of note issue was not profitable and they gave it up. Printed cheques were issued for the first time between 1749-59. The Bank of England did not have any branch outside and the private banks started playing an important role. After the middle of the 18th century there were about 300 banks. Then came the crisis of 1825 and it tolled the death knell for the small country banks and of the note as the foundation of the banking system. In 1826 an Act was passed which allowed the banks to be started with unlimited liability, consisting of more than six partners, with the right to issue note provided they had no office within the radius of sixty-five miles from London. Thus the new joint stock banks were started. Even at this time the monopoly of note issue given to the Bank of England by the Act of 1708, was interpreted to mean monopoly of Joint Stock Banking in London because during those days note issue was regarded as the most important as well as the most paying function of banks.

The modern banking institution had to wait for another century and four decades until the passage of the Banking Act of 1833 which provided for the establishment of the Joint Stock Banks.

In 1833, when the Charter of the Bank was revised, as a result of the studies made by one *Joplin*, a new clause was added and it gave legislative sanction for the establishment of Joint Stocks Banks in London and in 1834, The London and Westminster Bank was started in England, which is the first of the big five ones. In 1844 Peel Act was passed which provided for the extinction of the right of note issue and laid the foundation of the note by Bank of England. With the passing of the Peel's Act, 1844, new banks with the

right of note issue could not be started and those which already existed could not increase their circulation and thus greater emphasis was thereby laid on deposit banking and cheque currency.

There was amalgamation of banks after 1890 and the number of Joint Stock Banks in England and Wales came down from 104 in 1890 to 12 in 1956 although the number of bank offices increased from 2203 to 10700 by the end of 1961. The Currency and Bank Note Act, 1920 also regulated the issue of bank-note. The Securities Management Trust Ltd. was organized in 1929. In 1930 Bankers Industrial Development Corporation was formed. In 1947, the Labor Government nationalized the Bank of England and the power to appoint its Governor, Deputy Governors and Directors was vested in the Crown. This Act of the Labor Government had significant impact throughout the world.

“An Act to regulate the acceptance of deposits in the course of 'business; to confer functions on the Bank of England with respect to the control of institutions carrying on deposit-taking businesses; to give further protection to persons who are depositors with such institution to make provision with respect to advertisements inviting the making of deposits; to restrict the use of names and descriptions associate with banks and banking; to prohibit fraudulent inducement to make deposit; to amend the Consumer Credit Act, 1974 and me law wit respect to instruments to which section 4 of the Cheques Act, applies; to repeal certain enactments relating to banks and banking; and for purposes connected therewith.”

The significance in law of the terms 'bank', 'banker' and 'banking business' depends upon the particular operation which is in question an upon the particular statute/if any, under which the question arises. To take an obvious instance, only a banker may reap the benefit of the protective sections contained in different statutes.

In short the effect of the Banking Act, 1979 is, generally speaking, that a person or institution may accept deposits in the course of carrying on deposit taking business for the purposes of the Act unless he or it is a party recognized or licensed by the Bank of England or he or it is exempted or its business falls within the exceptions of section 1(3) or, again, the deposit is I the type included in sub-section (5). *Vide* section 1(4), 'deposit' is defined as sum of money paid on terms:

(a) Under which it will be repaid, with or without interest or premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it; and

(b) Which are not referable to the provision of property or service or the giving of security?

The penalty for contravention is liability to a fine or imprisonment both; but the civil liability of the acceptor of the deposit is not affected.

Thus so far as the English banking system is concerned, the entire matter is now covered by the Banking Act, 1979 which governs all the important aspects of the banking life in England

As per Sheldon's "*Practice and Law of Banking*", 10th Edn., p. 163, so far as the classification of banks is concerned, firstly, there is the Bank of England, incorporated by Royal Charter and not affected by the Companies Act. Secondly, there are the National Saving Banks, the National Giro and the Trustee Saving Banks. Thirdly, there are the great Joint Stock Banks, registered under the Companies Act with limited liability. Fourthly, there is at least one Joint Stock Bank with unlimited liability, namely, C. Hoare & Co., Coutts & Co. which is now a wholly owned subsidiary of National Westminster Bank Ltd. though it is still a clearing bank in its own right. There used to be many banking partnerships with unlimited liability but, with N.M. Rothschild & Sons becoming a limited company in 1970, it seems that there remains no banking partnership in England and Wales of any size. , Fifthly, there are the Scottish, Irish, Overseas and Foreign Banks whose principal places of business are outside the precincts of England and Wales. Some of the earlier overseas banks were incorporated by Royal Charter, *e.g.*, the Chartered Bank, British Bank of the Middle East, and so on. Sixthly, there are so called Merchant Banks, which are now without exception incorporated under the Companies Act, the shares of many of them being quoted on the London Stock Exchange. These banks are engaged in deposit banking but their more important role is in the provision of

finance, both by way of loan and acceptance credit and in acting as financial advisers to a large range of commercial companies/especially where 'take-over bids', mergers and amalgamations are concerned. Most of them are also prepared to act as investment advisers.

In conclusion, we can say that banking is not a static rather it is a dynamic concept. It is product of centuries and the development which has taken place is the product of the method of trial and error and experiences which were made and the results that followed relating to the acceptance of money and valuables as deposits, keeping them as such, lending them, whether to private individuals or to states or other bodies and for controlling the multifarious and multi-dimensional activities which in the beginning were only trivial and could be ignored but with the growth of time, became international in character and multi-dimensional in nature calling for actions on the part of the states as the actions on the part of the individuals failed and state control became eminent. Thus, one cannot understand the development of banking merely by looking at a particular period of time and one will have to consider the development by taking into account the progress as it has taken place during the centuries and by understanding the movement from one stage to the other.

Evolution of banking in Pakistan:

Commercial banks constitute the most important source of institutional credit in the economy. As the country's largest deposit institutions and the main source of short-term credit, they form the heart of the financial system.

At the time of independence, there were two banks incorporated in the undivided India in first half of 1940s' whose owners were Muslims. After independence they decided to establish their head office in Pakistan, thus laying the foundation of banking in this country.

The National Bank of Pakistan was set up in November 1949 in crises conditions following the first trade deadlock with India. The original intention was to establish it sometime in 1950. The plans for its establishment had to be advanced in view of the critical situation, which developed especially in the jute trade as a result of India's refusal to accept the exchange rate of the Pakistani Rupee following the Indian devaluation of 1949. The bank was set up through an Ordinance on 19 November 1949 and started its operations with five offices located at important jute centres. It played a notable role in financing the jute trade in collaboration with the Jute Board. In 1952, the National Bank of Pakistan took over the agency work of the State Bank of Pakistan to transact government business and manage currency chests at places where the state bank did not have an office of its own.

Prior to nationalization, the government owned 25 percent of the share capital while others held the remaining 75 percent. Following nationalization, the capital held by others was transferred to and invested in the federal government. Prior to nationalization, a Central Board of Directors governed the National Bank but consequent upon nationalization, the Central Board was dissolved and in its place an Executive Board consisting of a President who is the chief executive and four other members were appointed for the general direction and superintendence of the affairs and business of the bank.

All Pakistan banks were nationalized with 100 percent federal government ownership in 1974 and by now all nationalized banks stand disinvested and privatized. These aspects shall be discussed in detail in due course of time'

There were as many as thirty-four foreign banks with 172 branches at the time of independence. With the closure of many of the banks, the number had declined to twenty-one by June 1980. The Indian Banks, which numbered nine were entrusted to the Custodian of Enemy Property after the 1965 Indo-Pak war. Among foreign banks, a distinction was usually made between banks having their head offices in India and those with head offices in other countries. Foreign banks, other than the Indian banks, were commonly known as exchange banks in the early years. The term owed its origin to the fact that, prior to independence; foreign banks in the Indo-Pakistan subcontinent were engaged primarily in the financing of foreign trade. Seven exchange banks incorporated abroad were operation in Pakistan at the time of independence. Most of these banks were of British origin. There were twenty-nine Indian Banks operating in the territories of Pakistan at the time of Independence but they gradually curtailed their business and their

number stood at nine in 1965 when they were taken over by the Custodian of Enemy Property. The banks that were taken over were: (1) State bank of India; (2) Central Bank of India Ltd.; (3) Bank of India Ltd.; (4) United Commercial Bank Ltd.; (5) Punjab Commerce Ltd.; (7) United Bank of India Ltd.; (8) Bank of Baroda Ltd.; and (9) United industrial bank Ltd. Besides, there were as many as twelve non-schedule Indian banks which were also taken over by the Custodian of Enemy property following the 1965 Indo-Pakistan War.

Very few foreign banks have been attracted to Pakistan during the financial liberalization period. Indeed several have sold out to private Pakistani banks and terminated operations in Pakistan.

Evolution of Commercial Banks in Pakistan

As already discussed that at the time of independence, there were only two banks, which were incorporated in undivided India and whose owners were Muslims ,they opted to shift their Head Offices in Pakistan. With the establishment of SBP, the other banks also came into existence and by 1973 number of banks increased to fourteen.

Nationalization of Banks in Pakistan:

In 1974, the banks in Pakistan were nationalized through an Act called Nationalization Act, 1974. From 1991, the policy of liberalization of economy has been adopted whereby, nationalized banks have been denationalized and banking sector has been disinvested. At present banking sector is visibly growing at tremendous pace. These aspects shall be discussed at length in due course.

LESSON 6**THE BANKS (NATIONALIZATION) ACT, 1974****Nationalization of Banks**

We have gone through the evolutionary process of banking in Pakistan. We know that by June 30th 1948 the number of branches in Pakistan was only eighty one. However with the establishment of State Bank of Pakistan and efforts of the government, the number of schedule bank increased to 14 with 3323 branches all over Pakistan and also 74 branches in foreign countries by Dec 31st 1973. The commercial banks grew at tremendous speed and mobilized savings from the public and also contributed a lot in financing business and corporate sector. However it was considered that although banking sector was growing but the fruits of development were limited only to the urban population and corporate sector whereas most of the sectors, people and under develop regions were not getting due share. As such it was decided that banks should be nationalized. For the implementation of this objective Nationalization Act 1974 was promulgated.

Objectives of Nationalization

The nationalization was carried out with a view to achieve the following objectives:

- Disbursement of funds to the desired channels to achieve the priorities set out by the government for social welfare projects.
- Equitable distribution of credit to different classes, sectors and regions.

Salient features of The Bank (Nationalization) Act, 1974

The Act extends to the whole of Pakistan.

Act to override other laws.- This Act shall have effect notwithstanding anything contained in any other law for the time being in force or in any agreement, contract, award memorandum or articles of association or other instrument.

Statutory Definitions

The followings definitions as contained in section 3 of the Act, which are reproduced below

1. "Bank" means

- a. A company registered under the Companies Act, 1913 (VII of 1913), and transacting, in or outside Pakistan, the business of banking as defined in clause (b) of section 5 of the Banking Companies Ordinance, 1962 (LVII of 1962), in respect of which no proceedings under Part III or Part IV of the said Ordinance have been taken or are pending immediately before the commencing day; and
 - c. A banking company incorporated by or under any law within the legislative competence of
 - d. Parliament, including the State Bank, the National Bank of Pakistan, the Industrial Development Bank of Pakistan and the Agricultural Development Bank of Pakistan, but does not include;-
 - II. A bank which is an enemy firm within the meaning of the Defense of Pakistan Rules, or
 - III. A banking company incorporated outside Pakistan and transacting banking business in Pakistan, or
 - IV. A co-operative bank registered under the Co-operative Societies Act, 1925 (VII of 1925), or any other law for the time being in force relating to co-operative societies, not being a co-operative bank which is a scheduled bank; or
 - VI. A Government Savings Bank to which the Government Savings Bank Act, 1873 (V of 1873), applies, or
 - VII. A corporation or company owned or controlled by a Province and carrying on banking business only within that Province, or
 - VIII. a corporation or company established in Pakistan in pursuance of an agreement between the Government of Pakistan and Foreign Government or institution for transacting banking business in or outside Pakistan;
 - IX. (1A) "board" means Board of Directors constituted under this Act;
- 2. "Commencing day" means the 1st day of January, 1974;**

(4A) **"Loans and advances"** means "loans, advances and credit" as defined in the Banking Companies Ordinance, 1962 (LVII of 1962),

3. **"Prescribed"** means prescribed by rules made under this Act;

4. **"State Bank"** means the State Bank of Pakistan established under the State Bank of Pakistan Act, 1956 (XXXIII of 1956); and

Other words and expressions used but not defined in this Act shall have the same meaning as in the Banking Companies Ordinance, 1962 (LVII of 1962).

Provisions regarding transfer of ownership of banks are contained in section 5 of the Act which is reproduced below

1. The ownership, management and control of all banks shall stand transferred to, and vest in, the Federal Government on the commencing day.

2. All shares in the capital of a bank held by persons other than the Federal Government, a Provincial Government, a corporation owned or controlled by the Federal Government or the State Bank shall stand transferred to, and vest in, the Federal Government on the commencing day, free of all trusts, liabilities and encumbrances.

(2A) if any bank issues any additional share capital after the commencing day, then, without prejudice to the provisions of sub-section (1), a Provincial Government, a corporation owned or controlled by the Federal Government and the State Bank may contribute to the share capital so issued.

3. The vesting of any shares in the Federal Government under sub-section (2) shall not affect the right inter se of a shareholder and any other person who may have an interest in such shares and such other person shall be entitled to enforce his interest against the compensation awarded to the shareholder under section 6.

4. The safety of all deposits in banks shall stand guaranteed by the Federal Government.

5. The provisions of this Act and the vesting of the shares of the banks in the Federal Government thereunder shall not in any way affect the status of the banks as bodies corporate

6. The Federal Government or a corporation owned or controlled by the Federal Government may, from time to time, sell all or any of its shares in the capital of a bank, other than the State Bank, to such persons, and on such terms and conditions, as it may determine.

Procedure regarding compensation for transfer of ownership of shares in a bank is contained in section 6 which is reproduced below:

(1) Every person who stands registered as the holder of any share of a bank the ownership, management and control of which stands transferred to the Federal Government by virtue of section 5 shall be entitled to receive from the Federal Government by way of compensation per share an amount determined in accordance with the provisions of section 7 in the form of bonds of the Federal Government, repayable at par at any time within a period of fifteen years in accordance with a redemption programmed formulated by the Federal Government and bearing interest at the rate of one per cent above the bank rate notified by the State Bank from time to time:

Provided that, in formulating the redemption programmed, the Federal Government may make provision for preferential redemption of the bonds of such class of persons who are of meager means such as orphans, widows and pensioners, and the amount of compensation payable to whom does not exceed such maximum amount, as the Federal Government may deem fit:

Provided further that, where the amount so determined is not exact multiple of one hundred rupees, the amount in excess of the nearest lower multiple of one hundred rupees shall be paid in cash.

(2) The bonds shall be negotiable and eligible as security for advances.

The previous management was removed as per provisions contained in section 8 of the Act which is reproduced below:

- 1) Every person holding office in any bank as chairman, director or chief executive by what-ever name called, other than a person who holds such office by virtue of his appointment or nomination by the Federal Government or the State Bank, shall stand removed from his office on the commencing day and this removal shall not entitle him to any compensation and no such claim shall be entertained by any court, tribunal or other authority.
- 2) The vacation of his office by a Chairman, Director or Chief Executive under subsection (1) or otherwise shall not in any way absolve him of his liability, if any, under any law, contract or otherwise howsoever subsisting immediately before the commencing day or the day on which he ceases to hold such office.
- 3) A Chairman, Director or Chief Executive by whatever name called ceasing to hold office under any of the aforesaid provisions shall entrust or cause to be entrusted to the person succeeding him in that office, intact and in as good order as they existed on the day immediately preceding the commencing day all properties, all books of accounts and other records and documents belonging to or in the custody or control or pertaining to the affairs, of the bank.
- 4) Central Board of the banks mentioned in the Schedule, and all local bodies, area boards, managing committees, executive committees and similar other bodies for the management of any bank shall stand dissolved, and all members of such bodies shall stand removed from office, on the commencing day.

Pakistan Banking Council

- 1) At the time of promulgation of this Act, Pakistan banking council was established to oversee the working and performance of nationalized banks. However, the council was dissolved vide Banks (Nationalization) (Amendment) ordinance 1997, the main features as contained in section 9 of the Act are given below:
- 2) The Pakistan Banking Council (hereinafter referred to as the Council) shall stand dissolved forthwith.
- 3) All assets, properties and rights of the Council shall stand transferred to and vest in, and all liabilities and other encumbrances of the Council shall stand transferred to and become the liabilities and encumbrances of, the State Bank.
 - a) Employees of the Council, including its members,-
 - b) who are on deputation or secondment from any public sector financial institution shall revert to, and continue to be employed by, their parent institutions on terms and conditions governing their employment in their parent institutions; and
 - c) Who do not fall in clause (a) shall become employees of the State Bank on terms and conditions governing their employment with the Council.
 - d) Every contract or instrument to which the Council is a party shall continue to be in force and effective as if the State Bank had been a party thereto instead of the Council.
 - e) Any legal proceedings or, as the case may be, any application pending before any authority by or against the Council may be continued by or against the State Bank.
 - f) Where under any statute or statutory instrument, the Chairman or a member of the Council is nominated for a specified assignment of task, the vacancy caused by operation of this section shall be filled by a person nominated by the State Bank.

Provisions regarding management of banks are contained in section 11 which is reproduced below:

- 1) Subject to sub section (2) a bank shall have a Board consisting of-
 - a) A President, who shall be its Chief Executive; and
 - b) Not less than five and not more than seven other members.
- 2) The Federal Government may, if it deems necessary, appoint a Chairman of the Board in respect of a bank.
- 3) The Chairman, the President and other members of the Board-
 - a) shall be appointed by the Federal Government in consultation with the State Bank, for a term of three years, on such terms and conditions as may be fixed by the General Meeting of the bank:

- b) provided that the Chairman and the President shall be appointed from amongst professional bankers whose names are included in a panel of bankers qualified to be the Chairman or the President,
 - c) which panel shall be determined, maintained and varied, from time to time, by the State Bank;
 - d) may be removed for misconduct or physical and mental incapacity before the expiry of the three years term by the Federal Government in consultation with the State Bank;
 - e) shall stand removed if he becomes ineligible on any of the grounds specified in sub-section(12);
 - f) May be re-appointed by the Federal Government, in consultation with the State Bank of Pakistan, for a further period of three years.
- 4) The general direction and superintendence of the affairs and business of a bank, and overall policy making in respect of its operations, shall vest in its Board.
- 5) The Board shall determine-
- I. the credit policies of the banks;
 - II. evaluation criteria for the performance of the employees of the bank other than the President;
 - III. personnel policies of the bank including appointment and removal of officers and employees;
 - IV. guidelines for entering into any compromise with borrowers and other customers of the bank; and
 - V. Any other policy matter.
- 8) The Chief Executive and other officers of the bank shall act in accordance with the policies, criteria and guidelines determined by the Board.
- 9) The board shall appoint committees from amongst the executives of the bank, and determine the powers, functions and duties of such committees.
- 10) Where the Federal Government has appointed a Chairman he shall preside over the meetings of the Board, and in case a Chairman has not been appointed, then the president shall preside over the meetings of Board. In the absence of the Chairman or the President, as the case may be the directors may elect one of its members to preside over the meetings.
- 11) The President, subject to the control and directions of the Board, shall exercise powers of management of the affairs of the bank.
- 12) All selections, promotions and transfers of employees of banks except the President and decisions as to their remuneration and benefits shall be made by the President in accordance with evaluation criteria and personnel policies determined by the Board.
- 13) The Board, the President and other officers shall exercise their powers and discharge their duties in accordance with sound banking principles and prudent banking practices and shall ensure compliance with regulations and directions that may be issued by the State Bank from time to time.
- 14) No person shall be eligible for appointment as the Chairman, the President, or a member of the Board if-
- a. he is or has at any time been, adjudged an insolvent or has suspended payment or has compounded with his creditors; or
 - b. he is a minor or is found a lunatic or of unsound mind; or
 - c. he is not citizen of Pakistan; or
 - d. he was at any time in the service of Federal Government or a corporation controlled by any such Government or in the service of a bank and was dismissed; or
 - e. he is a person against whom any action has been taken or any proceedings are pending under section 412 of the Companies Ordinance, 1984, (XLVII of 1984), or section 83 of the Banking Companies Ordinance, 1962 (LVII of 1962); or
 - f. he is, or has been convicted for tax evasion under any law for the time being in force; or
 - g. he is a member of the Senate, National Assembly, any Provincial Assembly or an elected Member of a local council constituted under any law relating to local councils; or
 - h. He is holding an office in a political party.

Effects of Nationalization**Pros:**

- Availability of funds to the government for meeting its social sector targets
- Equitable distribution of credit to the different sectors, industries and regions.
- Centrally coordinated policy frame work

Cons:

- Excessive government control leading to the decisions on non professional considerations.
- Lack of fair market competition leading to absence of availability of innovative and diversified products to the customers.
- Neglect of personalized services to the customers.
- Mismanagement leading to alarming size of nonperforming loans portfolio.

Nationalization Act is an important part of our statutory history. We have, at length discussed objectives merits and grey areas of nationalization. At present the world is heading forward with the notions of disinvestment, privatization and free market and banking industry is no exception to it. At present banking industry is passing through this phase and visibly performing well.

LESSON 7**BANKING COMPANIES ORDINANCE, 1962****Introduction**

Law relating to Banking Companies is governed by Banking Companies Ordinance, 1962.

As we have seen that there are other laws which are related to the banking transactions and are of interest to different stake holders as such we shall take into account these ancillary statutes/ laws besides this ordinance.

Application of other laws shall not be barred under section 2

This ordinance shall have **limited application to certain financial institutions**

1. The provisions of sections 6, 25A, 25AA, 29, 31, 32, 33, 40, 41, 41A, 41B, 41C, 41D, 42, 83, 84, and 94 of this Ordinance shall, with such modifications as the State Bank may determine from time to time in relation to activities which have implications for the monetary or credit policies of the State Bank, apply to the Investment Corporation of Pakistan, the National Investment Unit Trust, the Pakistan Industrial Credit and Investment Corporation, the House Building Finance Corporation, the National Development Finance Corporation, the Bankers Equity Limited, the Pak-Libya Holding Company Limited, the Pakistan Kuwait Investment Company Limited, the Saudi-Pak Industrial and Agricultural Investment Company Limited, the Small Business Finance Corporation, the Regional Development Finance Corporation, Investment Finance Companies, Venture Capital Companies, Housing Finance Companies Corporations or Institutions which carry on one or more of the businesses enumerated in section 7 of this Ordinance, save and except for leasing companies and modaraba companies, as the Federal Government may from time to time, by notification in the Official Gazette, specify in this behalf.

2. All notifications issued by the Federal Government which are inconsistent with the provisions of sub-section (1) including such notifications in respect of the National Development Leasing Corporations, Leasing Companies and Modaraba Companies shall stand rescinded with immediate effect.

The Federal Government shall have powers to suspend the operations of Ordinance under section 4. The Federal Government, if on a representation made by the State Bank in this behalf is satisfied that it is expedient so to do, may by notification in the Official Gazette suspend for such period, not exceeding sixty days, as may be specified in the notification, the operation of all or any of the provisions of this Ordinance, either generally or in relation to any specified banking company. The Federal Government may, by notification in the official Gazette, extend from time to time, the period of any suspension under sub-section (1) for such period or periods, not exceeding sixty days at any one time, as it thinks fit so however that the total period does not exceed one year.

A copy of any notification issued under this section shall be laid on the table of the Federal Legislature—

- if it is in session, **within three days** of the issue of the notification; and
- If it is not in session, as soon as it meets after the issue of the notification.

The banking companies Ordinance 1962 has been divided in five parts, comprising of 94 sections. We shall also cover the banking companies rules, 1963. We shall discuss this ordinance in greater detail but to have a glimpse of the scope of the ordinance, the main topics to be covered are given below for ready reference.

PART 1 – Preliminary

Following topics are covered under this Part

- Title, extent and commencement
- Application of other laws not barred
- Limited application of Ordinance to certain financial institutions
- Power to suspend operation of Ordinance
- Definitions:

“Approved securities”

“banking”

“banking company”
“branch” or “branch office”
“creditor”
“company”
“debtor”
“demand liabilities”
“family members”
“gold”
“loans, advances and credit”
“managing director”
“prescribed”
“private company”
“registrar”
“scheduled bank”
“secured loans or advance”
“securities”
“State Bank”
“substantial interest”
- Ordinance to override memorandum, articles, etc

PART II

Business of Banking Companies

Following topics are covered under this Part

- Forms of business in which banking companies may engage.
- Use of the word ”Bank” or any of its derivatives.
- Prohibition of trading.
- Disposal of non-banking assets.
- Prohibition of employment of managing agents and restrictions on certain forms of employment.
- Restrictions on removal of records and documents.
- Requirement as to minimum paid-up capital and reserve.
- Regulation of paid-up capital subscribed capital and authorized capital and voting rights of shareholders.
- Election of new directors.
- Appointment of director by State Bank.
- Restriction on term of office of directors.
- Vacation of Office.
- Restriction on commission, brokerage discount, etc., on sale of shares.
- Prohibition of charge on un-paid capital.
- Prohibition of floating charge on assets.
- Restrictions as to payment of dividend.
- Prohibition of common directors.
- Reserve Fund.
- Cash Reserve.
- Restriction on the nature of subsidiary companies.
- Restrictions on loans and advances.
- Power of State Bank to control advances by banking companies.
- Power of State Bank to collect and furnish credit information.
- Preparation of special reports.
- Recovery of certain dues of banking companies as arrears of land revenue.

- Power of Federal Government prohibit acceptance of deposits by banking companies incorporated outside Pakistan.
- Deposits.
- Licensing of banking companies.
- Prohibition of advertising for deposits and collection.
- Disruptive union activities.
- Restrictions on opening of new, and transfer of existing place of business.
- Maintenance of liquid assets.
- Assets in Pakistan.
- Unclaimed deposits and articles of value.
- Half-yearly returns and power to call for other returns and information.
- Power to publish information.
- Fidelity and secrecy.
- Guidelines by the State Bank.
- Accounts and balance-sheet.
- Audit.
- Submission of returns.
- Copies of Balance Sheets, and Accounts to be sent to Registrar.
- Display of audited balance sheet by banking companies
- Incorporated outside Pakistan.
- Accounting provisions of this Ordinance not retrospective.
- Inspection.
- Responsibility of State Bank.
- Power of the State Bank to give directions.
- Power of the State Bank to remove directors or other managerial persons from office.
- Power of the State Bank to supersede Board of Directors of a banking company.
- Limitations.
- Prosecution of directors, Chief Executives or other Officers.
- Further powers and functions of the State Bank.
- Certain provisions of the Ordinance not to apply to certain banking companies.

Part –IIA

Transaction of Banking Business Illegally By Companies, etc.

Following topics are covered under this part

- Power to call for certain information, etc.
- Special provisions.
- Power to make declaration.
- Consequences of a declaration under section 43B.
- Deposit of cash and preservation of assets, etc.
- Statement of assets and liabilities to be submitted to State Bank.
- Consequential provisions for winding up, etc. 54

Part –III

Suspension of Business and winding up of Banking Companies

following topics are covered under this part

- High Court defined.
- Restriction on stay order.
- Restriction on compromise or arrangement between banking companies and creditors.

- 0 Power of State Bank to apply to Federal Government for suspension of business by a banking company and to prepare scheme of reconstruction or amalgamation.
- 0 Procedure for amalgamation of banking companies.
- 0 Winding up by High Court.
- 0 Court Liquidator.
- 0 State Bank to be Official Liquidator.
- 0 Application of Companies Act to Liquidators.
- 0 Stay of Proceedings.
- 0 Preliminary report by official liquidator.
- 0 Notice to preferential claimants and secured and unsecured creditors.
- 0 Power to dispense with meetings of creditors, etc.
- 0 Booked depositors' credits to be deemed proved.
- 0 Preferential payments to depositors.
- 0 Restriction on voluntary winding up. 71

Part –IV

Special Provisions for Speedy Disposal of Winding up Proceedings

following topics are covered under this part

- 0 Power of High Court to decide all claims in respect of banking companies.
- 0 Transfer of pending proceedings.
- 0 Settlement of list of debtors.
- 0 Special provisions to make calls on contributories.
- 0 Documents of banking company to be evidence.
- 0 Public examination of directors and auditors.
- 0 Special provisions for assessing damages against delinquent directors, etc.
- 0 Duty of directors and officers of banking company to assist in the realisation of property.
- 0 Special provisions for punishing offences in relation to banking companies being wound up.
- 0 Public examination of directors and auditors, etc., in respect of a banking company under scheme of arrangement.
- 0 Special provisions for banking companies working under scheme of arrangement at the commencement of the Ordinance.
- 0 Appeals.
- 0 Special period of limitations.
- 0 State Bank to tender advice in winding up proceedings.
- 0 Power to inspect.
- 0 Power to call for returns and information.
- 0 District Magistrate to assist. official liquidator in taking charge of property of banking company being wound up.
- 0 Enforcement of orders and decisions of High Court. 84
- 0 Power of High Court to make rules. 84
- 0 References to directors, etc., shall be construed as including references to past directors, etc.
- 0 Part II not to apply to banking companies being wound up.
- 0 Validation of certain proceedings.

Part--IVA

Banking Mohtasib

following topics are covered under this part

- 0 Appointment of Mohtasib.
- 0 Terms and conditions of the Banking Mohtasib.
- 0 . Reference to Banking Mohtasib by Court.
- 0 Procedure for making complaints.
- 0 Recommendations for implementation

- o Power to call for information.
- o Report of Banking Mohtasib.

Part –V

Miscellaneous

following topics are covered under Part V

- o Penalties.
- o Dishonest removal of pledged goods.
- o Cognizance of offences, etc.
- o Application of fines.
- o Special provisions for private banking companies.
- o Restriction on acceptance of deposits withdraws able by cheques. 95
- o Change of name by a banking company.
- o Alteration of memorandum of a banking company.
- o Certain claims for compensation barred.
- o Application of certain provisions to banking company incorporated by special enactments of the Federal Legislature.
- o Application of other laws barred.
- o Removal of difficulties.
- o Power of Federal Government to make rules.
- o Power to exempt in certain cases.
- o Exemption of Officers, etc., from liability
- o Exemption from requirement of license.
- o Exchange of information.
- o Continuance of charge and priority.
- o Protection of action taken in good faith. 98

Statutory definitions:

We shall discuss the statutory definitions as contained in section 5 of the ordinance, definitions of **banking** and **banking company** have already been briefly discussed and we shall focus on explanation of important aspects in coming Lessons.

LESSON 8**BANKING COMPANIES ORDINANCE, 1962****Statutory definitions**

These definitions as contained in section 5 of the ordinance are given below:

(a) “approved securities” means the securities in which a trustee may invest money under clause (a), clause (b), clause (bb), clause (c) or clause (d) of section 20 of the Trust Act, 1882 (II of 1882), and for the purpose of—

- (i) sub-section (2) of section 13, includes such other securities as the Federal Government may, by notification in the official Gazette, declare to be approved securities for the purpose of that subsection; and
- (ii) sub-section (1) of section 29, includes such types of Pakistan rupee obligations of the Federal Government or a Provincial Government or of a Corporation wholly owned or controlled, directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government as the Federal Government may, by notification in the official Gazette, declare, to the extent determined from time to time, to be approved securities for the purpose of that sub-section;¹ (b) “banking” means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdraw able by cheque, draft, order or otherwise; (c) “banking company” means any company which transacts the business of banking in Pakistan and includes their branches and subsidiaries functioning outside Pakistan of banking companies incorporated in Pakistan²;

Explanation.— Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause;

(d) “branch” or “branch office”, in relation to a banking company, means any branch or branch office, whether called a pay office or sub-pay office or by any other name, at which deposits are received, cheques cashed or moneys lent, and for the purposes of section 40 includes any place of business where any other form of business referred to in sub-section (1) of section 7 is transacted;

(dd) “creditor” includes persons from whom deposits have been received on the basis of participation in profit and loss and a banking company or financial institution from which financial accommodation or facility has been received on the basis of participation in profit and loss, mark-up in price, hire-purchase, lease, or otherwise;

General Concept of Creditor

From this definition, it is transpired that a banker can be a debtor as well as a creditor depending upon the nature of transaction. When the banker accepts deposits from his customers the bank becomes debtor and the customer is treated as creditor. However when a customer avails a loan or finance from the bank, the banker becomes creditor and customer shall be debtor. This relationship shall be explained in detailed while discussing banker’s customer’s relationship. However same is briefly discussed for understanding the said definition.

A bank performs a number of functions for the customer. After the account in the bank is opened and the relationship of a banker and customer is established, the bank not only undertakes to collect the cheques which are deposited in the account but also makes the payment on behalf of the customer, whenever there is a mandate from the customer. The cheques which are realized by the bank are deposited in this account of the customer and on many occasions, the bank performs certain other functions on behalf of the customer such as keeping the valuables, etc., deposited by the customer with the bank as a trustee. On many occasions, when the customer gives bills for collection to his bank and the said bank passes the bills for collection to another bank and the amount of the bills is reduced as a result of debiting the customer's account with collection charges as a result of an agreement between two banks, the bank is always acting on

behalf of the customer. There are thus too many occasions relating to so many matters which arise during the mutual dealings between the banker and the customer and at each time, a question arises as to what is the relationship between a banker and a customer

When a bank grants loan or other credit facilities to the customer, relationship is reversed, that is now

Customer is Debtor & Banker is Creditor

In such cases it is not the money of the customer in the hands of the banker but it is the money of the bank in the hands of the customer but in all such cases when a customer's account is over drawn, the customer does not cease to be a customer.

(e) "company" means any company which may be wound up under the Companies Ordinance, 1984 (XLVII of 1984) and includes a branch of a foreign banking company doing banking business in Pakistan under a license issued by the State Bank in this behalf;

(ee) "Debtor" includes a person to whom, or a banking company or financial institution to which, finance as defined in the Banking Tribunals Ordinance 1984, has been provided;

(f) "Demand liabilities" means liabilities which must be met on demand, and "time liabilities" means liabilities which are not demand liabilities;

(ff) "Family members" in relation to a person means his spouse, dependent lineal ascendants and descendants and dependent brothers and sisters;

(ffa) "foreign banking company" means a banking company, not incorporated in Pakistan, which has a branch or branches doing banking business in Pakistan under a license issued by State Bank in this behalf;

(g) "Gold" includes gold in the form of coin, whether legal tender or not, or in the form of bullion or ingot, whether refined or not;

(gg) "loans, advances, and credit" includes "finance" as defined in the Banking Tribunals Ordinance, 1984; The above definition is a referral definition. Definition of finance as contained in Banking Tribunal Ordinance, 1984 is reproduced here under:

'Finance' includes an accommodation or facility under a system which is not based on interest but provided on the basis of participation in profit and loss, mark-up or mark-down in price, hire-purchase, lease, rent sharing, licensing, charge or fee of any kin, purchase and sale of any property, including commodities, patents, designs, trade marks and copy rights, bills of exchange, promissory notes or other instruments with or without by-back arrangement by a seller, participation term certificate, musharika certificate, modaraba certificate, term finance certificate or any other mode other than an accommodation or facility based on interest and also includes guarantees, indemnities and any other obligation, facility the real beneficiary whereof is a person other than the person to whom or in whose name it was provided

(h) "managing director", in relation to a banking company, means a director who, by virtue of an agreement with the banking company or of a resolution passed by the banking company in general meeting or by its Board of Directors or, by virtue of its memorandum or articles of association, is entrusted with the management of the whole, or substantially the whole of the affairs of the company, and includes a director occupying the position of a managing director, by whatever name called;

(i) "Prescribed" means prescribed by rules made under this Ordinance;

(j) "Private company" has the same meaning as in the Companies Ordinance, 1984 (XLVII of 1984);

(k) "Registrar" has the same meaning as in, the Companies Ordinance, 1984 (XLVII of 1984);

(l) "Scheduled bank" has the same meaning as in the State Bank of Pakistan Act, 1956 (XXXIII of 1956);

This is a referral definition; the same as contained in State Bank of Pakistan Act 1956 is given here under:

"Scheduled bank" means a bank for the time being included in the list of banks maintained under sub-section (1) of Section 37;

Sub section (1) of Section 37 is also reproducing for ready reference.

(I) The Bank shall maintain at all its offices and branches an up-to-date list of banks declared by it to be scheduled banks under Clause (a) of sub-section (2).

(m) "secured loan or advance" means a loan or advance made on the security of assets the market value of which is not at any time less than the amount of such loan or advance, and "unsecured loan or advance" means a loan or advance not so secured, or that part of it which is not so secured;

(mm) "securities" includes securities as defined in the Capital Issues (Continuance of Control) Act, 1947 (XXIX of 1947),

(n) "State Bank" means the State Bank of Pakistan;

(o) "substantial interest" in an undertaking shall be deemed to be possessed by a person if he or any of his family members is the owner, director or officer of or has control over the undertaking or if he or any of his family members holds shares carrying not less than twenty per cent of the voting power in such undertaking;

Explanation. — For the purpose of this clause,—

(i) "control" in relation to an undertaking, means the power to exercise a controlling influence over the management or the policies of the undertaking, and, in relation to shares, means the Power to exercise a controlling influence over the voting power attached to such shares;

(ii) "Person" includes a Hindu undivided family, a firm, an association or body of individuals, whether incorporated or not, a company and every other juridical person; and

(iii) "undertaking" means any concern, institution, establishment or enterprise engaged in the production, supply or distribution of goods, or in the provision or control of any services relating to the provision of board, lodging, transport, entertainment or amusement, or of facilities in connection with the supply of electrical or other energy, or to the purveying of news, insurance or investment.

The Ordinance shall override memorandum, articles, etc of Banking Company under section 6 of the Ordinance:

The provisions of this Ordinance shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a banking company, or in any agreement executed by it, or in any resolution passed by the banking company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Ordinance; and

Any provision contained in the memorandum, articles, agreement or resolution aforesaid shall, to the extent to which it is repugnant to the provisions of this Ordinance, become or be void, as the case may be.

Memorandum of Associations and Article of Associations are very important concepts with regard to any company whether a banking company or a non banking company. The concepts are explained below:

Memorandum of Association

Memorandum of association is a legal document for incorporation of a company

Memorandum of association is a fundamental legal document on the basis of which the company conducts its external affairs. This document **signifies the powers of the company** as well as the **limitations of the company**. It contains information regarding the purpose, capital, and place of business, liability of the members and acquisition of shares by the subscribers.

- **Contents of Memorandum—these are discussed below:**

- Memorandum of association is required to be subscribed by at least three persons in case of public company and at least by one person in case of private company.
- Name Province in which the registered office of the company is to be located.
- Objects
- Liability of the members—limited or unlimited
- Authorized capital

Memorandum of company limited by shares. This is contained in Section 16 of the ordinance which is reproduced below.

- a. In the case of a company limited by shares,-
the memorandum shall state--
 - i. the name of the company with the word "limited" as the last word of the name in the case of a public limited company, and the parenthesis and words "(Private) Limited" as the last words of the name in the case of a private limited company,
 - ii. the Province or the part of Pakistan not forming part of a Province, as the case may be, in which the registered office of the company is to be situate;
 - iii. the objects of the company, and except in the case of a trading corporation the territories to which they extend;
 - iv. that the liability of the members is limited; and
 - v. the amount of share capital with which the company proposes to be registered, and the division thereof into shares of a fixed amount:
- b. No subscriber of the memorandum shall take less than one share; and
- c. Each subscriber of the memorandum shall write opposite to his name the number of shares he takes.

Memorandum of company limited by guarantee: sec 17

In the case of a company limited by guarantee,-

- a. whether or not the company has a share capital, the memorandum shall state-
 - i. the name of the company with the parenthesis and words "(Guarantee) Limited" as the last words of its name;
 - ii. the Province or the part of Pakistan not forming part of a Province, as the case may be, in which registered office of the company is to be situate;
 - iii. the objects of the company, and, except in the case of a trading corporation, the territories to which they extend;
 - iv. that the liability of the members is limited; and
 - v. that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year afterwards, for payment of the debts and liabilities of the company contracted before he ceases to be a member, and of costs, charges and expenses of winding up, and for adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount; and
- b. if the company has a share capital,--
 - i. The memorandum shall also state the amount of share capital with which the company proposes to be registered and the division thereof into shares of a fixed amount:
 - ii. no subscriber of the memorandum shall take less than one share: and
 - iii. Each subscriber shall write opposite to his name the number of shares he takes.

Memorandum of unlimited company: sec 18

In the case of an unlimited company—

- a. whether or not the company has a share capital, the memorandum shall state

- i. the name of the company;
 - ii. the Province or the part of Pakistan not forming part of a Province, as the case may be, in which the registered office of the company is to be situate; and
 - iii. the objects of the company, and, except in the case of a trading corporation, the territories to which they extend; and
- b. if the company has a share capital,-
- i. No subscriber of the memorandum shall take less than one share; and
 - ii. Each subscriber shall write opposite to his name the number of shares he takes

Requirements of memorandum

Following requirements must be fulfilled before submission of the memorandum of association to the Registrar.

- Required to be printed
- Should be divided into paragraphs
- Paragraphs to be consecutively numbered
- To be signed by the subscribers
- Signatures duly witnessed by at least one witness
- Signature of each subscriber to be attested by the witness
- Complete address/ occupation of the subscriber to be mentioned.
- Address, occupation of the witness to be mentioned
- Memorandum to be duly stamped under stamp Act.

Articles of Associations

Article of association is another important legal document which is subordinate to memorandum of association. It is concerned with the internal conduct and control of the company.

Articles of association as provided in section 2 (1) (i)

--"articles" means the articles of association of a company as originally framed or as altered in accordance with the provisions of any previous Companies Act, or of this Ordinance, including, so far as they apply to the company, the regulations contained in Table A in the First Schedule;

Contents of Articles of association is comprised of provisions, rules of Articles of Association:

- Regulations concerning the internal management of the company which is outlined here under:
- Definition of important terms
- Issue of shares and allotment of shares
- Share capital, rights of share holders.
- Transfer of shares
- Alteration of share capital
- Dividend
- Directors—appointment, election, removal, powers, duties
- Meetings, voting, powers
- Borrowing powers
- Accounts and Audit
- Winding up

Registration of articles is contained in section 26 which is given below:

1. There may, in the case of a company limited by shares, and there shall, in the case of a company limited by guarantee or an unlimited company, be registered with the memorandum, articles of association signed by the subscribers to the memorandum and setting out regulations for the company.
2. Articles of association may adopt all or any of the regulations contained in Table A in the First Schedule.
3. In the case of an unlimited company or a company limited by guarantee, the articles, if the company has a share capital, shall state the amount of share capital with which the company proposes to be registered.
4. In case of an unlimited company or a company limited by guarantee, if the company has not a share capital, the articles shall state the number of members with which the company proposes to be registered.
5. In the case of a company limited by shares and registered after the commencement of this Ordinance, if articles are not registered, or, if articles are registered, in so far as the articles do not exclude or modify the regulations in Table A in the First Schedule, those regulations shall, so far as applicable, be the regulations of the company in the same manner and to the same extent as if they were contained in duly registered articles.
6. The articles of every company shall be explicit and without ambiguity and, without prejudice to the generality of foregoing, shall list and enumerate the voting and other rights attached to the different classes of shares and other securities, if any, issued or to be issued by it.

Alteration of articles: sec 28

Subject to the provisions of this Ordinance and to the conditions contained in its memorandum, a company may by special resolution alter or add to its articles, and any alteration or addition so made shall be as valid as if originally contained in the articles, and be subject in like manner to alteration by special resolution: Provided that, where such alteration affects the substantive rights or liabilities of members or of a class of members, it shall be carried out only if a majority of at least three-fourth of the members or of the class of members affected by such alteration, as the case may be, personally or through proxy vote for such alteration.

Form of memorandum and articles: sec 29

- a. The form of memorandum of articles shall be in accordance with the forms set out in tables, B,C,D and E of the first schedule the memorandum of association of a company limited by shares;
- b. The memorandum and articles of association of a company limited by guarantee and not having a share capital;
- c. the memorandum and articles of association of a company limited by guarantee and having a share capital;
- d. The memorandum and articles of association of an unlimited company having a share capital;

Registration of memorandum and articles, etc: sec 30

1. The memorandum and the articles, if any, shall be filed with the registrar in the Province or the part of Pakistan not forming part of a Province, as the case may be, in which the registered office of the company is stated by the memorandum to be situated.
2. A declaration by such person as may be prescribed in this behalf, or by a person named in the articles as a director, or other officer of company, of compliance with all or any of the requirements of this Ordinance and the rules made there under shall be filed with the registrar; and the registrar may accept such a declaration as sufficient evidence of such compliance.
3. If the registrar is satisfied that the company is being formed for lawful purposes, that none of its objects stated in the memorandum is inappropriate or deceptive or insufficiently expressive and that all the requirements of this Ordinance and the rules made there under have been complied with in respect of registration and matters precedent and incidental thereto, he shall retain and register the memorandum and articles. if any.

4. If registration of the memorandum is refused, the subscribers of the memorandum or any one of them authorized by them in writing may either supply the deficiency and remove the defect pointed out, or within thirty days of the order of refusal prefer an appeal--
 - (a) where the order of refusal has been passed by an additional registrar, a joint registrar, a deputy registrar or an assistant registrar, to the registrar; and
 - (b) where the order of refusal has been passed, or upheld in appeal, by the registrar, to the Authority.
5. An order of the Authority under subsection (4) shall be final and shall not be called in question before any Court or other authority.

LESSON 9**BANKING COMPANIES ORDINANCE, 1962****Forms of business carried out by a banking company under section 7 of the Ordinance:**

A banking company may engage in any one or more of the **following forms of business**, namely:

- Borrowing, raising, or taking up of money;
- the lending or advancing of money either upon or without security;
- the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates,

[The different instruments such as bill of exchange can be drawn, discounted and endorsed under the provisions of this Ordinance. All instruments including promissory notes, bills, bills of lading, drafts and debentures play an important role in various transactions carried out by the banks and provide liquidity to financial system. Role of bill of exchange is particularly very important. We shall discuss the concept of bill of exchange in greater details. Some aspects of bill of exchange are discussed so that the purpose and scope of these provisions may be duly understood.

Bill of exchange is an important type of negotiable instruments, and has been defined in section 5 of the Negotiable Instruments Act, 1881; the said definition is reproduced below:

“A bill of exchange is an instrument in writing containing an unconditional order, signed by maker, directing a certain person, to pay on demand or at fixed or determinable future time a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument”.

Ingredients of a bill of exchange

Some of the ingredients of bill of exchange are outlined below:

1. It must in writing
2. It must contain an order to pay and addressed to some person
3. The order must be unconditional
4. The order must be signed by the maker
5. The order must direct to pay on demand or at a fixed or determinable future time.
6. The sum ordered to be paid must be certain.
7. The payment should be ordered to be paid to a certain person, or to his order, or to the bearer.

Features of a bill of exchange

Features of bill of exchange are discussed below:

A promise or order to pay is not conditional by reason of the time for payment of the amount or any installment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain.

The sum payable must be “certain” within the meaning of this section and section 4, although it includes future interest or return in any other form or is payable at an indicated rate of exchange, or is payable at the current rate of exchange and although it is to be paid in stated installments and contains a provision that on default of payment of one or more installments or interest or return in any other form the whole or the unpaid balance shall become due.

A promise to pay or order to pay is not ‘conditional’ nor is the sum payable uncertain within the meaning of this section or section 4 by reason of the sum payable being subject to adjustment for profit or loss, as the case may be of the business of the maker.

Where the person intended can reasonably be ascertained from the promissory note or the bill of exchange; he is a 'certain person' within the meaning of this section and section 4, although he is misnamed or designated by description only.

An order to pay out of a particular fund is not unconditional within the meaning of this section; but an unqualified order to pay, coupled with—

- (c) an indication of a particular fund out of which the drawer is to reimburse himself or a particular account to be debited to the amount, or \
- (d) a statement of the transaction which gives rise to the note of bill, in unconditional

An essential character of a bill of exchange is that it shall contain an order to accept or to pay and that acceptor should accept it, in the absence of such a direction to pay the document will not be a bill of exchange or a hundi.

Besides the forms discussed above following forms of business may also be carried out by a banking company.

- o Dealing in (participation term certificates, term finance certificates, musharika certificates; modaraba certificates and such other instruments as may be approved by the State Bank) and other instruments. The State Bank of Pakistan issues securities on behalf of government of Pakistan. Concept and scope of government securities is explained below:

Government Securities shall include such types of Pak. Rupee obligations of the Federal Government or a Provincial Government or of a Corporation wholly owned or controlled, directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government as the Federal Government may, by notification in the Official Gazette, declare, to the extent determined from time to time, to be Government Securities.]

- o The granting and issuing of letters of credit. Under the provisions of this Ordinance, banking companies may engage in non funded facilities particularly letter of credit besides funded facilities. The concept of the letter of credit is discussed in the following paragraphs:

Letter of Credit in general terms is defined as under:

'A letter of credit can be defined as an instrument issued by a bank in which the bank furnishes its credit which is both good and well known, in place of the buyer's credit, which may be good but is not so well known. A bank issues a letter of credit on behalf of one of its customers authorizing an individual or firm to draw draft (bill of exchange) on the bank or one of its correspondents for the bank's account under certain conditions stipulated in the credit.

The instrument of letter of credit is governed by Uniform Customs and Practices for documentary credit, called UCP 600 which is issued by the international chambers of commerce. According to UCP 600, letter of credit is defined as under:

Credit means any arrangement, however named or described that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation.

In a letter of credit the following parties are engaged:

- 1) Applicant (opener of L.C): means the party on whose request the credit is issued.
- 2) Issuing bank (opening bank): means the bank that issues a credit at the request of an applicant or on its own behalf.
- 3) Advising bank: means the bank that advises the credit at the request of issuing bank.
- 4) Confirming bank: means the bank that adds its confirmation to a credit upon the issuing bank's authorization or request.
- 5) Negotiating bank: means the bank where negotiation of documents is carried out. Negotiation means the purchase by the nominated bank of drafts and/ or documents under a

complying presentation by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

- 6) Nominated Bank: means the bank with which the credit is available or any bank in the case of the credit available with any bank.

Form of business in which a banking company may engage is continued below:

- o Issuing of traveler's cheques and circular notes;
- o Underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities (participation term certificates, term finance certificates, musharika certificates, modaraba certificates and such other instruments as may be approved by the State Bank) and investment of all kinds;
- o The purchasing and selling of bonds, scripts or other forms of securities (participation terms certificates, term finance certificates, musharika certificates, modaraba certificates and such other instruments as may be approved by the State Banks)* on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips of valuables on deposit or for safe custody or otherwise;
- o “the providing of safe deposit vaults”
- o Collecting and transmitting of money and securities;
- o The providing of finance as defined in the Banking Tribunals Ordinance, 1984.

Definitions of finance as contained in the Banking Tribunals Ordinance, 1984 is given below:

‘Finance’ includes an accommodation or facility under a system which is not based on interest but provided on the basis of participation in profit and loss, mark-up or mark-down in price, hire-purchase, lease, rent sharing, licensing, charge or fee of any kind, purchase and sale of any property, including commodities, patents, designs, trade marks and copy rights, bills of exchange, promissory notes or other instruments with or without by-back arrangement by a seller, participation term certificate, musharika certificate, modaraba certificate, term finance certificate or any other mode other than an accommodation or facility based on interest and also includes guarantees, indemnities and any other obligation, facility the real beneficiary whereof is a person other than the person to whom or in whose name it was provided.]

Form of business in which a banking company may engage is discussed below:

- o acting agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a managing agent or treasurer of a company.

[Agency service is a very important function of a bank and the relationship of Principal and Agent between customer and banker is one of important relationships.

The agency relationship is explained in the following paragraphs:

In general terms, Agency refers to the relationship which exists between two persons, the **Principal** and the **Agent** in which the Agent has to perform different duties/ functions as per instructions of the **principal** and also enters into contract with the third party / parties on behalf of the principal. The relationship of agency plays an important role in business and commercial dealings. This relationship is legal created by virtue of agreement between **Principal** and **Agent**

Definition of Agent and Principal as contained in section 182 of the Contract Act, 1872 is given below:

Agent is a person employed to do any act for another or to represent another in dealing with a third persons. The person for whom such act is done, or who is so represented, is called the **Principal**.

Explanation

The legal relation between a merchant in one country and a commission agent in other is that of principal and agent, and not seller and buyer, though this is consistent with the agent and principal, when the agent consigns the goods to the principal, being in a relation like that of seller and buyer for some purposes. A merchant, therefore, in this country who orders goods through a firm of commission agents in Europe cannot hold the firm liable as if they were vendors for failure to deliver the goods. And the result is the same if the goods are ordered through a branch in this country of a firm of commission agents in another country. For the same reason, where a commission agent buys goods for a merchant at a price smaller than the limit specified in the indent, he cannot charge any price higher than that actually paid by him, except in the case of a custom to the contrary. An agent may have, and often has, in fact, a large discretion, but he is bound in law to follow the principal's instructions provided they do not involve anything lawful. To this extent an agent may be considered it's a superior kind of servant; and a servant who is entrusted with any dealing with third persons on his master's behalf is to that extent an agent. But a servant may be wholly without authority to do anything as an agent, and agency, in the case of partners, even an extensive agency, may exist without any contract of hiring and service.]

Form of business is continued below:

- Acting as “Modaraba Company” under the provision of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980.

[The definition of modaraba company as contained in Modaraba Ordinance, 1980 is given below:

Modaraba Company means a company engaged in the business of floating and managing modaraba. The definition of the modaraba is given hereunder. Modaraba means a business in which a person participates with his money and another with his efforts or skill or both his efforts and skill and shall include Unit, Trust and Mutual Fund by whatever name called.

Modaraba certificate and Modaraba fund have also been defined in this Ordinance; the said definitions are also given here under for ready reference.

Modaraba Certificate: means a certificate of definite denomination issued to the subscriber of the modaraba acknowledging receipt of money subscribed by him.

- Contracting for public and private loans and negotiating and issuing the same;
- The effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of **any issue** public or private, Government, municipal or other loans **or of shares**, stock debentures, (debenture stock or other securities) of any company, corporation or association and the lending of money for the purpose of any such issue;
- Carrying on and transacting every kind of guarantee and indemnity business;
- Purchase or acquisition in the normal course of its banking business of any property, including commodities, patents, designs, trade marks and copyrights with or without buy-back arrangements by the seller, or for sale in the form of hire-purchase or on deferred payment basis with mark-up or for leasing or licensing or for rent sharing or for any other mode of financing
- Managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;
- Acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form security or part of the security for any loans or advances or which may be connected with any such secure
- Undertaking and executing trusts;

We shall continue our discussion on this topic in the next Lesson.

LESSON 10**BANKING COMPANIES ORDINANCE, 1962****Forms of business carried out by the banking company under section 7 of the Ordinance:**

In previous Lesson we have discussed some forms of business that can be carried out by a banking company, there are other forms of business that can be carried out by a banking company under the provisions of this ordinance, and the same are enumerated and discussed hereunder:

O undertaking the administration of estates as executor, trustee or otherwise;

[The concept of **executor, trustee and administrator** is explained below. An executor is a person who is nominated by the testator (writer of the Will). The authority in executor is vested by virtue of the Will. Executor has just to carry out the directions contained in the will. However in certain cases, the person appointed as executor may not have the legal competency to execute the Will, for instance the person appointed as executor may be a minor and minor is the person who does not have the capacity to enter into any contract.

As such in such situations, the court of law shall appoint a person as administrator to look after to execute the directions contained in the Will.

The person who accepts the confidence reposed under a trust is called the trustee. The trust has been defined in section 3 of the Trust Act 1882 as under:

A "**trust**" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner the person who reposes or declares the confidence is called the "author of the trust": the person who accepts the confidence is called the "**trustee**": the person for whose benefit the confidence is accepted is called the "**beneficiary** ": the subject matter of the trust is called "trust property" or "trust money": the "**beneficial interest**" or "interest" of the beneficiary is his right against the trustee as owner of the trust property; and the instrument, if any, by which the trust is declared is called the "**instrument of trust**": a breach of any duty imposed on a trustee, as such, by any law for the time being in force, is called a "breach of trust": and in this Act, unless there be something repugnant in the subject or context, "registered" means registered under the law for the registration of documents for the time being in force: a person is said to have "notice" of a fact either when he actually knows that fact, or when, but for willful abstention from inquiry or gross negligence, he would have known it, or when information of the fact is given to or obtained by his agent, under the circumstances mentioned in the Contract Act, 1872, section 229; and all expressions used herein and defined in the Contract Act, 1872, shall be deemed to have the meanings respectively attributed to them by that Act.

Purpose of the trust must always been lawful, this concept is contained in section 4 of the Act which is reproduced for reference:

A trust may be created for any lawful purpose. The purpose of a trust is lawful unless it is

- a.** Forbidden by law, or is of such a nature that, if permitted, it would defeat the provisions of any law, or
- b.** Is fraudulent, or
- c.** Involves or implies injury to the person or property of another, or
- d.** The Court regards it as immoral or opposed to public policy.

Every trust of which the purpose is unlawful is void. And where a trust is created for two purposes, of which one is lawful and the other unlawful and the two purposes cannot be separated, the whole trust is void.

Explanation In this section the expression "law" includes, where the trust property is immoveable and situate in a foreign country, the law of such country.

Form of Business is continued below:

- Establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;
- The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purpose of the company;
- selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

Mortgage is a very important concept particularly as collateral in lending operations. The concept and scope of mortgage is explained in the following paragraphs.

Mortgage has been defined in section 58 of the Transfer of Property Act; the said definition is given below:

(a) A mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.

Mortgagor:

The transferor is called mortgagor

Mortgagee:

The transferee is called mortgagee

Mortgage Money:

The principal money and interest of which payment is secured for the time being are called the mortgage-money

Mortgage Deed:

The instrument (if any) by which the transfer is effected is called a mortgage deed.

Scope of Mortgage:

According to the provisions of sec 58 of the Act, Mortgages can be made as outlined below:

Of specific immovable property

Purpose--securing the payment of:

Money advanced or to be advanced by way of loan

For an existing debt or future debt or

For performance of an engagement which may give rise to pecuniary liability

Rights of Mortgagee

- Mortgagee has the right to sell the mortgaged property in case of default by mortgagor.
- Right of fore-closure is also vested in the mortgagee.
- Mortgagee also has the right to file suit before a court of law.

Types of Mortgages:

In practice there are two types of Mortgages which are given below:

Registered Mortgage**Equitable Mortgage****Registered or Legal Mortgage**

This is created through a formal document called mortgage deed.

Mortgage deed is registered with the Registrar of titles.

It is comparatively expensive as it involves stamp duty and registration fee.

Equitable Mortgage

This is created by deposit of title deed by the mortgagor.

- Memorandum regarding deposit of title deed is also signed by respective parties.
- Clear title of the mortgagor must be ascertained by the mortgagee.]

Form of business--- continued

Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;

- o Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;
- o Any other form of business which the federal government may, by notification in the official gazette, specify as a form of business in which it is lawful for a banking company to engage.
- o No banking company shall engage in any form of business other than those referred to in sub-section (1).

Use of the word “Bank”: Sec 8

Every company carrying on the business of banking in Pakistan shall use the word “bank”, or any of its derivatives as part of its name and no company other than a banking company shall use in its name any word calculated to indicate that it is a banking company:

Provided that nothing in this section shall apply to- subsidiary of a banking company formed for one or more of the purpose mentioned in sub-section (1) of Section 23 whose name indicates that it is a subsidiary of that banking company; and

Provided that nothing in this section shall apply to- any association of banks formed for the protection of their mutual interests and registered under section 42 of the Companies Ordinance 1984(XLVII of 1984):

Provided further that the State Bank may, subject to such conditions, if any, as it may deem fit, by notification in the Official Gazette, authorize a company, not being a banking company to use in its name the word ‘bank’ or any of its derivatives

Prohibition of trading: Sec 9

Except as authorized under section 7, no banking

company shall directly or indirectly deal in the buying or selling or bartering of goods or engage in any trade or buy, sell or barter goods for others, otherwise than in connection with bills of exchange received for collection or negotiation.

Explanation._ For the purpose of this section, “goods” means every kind of movable property, other than actionable claims, stocks, shares, money, bullion and species, and all instruments referred to in clause (a) of sub-section (1) of Section 7.

Disposal of non-banking assets: Sec 10

Notwithstanding anything contained in section 7, no banking company shall hold (except as may be permitted by the State Bank from time to time or as is required) for any period exceeding seven years from the acquisition thereof or from the commencement of this Ordinance, whichever is later or any extension of such period as in this section provided, and such property shall be disposed of within such period or extended period, as the case may be:

Provided that the banking company may, within the period of seven years as aforesaid, deal or trade in any such property for the purpose of facilitating the disposal thereof:

Provided further that the State Bank may in any particular case extend the aforesaid period of seven years by such period not exceeding five years where it is satisfied that such extension would be in the interests of the depositors of the banking company.

Explanation.—For the purpose of this section property, a substantial portion of which is in use by banking company for its own genuine requirements shall be deemed to be property for its own use.

Prohibition of employment of managing agents and restrictions on certain forms of employment: (Sec 11)

(1) No banking company—

(a) Shall employ or be managed by a managing agent; or

(b) Shall employ or continue the employment of any person—

Who is, or at any time has been, adjudicated insolvent or has suspended payment, or has compounded with his creditors, or who is, or has been, convicted by a criminal court of an offence involving moral turpitude; and shall employ or continue the employment of any person— whose remuneration or part of whose remuneration takes the form of commission or a share in the profits of the company:

Provided that nothing contained in sub-clause (ii) shall apply to the payment by a banking company of any bonus in pursuance of a settlement or award arrived at or made under any law relating to industrial disputes or in accordance with any scheme framed by such banking company or in accordance with the usual practice prevailing in banking business; or any commission to any broker (including guarantee broker), cashier-contractor, clearing and forwarding agent, auctioneer or any other person, employed by the banking company under a contract otherwise than as a regular member of the staff of the company; or shall be managed by any person—

(i) Who is a director of any other company not being a subsidiary company of the banking company or a company registered under section 26 of the Companies Act, 1913 (VII of 1913), except with the previous approval of the State

Bank; or shall be managed by any person— who is engaged in any other business or vocation; or who has a contract with the company for its management for a period exceeding five years at any one time:

Provided that any contract with the company for its management may be renewed or extended for a further period not exceeding five years at a time if and so often as the directors so decide:

Provided further that nothing in this clause shall apply to a director, other than the managing director, of a banking company by reason only of his being such director.

(2) Where a person holding the office of a chairman or director or manager or chief executive officer (by whatever name called) of a banking company is, or has been found by any tribunal or other authority (other than a criminal court) to have contravened the provision of any law and the State Bank is satisfied that the contravention is of such a nature that the association of such person with the banking company is or will

be detrimental to the interest of the banking company or its depositors or otherwise undesirable, the State Bank may make an order that person shall cease to hold the office with effect from such date as may be specified therein and thereupon, that office shall, with effect from the said date, become vacant.

(3) Any order made under sub-section (2) in respect of any person may also provide that he shall not, without the previous permission of the State Bank in writing, in any way, directly or indirectly, be concerned with, or take part in the management of, the banking company or any other banking company for such period not exceeding five years as may be specified in the order.

(4) No order under sub-section (2) shall be made in respect of any person unless he has been given an opportunity of making a representation to the State Bank against the proposed order:

Provided that it shall not be necessary to give any such opportunity if, in the opinion of the State Bank, any delay would be detrimental to the interests of the banking company or its depositors.

(5) Any decision or order of the State Bank made under this section shall be final for all purposes.

Restrictions on removal of records and documents: Sec 12

No banking company shall remove from Pakistan to a place outside Pakistan any of its records and documents relating to its business at its branches, whether they are functioning or not, without the prior permission in writing of the State Bank.

Explanation.— In this section the term “records” means ledgers, day books, cash books, accounts books and all other books used in the business of a banking company and the term “documents” means vouchers, cheques, bills, pay orders, securities for advances and any other documents supporting entries in the books of, or claims by or against, a banking company.

From the provisions of section 12 of the ordinance it is mandatory for a banking company to seek prior permission in writing in case it desires to shift any record from Pakistan to any place outside Pakistan.

LESSON 11**BANKING COMPANIES ORDINANCE, 1962**

In this Lesson we shall cover the following aspects:

- Requirement as to minimum paid-up capital and reserve.
- Regulation of paid-up capital subscribed capital and authorized capital and voting rights of shareholders.
- Election of new directors.
- Appointment of director by State Bank.
- Restriction on term of office of directors.

Requirement as to minimum paid-up capital and reserves: these requirements are contained in section 13 of the Ordinance which is reproduced hereunder for reference.

Subject to sub-section (2) no banking company incorporated in Pakistan shall:—

- a. Commence business unless it has such minimum paid-up capital as may be determined by the State Bank; or
- b. carry on business unless the aggregate value of its paid-up capital and unencumbered general reserves is of such minimum value within such period as may be generally determined by the State Bank from time to time, subject to a maximum of ten per cent of the total demand and time liabilities of the banking company at any time:

(2) No banking company incorporated outside Pakistan shall be deemed to have complied with the provisions of sub-section (1) unless it deposits, and keeps deposits, with the State Bank an amount by transfer of funds from outside Pakistan or in the form of assets acquired out of remittable profits made by it from deposits in Pakistan which is not less than what is required to be maintained under sub-section (1), in any one or more of the following forms, namely:—

- i. Interest-free deposit in cash in Pakistan rupees
- ii. Interest-free deposit in a freely convertible approved foreign exchange within the meaning of the State Bank of Pakistan Act, 1956 (XXXIII of 1956), specified by the State Bank in respect of such banking company; and
- iii. Deposit of un-encumbered approved securities.

Explanation.— In this section and in sections 22 and 29, ‘liabilities’ shall not include the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company or the amount of any loan taken from the State Bank or the amount received as loan in Pakistan currency by the banking company from the Federal Government, whether out of a foreign currency loan contracted by the Government or otherwise, or the amount of foreign currency loans obtained by the banking company directly from any foreign agency:

(3) Without prejudice to the provisions of section 83, the State Bank may, by order in writing, require any banking company which has failed to comply with the provisions of clause (b) of sub-section (1), within the period determined under that clause to deposit with the State Bank such amount on such terms and conditions as the State Bank may determine; and every banking company which is so required shall be bound to comply with the order

Provided that the amount of the deposit so required shall not exceed the amount by which the aggregate of the time and demand liabilities of the banking company exceeds the amount of such liabilities computed on the basis of [the aggregate value of its paid-up capital and unencumbered general reserves] @ determined under clause (b) of sub-section (1).

Any amount deposited and kept deposited with the State Bank under the proviso to sub-section (3) by any banking company incorporated outside Pakistan shall, in the event of the company ceasing for any reason to carry on banking business in Pakistan, be an asset of the company on which the claims of all the creditors of the company in Pakistan shall be a first charges.

The State Bank may, if it thinks fit, extend the period referred to in sub-section (1) or sub-section (3) either generally or in any particular case.

If any dispute arises in computing the aggregate value of the paid-up capital [and unencumbered general reserves] of any banking company, a determination thereof by the State Bank shall be final.

For the purposes of this section, (a) expression “value” means the real or exchangeable value or, if the real or exchangeable value exceeds the nominal value, the nominal value; and (b) the expression ‘capital and unencumbered general reserves’ means paid-up capital and such other items as may be notified by State Bank.

MINIMUM CAPITAL REQUIREMENTS FOR BANKS/DFIs: as set out by State Bank of Pakistan are given below:

Minimum Paid-up Capital	Deadline by which to be increased
a) Rs 3 billion	By 31-12-2006
b) Rs 4 billion	By 31-12-2007
c) Rs 5 billion	By 31-12-2008
d) Rs 6 billion	By 31-12-2009

Regulation of paid-up capital subscribed capital and authorized capital and voting rights of shareholders:

These regulations are contained in section 14 of the Ordinance; these are very important concepts and shall be explained in detail. However provisions of section 14 are reproduced below:

- 1) No banking company incorporated in Pakistan shall carry on business in Pakistan unless it satisfies the following conditions, namely:-
 - i. that the subscribed capital of the company is not less than one half of the authorized capital and paid-up capital is not less than one half of the subscribed capital and that if the capital is increased it complies with the conditions prescribed in this clause within such period not exceeding two years as the State Bank may allow;
 - ii. that the capital of the company consists of ordinary shares only; That, subject to the provisions contained in clause (iv), the voting rights of any one shareholder are strictly proportionate to the contribution made by him to the paid-up capital of the company;
 - iii. That the voting rights of any one shareholder, except those of the Federal Government or a Provincial Government do not exceed five per cent of the total voting rights of all the shareholders.
- 2) Notwithstanding anything contained in any law for the time being in force or in any contract or instrument no suit or other proceeding shall be maintained against any person registered as the holder of a share in a banking company on the ground that the title to the said share vests in a person other than the registered holder: Provided that nothing contained in this sub-section shall bar a suit or other Proceeding—
 - (a) by a transferee of the share on the ground that he has obtained from the registered holder a transfer of the share in accordance with any law relating to such transfer; or
 - (b) on behalf of a minor or a lunatic on the ground that the registered holder holds the share on behalf of the minor or lunatic.
- 3) Every chairman, managing director or chief executive officer by whatever name called of a banking company shall furnish to the State Bank through that banking company returns containing full particulars of the extent and value of his holding of shares, whether directly or indirectly, in the banking company and of any change in the extent of such holding or any variation in the rights attaching thereto and such other information relating to those shares as the State Bank may, by order, require and in such form and at such time as may be specified in the order.

To understand the above we need to know the concept of share of a company, different type of shares, and categories of share capital that is authorized capital, issued capital, unissued capital, subscribed capital and paid up capital.

Meaning of Share

A share in a company is one of the units into which the total capital of the company is divided. Thus share means a share in the capital of a company a share is a proportion of capital which each shareholder is entitled to. A share is not a sum of money, but an interest measured by a sum of money and made up of various rights and liabilities of the shareholders. A share involves rights and liabilities. In simple words, a share indicates the pecuniary interest of the shareholders and their rights and liabilities. Therefore, in this sense a share may be defined as an existing bundle of rights and liabilities.

A share is an abstract right to participate in profits and in the capital and assets of a company. Shares are deemed to be situated at a place at which the rights of members are kept, and where the shares can be dealt with.

Kinds of Shares Allowed Under Law:

A company limited by shares may have different kinds of shares and classes therein as provided by its memorandum and articles. The shares which a company can issue are of following types

1. Ordinary or equity shares
2. Preference shares
3. Deferred shares

Ordinary or Equity shares:

The equity shares are those which are not preferential shares, i.e. these shares do not enjoy any preferential rights. Thus, for the purpose of dividend and repayment of capital, the equity shares rank after the preference shares. Generally, their rate of dividend is not fixed. It may vary from year to year depending upon the profits of the company, they may get higher dividend if the profits are huge, and may get nothing if there are no profits. The rate of dividend is determined by the directors of the company, the sum total of equity shares is the equity share capital.

Preference Shares

The preference shares are those which have some preferential rights over the other types of shares i.e., which enjoy some priority over the equity shares. A share to be preference share, must have both the following preferential rights:

1. **A preferential right as to the payment of dividend:** during the continuance of the company, the preference shareholders must get some dividend. The preference dividend may consist of fixed amount to be distributed among the preference shareholders, or it may be paid at a fixed rate e.g. 5 % of nominal value of shares.
2. **A preferential right as to the repayment of capital:** in the event of winding up of the company, the amount paid on preference shares must be paid back before anything is paid to the equity shareholders.

The sum-total of the preference shares is the “preference share capital of the company.

Kinds of Preference Shares:

The preference shares may be of the following classes:

1. Cumulative and non-cumulative preference shares
2. Participating and non-participating preference shares
3. Convertible and non-convertible preference shares
4. Redeemable preference shares.

Deferred Shares

Deferred shares are also called Founders Shares or Management Shares. These shares are usually issued to the promoters, vendor or their nominees, and are generally for the purpose of indicating the promoter's faith in the propositions. These shares are generally used to remunerate the promoters or founders of the company or the underwriters of the share capital. These are always few in numbers. The holders of these

shares usually receive no dividends until the dividends on all other classes of shares are paid in full, or there has been paid in each year a stated dividend on the capital paid up on all the other issued shares. There is usually no limit placed on the rate of dividend that may be payable to deferred shareholders, but it would be necessary to place some restriction on the amount of dividend payable to the ordinary shareholders where deferred shares have been issued. When surplus profits are large these shares become very valuable. This type of shares may be deferred as to a claim of capital in a winding up, in addition to or in lieu of its being deferred as to dividends.

Categories of Share Capital

The term share capital used in connection with the capital of a limited company is used in several senses. So the capital of a company may be categorized as follows:

- a. Authorized capital
- b. Issued capital
- c. Unissued capital
- d. Subscribed capital
- e. Paid-up capital

Authorized Capital

It is also called nominal capital, or registered capital. Authorized capital is the maximum amount of share capital which a company sets out in the memorandum of association and which it has power to issue. It is the amount of capital with which a company proposes to be registered, the authorized capital depends upon the business requirements of each company, there is no legal restriction upon the maximum limit of authorized capital. The amount of authorized capital stated in the memorandum may be increased by the company.

A company is not obliged to issue whole of its authorized capital at once. It may issue the whole or any part of authorized capital and keep the balance for future requirements. When the authorized capital is increased the extent of the increase is not limited to the requirements of the company at the time, but also covers probable requirements in the future.

Issued capital: is that part of the authorized capital which is actually offered (issued) to prospective share holders for subscription. It represents the amount which is available for subscription. Further issue is made as and when the need arises. Thus the expression “issued capital” is used for the total number of shares allotted by the company for the time being.

Unissued capital: the part of the authorized capital which is not issued, at any given time, is called unissued capital.

Subscribed Capital:

The whole of the issued capital may not be taken up by the prospective shareholders. Subscribed capital is that part of the issued capital which is actually subscribed (taken up) by the public

Paid-up Capital

Paid-up capital is that part of the issued capital which has been paid-up by the shareholders. Paid up capital is always equal to subscribed capital.

Election of new directors: Sec 15

- 1) The State Bank may, by order, require any banking company to call a general meeting of the shareholders of the company within such time, not less than two months from the date of the order, as may be specified therein or within such further time as the State Bank may allow in this behalf, to elect in accordance with the voting rights permissible under this Ordinance fresh directors, and the banking company shall be bound to comply with the order.
- 2) Every director elected under sub-section (1) shall hold office until the date up to which his predecessor would have held office, if the election had not been held.

- 3) Any election duly held under this section shall not be called in question in any court.

Appointment of director by the State Bank: Sec 15-A

Notwithstanding anything contained in the Companies Act, 1913 (VII of 1913), or in the memorandum or articles of association of any banking company, the State Bank may appoint not more than one person to be a director of a banking company, whether or not he holds any qualification shares.

Restriction on term of office of directors: Sec 15-B

- 1) A director of a banking company, not being its chief executive, by whatever name called, or a director nominated under section 15A, shall not hold office for more than six consecutive years. Explanation.—in computing the period of six consecutive years for the purpose of this sub-section, any break of less than three years in the continuity of office shall be disregarded.
- 2) A director of a banking company vacating office in pursuance of sub-section (1) shall not be eligible for re-election as a director of that banking company unless a period of three years has elapsed since the date on which he so vacated his office:

Provided that a director who has to so vacate his office may continue in his office for a period of not more than six months from the commencement of the Banking Companies (Amendment) Act, 1972, or until a new director is elected or co-opted in his place whichever is earlier.

We shall continue with section 15 and rest of the provisions of the Ordinance in the coming Lessons.

LESSON 12**BANKING COMPANIES ORDINANCE, 1962**

We shall cover the following aspects/ statutory provisions:

- Vacation of Office.
- Restriction on commission, brokerage discount, etc., on sale of shares.
- Prohibition of charge on un-paid capital.
- Prohibition of floating charge on assets.
- Restrictions as to payment of dividend.
- Prohibition of common directors.
- Reserve Fund.
- Cash Reserve.
- Restriction on the nature of subsidiary companies. Restrictions on loans and advances.
- Power of State Bank to control advances by banking companies.

Vacation of Office of a Director of Banking Company: Sec 15-C

A director of a banking company shall vacate his office if in relation to the banking company he has failed to pay any advance or loan or any installment thereof or interest thereon or any amount due on any guarantee, or to do or perform any act agreed to or undertaken in writing to be done or performed by him, and such failure continues for a period of one month after notice in writing has been served on him by the banking company calling upon him to make the payment or to do or perform the act.

Restriction on commission, brokerage, discount, etc. on sale of shares: Sec 16

Notwithstanding anything to the contrary in sections 105 and 105A of the Companies Act, 1913, no banking company shall pay out directly or indirectly by way of commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, any amount exceeding in the aggregate two and one-half per cent of the paid-up value of the said shares.

Prohibition of charge on unpaid capital: Sec 17

No banking company shall create any charge upon any unpaid capital of the company and such charge, if created, shall be invalid.

Prohibition of floating charge on assets: Sec 18

Notwithstanding anything contained in section 7 no banking company shall create a floating charge on the undertaking or any property of the company or any part thereof, unless the creation of such floating charge is certified in writing by the State Bank as not being detrimental to the interest of the depositors of such company.

Any such charge created without obtaining the certificate of the State Bank shall be invalid.

Any banking company aggrieved by the refusal of a certificate under subsection (1) may, within ninety days from the date on which such refusal is communicated to it, appeal to the Federal Government.

The decision of the Government where an appeal has been preferred to it under sub-section (3) or of the State Bank where no such appeal has been preferred shall be final.

No banking company shall pay any dividend on its shares until all its capitalized expense (including preliminary expenses, organization expenses, share-selling commission, brokerage, amounts of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off.

Charge and floating charge are very important concepts which are explained in the following paragraphs:

Charge:

According to transfer of property Act, charge has been defined as under:

“where immovable property of one person is by act of parties, or operation of law, made securities for payment of money how another, and transaction does not amount to a mortgage, the latter person is said to have a charge on the property; and all the provisions here in before contained which apply to a simple mortgage shall, so far as may be, apply to such charge. The concept of mortgage and simple mortgage (registered mortgage) is explained below:

(Mortgage): A mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.

(Registered or Legal Mortgage): This is created through a formal document called mortgage deed.

Mortgage deed is registered with the Registrar of titles. It is comparatively expensive as it involves stamp duty and registration fee.

Charge as defined above is a right of payment out of a specified property. The charge can be created by an agreement between the parties or by operation of law. It is, worth mentioning that no doubt a property is offered as a security for fulfillment of an obligation but this transaction cannot be termed as mortgage. According to Lord Atkinson, the charge is explained in the following words

“ I think there can be no doubt that where in a transaction for value both parties evince an intention that property, existing or future, shall be made available as securities for the payment of a debt and that the creditors shall have a present right to have it made available, there is a charge, even though the present legal right which is contemplated can only be enforced at some future date; and though the creditor gets no legal right of property, either absolute or special, or any legal right to possession, but only gets the right to have the security available by an order of the court. If on the other hand, the parties do not intend that there should be a present right to have the security made available, but only that there should be a right in future, by agreement such as a license to seize goods. There will be no charge”

Registration of a Charge:

Though no interest in immovable property is transferred under a charge, the document creating a charge would purport to declare a right to immovable property; and its registration should be made under Section 17 (1-b) of the Registration Act. For the enforcement of a charge, reasonable notice must be serving on the counter party.

Floating Charge

A mortgage, debenture or other security documentation, is likely to create charges over particular assets as security for borrowings or other indebtedness. There are essentially two types of charge, floating and fixed. A floating charge is appropriate to assets and material which is subject to change on a day to day basis, such as stock. Individual items move into and out of the charge as they are bought and sold in the ordinary course of events. The floating charge crystallizes if there is a default or similar event. At that stage the floating charge is converted to a fixed charge over the assets which it covers at that time. A floating charge is not as effective as a fixed charge but is more flexible.

For the banking companies, it is advisable that while accepting properties as collaterals to make arrangements to search the prior charges on the said properties. A search should be made in the office of the Collector and Sub-Registrar or the District Registrar to ensure that there exists no prior charge on the property, because any transfer of interest in an immovable property, is subject to all previous mortgages and charges which had been registered. The search for possession should pertain to at least previous 20 years. If the title deeds of the property are in the name of more than one person, the search should be directed against the name of each person through whom the title is made.

When the banker is satisfied as to his borrower's title, he should decide about the execution of mortgage. In case of a registered mortgage, the deed should be properly drafted, preferably with the help of a lawyer. The finalized mortgage deed should be signed by the borrower who now becomes the mortgagor, and should be witnessed by two independent person; and the deed should be properly stamped and registered. In case of an equitable mortgage, a proper Memorandum of Deposit of title deeds should be drafted and signed by the borrower in the presence of two witnesses. As a matter of precaution the banker should see that the

borrower has insured the property against fire. In addition, the banker should obtain the last premium receipt and see whether it is paid up to date. Bankers should register the assignment with the insurance company; and when the policy is renewed, it may be in the banker's name.

The banker should see that the title deeds deposited as security are the original title deeds of the property. If the title deeds relate to the site on which the building is to be erected, the banker should take the written agreement to mortgage the property after its construction.

Restrictions as to payment of dividend: sec 19

Notwithstanding anything to the contrary contained in sub-section (1) or in the Companies Act, 1913 (VII of 1913), a banking company may pay dividends on its shares without writing off— the depreciation, if any, in the value of its investment in approved securities in any case where such depreciation has not actually been capitalized or otherwise accounted for as a loss;

The depreciation, if any, in the value of its investments in shares, debentures or bonds (others than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditor of the banking company;

the bad debts, if any, in any case where adequate provision for such debts had been made to the satisfaction of the auditor of the banking company.

In section 19, it has been provided that dividend can be paid if adequate provisions on account of depreciation and bad debts have been made by the banking company to the satisfaction of the auditors. The concept of dividend is very important and has been explained in the following paragraph:

The term dividend has not been defined in the Companies Ordinance. It is used in two different senses viz. while a company is a going concern earning profit and distributing the same.

The term dividend when used in connection with the winding up of a company means the division of company's assets among the contributors (i.e. members at the time of winding up) and companies' creditors.

Dividend in the sense of share of profit means a distribution to the members of a company and represents a return on capital invested by the members as a reward for the risk of such investment. So a dividend may be defined as 'that portion of the profits of the company that falls to the share of each individual shareholders of the company, in other words, dividend is the return on the shares that each shareholder gets from the company out of its profits. Thus it is that portion of the company's profits which is distributed among the eligible shareholders of the company. So to say, a dividend means that portion of accumulated profit of the company which is divided amongst the members in proportion to the number of shares held by each.

Rules Regarding Dividend:

Both the Board of Directors and the shareholders know that the shareholders must be given some incentive in the form of share of profits earned by the company. Every company, after the determination of trading results intends to distribute some portion of profit as dividend. The directors power to recommend and members power to declare dividend need not expressly be given by the memorandum or articles of association of the company. The company has an implied power to pay dividends if there are distributable profits. The manner of paying may, however, be regulated by inclusion of necessary provisions in the articles of association.

Prohibition of common directors: these are contained in section 20 which is given hereunder:

1. Except with the permission of the State Bank, no banking company incorporated in Pakistan shall have as a director any person who is a director—
 - i. Of any other banking company; or
 - ii. Of companies which among themselves are entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the shareholders of the banking company.
- (IA) No banking company incorporated in Pakistan shall have as a director any person who is—

- a. A Federal Minister, a Minister of State or a Provincial Minister; or

- b. A person in the service of Pakistan who is not appointed or nominated by Government as a director by virtue of his office.
- 2. If immediately before the commencement of this Ordinance any person holding office as a director of a banking company is also a director of companies which among themselves are entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the shareholders of the banking company he shall, within such period from such commencement as the State Bank may specify in this behalf—
 - i. Either resign his office as a director of the banking company; or
 - ii. Choose such number of companies as among themselves are not entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the shareholder of the banking companies as companies in which he wishes to continue to hold the office of a director and resign his office as a director in the other companies.

Reserve Fund: Sec 21

Every banking company incorporated in Pakistan shall create a reserve fund to which shall be credited— if the amount in such fund together with the amount in the share premium account is less than the paid-up capital of the banking company, a sum equivalent to not less than twenty per cent of the balance of profit of each year as disclosed in the profit and loss account prepared under section 34 and before any dividend is declared; and

If the amount in such fund together with the amount in the share premium account is equal to or exceeds the paid-up capital of the banking company, a sum equivalent to not less than ten per cent of the balance of profit disclosed as aforesaid and before any dividend is declared

Where a banking company appropriates any sum or sums from the reserve fund or the share premium account, it shall, within twenty-one days from the date of such appropriation, report the fact to the State Bank explaining the circumstances relating to such appropriation:

Provided that the State Bank may, in any particular case, extend the said period of twenty-one days by such period as it thinks fit or condone any delay in the making of such report.

Cash Reserve: Sec 22

Every banking company, not being a schedule bank, shall maintain by way of cash reserve in cash with itself, or in current account opened with the State Bank or its agent or partly in cash with itself and partly in such account or accounts a sum equivalent to at least two per cent of its time liabilities in Pakistan and five per cent of its demand liabilities in Pakistan and shall submit to the State Bank before the fifteenth day of every month a return showing the amount so held on Thursday of each week of the preceding month with particulars of its time and demand liabilities in Pakistan on each such Thursday* or if any such Thursday is a public holiday under the Negotiable Instruments Act, 1881 (XXVI of 1881), at the close of business on the preceding working day.

Restriction on the nature of subsidiary companies: Sec 23

A banking company shall not form any subsidiary company except a subsidiary company formed for one or more of the following purposes, namely:— the undertaking and executing of trusts,

(aa) the carrying on of banking business strictly in conformity with the Injunctions of Islam as laid down in the Holy Quran and Sunnah;” the undertaking of the administration of estates as executor, trustee or otherwise,

(bb) the carrying on of business of modaraba under the provisions of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance 1980 the providing of safe deposit vaults, with the previous permission in writing of the State Bank, the carrying on of the business of banking exclusively outside Pakistan;

(dd) the conduct of any from of business permitted by section 7; or

(e) Such other purposes as are incidental to the business of banking.

Save as provided in sub-section (1), no banking company shall hold shares in any company whether as pledgee, mortgagee or absolute owner, of an amount exceeding thirty per cent of the paid-up share capital of that company or thirty per cent of its own paid-up share capital and reserves, whichever is less:

Provided that any banking company which is on the date of commencement of this Ordinance holding any shares in contravention of the provisions of this sub-section shall not be liable to any penalty therefore if it

reports the matter without delay, to the State Bank and if it brings its holding of shares into conformity with the said provision within such period, not exceeding two years

Restrictions on loans and advances: (Sec 24)

No banking company shall— make any loans or advances against the security of its own shares; or grant unsecured loans or advances to, or make loans and advances on the guarantee of .— any of its directors;

(ii) any of the family members of any of its directors; any firm or private company in which the banking company or any of the persons referred to in sub-clause (i) or sub-clause (ii) is interested as director, proprietor or partner; or any public limited company in which the banking company or any of the persons as aforesaid is substantially interested.

No banking company shall make loans or advances to any of its directors or to individuals, firms or companies in which it or any of its directors is interested as partner, director or guarantor, as the case may be, without the approval of the majority of the directors of that banking company, excluding the director concerned.

Power of State Bank to control advances by banking companies: Sec 25

Whenever the State Bank is satisfied that it is necessary or expedient in the public interest so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and, when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.

(2) Without prejudice to the generality of the power conferred by sub-section (1), the State Bank may give directions to banking companies either generally or to any banking company or group of banking companies in particular.—as to the credit ceilings to be maintained, credit targets to be achieved for different purposes, sectors and regions, the purposes for which advances may or may not be made, the margins to be maintained in respect of advances, the rates of interest, charges or mark-up to be applied on advances and the maximum or minimum profit sharing ratios.

We shall continue with the powers vested in State Bank under various provisions of the Banking Companies Ordinance, 1962.

LESSON 13**BANKING COMPANIES ORDINANCE, 1962**

We shall cover the following aspects of this Ordinance:

- Power of State Bank to control advances by banking companies.
- Power of State Bank to collect and furnish credit information.
- Preparation of special reports.
- Recovery of certain dues of banking companies as arrears of land revenue.
- Power of Federal Government prohibit acceptance of deposits by banking companies incorporated outside Pakistan.
- Deposits.
- Licensing of banking companies.
- Prohibition of advertising for deposits and collection.
- Disruptive union activities.
- Restrictions on opening of new and transfer of existing place of business.
- Maintenance of liquid assets.
- Assets in Pakistan.
- Unclaimed deposits and articles of value.

Power of State Bank to control advances by banking companies: Sec 25

1. Whenever the State Bank is satisfied that it is necessary or expedient in the public interest so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and, when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.
2. Without prejudice to the generality of the power conferred by sub-section (1), the State Bank may give directions to banking companies either generally or to any banking company or group of banking companies in particular.— as to the credit ceilings to be maintained, credit targets to be achieved for different purposes, sectors and regions, the purposes for which advances may or may not be made, the margins to be maintained in respect of advances, the rates of interest, charges or mark-up to be applied on advances and the maximum or minimum profit sharing ratios; and prohibiting the giving of loans, advances and credit to any borrower or group of borrowers on the basis of interest, either for a specific purpose or for any purpose whatsoever; and each banking company shall be bound to comply with any direction so given.
3. If any default is made by a banking company in complying with the policy determined under sub-section (1) or direction given under sub section (2), every director and other officer of the banking company and every other person who is knowingly a party to such default shall, by order of the State Bank, be liable to a penalty of an amount which may extend to twenty thousand rupees and, where the default is a continuing one, of a further amount which may extend to one thousand rupees for every day after the first during which the default continues.
4. Without prejudice to the provisions of sub-section (3), the State Bank may, for the purposes of securing implementation of any special credit schemes or monetary policy or observance of credit ceilings by a banking company, by order in writing require banking companies generally, or any banking company in particular, to make special deposits with it for such amount and on such terms and conditions as may be laid down by the State Bank in this behalf.
5. The amount deposited with the State Bank under sub-section (4) or any part thereof may, at the discretion of the State Bank, be released by it to the banking company which deposited it as and when the State Bank deems fit either unconditionally or on such terms and subject to such conditions as the State Bank may, by order in writing, determine from time to time.

6. Any penalty imposed under sub-section (3) shall be payable on demand made by the State Bank and, in the event of refusal or failure by the director, officer or other person concerned to pay on such demand, shall be recoverable as arrear of land revenue.

Power of the State Bank to collect and furnish credit information: Sec 25-A

1. Every banking company shall furnish to the State Bank credit information in such manner as the State Bank may specify, and the State Bank may, either of its own motion or at the request of any banking company, make such information available to any banking company on payment, of such fee as the State Bank may fix from time to time:

Provided that, while making such information available to a banking company, the State Bank shall not disclose the names of the banking companies which supplied such information to the State Bank:

Provided further that, a banking company which proposes to enter into any financial arrangement which is in excess of the limit laid down in this behalf by the State Bank from time to time shall, before entering into such financial arrangement, obtain credit information on the borrower from the State Bank.

2. Any credit information furnished by the State Bank to a banking company under sub-section (1) shall be treated as confidential and shall not, except for the purposes of this section or with the prior permission of the State Bank, be published or otherwise disclosed. No court, tribunal or other authority, including an officer of Government shall require the State Bank or any banking company to disclose any information furnished to, or supplied by, the State Bank under this section.

Explanation.—For the purpose of this section,

- i. “Borrower” means any person to whom any credit limit has been sanctioned by any banking company, whether availed of or not, and includes—in the case of a company or corporation, its subsidiaries;
- ii. In the case of a Hindu undivided family, any member thereof or any firm in which such member is a partner;
- iii. In the case of a firm, any partner thereof or any other firm in which such partner is a partner; and
- iv. In the case of an individual, any firm in which such individual is a partner; and

“Credit information” means any information relating to—

- i. The amounts and the nature of loans or advances or other credit facilities, including bills purchased or discounted, letters of credit and guarantees, indemnities and other engagements extended by a banking company to any borrower or class of borrowers;
- ii. The nature of security taken from any borrower for credit facilities granted to him;
- iii. The guarantees, indemnities or other engagements furnished to a banking company by any of its customers; and
- iv. Operations or accounts in respect of loans, advances and other credit facilities referred to in this clause.

The State Bank shall prepare, and submit to the Federal Government, a special report every year on cases of write off of loans, mark-up and other dues, or financial relief through rescheduling and restructuring of loans and subsidized loans provided by the banking companies, in which established banking practices or authorized procedures have been departed from with a view to causing wrongful loss to the bank or conferring wrongful loss to the bank or conferred wrongful gain on any constituent. If the matters raised in the report relate to public interest, the Federal Government may submit the report, or such part of it as relates to public interest, to Parliament or to the Standing Committee of a House of Parliament dealing with Finance

Recovery of certain dues of banking companies as arrears of land revenue: Sec 25 B

Loans and advances made by a banking company for agricultural and other purposes “and any other amounts decreed by any court in favor of a banking company or a financial institution specified in “section 3A” shall be recoverable as an arrear of land revenue as if the banking company were a local authority for the purposes of Section 5 of the

Revenue Recovery Act, 1980

Provided that no sum shall be so recoverable unless the banking company has, by notice in writing, informed the debtor, not less than fifteen days before proceeding to have it so recovered, that he may repay by such installment as may be fixed in the notice and that action to have the debt recovered as an arrear of land revenue will be taken if he fails to pay any installment on or before the due date

Power of State Bank to prohibit acceptance of deposits by banking companies incorporated outside Pakistan: Sec 26

The State Bank may, by notification in the Official Gazette, order that any banking company or any class of banking companies incorporated outside Pakistan shall from a date to be specified in the notification: discontinue to accept any deposits or accept deposits only upon such terms and under such conditions as may be specified in the notification:

Provided that no such notification shall be made earlier than three years after the commencement of this Ordinance and the date specified in the notification shall not be earlier than one year from the date of the notification.

Licensing of banking companies: Sec 27

No individual or association or body of individuals, not being a company, shall carry on banking business in Pakistan and, save as hereinafter provided, no company shall carry on banking business in Pakistan unless it holds a license issued in that behalf by the State Bank; and any such license may be issued subject to such conditions as the State Bank may think fit to impose.

Every banking company in existence on the commencement of this Ordinance, before the expiry of six months from such commencement, and every other company before commencing banking business in Pakistan, shall apply in writing to the State Bank for a license under this section:

Provided that nothing in sub-section (1) shall be deemed to prohibit a banking company in existence on the commencement of this Ordinance from carrying on banking business until it is granted a license in pursuance of this section or is by notice in writing informed by the State Bank that a license cannot be granted to it:

Provided further that the State Bank shall not give a notice as aforesaid to a banking company in existence on the commencement of this Ordinance before the expiry of the period of two years in the case of banking companies incorporated in Pakistan and of six months in the case of banking companies incorporated outside Pakistan.

Before granting any license under this section, the State Bank may require to be satisfied by an inspection of the books of the company or otherwise that all or any of the following conditions are fulfilled, namely:- that the company is or will be in a position to pay its present or future depositors in full as their claims accrue; that the affairs of the company are not being or are not likely to be conducted in a manner detrimental to the interests of its present or future depositors; that in the case of a company incorporated outside Pakistan, the Government or law of the country in which it is incorporated provides the same facilities to banking companies registered in Pakistan as the Government or law of Pakistan grants to banking companies incorporated outside Pakistan and that the company complies with all the provisions of this Ordinance applicable to banking companies incorporated outside Pakistan.

The State Bank may cancel a license granted to a banking company under this section,—

- i. If the company ceases to carry on banking business in Pakistan; or
- ii. If the company at any time fails to comply with any of the conditions imposed upon it under sub-section (1); or
- iii. If at any time, any of the conditions referred to in sub-section (3) ceases to be fulfilled:

Provided that before canceling a license under clause (ii) or clause (iii) of this sub-section on the ground that the banking company has failed to comply with or has failed or ceased to fulfill any of the conditions referred to therein, the State Bank, unless it is of opinion that the delay will be prejudicial to the interest of the company's depositors or the public, shall grant to the company on such terms.

Any banking company aggrieved by the decision of the State Bank canceling a license under this section may, within thirty days from the date on which such decision is communicated to it apply for review to the Central Board of the State Bank.

The decision of the State Bank subject to the result of review under sub-section (5), if any, shall be final.

Prohibition of advertising for deposits and collection: Sec 27-A

Notwithstanding anything contained in any other law for the time being in force, no company, firm or person, not being a banking company or a corporation or authority established by the Federal Government or a company duly authorized in this behalf by the Controller of Capital Issues or the Corporate law Authority or the Registrar

Co-operative Societies shall solicit or invite deposits of money from the public through advertisements in the public media or by postal circulars, handbills, displays in public places or by any other means, or collect or receive any deposits of money in pursuance thereof.

Explanation.—For the purposes of this section, “deposits of money” shall be deemed to include money called, invited or collected for the purpose, or declared object, of investment or borrowing in any business carried on, or proposed to be carried on, by the company, firm or person by whom, or on whose behalf, such money is called, invited, collected or received irrespective of the nature of the relationship, arrangement or terms offered or provided by such company, firm or person to the person making the investment, deposits of money or payment or of the basis or understanding or which the money is so called, invited, collected or received.

Restrictions on opening of new, and transfer of existing place of business: Sec 28

No banking company shall open a new place of business in any part of Pakistan or change, otherwise than within the same city, town or village the location of an existing place of business situated in any part of Pakistan and

No banking company incorporated in Pakistan shall open a new place of business outside Pakistan or change, otherwise than within the same city, town or village in any country or area outside Pakistan, the location of an existing place of business situated in that country area without first obtaining the prior permission in writing of the State Bank

Nothing in this section shall apply to the opening for a period not exceeding one month of a temporary place of business within a city, town or village or the environs thereof within which the banking company already has a place of business, for the purpose of affording banking facilities to the public on the occasion of an exhibition, a conference or a mela or any other like occasion

Provided intimation of such opening is given to the State Bank within one week of the date of opening.

The State Bank may, before giving the permission to any banking company, require to be satisfied by an inspection under section 40 or otherwise regarding such aspects of the company's affairs as the State Bank may deem necessary.

Maintenance of liquid asset: Sec 29

Every banking company “and every financial institution specified in section 3A , shall maintain in Pakistan in cash, gold or unencumbered approved securities valued at a price not exceeding “the lower of the cost or” the current market price an amount which shall not at the close of business on any day be less than “such percentage” of the total of its **time and demand liabilities in Pakistan**, as may be notified by the State Bank from time to time.

Provided that the State Bank may separately specify for banking companies or financial institutions the applicable percentage either in general or in relation to any class of banking companies or any class of financial institutions or to any bank or financial institution in particular.

Explanation:

For the purpose of this section, “unencumbered approved securities” of a banking company “or financial institution” shall include its approved securities lodged with another institution for an advance or any other credit arrangement to the extent to which such securities have not been drawn against or availed of ‘and the liabilities shall not include the paid up capital or the reserves or any credit balance in the profit and loss account of the Banking company or, as the case may be, the financial institution or any such liabilities as may be notified by the State Bank for the purposes of this in computing the amount provided for in sub-section (1), any deposit required under the proviso to sub-section (3) of section 13 to be made with the State Bank by a banking company incorporated outside Pakistan and any balances maintained in Pakistan by a banking company in current account with the State Bank or its agent or both including in the case of a scheduled bank the balance required to be so maintained under section 36 of SBP Act, 1956

Every banking company shall, before the close of the month succeeding the month to which the return relates, furnish to the State Bank a monthly return in the prescribed form and manner showing particulars of the company’s assets maintained in accordance with this section

Assets in Pakistan: Sec 30

At the close of business on any day the assets in Pakistan of every banking company shall not be less in value than an amount representing such percentage of its time and demand liabilities in Pakistan as may be prescribed by the State Bank from time to time provided that the percentage so prescribed shall not exceed eighty five per cent.

At the close of business on any day the assets in Pakistan of every banking company shall not be less in value than an amount representing such percentage of its time and demand liabilities in Pakistan as may be prescribed by the State Bank from time to time provided that the percentage so prescribed shall not exceed eighty five per cent.

Every banking company shall, before the close of the month succeeding that to which the return relates, furnish to the State Bank, in the prescribed form and manner a monthly return showing particulars of the company’s assets maintained in accordance with this section and its time and demand liabilities in Pakistan at the close of business in every Thursday

“assets in Pakistan” shall be deemed to include export bills drawn in, and import bills drawn on and payable in Pakistan and expressed in such currencies as the SBP may from time to time approve in this behalf and also such securities as the SBP may approve in this behalf notwithstanding that all or any of the said bills or securities are held outside Pakistan, but shall exclude such assets as in the opinion of the SBP cannot properly be regarded as assets;

(b) “Liabilities in Pakistan” shall not include the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company.

“Liabilities in Pakistan” shall not include the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company.

Unclaimed deposits and articles of value: Sec 31**(1)Where—**

(a) a debt payable in Pakistan currency is owing by a banking company by reason of a deposit, not being a deposit in the name of a minor or a Government or a court of law, at a branch of the banking company in Pakistan in respect of which no transaction has taken place and no statement of account has been requested or acknowledged by the creditor during a period of ten years reckoned—(i) in the case of a deposit made for a fixed period, from the day on which the fixed period terminated, and (ii) in the case of any other deposit, from the day on which the last transaction took place or a statement of account was last requested or acknowledged by the creditor, whichever is later; or (b) a dividend, bonus, profit or other sum of money whatsoever which has become due on a deposit and remained unpaid or unacknowledged by the creditor for period of ten years reckoned from the date on which the dividend, bonus, profit or other sum of money, as the case may be, became due and payable; or (c) a cheques, draft or bill of exchange including an instrument drawn by one branch of the banking company upon another such branch payable in Pakistan currency has been issued, certified or accepted by a banking company at a branch of the banking company in Pakistan and no payment has been made in respect thereof for a period of ten years from the date of issue, certification or acceptance; or (d) a security share, goods or any valuable article, hereinafter

collectively and individually called article, lying in safe custody with a banking company has not been inspected or acknowledged by the person who deposited the article with the banking company for a period of ten years from the day on which it was last inspected or acknowledged by such person;

the banking company shall give forthwith a three months' notice in writing by registered post acknowledgement due to the creditor or the beneficiary of the cheque, draft or bill of exchange or the person in whose name the article stands in the books of the banking company on his address last made known by him to the banking company, and if on the expiry of the three months' period no acknowledgement or reply is received from the addressee, the banking company shall pay or deliver, as the case may be, to the State Bank an amount equal to the amount, owing by the banking company in respect of the debt or to the amount that would be owing if the instrument had been presented for payment, including interest, if any, or the article, in accordance with the terms of the debt or instrument or of the arrangement under which the article is lying in the safe custody of the banking company, an payment or delivery accordingly shall discharge the banking company from all liabilities in respect of the debt or instrument or to the amount that would be owing if the instrument had been presented for payment, including interest, if any or the article, in accordance with the terms of the debt or instrument or of the banking company, and payment or delivery accordingly shall discharge the banking company from all liabilities in respect of the debt or instrument or article, as the case may be (2) A notice required to be given by sub-section (1)— (a) may, in the case of a firm or a Hindu undivided family be addressed to any member of the firm or the manager or any adult male member of the family and, in the case of any other association of persons, to the principal officer the roof; (b) may be given to a duly authorized agent of the person whom it is required to be given or, where he has died, to his legal representative or where he has been declared an insolvent, to his assignee, provided the banking company has had notice of appointment of the agent or of the death or insolvency of the person to whom it is required to be given; (c) shall, in the case of joint creditor or more than one beneficiaries of a cheque, draft or bill of exchange or article standing in the names of more than one person, be deemed to be sufficient notice to all such persons if given to any one of them; and (d) shall, notwithstanding the fact that it is miscarried or the addressee is dead or insane or has become insolvent or the envelope or wrapper is returned with the postal endorsement "addressee is untraceable" or any other like endorsement, be deemed to have been served on the fifteenth day following the day on which the envelope or wrapper in which it is contained is posted, if it is properly addressed, prepaid and posted, provided the banking company has had no notice of the death, insanity or insolvency of the person to whom it is required to be given. (3) A certificate in writing under the signature of an employee of the banking company whose duty it is to address, prepay and post letters on behalf of the banking company to the effect that the envelope or wrapper containing a notice required to be given by sub-section (1) was addressed, prepaid and posted shall be conclusive evidence of its having been so addressed, prepaid and posted. (4) As soon as an amount is paid by a banking company to the State Bank under sub-section (1), it shall cease to bear interest [or rank for a share of profit or loss]* notwithstanding anything to the contrary contained in the terms of the debt or instrument or any law for the time being in force. (5) Where any banking company has paid an amount or delivered an article to the State Bank under sub-section (1), the banking company shall preserve and continue to preserve all signature cards and signing authorities and other documents relating to the debt or instrument or article, as the case may be, until it is informed by the State Bank in writing that they need not be preserved any longer. (6) Nothing in the Limitation Act, 1908, or in any other law for the time being in force shall affect the liability of a banking company toward the State Bank under sub-section (1). (7) Every banking company shall, within thirty days after the close of each calendar year, submit to the State Bank a return in the prescribed form and manner of all unclaimed amounts and articles remaining unpaid or undelivered, as the case may be, in the books of the banking company, after the expiry of ten years as reckoned under sub-section (1). (8) The State Bank shall publish in the Gazette of Pakistan and not less than two newspapers once each quarter for a period of one year a list of the amounts and articles received by the State Bank under sub-section (1) and not claimed by any person: Provided that it shall not be necessary to include in a list so published such amounts and articles of such value as the Federal Government may from time to time determine. (9) Any banking company which has paid any amount or delivered any article to the State Bank in accordance with sub-section (1) may, within thirty days from the date of such payment or delivery, as the case may be, submit to the State Bank its claim as regards lien, counter-claim or right of set-off in relation to the amount so paid or article so delivered. (10) Any person who claims to be entitled to any money or article paid or delivered to the State Bank under sub-

section (1) may submit his claim to the State Bank. (11) Subject to sub-sections (9), (12) and (14), the State Bank may pass such order on a claim submitted to it under sub-section (9) or sub section (10) as it may deem fit, and, where the State Bank makes any payment or delivers any article to any person submitting a claim under sub-section (10) a receipt given by him shall be a good discharge to the State Bank. (12) If any action involving a dispute about the ownership of any amount or article paid or delivered to the State Bank under sub-section (1) is pending in any court before the expiry of one year following the year in which the amount or article is so paid or delivered to the State Bank and the State Bank receives an intimation from the court or otherwise about such dispute, it shall retain the amount or article in the custody and dispose of it in accordance with the decision of the court. (13) Subject to sub-sections (9), (12) and (14), any amount or article in respect of which no claim is preferred or about the disposal of which no information is received from any person before the expiry of one year following the year in which the amount or article is received by the State Bank shall, on the expiry of the said period of the said period of one year, cease to be claimable and shall, become the absolute property of and vest.— (a) in the Government of the Province in the territory of which the debt or instrument was payable or , as the case may be the article was to be delivered, and (b) in the Federal Government in any other case. (14) Notwithstanding anything contained in sub-section (1) about the giving of a notice by a banking company to any creditor or beneficiary of any cheque, draft or in subsection (8) about the publication by the State Bank of the list of unclaimed amounts or articles, the procedure to be followed and the manner of disposal of debts, instruments and articles in a case where the person concerned is not for the time being residing in Pakistan shall be such as may be determined by the Federal Government from time to time. (15) Any decision of the State Bank under sub-section (11) about the acceptance, satisfaction or otherwise of the lien, right of set-off or counter-claim of a banking company or, as the case may be, the entitlement of any person to any money or article received by the State Bank under sub-section (1) shall be final and shall not, except as provided in subsection (16), be called in question in any manner by or before any court, tribunal or other authority. (16) Any person aggrieved by a decision of the State Bank under sub-section (11) may, within one month from the date of the decision, prefer an appeal to such officer of the State Bank superior in rank to the officer by whom the decision appealed against was given as may be authorized in this behalf by the Governor or the State Bank. (17) For the purpose of adjudicating and determining any claim under sub-section (9) or sub-section (10) or deciding any appeal under sub-section (16) the State Bank shall follow such procedure as may be prescribed and shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908 (Act V of 1908), when trying a suit in respect of the following matters, namely:- (a) enforcing the attendance of any person and examining him on oath; (b) compelling the production of documents and materials objects; and (c) issuing commissions for the examination of witnesses. (18) Any proceeding before the State Bank under this section shall be deemed to be a “judicial proceeding” within the meaning of section 228 of the Pakistan Penal Code , and the State Bank shall, for the purposes of any such proceeding, be deemed to be a “Civil Court” within the meaning of section 480 of the Code of Criminal Procedure, 1898 (19) No court fee shall be payable for filing, exhibiting or recording any document in, or obtaining any document from, the State Bank in any proceeding under this section.

We shall continue with some more provisions contained in the Banking Companies Ordinance, 1962.

LESSON 14**BANKING COMPANIES ORDINANCE, 1962**

In this Lesson we shall cover the following aspects of this Ordinance:

- Power to publish information
- Fidelity and secrecy.
- Guidelines by the State Bank.
- Accounts and balance-sheet.
- Audit.
- Submission of returns.
- Copies of Balance Sheets, and Accounts to be sent to Registrar.
- Display of audited balance sheet by banking companies Incorporated outside Pakistan.
- Accounting provisions of this Ordinance not retrospective.
- Inspection.
- Responsibility of State Bank.
- Power of the State Bank to give directions.
- Power of the State Bank to remove directors or other managerial persons from office.
- Power of the State Bank to supersede Board of Directors of a banking company.
- Limitations.
- Prosecution of directors, Chief Executives or other Officers.
- Further powers and functions of the State Bank.
- Certain provisions of the Ordinance not to apply to certain banking companies.
- Power to call for certain information, etc.
- Special provisions.
- Power to make declaration.
- Consequences of a declaration under section 43B.
- Deposit of cash and preservation of assets, etc.
- Statement of assets and liabilities to be submitted to State Bank.
- Consequential provisions for winding up, etc.
- Restriction on stay order.
- Restriction on compromise or arrangement between banking companies and creditors.
- Power of State Bank to apply to Federal Government for suspension of business by a banking company and to prepare scheme of reconstruction or amalgamation.
- Procedure for amalgamation of banking companies.
- Winding up by High Court.
- Court Liquidator.

Half-yearly returns and power to call for other returns and information**Power to publish information: Sec 33**

The State Bank, if it considers it in the public interest so to do, may publish any information obtained by it under this Ordinance in such consolidated form as it thinks fit.

Fidelity and secrecy: Sec 33-A

Subject to sub-section (4), every bank and financial institution shall, except as otherwise required by law, observe the practices and usage customary among bankers and, in particular, shall not divulge any information relating to the affairs of its customers except in circumstances in which it is, in accordance with law, practice and usage customary among bankers, necessary or appropriate for a bank to divulge such information.

Every president, chairman, member of the Board, administrator, auditor, adviser, officer or other employee of any bank and financial institution shall, before entering upon his office, make a declaration of fidelity and secrecy in such form as may be prescribed.

Notwithstanding anything contained in sub-section (1) and (2), every balance sheet and profit and loss account statement prepared by a bank and financial institution shall include statements prepared in such form and manner as the State Bank may specify in respect of written off loans or any other financial relief of five hundred thousand repress or above allowed to a person as well as the provision, if any, made for bad or doubtful debts.

The SBP may, if satisfied that it is necessary so to do at the time of holding general elections under any law relating thereto, publish a list of persons to whom any loans, advances or credits were extended by a bank or financial institution, either in their own names or in the names of their spouses or dependents or of their business concerns (if mainly owned and managed by them) which were due and payable and had not been paid back for more than one year from the due date, or whose loans were unjustifiably written off in violation of banking practices, rules or regulations on or after such date as may be determined by the Government:

Provided the before publishing the name of any person in any such list he shall be, given prior notice and, if he so requests, an opportunity of hearing.

Accounts and balance-sheet: Sec 34

1. At the expiration of each calendar year every banking company incorporated in Pakistan, in respect of all business transacted by it, and every banking company incorporated outside Pakistan, in respect of all business transact through its branches in Pakistan, shall prepare with reference to that year a balance -sheet and profit and loss account as on the last working day of the year in the forms set out in the Second Schedule or as near thereto as circumstances admit.
2. The balance sheet and profit and loss account shall be signed.— (a) in the case of a banking company incorporated in Pakistan, by the manager or the principal officer of the company and where there are more than three directors of the company, by at least three of those directors, or where there are not more than three directors, by all the directors, and (b) in the case of a banking company incorporated outside Pakistan by the manager or agent of the principal office of the company in Pakistan and by another officer next in seniority to the manager or agent.
3. Notwithstanding that the balance sheet of a banking company is under subsection (1) required to be prepared in a form other than the form marked 'F' in the Third Schedule to the Companies Act, 1913 (VII of 1913), the requirements of that Act relating to the balance sheet and profit and loss account of a company shall, in so far as they are not inconsistent with this Ordinance, apply to the balance-sheet of profit and loss account, as the case may be, of a banking company. The State Bank may, after giving not less than fifteen days notice of its intention so to do, from time to time by a notification in the official Gazette, amend the forms set out in the Second Schedule.

Audit: Sec 35

The balance sheet and profit and loss account prepared in accordance with section 34 shall be audited by a person who is duly qualified, under the Chartered Accountants Ordinance, 1961 (X of 1961), or any other law for the time being in force, to be an auditor of companies and is borne on the panel of auditors maintained by the State Bank for the purposes of audit of banking companies.

1. An auditor shall hold office for a period of three years and shall not be removed from office before the expiry of that period except with the prior approval of the State Bank.
2. The State Bank may, from time to time, lay down guidelines for the audit of banking companies and the auditors shall be bound to follow those guidelines.
3. Subject to the provisions of sub-section (2), the auditor shall have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by section 145 of the Companies Act, 1913 (VII of 1913).
4. In addition to the matters which, under the aforesaid Act and the guidelines laid down by the State Bank under sub-section (3), the auditor is required to state in his report, he shall also state—
 - a) Whether or not the information and explanations required by him have been found to be satisfactory;

- b) Whether or not the transactions of the banking company which have come to his notice have been with in the powers of the banking company;
- c) Whether or not the returns received from branch offices of the banking company have been found adequate for the purposes of his audit;
- d) Whether the profit and loss account shows a true balance of profit and loss for the period covered by such account; and any other matter which he considers should be brought to the notice of the shareholders of the banking company.

Submission of returns: Sec 36

The accounts and balance-sheet referred to in section 34 together with the auditor's report as passed in the Annual General Meeting shall be furnished as returns to the State Bank within three months of the close of the period to which they relate: Provided that the State Bank may in special circumstances extend the said period of three months for the furnishing of such returns by a further period not exceeding three months.

Suspension of business and winding up of banking companies

Important aspects under this head are outlined below:

- Operations of a Banking Company may be suspended under this Ordinance.
- High Court is the judicial forum for Winding up of Banking Company.
- High Court may also stay proceedings against a Banking Company initiated by SBP (maximum stay can be granted up to six months) copy of stay order shall be forwarded to SBP by High Court. Special officer may be appointed by High Court.
- Application may be submitted by SBP to High Court for winding up of a Banking Company, if satisfied that affairs of Banking Company are being conducted in a manner detrimental to the interests of depositors.

In this regard, the statutory provisions has contained in various sections of the Ordinance are reproduced below:

High Court defined: Sec 44

In this Part and in Part IV "High Court", in relation to a banking company, means the High Court exercising jurisdiction in the place where the registered office of the banking company is situated or, in the case of a banking company incorporated outside Pakistan, where its principal place of business in Pakistan is situated.

Restriction on stay order: Sec 45

The High Court may, on the application of a banking company which is temporarily unable to meet its obligations make an order staying for a fixed period on such terms and conditions as it may think fit the commencement or continuance of all proceedings against the company and may from time to time extend the period so however that the total period including the period of any stay order granted under the proviso to sub-section (2), shall not exceed six months.

Except as hereinafter provided no order of stay shall be granted upon such application unless it is accompanied by a report of the State Bank showing that in the opinion of the State Bank the banking company will be able to pay its debts if the application is granted.

Provided that in the case of an application not so accompanied the High Court may, if it thinks fit, grant stay for a period of not more than thirty days in aggregate, and, if such stay is granted, shall call for a report from the State Bank on the affairs of the banking company, on receipt of which it may either rescind an order already passed or pass such further orders as it may consider just and proper in the circumstances.

The High Court shall forward to the State Bank a copy of every stay order made under this section.(4) Where an application is made under sub-section (1), the High Court may appoint a special officer who shall forthwith take into his custody or under his control all the assets, books, documents, effects and actionable claims to which the banking company is or appears to be entitled and shall also exercise such other powers as the interests of the depositors of the banking company.

Restriction on compromise or arrangement between banking companies and creditors: Sec 46

Notwithstanding anything contained in any law for the time being in force, no High Court shall sanction a compromise or arrangement between a banking company and its creditors or any class of them or between such company and its members or any class of them unless the compromise or arrangement is certified by the State Bank in writing as not being incapable of being worked and as not being detrimental to the interests of the depositors of such banking company.

Where an application under section 153 of the Companies Act, 1913 (VII of 1913), is made in respect of a banking company, the High Court may direct the State Bank to make an inquiry in relation to the affairs of the banking company and the conduct of its directors and when such a direction is given, the State Bank shall make such inquiry and submit its report to the High Court.

Powers of State Bank to apply to Federal Government for suspension of business by a banking company and to prepare scheme of reconstruction or amalgamation: Sec 47

Notwithstanding anything contained in the provisions of this Part or in any other law or any agreement or other instrument, for the time being in force, where it appears to the State Bank that there is good reason so to do, the State Bank may apply to the Federal Government for an order of moratorium in respect of a banking company.

The Federal Government, after considering the application made by the State Bank under sub-section (1), may make an order of moratorium staying the commencement or continuance of all action and proceedings against the company for a fixed period of time on such terms and conditions as it thinks fit and proper and may from time to time extend the period so however that the total period of moratorium shall not exceed six months.

Except as otherwise provided by any directions given by the Federal Government in the order made by it under sub-section (2) or at any time thereafter, the banking company shall not during the period of moratorium make any payment to any depositors or discharge any liabilities or obligations to any other creditors.

During the period of moratorium, if the State Bank is satisfied that (prepare scheme for reconstruction in the public interest; or in the interests of the depositors; or in order to secure the proper management or the banking company; or in the interests of the banking system of the country as a whole-

Procedure for amalgamation of banking companies: Sec 48

Notwithstanding anything contained in any law for the time being in force, no banking company shall be amalgamated with another banking company, unless a scheme containing the terms of such amalgamation has been placed in draft before the shareholders of each of the banking companies concerned separately, and approved by a resolution passed by a majority in number representing two thirds in value of the shareholders of each of the said companies, present either in person or by proxy at a meeting called for the purpose.

1) Notice of every such meeting as is referred to in sub-section (1) shall be given to every shareholder of each of the banking companies concerned in accordance with the relevant articles of association, indicating the time, place and object of the meeting, and shall also be published at least once a week for three consecutive weeks in not less than two newspapers which circulate in the locality or localities where the registered offices of the banking companies concerned are situated, one of such newspapers being in a language commonly understood in the locality or localities.

Any shareholder, who has voted against the scheme, of amalgamation at the meeting or has given notice in writing at or prior to the meeting to the company concerned or the presiding officer of the meeting that he dissents from the scheme of amalgamation, shall be entitled, in the event of the scheme being sanctioned by the State Bank to claim from the banking company concerned, in respect of the shares held by him in that company, their value as determined by the State Bank when sanctioning the scheme and such determination by the State Bank as to the value of the shares to be paid to dissenting shareholder shall be final for all purposes.

2) If the scheme of amalgamation is approved by the requisite majority of shareholders in accordance with the provisions of this section, it shall be submitted to the State Bank for sanction and shall, if sanctioned by the State Bank by an order in writing passed in this behalf be binding on the Banking by an order in writing

passed in this behalf be binding on the banking companies concerned and also on all the shareholders thereof.

3) Where a scheme of amalgamation is sanctioned by the State Bank under the provisions of this section, the State Bank shall transmit a copy of the order sanctioning the scheme to **the** registrar before whom the banking companies concerned have been registered and the registrar shall, on receipt of any such order, strike off the name of the company which by reason of the amalgamation will cease to function.

Winding up by High Court: Sec 49

Notwithstanding anything contained in section 153, section 162 and section 271 of the Companies Act, 1913 (VII of 1913), but and section 271 of the Companies Act, 1913 (VII of 1913), but without prejudice to its powers under the sub-section (1) of section 45 of this Ordinance, the High Court shall order the winding up of a banking company— if the banking company is unable to pay its debts; or if an application for its winding up has been made by the State Bank under section 45 or this section.

The State Bank shall make an application under this section for the winding up of a banking company if it is directed so to do by an order under clause (b) of sub-section (6) of section 40.

The State Bank may make an application under this section for the winding up of a banking company— has failed to company with the requirements specified in section 13; or has be reason of the provisions of section 27 become disentitled to carry on banking business in Pakistan; or has been prohibited from receiving fresh deposits by an order under clause (a) of sub-section (6) of section 40, or under clause (b) a compromise or arrangement sanctioned by a Court in respect of the banking company cannot be worked satisfactorily with or modifications; or the returns, statements or information furnished to it under or in pursuance of the provisions of this Ordinance disclose that the banking company is unable to pay its debts; or the continuance of the banking company is prejudicial to the interest of its depositors. A copy of every application made by the State Bank under sub-section (1) shall be sent by the State Bank to the registrar.

Notwithstanding anything contained in the Companies Act, 1913, no court shall entertain an, application for winding up of banking company by the Court unless such application is accompanied by a certificate in writing from the SBP certifying that it has no objection to the making of application.

Court Liquidator: Sec 50

When, having regard to the number of proceedings for the winding up of banking companies or the extent of the work involved in such proceedings, in any Province or at any place in any Province, the Federal Government is of the opinion that it is necessary or expedient to attach a court Liquidator to the High Court of that province it may, in consultation with the State Bank, appoint a Court Liquidator, the province or at a place in Province, and for such time as the Federal Government may think fit, for the purpose of conducting all proceedings for the winding up of banking companies and performing such duties in reference thereto as the High Court may impose.

Where there is a court liquidator attached to a High Court and an order is passed by the High court for the winding up of any banking company, then notwithstanding anything contained in section 171A or section 175 of the Companies Act, 1913 (VII of 1913), the court liquidator shall become the official liquidator of the banking company.

where there is a court liquidator attached to a High Court and any proceeding, for the winding up of a banking company in which any person other than the State Bank or the court liquidator has been appointed as official liquidator, is pending before the High Court immediately before the commencement of this Ordinance or the date on which the court liquidator is so attached the High court, whichever is later, then, notwithstanding anything contained a section 176 of the Companies Act, 1913 (VII of 1913), the person appointed as official liquidator shall, on such commencement or, as the case may be, on the aforesaid date, be deemed to have vacated his office as such and the vacancy so caused shall be deemed to be filled up by the appointment of the court liquidator as the official liquidator: Provided that where the High Court, after giving the court liquidator and the State Bank an opportunity of being heard, is of opinion that the appointment of the court liquidator would be detrimental to the interests of the depositors of the banking company, it may direct the person appointed as the official liquidator to continue to act as such.

Provided that where the High Court, after giving the court liquidator and the State Bank an opportunity of being heard, is of opinion that the appointment of the court liquidator would be detrimental to the interests

of the depositors of the banking company, it may direct the person appointed as the official liquidator to continue to act as such.

The remaining aspects of this Ordinance shall be discussed in the coming Lesson

LESSON 15**BANKING COMPANIES ORDINANCE, 1962**

We shall cover the following aspects:

Ombudsman—Defined

Historical Background

Scope of Banking Mohtasib

Ombudsman Defined:

- According to International Bar Association, Ombudsman is defined as an “office” provided by the constitution or by an action of the legislature or parliament and headed by an independent, high level public official which is responsible to the legislature or parliament, who receives complaints from the aggrieved person, official, and employees or who acts on his own motion and has the power to investigate, recommend corrective action and issue reports.
- A man who investigates complaints and mediates fair settlements, especially between aggrieved parties such as consumers or students and an institution or organization.
- A government official, especially in Scandinavian countries, who investigates citizens' complaints against the government or its functionaries.

Evolution

In the modern world, an ombudsman was first established in 1809 in Sweden. The word “ombudsman” is of Swedish origin and means “representative or agent” of the people. In 1919, more than a century after Sweden appointed an ombudsman, another Scandinavian country, Finland, adopted the Swedish model for the redressal of public grievances against agencies of state. The next country to follow was Denmark - this happened more recently in 1955. The first country outside Europe to establish such an office was New Zealand. This was in 1962 and generated tremendous global interest inspiring many countries, in search of good governance, to launch such schemes. Today, over 100 countries have such a platform in place. In 1995, the European Union established the first European Ombudsman under the Maastricht Treaty.

With the spread of education throughout the globe, the cognizance and awareness as well as the desire for human rights, better living conditions, public participatory role in the governance of state and establishment of NGO's and availability of information, this desire for the rule of law and redressing the grievances of the affected parties has emerged as predominant feature in the modern society. Initially the role of Ombudsman was restricted to the complaints pertaining to the government departments. But now there is a shift of complaints towards private sector and as such Ombudsman in the modern days entertains complaints against public sector as well as private sector. However the aggrieved party has the right to move to a court of law, in case one is not satisfied by any decision of Ombudsman.

Important Features of Ombudsman's Law

- Wide scope of Jurisdiction over Agencies and their functionaries.
- Powers for *Suo Motu* cognizance.
- Right to undertake Research and Studies on important issues involving mal-administration.
- Provision for informal resolution of disputes.
- Spot inspection where required.
- Powers to grant compensations to aggrieved party both complainants and public servants.
- To recommend disciplinary action against delinquent public servants.

Historical Background—in Pakistan's perspective

Wafaqi Mohtasib: this was established in 1983

Federal Tax Ombudsman: this was established in year 2000

Banking Mohtasib: it became functional from 2005

Wafaqi Mohtasib:

The Constitution of 1973 included the Federal Ombudsman at item 13 of the Federal Legislative List in the Fourth Schedule. The Institution of Ombudsman was, however, actually brought into being through the Establishment of the Office of Wafaqi Mohtasib (Ombudsman) Order, 1983 (President's Order No. 1 of 1983, which is a form of law). In order to ensure legal autonomy to the institution, it is reflected in Schedule 7 of the 1973 Constitution implying thereby that any amendment can be brought about by a two-third majority of the Parliament.

Objective

The main purpose of the Wafaqi Mohtasib is to diagnose, investigate, redress and rectify any injustice done to a person through mal-administration on the part of a Federal Agency or a Federal Government Official. The primary objective of the office is to institutionalize a system for enforcing administrative accountability.

Functional Attributes of the Institution

- Easily accessible
- Free of cost
- Flexible in operation
- Informal procedure
- Prompt action
- Service at the citizen's door-step

Banking Mohtasib:**Scope:**

In relation to all banks operating in Pakistan, the Banking Mohtasib has been empowered to entertain complaints of the following nature:

Failure to act in accordance with banking laws and regulations including policy directives or guidelines issued by the State Bank of Pakistan from time to time.

1. Delays or fraud in relation to the payment or collection of cheques, drafts or other banking instruments or transfer of funds.
2. Fraudulent or unauthorized withdrawals or debit entries in accounts.
3. Complaints from exporters or importers, relating to banking services and obligations including letters of credit.
4. Complaints from holders of foreign currency accounts whether maintained by residents or non-residents.
5. Complaints relating to remittances to or from abroad.
6. Complaints relating to payment of utility bills.
7. Delays or fraud in relation to the payment or collection of cheques, drafts or other banking instruments or transfer of funds.
8. Fraudulent or unauthorized withdrawals or debit entries in accounts.
9. Complaints from exporters or importers, relating to banking services and obligations including letters of credit.
10. Complaints from holders of foreign currency accounts whether maintained by residents or non-residents.
11. Complaints relating to remittances to or from abroad.
12. Complaints relating to payment of utility bills.
13. Complaints relating to remittances to or from abroad.
14. Complaints relating to payment of utility bills.

Complaints entertained by Banking Mohtasib

Complaints can be filed with the Banking Mohtasib for resolution of grievances against scheduled banks operating in Pakistan. Also banks may lodge complaints against another bank in case of dispute.

Types of Complaints

All complaints rejected by banks can be entertained by the Banking Mohtasib provided these are not barred by time or records pertaining thereto have not been destroyed by the bank in accordance with its laid down record destruction policies. Rejected complaints may also be sent to Banking Mohtasib along with all related correspondence and the Complaint Form, without the need to give 45 days notice to the concerned bank. The Banking Mohtasib handles complaints relating to violation of banking laws and regulations, excessive delays and inefficiency, poor service, discriminatory actions, etc.

Appeal Process:

Complainant's right of appeal A complainant not satisfied with the decision of the Banking Mohtasib has the right to appeal to the **Governor**, State Bank of Pakistan within 30 days from the date of the order of the Banking Mohtasib. If the complainant does not choose to go into appeal or does not accept the decision of the State Bank of Pakistan in appeal, the complainant has the right to go to a court of law.

Bank's right of appeal In case a bank is not satisfied with the Banking Mohtasib's order in the matter of a complaint, it may file an appeal with the Governor, State Bank of Pakistan within thirty days. However, if no appeal is filed, or the State Bank of Pakistan does not uphold the appeal, the Banking Mohtasib's order shall become final, operative and binding upon the bank.

Benefits of Mohtasib Scheme:

- Globally a phenomenal success
- A cost free service
- Cost effective for both complainants and banks
- Unlike the courts, legal representation is neither required nor advantageous
- Accessible, friendly, informal and flexible
- Complainants retain the right to take the matter to court if not satisfied
- Ombudsmen are also successful because they may provide remedies where none may be available through the formal system.

The provisions regarding establishment of the office of Banking mohtasib are contained in section 82 of Banking Companies Ordinance, 1962. The respective statutory provisions are reproduced hereunder.

Appointment of Mohtasib: Sec 82-A

1. There shall be a Banking Mohtasib who shall be appointed by the President in consultation with the Governor of the State Bank of Pakistan.
2. The Banking Mohtasib shall be a person of high integrity and unimpeachable banking or legal credentials who is not a share-holder of a banking company or financial institution and is not or has not, been a bank defaulter.
3. The jurisdiction of the Banking Mohtasib in relation to banking transactions shall be to— (a) enquire into complaints of banking malpractices; (b) perverse, arbitrary or discriminatory actions; (c) violations of banking laws, rules, regulations or guidelines; (d) inordinate delays or inefficiency and (e) corruption, nepotism or other forms of maladministration.
4. The Banking Mohtasib shall hold office a period of three years and shall not be eligible for any extension of tenure or for re-appointment under any circumstances whatsoever.
5. The Banking Mohtasib shall not hold any other office of profit in the service of Pakistan or occupy any other position carrying the right to remuneration for the rendering of services.

Terms and conditions of the Banking Mohtasib Sec 82-b

1. The Banking Mohtasib shall be entitled to the same salary and allowances as a Judge of a High Court.
2. The Banking Mohtasib may be removed from office on the ground that he has been guilty of misconduct or that he is incapable of properly performing the duties of his office by reason of physical or

mental incapacity. Provided that he shall have the right to file an appeal before the Federal Services Tribunal.

3. The Banking Mohtasib shall be provided with a secretariat to be appointed in consultation with the State Bank. Appointments to the Secretariat may be made on deputation from the State Bank of Pakistan or other banks or otherwise on the basis of professional qualifications and the costs of the Secretariat shall be shared by banks in such proportions as may be determined by the State Bank of Pakistan. The Banking Mohtasib shall have the power and responsibility—

- a) To entertain complaints from customers, borrowers, banks or from any concerned body or organization;
- b) To facilitate the amicable resolution of complaints after giving hearings to the complainant and the concerned bank; and
- c) In the event that complaints cannot be resolved by consent, to give finding which shall be acted upon in the manner set out herein.

4. The Banking Mohtasib shall exercise his powers and authority in the following manner:-

a) In relation to all banks operating in Pakistan.— The Banking Mohtasib shall be authorized to entertain complaints of the nature set out herein below:-

- a. failure to act in accordance with banking laws and regulations including policy directives or guidelines issued by the State bank from time to time.
- b. Provided that if there is a dispute as to the proper interoperation of any regulations, directions or guidelines, the same shall be referred to the State Bank for clarification. delays or fraud in relation to the payment or collection of cheques, drafts or other banking instruments or the transfer of funds;
- c. fraudulent or unauthorized withdrawals or debit entries in accounts;

- i. Complaints from exporters or importers relating to banking services and obligations including letter of credits;
- ii. Complaints from holders of foreign currency accounts, whether maintained by residents or non-residents;
- iii. Complaints relating to remittances to or from abroad;
- iv. Complaints relating to mark-up or interest rates based on the ground of a violation of an agreement or of state bank directives; and
- v. Complaints relating to the payment of utility bills.

b. In relation to banks in the public sector. — The Banking Mohtasib shall be authorized to entertain complaints against such banks on the following additional grounds as well—

- i. Corrupt or mollified practices by bank officers;
- ii. Gross dereliction of duty in dealing with customers; and
- iii. Inordinate delays in taking decisions.

Reference to Banking Mohtasib by Court: Sec 82-C—

if at any time during the pendency of a case, a court trying a case relating to recovery of loan by a banking company is of the opinion that the management of the banking company has prima facie acted in a malafide manner, or in violation of banking rules and regulations, it may reference to the Banking Mohtasib for inquiring into the matter and passing such order in accordance with the provisions hereof as may deem fit: Provided that the making of a reference shall not prevent the court from deciding the claim before it on merits.

Procedure for making complaints: Sec 82-D

(1) A complaint shall be made on solemn affirmation or oath in writing addressed to the Banking Mohtasib. The complaint shall set out the full particulars of the transaction complained of and the name and address of the complainant. (2) Prior to making a complaint the complainant shall intimate in writing to the concerned bank his intention of filing a complaint and if the bank either fails to respond, or makes a reply which is unsatisfactory to the complaint, within a period of three months, the complainant may file a complaint at any time thereafter within a further period of three months (3) The Banking Mohtasib may

adopt any procedure as he considers appropriate for investigating a complaint: Provided that he shall not pass any order against a bank without first giving it a notice and an opportunity of a hearing. (4) Subject to section 82C, the Banking Mohtasib shall not have any power to issue an order in the nature of a stay order or to entertain any complaints if the matter is pending before a court or other legal forum.

(5) The Banking Mohtasib may reject a complaint summarily or he may accept the same or pass any other order he deems fit:

Provided that in each case he shall pass a reasoned order for his decision

The Banking Mohtasib shall hold office a period of three years and shall not be eligible for any extension of tenure or for re-appointment under any circumstances whatsoever.

Banking Mohtasib shall not hold any other office of profit in the service of Pakistan or occupy any other position carrying the right to remuneration for the rendering of services.

Recommendations for implementations 82-E

In the event the Banking Mohtasib comes to the conclusion that the complain is justified, in part or in whole, he shall try and facilitate an amicable resolution or settlement by resort to mediation and failing that communicate his findings to the concerned bank with the direction—

- a. to reconsider the matter; to modify or cancel the earlier decision, action or failure to take the appropriate action;
- b. To pay reasonable compensation to the complainant as fixed by the Banking Mohtasib;
- c. To take the requisite steps to improve the functioning or efficiency of the bank; and
- d. To take such other remedial steps or actions as may be specified by the Banking Mohtasib.

The Banking Mohtasib may, in any case, he deems fit or proper, forward a report to the State Bank recommending—

- a. An inquiry, or the taking of the requisite steps or legal proceedings against a bank which has acted in violation of banking laws, procedure, regulations or directives of the State Bank; and
- b. In the case of a bank in the public sector in cases of banking malpractices or corruption, nepotism or gross and flagrant dereliction by bank officers of their duties and responsibilities, the initiation of such action including a criminal prosecution or disciplinary proceedings as the State Bank may deem fit, either by itself, or through filing a report with the Government of Pakistan.

In no case whatsoever shall be Banking Mohtasib have the power to direct that loans, advances or finances be given to a complainant. (4) Any bank, or official of a bank or a complainant aggrieved by an order passed by the Banking Mohtasib may file an appeal with the State Bank within thirty days which shall pass any order thereon it deems fit.

Any order passed by the Banking Mohtasib which has not been appealed against, or any order passed by the State Bank in appeal, as the case may be, shall become final and operative and if not implemented shall render the bank concerned to such action including the imposition of a fine or penalty as the State Bank may deem fit, and in relation to a bank officer, to the appropriate disciplinary or other proceedings.

Nothing contained herein shall prevent a complainant from filing a suit against a bank in the event his complaint is rejected.

Power to call for information: Sec 82-F

The Banking Mohtasib shall have the power for purposes of disposing a case, to require a bank to disclose to him any information subject to the following conditions:-

- a. The Banking Mohtasib shall make every endeavor to ensure that banking confidentiality is maintained as required by banking law and procedure and shall take no action which is volatile thereof.
- b. The Banking Mohtasib may call for any or all such documents which are relevant or pertinent for purposes of deciding a complaint: --Provided that he shall not be entitled to call for unrelated documents or documents which may compromise the bank's position in relation to other customers:

c. In the event of a bank refusing to furnish information, or copies of relevant documents, the Banking Mohtasib shall not be authorized to compel the bank to comply with his order but he may draw an adverse inference and comment on the same in his findings.

The banking companies rules, 1963

- These rules may be called the Banking Companies Rules, 1963.
- They extend to the whole of Pakistan.
- They shall come into force on such date as the Federal Government may, by notification in the official Gazette, specify in this behalf.

Definitions:

"Ordinance" means the Banking Companies Ordinance, 1962 (LVII of 1962):

"Principal office of the State Bank" means the office of the State Bank to which the returns required under the Ordinance or these rules are to be submitted;

"Principal office of the banking company" means the office of the banking company which shall be responsible for the submission of returns under the Ordinance or these rules:

"Quarter" means a period of three months ending on the last day of March, June, September and December of any year ; and

"Place of business" of a banking company includes any sub-office, pay-office, sub-pay-office or any place of business at which deposits are received, cheques cashed or moneys lent.

List of Officers: Sec 4

A banking company shall, within one month of the commencement of these rules or of the commencement of its business, whichever is later, send to the principal office of the State Bank a written statement containing a list of –

The names, the official designations and specimen signatures of the officers authorized **to sign** on behalf of the banking company **returns** required under the Ordinance or these rules; and **the names** and addresses of **the directors** of the banking company.

Any change in the list referred to in clause (i) shall be intimated to the principal office of the State Bank within one month of such change.

A banking company incorporated outside Pakistan, which at the commencement of these rules has a place of business in Pakistan, and every such company which after the commencement of these rules establishes a place of business in Pakistan, shall, within one month of the commencement of these rules or of the establishment of such place of business, as the case may be, furnish to the principal office of the State Bank the full address of the principal place of business declared in terms of clause (e) of sub-section (1) of Section 277 of the Companies Act, 1913 and the name and address of one or more persons resident in Pakistan authorized to accept on behalf of the company any notice or order required to be served on the company under the Ordinance or these rules and shall intimate the principal office of the State Bank any change in such name or address within one month of such change:

Provided that information furnished by a banking company under rule 4 of the Banking Companies (Control) Rules, 1949, shall be deemed to have been furnished under this rule.

Withdrawals of Deposits: Sec 6

The principal office of the State Bank shall not be bound to return securities actually deposited, but may substitute therefore new scrip of securities of the same description and amount.

Changes in deposits: Sec 7

The office of the National Bank of Pakistan holding securities under sub-rule (1) of rule 5 shall permit the withdrawal of foreign approved securities only under instructions from the principal office of the State Bank.

When the form or amount of deposit is changed by reason of a subsequent deposit or withdrawal, the principal office of the State Bank of Pakistan shall, as soon as possible, send to the principal office of the banking company a fresh certificate in Form 1.]

Maturing of security deposits: Sec 8

When a security in deposit matures or when any yield on such a security ceases to accrue, the principal office of the State Bank shall not be bound to inform the banking company; but upon the receipt of a requisition in writing from the banking company, the principal office of the State Bank shall, as soon as possible, collect the discharge value and hold the amount in deposit for purposes of sub-section (3) of section 13 of the Ordinance.

Interest on deposits: Sec 9

No interest shall be payable on cash deposits

The principal office of the State Bank shall credit, as soon as possible, the current account of the banking company maintained with it with the interest realised on securities subject to the usual charges.]

Licensing of banking companies: Sec 10

A company desiring to have a license under section 27 of the Ordinance **shall apply to the Director**, Banking Control Department, State Bank of Pakistan, Central Directorate, Karachi.—

In Form IV in the case of a company incorporated in Pakistan and desiring to commence banking business; **In Form V** in the case of a company incorporated in Pakistan and in existence at the commencement of the Ordinance; **In Form VI** in the case of a company incorporated outside Pakistan and desiring to commence or carry on banking business in Pakistan.

Opening of new places of business: Sec 11

An application by a banking company for permission to open a new place of business or change the location of an existing place of business under Section 28 of the Ordinance shall be submitted in form VII to— the Director, Banking Control Department, State Bank of Pakistan, Central Directorate, Karachi in the case of banking companies having their principal offices in West Pakistan, and the Deputy Chief Officer, Banking Control Department; State Bank of Pakistan, Dacca, in the case of banking companies having their principal offices in East Pakistan.

List of offices: Sec 12

A banking company shall, within a period of one month from the close of every quarter, send to the principal office of the State Bank a list in Form VIII of all its offices in Pakistan at which it was doing business during that quarter.

Manner of publication of accounts and balance-sheet: Sec 14

The balance-sheet and profit and loss account prepared in terms of Section 34 of the Ordinance together with the auditor's report shall be published within a period of six months from the end of the period to which they relate in a newspaper which is in circulation at the place where the banking company has its principal office.

Explanation.—For the purposes of this rule, the expression “newspaper” means any newspaper or journal published at least once a week, but does not include a journal other than a banking, commercial, financial or economic journal.

List of Debtors: Sec 15

The list of debtors under Section 63 of the Ordinance shall be in Form XIII or as near thereto as circumstances permit.

Power to exempt in certain cases: Sec 16

The Federal Government may, on the recommendation of the State Bank, declare by notification in the Official Gazette that any or all of the provisions of these rules shall not apply to any banking company or to any class of banking companies either generally or for such period as may be specified.

LESSON 16**STATE BANK OF PAKISTAN ACT, 1956**

This extends to the whole of Pakistan. It shall come into force at once and except Section 46, shall be deemed to have taken effect on and from the twelfth day of May, 1948.

In this Act we shall cover the following aspects/ statutory provisions

- Definitions
- Establishment and incorporation of the Bank
- Share Capital Guarantee by Federal Government Notice of Trust
- Register of shareholders
- Offices, Branches and Agencies
- Central Board of Directors
- Functions and responsibilities of the Central Board
- Monetary and fiscal policies board
- Executive Committee Qualifications and disqualification of Directors and Members
- Term of office of Directors and Members
- Directors and Members
- General and annual general meeting
- Business which State Bank may transact
- Issue Department
- Cash Reserve of Scheduled Banks to be kept with the Bank
- Scheduled Banks
- Power to require returns from Corporations
- Publication of consolidated statement by the Bank
- Submission of Returns by State Bank
- The Bank and its officers to be public officers
- Liquidation of the Bank

Definitions: the definitions as contained in the Act are given hereunder:

"Annual general meeting" means the annual meeting of the shareholders-of the Bank;

"Approved foreign exchange" means currencies declared as such by any notification under Sec19;

"The Bank" means the State Bank of Pakistan;

"Bank Notes" means notes made and issued by the Bank in accordance with Section 24 and include currency notes of the Government of Pakistan issued by the Bank;

"Central Board" means the Central Board of Directors of the Bank;

"Co-operative Bank" means a society registered under the Co-operative Societies Act, 1912, or any other law for the time being in force in Pakistan relating to co- operative societies, the primary object of which is to provide financial accommodation to its members;

"Debentures" includes participation term certificates;

"Director" means a Director for the time being of the Central Board;

"General meeting" means the meeting of the share-holders ' of the Bank convened for transacting such business as may be specified in the notice convening the meeting;

"Governor" and "Deputy Governors" means respectively the Governor and Deputy Governors of the Bank;

"Loans and advances" includes finances provided on the basis of participation in profit and loss, mark up in price, leasing, hire-purchase of otherwise;

"Local Board" means a Local Board of Members;

"Member" means a Member for the Local Board;

"Rupee coin" means one-rupee coin and one-rupee notes which are legal tender in Pakistan;

"Scheduled bank" means a bank for the time being included in the list of banks maintained under sub-section (1) of Section 37;

"Securities" includes securities as defined in the Capital Issues (Continuance of Control) Act, 1947 (XXIX of 1947);

"Shares" includes modaraba certificates.

Establishment and incorporation of the Bank: Sec 3:

As soon as may be after the commencement of this Act steps shall be taken to establish, in accordance with the provisions of this Act, a bank to be called the State Bank of Pakistan or Bank Dautat-e-Pakistan, for the purposes of taking over, as from the first day of July, 1948, the management of the currency from the Reserve Bank of India, and carrying on the business of Central Banking.

The Bank shall be a body corporate by the name of the State Bank of Pakistan or Bank Daulat-e-Pakistan, having perpetual succession and a common seal, and shall by the said name sue and be sued.

Share Capital: Sec 4

The original share capital of the Bank shall be three corers of rupees divided into three hundred thousand fully paid-up shares of the nominal value of one hundred rupees each, out of which not less than fifty one per cent shall be held by the Federal Government and the balance by the public.

The share capital may be increased by a resolution of the Central Board subject to the approval of the Federal Government, but not less than fifty-one per cent of the additional share capital shall be issued to the Federal Government.

The nominal value, issue price, the manner in which the new shares may be issued and allotted and their assignment to the registers of shareholders maintained under sub-section (1) of Section 7 shall, subject to the approval of the Federal Government, be determined by the Central Board

Guarantee by Federal Government: Sec 5

Notwithstanding anything contained in the Acts hereinafter mentioned in this Section, the shares of the Bank shall be deemed to be included among the securities enumerated in Section 20 of the Trusts Act, 1882 and to be approved securities for the purposes of the Insurance Act, 1938 and the Banking Companies Ordinance, 1962 (LVII of 1962).

Offices, Branches and Agencies: Sec 8

The head office of the Bank shall be situated in Karachi.

- 1) The Bank may establish branches, offices and agencies in Pakistan, or, with the prior approval of the Federal Government any-where outside Pakistan.
- 2) The Bank shall create a special Agricultural Credit Department, the functions of which shall be
- 3) To maintain an expert staff to study all questions of agricultural credit and be available for consultation by the Federal Government, Provincial Governments, Provincial Co-operative Banks and other banking organizations;
- 4) To co-ordinate the operations of the Bank in connection with agricultural credit and its relations with the Provincial Co-operative Banks and any other organizations engaged in the business of agricultural credit.

Central Board of Directors: Sec 9

The general superintendence and direction of the affairs and business of the Bank shall be entrusted to the Central Board of Directors which may exercise all the powers and do all acts and things that may be exercised or done by the Bank and are not by this Act expressly directed or required to be done by the Bank in general meeting or in annual general meeting.

The **Central Board** shall consist of-

- a. The Governor;
- b. Secretary, Finance Division, Government of Pakistan; and
- c. Seven Directors, including one Director from each Province, to be nominated by the Federal Government ensuring representation to agriculture, banking and industrial sectors.

The Governor shall be the chairman of the Central Board.

All decisions of the Central Board shall be taken by majority of members present and voting and in the event of equality of the votes, the Governor may exercise a casting vote

Functions and responsibilities of the Central Board: Sec 9-A

The Central Board shall, with a view to secure stability of monetary system:

Regulate and supervise monetary and credit system:

- o Provided that in regulating the monetary and credit system, the Central Board shall keep in view the National policy objectives of the Federal Government,
- o Provided further that the Governor may, in any emergency which in his opinion requires immediate action, take measures under this clause as may be necessary in the circumstances and shall, in the next meeting of the Central Board, report to it for approval of such action;
- o determine, in consultation with the Federal Government, the limit of credit to be extended to the Federal Government and Provincial Governments tender advice to the Federal Government on monetary policy and its interaction with fiscal and exchange rate policy;
- o Analyze and report periodically to the Federal Government on the impact of the policies being followed on the state of the economy; and
- o Discharge such other functions as may be necessary for regulating the monetary system or as may be assigned by the Federal Government.

Monetary and Fiscal Policies Coordination Board Sec. 9B

- i. Federal Minister for Finance Chairman
- ii. Federal Minister for Commerce Member
- iii. Deputy Chairman, Planning Commission Member
- iv. The Governor Member
- v. Secretary, Finance Division, Govt of Pakistan Member

The Board shall-

- a. Coordinate fiscal, monetary, foreign trade and exchange rate policies;
- b. Ensure consistency amongst macro-economic targets in the areas of fiscal, monetary and external account aggregates and recommend adjustments for the approval of the Federal Government;
- c. Recommend monetary aggregates and Government borrowing for consideration of the National Economic Council;
- d. Review fiscal and monetary measures to secure monetary aggregate targets;
- e. Consider limits of the government borrowing as revised from time to time in the meetings to be held before and after passage of the annual budget; and
- f. Review the level of Government borrowing in relation to the predetermined or revised targets after every quarter; and
- g. Review the expenditure incurred in connection with raising of loans and Government borrowing

Executive Committee: Sec 11

There shall be an Executive Committee consisting of the Governor, Deputy Governor, if any, three Directors elected by the Central Board to represent respectively the areas specified in the Schedule and an officer appointed by the Federal Government to act as Member of the Executive Committee.

Except when the Central Board is in session, the Executive Committee shall deal with and decide any matter within the competence of the Central Board. Local Boards, their constitution and functions

Qualifications and disqualification of Directors and Members: Sec 13

No person shall be or shall continue to be a Director or Member-

- a. Who is a Member of the Central or Provincial **Legislature**; or
- b. Who is a salaried Government official; or
- c. Who is, or at any time has been, adjudicated an insolvent or has suspended payment or has compounded with his creditors; or
- d. Who is found lunatic or becomes of unsound mind; or

- e. Who is an officer or employee of any bank; or
- f. Who is a Director of any bank other than the Bank, but he shall not- be disqualified or cease to be a Director if he is a Director of a co-operative bank.
- g. Who is not, within six months from the date of his becoming a Director or Member, as the case may be, registered as a holder of unencumbered shares of the Bank of the nominal value of five hundred rupees;
- h. Who absents himself from three consecutive meetings of the Central Board, or Local Board without leave from the Central Board or Local Board as the case may be?

Nothing in clause (b) and (g) of sub-section (1) shall apply to the Government official nominated as a Director by the Federal Government.

The Federal Government shall sell shares at par to a Director or Member nominated by it under Section 9 and 12, seeking to obtain the minimum shares qualification required under this Section, but no such share shall be disposed of by such Director or Member otherwise than by resale to the Federal Government at par, and the Federal Government shall have the right to order the transfer at par of all or any of such shares to itself, whereupon all or any of such shares shall be deemed to have been transferred to it.

Term of office of Directors-and Members: Sec 14

The elected Directors and Members shall hold office for three years on the expiry of which they shall cease to hold office.

A Director or member shall not be removed from his office before the completion of his tenure except when he has done any act which is a breach of trust reposed in him or is guilty of misconduct:

Directors and Members shall on the expiry of their term of office be eligible for re-election or re-nomination, as the case may be.

Removal from and vacation of office of the Governor, Deputy Governors, Directors and Members: Sec 15

Subject to sub section (2), the Federal Government may remove the Governor from his office, if he becomes permanently incapable of performing his duties, or is subject to any of the disqualification specified in sub-section (10) of section 10, or has done any act which is breach of the trust reposed in him, or is guilty of misconduct:

An elected Director or Member shall not be removed from his office except upon a resolution passed by the Central Board in that behalf by in majority of not less than six Directors.

- a. The Governor, a Deputy Governor or a Director may resign his office by statement to that effect in writing signed by him and addressed to the Federal Government.
- b. A statement of resignation by a Deputy Governor or Director shall be addressed as above through the Governor
- c. A Member may resign his office by a statement to that effect in writing signed by him and addressed 'to the Central Board.
- d. On the acceptance of such a resignation by the Federal Government or the Central Board, as the case may be, the office shall become vacant.

Any Director or Member vacating office under this section shall not be eligible to become a Director or Member, as the case may be, until the expiry of the term of office for which he was nominated or elected. In the event of a vacancy occurring amongst the nominated Directors or Members, the Federal Government shall fill the vacancy by nominating another Director or Member, as the case may be.

In the event of a vacancy occurring amongst the elected Directors or Members before the expiry of their term of office, a new Director or Member, as the case may be, shall be elected for the remainder of the term by and from amongst the shareholders registered on the same register as that from which the vacating Director or Member was elected.

General and annual general meeting: Sec 16

The annual general meeting shall be held annually at Karachi, or a place in Pakistan where there is an office or branch of the Bank, within three months from the date on which the annual accounts of the Bank are closed.

In the said meeting the shareholders present shall be entitled to discuss the annual accounts, the report of the Central Board on the working of the Bank throughout the year, and the auditors' report on the annual balance sheet and accounts.

A general meeting may be convened by the Central Board at any other time.

Every share holder shall be entitled to attend at any general meeting; and each shareholder who has been registered on a register maintained under Section 7 for a period of not less than six months ending with the date of the meeting, as holding five or more shares shall have one vote, and on a poll, each shareholder so registered shall, subject to a maximum of ten votes, have one vote for each five shares, and such votes may be exercised either personally or by proxy

Business which the Bank may transact: Sec 17

(1) Bank is authorized to carry on and transact the several **kinds of business hereinafter specified, namely:-** The **accepting** of money on deposit from, and the collection of money for the Federal Government, the Provincial Governments, Local Authorities, bank and other persons: provided that no interest shall be paid on deposits received from the Federal Government, a Provincial Government, or a Local Authority;

(2)

(a) The purchase, sale and rediscount of bills of exchange and promissory notes drawn on and payable in Pakistan and arising out of bonafide commercial or trade transactions bearing two or more good signatures one of which shall be that of a scheduled bank, and maturing within one hundred and eighty days from the date of such purchase or rediscount, exclusive of days of grace;

(b) The purchase, sale and rediscount of bills of exchange and promissory notes, drawn on and payable in Pakistan and bearing two or more good signatures one of which shall be that of a scheduled bank and drawn or issued for the purpose of financing seasonal agricultural operation or the marketing of crops, and maturing within fifteen months from the date of such purchase or rediscount exclusive of days of grace;

(3) The purchase and the sale of approved foreign exchange;

(b) The purchase, sale and rediscount of bills of exchange including treasury bills, drawn in or on any place in countries whose currency has been declared as approved foreign exchange and maturing within one hundred and eighty days from the date of purchase, provided that no such purchase, sale or rediscount shall be made in Pakistan except with a scheduled bank;

(4) The making to Local Authorities, scheduled banks or co-operative banks of advances and loans repayable on demand or on expiry of fixed periods not exceeding one hundred and eighty days against the security of: stocks, funds and securities, other than immovable property, in which a trustee is authorized to invest trust money by any law for the time being in force in Pakistan;

(5) The making to the Federal Government or Provincial Governments of advances repayable in each case not later than three months from the date of the making of the advance;

(6) The making to institutions or banks, specially established for the purpose of promoting agricultural or industrial development, or for the financing of construction of houses, in the country or co-operative banks of advances and loans for such amounts and on such terms and conditions

(7) the issue and purchase of telegraphic transfers, demand drafts and other kinds of remittances made payable at its own branches, offices or agencies;

(10)(a) The purchase and sale of securities of the Federal Government or a Provincial Government of any maturity or of such securities of a Local Authority as may be specified in this behalf by the Federal Government by notification in the Official Gazette on the recommendation of the central Board;

(12) The sale and realization of all property, whether movable or immovable which may in any way come into the possession of the Bank in satisfaction, or part satisfaction of any of its claims;

(13) The acting as agent to Federal Government, any Provincial Government, or any Local Authority in the transaction of any of the following kinds of business, namely:-

- (a). the purchase and sale of gold or silver or approved foreign exchange;
- (b). the purchase, sale, transfer and custody of bills of exchange, securities or shares in any company;
- (c). the collection of the proceeds, whether principal or interest, profit, dividend or other return, of any securities;
- (d). the remittance of such proceeds at the risk of the principal, by bills of exchange payable either in Pakistan or elsewhere;
- (e). the management of public debt; and
- (f). the transacting of special drawing rights with the International Monetary Fund;

(17) The making and issue of bank notes subject to the provisions of this Act;

(18) The exercise of powers and the performance of functions and duties entrusted to the Bank by or under this Act or any other law for the time being in force;

(18A) The entering into clearing and payments arrangements with any country or group of countries, on a general or regional or sub-regional basis, participation in the formation and settlement of international payments transactions under such arrangements, and incurring financial and other obligations relating thereto;

(19) Establish credits and give guarantees; and

(20) Generally, the doing of all such matters and things as may be necessary, incidental to or consequential upon the exercise of its powers or the discharge of its duties or functions under this Act.

Issue Department: Sec 26

The issue of Bank Notes shall be conducted by the Bank in an Issue Department which shall be separated and kept wholly distinct from the Banking Department and the assets of the Issue Department shall not be subject to any liability other than the liabilities of the Issue Department as hereinafter defined in Section 32.

Cash Reserve of Scheduled Banks to be kept with the Bank: Sec 36

Every scheduled bank shall maintain with the Bank a balance the amount of which shall not at the close of business on any day be less than such percentage of demand liabilities and that of the time liabilities of such bank in Pakistan as may be determined by the State Bank.

Scheduled Banks: Sec 37

(1) The Bank shall maintain at all its offices and branches an up-to-date list of banks declared by it to be scheduled banks under Clause (a) of sub-section (2).

(2) The Bank shall, by notification, in the official Gazette

(a) Declare any bank to be scheduled bank which is carrying on the business of banking in Pakistan and which-

(i) is a banking company as defined in Section 227F of the Companies Act, 1913, or a Co-operative bank, or a corporation or a company incorporated by or established under any law in force in any place in or outside Pakistan;

(ii) has a paid-up capital and reserves of an aggregate value of not less than five lakhs of rupees:

Provided that in the case of a co-operative bank, an exception may be made by the Bank;

(iii) satisfies the Bank that its affairs are not being conducted in a manner detrimental to the interests of its depositors;

(iii) satisfies the Bank that its affairs are not being conducted in a manner detrimental to the interests of its depositors;

Power to require returns from Corporations: Sec 38

The Bank may require any Corporation with which it has any transactions under Section 17 to furnish returns referred to in under sub section (3) of Section 36, and if it does so require, the provisions of sub-Section. (6), (7) and (8) of Section 36 shall apply, so far as may be, to such Corporation as if it were a scheduled bank.

Publication of consolidated statement by the Bank: Sec 39

The Bank shall compile and publish in such manner and at such times as the Federal Government may direct, a consolidated statement from such information as may be received under this Act.

Returns

Submission of Returns by State Bank: Section 40

(1) The Bank shall prepare and transmit to the Federal Government a weekly account of the Issue Department and of the Banking Department in such form as the Federal Government may, by notification in the official Gazette direct. The Federal Government shall cause these accounts to be published weekly in the official Gazette.

(2) The Bank shall also, within four months from the date on which the annual accounts of the Bank are closed, release to the public and simultaneously transmit to the Federal Government a copy of the annual accounts signed by the Governor, the Deputy Governor, if any, and the Chief Accounting Officer of the Bank, and certified by the Auditors together with a report by the Central Board on the working of the Bank throughout the year, and the Federal Government shall cause such accounts and report to be published in the official Gazette.

(3) The Bank shall also, within two months from the date on which the annual accounts of the Bank are closed, transmit to the Federal Government a statement showing the name, address and occupation of, and the number of shares held by each shareholder of the Bank.

The Bank and its officers to be public officers: **Section 46:**

(1) For the purposes of Section 124 of the Evidence Act, 1872, the provisions of Part IV of the Code of Civil Procedure, 1908 -and the provisions of rule 27 of Order V, and rule 52 of Order XXI of the said Code, the Bank and any person in the service of the Bank acting in his capacity as such shall be deemed to be public officer.

(2) The provisions of Section 123 of the Evidence Act shall apply to the unpublished records of the Bank and the Governor shall be deemed to be the officer or head of the department concerned.

(3) Every person in the service of the Bank shall be deemed to be a public servant within the meaning of section 21 of the Pakistan Penal Code (Act XLV of 1860) -

Production of unpublished record of bank, etc: Sec 46-A

(1) No court tribunal or other authority shall be entitled to compel the bank or any person in the service of the bank to produce or, as the case may be, give any evidence derived from, any unpublished record of the bank

(2) No court, tribunal or other authority shall permit any one to produce or give evidence derived from, any unpublished record of the bank, except with the prior permission in writing of the Governor who may give or withhold such permission as he thinks fit.

(3) Notwithstanding anything contained in this Act or any other law for the time being in force', a report prepared by the Bank on a banking company under Section 40 of the Banking Companies Ordinance, 1962 (LVII of 1962), shall be deemed to be unpublished for the purposes of subsections (1) and (2) even if a copy of such report has been supplied to the banking company to which the report pertains or to the Federal Government or to the Pakistan Banking Council constituted under Section 9 of the Banks (Nationalization) Act, 1974.

Inconsistent orders not to be issued: Sec 46-B

No governmental or quasi-governmental body or agency shall issue any directive, directly or indirectly, to any banking company or any other financial institution regulated by the Bank which is inconsistent with the policies, regulations and directivities issued by the Bank pursuant to this Act, the Banking Companies Ordinance, 1962 (LVII of 1962) or any other law in force.

Liquidation of the Bank: Sec 50

The Bank shall not be placed in liquidation save by order of the Federal Government and in such manner and on such terms and conditions as it may direct.

From the above we understand that State Bank of Pakistan exercises various powers as well as certain duties and obligations are entrusted on the Bank by virtue of Statutory Provisions contained in this Act.

LESSON 17**SBP BANKING SERVICES CORPORATION ORDINANCE, 2001**

This Ordinance extends to the whole of Pakistan. Central Banks all over the world are required to discharge an important obligation as regulator and policy maker as well as advisor to the Government; as such it is not advisable that Central Bank should engage themselves into day to day affairs of the Banking. As such it was decided that a corporation may be established for discharging various functions which are contained in this Ordinance, so that the State Bank of Pakistan may focus its attention towards its prime objectives.

In this Ordinance we shall especially focus on the following aspects/ statutory provisions:

- Definitions
- Establishment and incorporation of the Bank
- Bank to be a subsidiary of the State Bank
- Business and functions of the Bank
- Board of Directors
- Managing Director of the Bank
- Accounts and audit
- Liquidation of the Bank
- Transfer of undertaking to the Bank
- Provisions with respect to employees transferred to the bank
- Delegation of the powers of the State Bank to SBP Banking Services Corporation
- Duty of officers and servants to maintain secrecy

Definitions: the definitions as contained in the Ordinance are given hereunder:

"Act" means the State Bank of Pakistan Act, 1956.

"Bank" means the SBP Banking Services Corporation established under section 3;

"Board" means the Board of Directors of the Bank;

"Chairman" means the Chairman of the Board;

"Committee of Directors" means a Committee of Directors constituted under section 11;

"Director" means a member of the Board;

"Governor" means the Governor and includes an Acting Governor of the State Bank appointed under the Act;

"Managing Director" means the Managing Director appointed under section 9;

"Regulations" means regulations made under this Ordinance;

"Rules" means rules made under this Ordinance;

"Seal" means the common seal of the Bank;

"State Bank" means the State Bank of Pakistan established under the Act;

"Transfer Date" means the date specified in the Transfer Order;

"Transfer Order" means Transfer Order made under sub-section (1) of section 15-

"Transferred Employees" means the employees of the State Bank who shall, as from the Transfer Date, stand transferred to and become the employees of the Bank, by virtue of the Transfer Order; and

"Transferred Undertaking" means a part of the undertaking of the State Bank specified in sub-section (1) of section 15.

Establishment and incorporation of the Bank: Sec 3:

- (1) As from the date of promulgation of this Ordinance, there shall be established, a bank to be called SBP Banking Services Corporation.
- (2) It is worth mentioning that wherever the word bank is used in this Ordinance that would invariably mean SBP Banking Services Corporation.

- (3) The Bank shall be a body corporate having perpetual succession and a seal and shall, by the name assigned to it by sub-section (1), sue and be sued.
- (4) The head office of the Bank shall be situated in Karachi and it may establish branches, offices and agencies in Pakistan and anywhere outside Pakistan with the prior approval, in writing of the State Bank.

Bank to be a subsidiary of the State Bank: Sec 4

The Bank shall be a subsidiary of the State Bank, and the State Bank shall exercise control over the Bank in accordance with the provision of this Ordinance

Business and functions of the Bank: Sec 5:

- (1) Subject to sub-section (2), the Bank, under the overall supervision and control of the State Bank, may transact and carry on all or any of the following functions namely:—
 - (a). The carrying on of the Transferred Undertaking, statutory and administrative functions and activities of the State Bank transferred or delegated by the State Bank to the Bank under this Ordinance;
 - (b). The handling of receipt, supply and exchange of Bank notes and coins which are legal tender;
 - (c). The issue, supply, sale, encashment and handling of prize bonds, holding draws thereof and other savings instruments of the Federal Government or of a Provincial Government;
 - (d). The performance of any other activity or business which the State Bank may, by order in writing, specify; and
 - (e). The carrying on of any business and discharging of any functions and powers as are incidental to, or in connection with, the affairs of the Bank, including, without limiting the generality of the foregoing and, the power to enter into any contracts or other instruments or any financial or other transactions, issue guarantees and indemnities, borrow and lend moneys, accept deposits of money, make investments, purchase and hold any property and assets, and to provide any services to the State Bank and to others and receive any fee, commission or other compensation for such services.
- (2) The State Bank shall not transfer or delegate any of the functions specified in section 9A Of the Act, including formulation and monitoring of monetary and credit policies, regulation *and* supervision; of the financial sector, foreign exchange regime and exchange-rate policy, and payment and settlement system.

Share capital and limited liability: Sec 6

The authorized share capital of the Bank shall be one billion rupees or such other amount the State Bank may, from time to time, determine by order in writing and shall be divided into shares of one million rupees each.

The paid-up capital of the Bank shall be such amount as may, from time to time, by order in writing be determined by the State Bank and held *inter alia*, by -it, including the fully paid-up shares issued to it under sub-section (7) of section 15.

The share capital may be divided into different kinds and classes therein as' may be prescribed by regulations.

The liability of shareholders of the Bank shall be limited to the amount, if any, not fully paid-up on the shares held by them in the capital of the Bank.

Board of Directors: Sec 7:

The general superintendence, direction and management of the affairs and business of the Bank and overall policy making in respect of its operations shall vest in the Board of Directors which may exercise all such powers and do all such acts, deeds and things that may be exercised or done by the Bank.

In discharging its functions, the Board shall ensure compliance with the orders and directions that may be issued by the State Bank from time to time.

The Board shall consist of:-

- a) Members of the Central Board of the State Bank; and
- b) The Managing Director.

The meetings of the Board shall be held at such times and places as may be prescribed by regulations or, until so prescribed by regulations, as and when convened by the Chairman.

No act or proceedings of the Board shall be invalid merely on the ground of the existence of any vacancy in, or defect in the constitution of the Board

The quorum of meetings of the Board shall be as may be prescribed by regulations or, until so prescribed by regulation, shall be five Directors.

All decisions of the Board shall be taken by majority of the Directors present and voting at a meeting duly convened and held, and in the event of an equality of votes, the Chairman may exercise a casting vote.

A resolution in writing signed by all Directors shall be as effective as if such resolution had been passed at a meeting of the Board

Chairman: Sec 8

The **Governor** shall be the Chairman of the Bank.

The Chairman shall, whenever present, preside over meetings of the Board, but if at any meeting the Governor is not present, a Deputy Governor of the State Bank, designated for this purpose by the Governor, shall attend the meeting on behalf of the Governor and preside over such *meeting* provided that if the Deputy Governor being present, is not willing to act, or is also absent, the Directors present shall choose one of their member to be the Chairman of such meeting.

Managing Director: Sec 9

The Managing Director shall be appointed by the State Bank

The Managing Director shall hold office during the pleasure of the State Bank.

The Managing Director shall be the chief executive officer of the Bank and shall, subject of the control and direction of the Board, administer the affairs of the Bank, and shall have such powers for this purpose as are from time to time delegated to him by the Board.

The salary and other terms and conditions of service of the Managing Director shall be such as the Board may determine.

The Managing Director shall devote his whole time and attention to the affairs of the Bank, provided that the Managing Director may, in addition to his duties as the Managing Directors, be entrusted with such other duties for such period as the State Bank may, by order in writing determine.

Disqualifications of the Managing Director: Sec 10

No person shall be appointed or hold office as Managing Director:—

- a. Who is a member of the Senate, National Assembly, any Provincial Assembly, or an elected member of a local council or local body constituted under any law relating to local councils or local bodies.
- b. Who is employed in any capacity in the service of the Federal Government or of a Provincial Government or holds any office or position for which any salary or other remuneration is payable out of public funds.
- c. Who is a director, officer or employee of any other Bank or of a financial institution or has an interest as a shareholder in any other bank or financial institution:
- d. Provided that nothing in this clause shall apply where this Managing Director is in the employment of the State Bank or where the Managing Director is, in addition to holding the office of Managing Director of the Bank, entrusted with additional duties under sub-section (5) of section 9;

- e. Who has been convicted of tax evasion under any law, or has been convicted or proceedings are pending against him under section 412 of the Companies Ordinance, "1984 (XLVII of 1984), or section 83 of the Banking Companies Ordinance, 1962 (LVII of 1962), or has been convicted by a Court of law for an offence involving moral turpitude;
- f. Who is in default of payments due from him to any Bank, financial institution, cooperative society, Government department? Government controlled or managed company or corporation and for the purpose of this clause, default in payment by the spouse, dependent children, and companies, firms and other business concerns under the control or management of a person shall be considered as the default of such person; or
- g. Who holds an office in a political party?

Committees of Directors: Sec 11

The Board may constitute one or more Committees consisting of such number of Directors as it may determine.

(2) The powers, functions, duties and other terms of appointment of a Committee of Directors shall be such as the Board may determine.

The members of a Committee of Directors shall hold office for such period as the Board *may* determine.

The minutes of every meeting of a Committee of Directors shall be laid before the Board as its next meeting following the meeting of the Committee.

Subject to the general and any special directions of the Board, a Committee of Directors shall deal with any matter entrusted to it by the Board

Delegation of powers and appointment of attorneys: Sec 12

The Board may, for the purpose of ensuring smooth and efficient functioning of the Bank and facilitating transactions of its daily business, by resolution, delegate to the Managing Director or any other executive of the Bank, subject to such conditions and limitations, if any, as may be specified therein, such of its powers and duties under this Ordinance as it may deem necessary

The Board may, from time to time, by resolution appoint any company, firm or person to be the attorney of the Bank for such purposes and with such powers, authorities and discretions, not exceeding those vested in or exercisable by the Board under this Ordinance and for such period and subject to such conditions as the Board may think fit, and any such resolution may contain such provisions for the protection and convenience of persons dealing with any such attorney as the Board may think fit.

Accounts and audit: Sec 13

The accounting year of the Bank shall commence on the first day of July and end on *the* thirtieth day of June

The Bank shall maintain proper accounts and other records to reflect true and fair view of its state of affairs and prepare annual statement of accounts, including the profit and loss account and balance sheet.

The accounts of the Bank shall be audited by one or more auditors who shall be chartered accountants within the meaning of the Chartered Accountants Ordinance , 1961 (X of 1961) to be appointed by the State Bank.

Every auditor shall be supplied with a copy of the annual statement of accounts and it shall be the duty of the auditor to examine the same together with the accounts and vouchers relating thereto, and every auditor shall have a list delivered to him of all books kept by the Bank and shall, at all reasonable times, have access to books, accounts and other documents of the Bank and may employ accountants or other persons to assist him in auditing such accounts and may, in relation to such accounts, examine the Managing Director, any Director and executive of the Bank.

The auditors shall submit a report to the Board and to the State Bank regarding the annual statement of accounts, and in any such report they shall state whether in their opinion the statement of accounts is a full and fair statement of accounts containing all necessary particulars and is properly drawn up so as to exhibit a true and correct view of the state of affairs of the Bank and, in case they have called for any explanation or information from the Managing Director or the Board, whether it has been given and whether it is satisfactory.

The Board may, in addition to the audit under sub-sections (3) and (4), cause to be carried out internal audit of the Bank's accounts and the internal auditors' reports shall be submitted to the Board.

The Board may, in addition to the audit under sub-sections (3) and (4), cause to be carried out internal audit of the Bank's accounts and the internal auditors' reports shall be submitted to the Board.

Liquidation of the Bank: Sec 14

The Bank shall not be placed in liquidation save by order of the State Bank and in such manner and on such terms and conditions as the State Bank may direct.

Transfer of undertaking to the Bank: Sec 15

(1) Subject to the powers under section 5, the State Bank may direct, by Transfer Order and as particularly described in such Order, that

- i. The operational functions and activities of SBP
- ii. All related offices and departments;
- iii. All related assets and liabilities; and
- iv. Certain employees of the State Bank shall transfer to and vest in the Bank as of the Transfer Date.

On the making of the Transfer Order by the State Bank under subsection(1), the Transferred Undertaking and the Transferred Employees shall stand transferred to and vest in the bank as on the Transfer Date and shall be operated, managed and regulated by the Bank as the undertaking and employees of the Bank, provided that the rules and regulations of the State Bank applicable to the operation of the Transferred Undertaking and to the employment of the Transferred Employees as of immediately before the Transfer Date shall continue **to be** applied by the Bank unless altered by the Board with the approval of the State Bank

For the purposes of sub-section (1),-

(a) "assets" include properties whether tangible or intangible, rights, benefits and Entitlements of every description and nature (other than immovable property) of the State Bank and relating to, as of the Transfer Date, the operational functions and activities of the State Bank and to the related offices and departments;

(b) "Employees" means the employees of the State Bank as are specified in the Transfer Order;

(c) "liabilities" include debts, obligations, commitments, loans, encumbrances, claims and charges of every description and nature, actual or contingent of the State Bank and related to, as on the Transfer Date, the operational functions and activities of the State Bank and to the related offices and departments;

(3) For the purposes of sub-section (1),-

"related offices and departments" include all field offices of the State Bank and certain other offices and departments, in full or in part, as are specified in the Transfer Order;

"Operational functions and activities" shall consist of the following, namely:—

- i. revenue collecting and payments for and on behalf of the Federal Government, a Provincial Government, Local Governments, local bodies **or** any other governmental body, authority, institution, company or corporation;
- ii. maintenance of the accounts of the Federal Government, a Provincial Government, local governments, local bodies, other governmental bodies, authorities, institutions, companies, corporations and of other banks and financial institutions;
- iii. Operational work relating to management of debt;
- iv. Operational work relating to foreign exchange;
- v. Prize bonds and Government savings schemes;
- vi. cash and other business as provided for in agreements between the State Bank and the Federal Government and between the State Bank and the Provincial Governments or in the Act, the Foreign Exchange Regulation Act, 1947 (VII of 1947), the Banking Companies Ordinance, 1962

- (LVII of 1962), the Public Debt Act, 1944 (XVIII of 1944), the Securities Act, 1920 (X of 1920), or in any other applicable laws, rules, regulations, orders and notifications made or issued there under; and
- vii. Any other business, offices or departments, and functions, in full or to part, as may be set out in or authorized or delegated by the Transfer Order.

(4) As and after the Transfer Date, the Bank shall undertake, pay, satisfy, discharge, perform and fulfill all debts, liabilities, contracts, engagements, commitments and obligations whatsoever, of the State Bank existing immediately before the Transfer Date and comprised in or exclusively relating to the Transferred Undertaking, and as on the Transfer Date, the State Bank shall stand released and discharged from all such debts, liabilities, contracts, commitments and obligations.

(5) All agreements, contracts, deeds, bonds, securities, powers-of-attorneys, grant of instruments and other legal representations, guarantees, letters of credit, negotiable instruments of whatever kind subsisting or having effect as at immediately before the Transfer Date to which the State Bank may be a party or which shall be in favor of the State Bank and which are compromised in the Transferred Undertaking or exclusively relate thereto shall be of full force and effect, on the Transfer Date, against or in favor of the Bank and be enforced or acted upon by or against the Bank, as if instead of the State Bank, the Bank had been a party thereto or as if the same had been issued by or in favor of the Bank.

All suits, appeals or other legal proceedings, including arbitration proceedings, of whatsoever nature by, or against, the State Bank which exclusively relate to the Transferred Undertaking and which shall be pending immediately before the Transfer Date in any Court, Tribunal, other competent authority or before any arbitrator shall be continued exclusive by, or against, the Bank and the State Bank shall cease to be a party to such suits, appeals or other legal proceedings.

In consideration of the transfer to the Bank of the Transferred Undertaking *under sub-section (1)*, the Bank shall issue such number of fully paid-up shares in its share capital to the State Bank as shall be specified in the Transfer Order.

Notwithstanding anything in the Stamp Act, 1899 (II of 1899) or any other law for the time being in force no stamp duty, registration or any other similar tax or levy shall be payable under any law for the time being in force on or in relation to the vesting and transfer made by the Transfer Order

The State Bank may take all such further, supplemental, incidental and consequential actions, and steps as may be necessary to give full effect to the provisions of this section.

Employees transferred to the Bank: Sec 16

1) The Transfer Order shall specify by category or by name the employees of the State Bank who shall, as from the Transfer Date, stand transferred to, and become the employees of, the Bank by virtue of the Transfer Order.

(2) The Transferred Employee shall not be entitled to any compensation or any other payments whatsoever as a consequence of transfer to the Bank.

(3) The existing terms and conditions of service and the benefits to which the Transferred Employees are entitled to in the State Bank, including pension, gratuity, provident and benevolent funds benefits and benefits of the existing staff regulations shall be assured to the Transferred Employees upon their transfer to the Bank except where altered with the consent of the Transferred Employees

As from the Transfer Date, the benefits accrued to the Transferred Employees under the State Bank's pension, gratuity, provident fund, benevolent fund any other employees benefit Of the State Bank shall be transferred to similar funds and schemes established by the Bank and the Transferred Employees shall be deemed to have become members of, and become entitled to the benefits of, such funds and schemes of the Bank.

For the purpose of payment of benefits to the Transferred Employees under the pension, gratuity, provident and benevolent funds and other employees benefits schemes of the Bank, the period of employment of the Transferred Employees under the State Bank shall count towards then-under the Bank notwithstanding the date of transfer of the Transferred Employees to the Bank.

Power of the State Bank to give direction: Sec 17

Where the State Bank is satisfied

- a. In the public interest; or
 - b. To prevent the affairs of the Bank being conducted in a manner detrimental to the interests of its customers or in a manner prejudicial to the interests of the Bank or of the State Bank; or
- to secure the proper management of the Bank generally, It is necessary to issue directions to the Bank, the State Bank may, from time to time, issue such directions as it may deem fit and the Bank shall be bound to comply with such directions.

The State Bank may, on representation made to it, or on its own motion, modify or cancel any direction issued under sub-section (1) and in so modifying or cancelling any such direction may impose such conditions as it thinks fit, subject to which the modifications or shall have effect.

Delegation of the powers of the State Bank: Sec18

The State Bank may, by order in writing, direct that all or any of the State Bank's powers and functions under this Ordinance, the Act, the Banking Companies Ordinance, 1962, the Foreign Exchange Regulation Act, 1947 or under any other law, rules, regulations, orders, notifications or bye-laws for the time being in force shall, subject to the provision of section 5 of this Ordinance, be exercised by the Bank, as the SBP may, from time to time, specify by order in writing, ,

Where the Governor or any other executive of the State Bank authorized by the Governor in this behalf has, under sub-section (1), directed that any of the State Bank's powers or functions under any law, rules, regulations, orders, notifications or bye-laws for the time being in force shall be exercised or performed, by the Bank the **Board may**, by resolution, direct that any of such powers and functions shall be exercised, or performed, subject to **such limitations**, restrictions or conditions, if any, as the Board may, from time to time, impose by the Managing Director or any other Director, executive or other employee of the Bank specified by the Board

Appointments under section 23B of the Foreign Exchange Regulation Act, 1947: Sec 19

Notwithstanding the provisions of section 23B of the Foreign Exchange Regulation Act, 1947 the State Bank may, by order in writing, authorize in relation to any area specified in such order any executive of the Bank to act as the Director of Adjudication, an Additional Director of Adjudication, a Joint Director of Adjudication, a Deputy Director of Adjudication Director of Adjudication for the purposes of section 23B thereof.

The executives of the State Bank currently acting as the Director of Adjudication, the additional Director of Adjudication, the Joint Director of Adjudication, the Deputy Director of Adjudication, And the Assistant Director of Adjudication in respect of any area and transferred to the Bank pursuant to the Transfer Order shall continue to hold such appointments until removed by the State Bank and shall be deemed to have been appointed by the Federal Government for the purposes of Section 23-B of the Foreign Exchange Regulation Act, 1947 (VII of 1947).

Duty of officers and servants to maintain secrecy: Sec 20

Except in the performance of his duties under this Ordinance, every executive or other employee of the Bank shall preserve and aid in preserving secrecy with regard to all matters relating to the affairs of the Bank and of the State Bank coming to his knowledge and not published by the Bank or by the State Bank and with regard to all matters relating to the financial or monetary affairs of any Bank, institution, person, body of persons, any Government or authority whether in Pakistan or outside Pakistan that may come to his knowledge in the performance of his duties.

Every such executive or other employee who communicates any such matter, except when required by law so to do, or in the discharge of his duties as such, shall be guilty of an offence punishable with imprisonment of either description for a term which may extend to three years or with fine which may extend to one hundred thousand rupees; or with both.

No Court shall take cognizance of any offence punishable under this section except upon a complaint in writing by a person authorized in this behalf by the Board.

Bank and its officers to be public officers: Sec 21

For the purposes of Article 7 of the Qanun-e-Shahadat Order, 1984 (P.O. No. 10 of 1984), the provisions of Part IV -of the Code of Civil Procedure, 1908 (Act V of 1908), and the provisions of rule 27 of Order V, and rule 52 of order XXI of the said Code, the Bank and any person in the service of the Bank acting ate, capacity as such shall be deemed to be a public officer.

The provisions of Article 6 of the Qanun-e-Shahadat Order, 1984 (P.O. No.. 10 of 1984), shall apply to the unpublished records of the Bank and the Managing Director shall be deemed to be the officer or head of the department concerned.

Persons in the service of the Bank to be public servants: Sec 22

Every person in the service of the Bank shall be deemed to be a public servant within the meaning of section 21 of the Pakistan Penal Code (Act XLV of 1860).

Production of unpublished records of the Bank, etc: Sec 23

No Court, Tribunal or other authority shall be entitled to compel the Bank or any person in the service of the Bank to produce or , as the case may be, give any evidence derived from, any unpublished records of the Bank

No Court, Tribunal or other authority shall permit any one to produce or give evidence derived from, any unpublished records of the Bank, except with the prior permission in writing of the Managing Director who may give or withhold such permission as he thinks fit.

Notwithstanding anything contained in this Ordinance or any other law for the time being in force, a report prepared by the Bank on a banking company under any law for the time being shall be deemed to be unpublished for the purposes of sub-sections (1) and (2) even if la copy of such report has been supplied to the banking company to which the report pertains, the State Bank or the Federal Government.

Pension of Bank employees to be exempt from attachments, etc Sec 24

Notwithstanding anything contained in any law for the time being in force, pensions granted by the Bank to its executives and other employees shall not be liable to seizure, attachment or sequestration by process of any court at the instance of a creditor, for any demand against the pensioner or in satisfaction of a decree or order of any such Court

Exemption from taxes: Sec 25

Notwithstanding anything contained in the Wealth Tax Act, 1963 (XV of 1963), and the Income Tax Ordinance, 1979 (XXXI of 1979) or any other law for the time being in force relating to wealth tax, income tax or super tax, the Bank shall not be liable to pay any wealth tax, income tax or super tax on its income or wealth.

Power to make rules: Sec 26

The State Bank may, by notification in the official Gazette, make rules, consistent with the provision of this Ordinance, for carrying out the purposes of this Ordinance

Power to make regulations: Sec 27

The Bank may, subject to the prior approval of the State Bank, make regulations, not inconsistent with the provisions of this Ordinance and the rules made there under, to provide for all matters for which provision is necessary or convenient for the purpose of giving effect to the provisions of this Ordinance.

Where any provision of the regulations is inconsistent with any provision of the-rules, the provision of the rules shall prevail.

Where the State Bank considers it expedient so to do, it may by order in writing, direct the Bank to make any regulations or to amend or rescind any regulations already made, within such period as it may specify in this behalf.

If the Bank fails or neglects to comply with any direction of the State Bank under sub-section (3) within the specified period, the State Bank may make, amend or rescind any regulation directed by the State Bank to be made, amended or rescinded, and a regulation so made, amended **or** rescinded by the State Bank shall be

deemed to have been made, amended or rescinded by the Bank in accordance with the provisions of this section and shall have effect accordingly.

Protection of action taken in good faith: Sec 28

No suit or other legal proceedings shall lie against the State Bank or any director or officer of the State Bank for anything which is in good faith done or intended to be done in pursuance of this Ordinance or of any rules, regulations or orders made there under

Ordinance to override, etc: Sec 29

Except the application of any provision of the Act to the Bank as a subsidiary of the State Bank, this Ordinance shall have effect notwithstanding any thing contained in any law for the time being in force or in any agreement, contract, or other applicable document or instrument.

The Banking Companies Ordinance, 1962 (L VII of 1962), shall not apply to the Bank.

Removal of difficulties: Sec 30

If any difficulty arises in giving effect to & provisions of this Ordinance, the State Bank may make such order not inconsistent with the provisions of this Ordinance, as may appear to it to be necessary for the purposes, of removing the difficulty:

Provided that no such power shall be exercised after the expiry of two years from the commencement of this Ordinance

It is worth mentioning that with the establishment of SBP Banking Services Corporation, the Central Bank is discharging its time functions in a more efficient and effective manner.

LESSON 18**PAKISTAN BANKING AND FINANCE SERVICES COMMISSION ACT, 1992****THE CO-OPERATIVE SOCIETIES AND CO-OPERATIVE BANKS (REPAYMENT OF LOANS) ORDINANCE, 1966****Establishment of Federal Bank for Co-Operative and regulation of Co-Operative Banking Act, 1977****Federal Bank for Co-Operative and Regulation of Co-Operative Banking (Account) Rules****PAKISTAN BANKING AND FINANCE SERVICES COMMISSION ACT, 1992****Object:**

The object and purpose of establishment of the commission was to promote merit and transparency in recruitment of bank officers through competitive examination and interview as well as conducting test for promotion, advice Federal Government on matters relating to requisite qualifications, methods of recruitment in officer grade-2 (OG-2) and higher grades in financial institutions. The commission was required to submit annual report to the President of Pakistan.

In this Act we shall cover the following aspects/ statutory provisions:

- Definitions
- Establishment of the Commission
- Salary, allowances and privileges
- Term of office
- Resignation and filling of vacancies
- Functions of the Commission
- Recruitment to posts in Financial Institutions
- Funds of the Commission:
- Appointment of officers, employees, etc
- Report of the Commission
- Power to amend Schedule
- Act to override other laws
- Power to make rules

Definitions: the definitions as contained in the Act are given hereunder:

"Commission" means the Pakistan Banking and Finance Services Commission established under section 3;

"Financial institution" means an institution referred to in the Schedule;

"Member" means a member of the Commission;

"Recruitment" means initial appointment otherwise than by promotion or transfer;

"Rules" means rules made under section 14; and

(f) "schedule" means the schedule to this Act.

Establishment of the Commission: Sec 3

There shall be established for the purposes of this Act a commission to be called the Pakistan Banking and Finance Services Commission and consisting of a Chairman and not more than four members appointed by the Federal Government.

Salary, allowances and privileges: Sec 4

The Chairman and the Members shall be entitled to such salary, allowances and privileges as the Federal Government may determine from time to time

Term of office: Sec 5

The Chairman and Members shall hold office for such term as may be determined by the Federal Government

Resignation and filling of vacancies: Sec 6

The Chairman or a Member may, by statement under his hand addressed to the Federal Government, resign his office.

Any vacancy occurring in the membership of the Commission due to death, resignation or removal shall be filled by the appointment of another person by the Federal Government.

Functions of the Commission: Sec 7

The functions of the Commission shall be— to conduct open competitive examinations for recruitment to Grade III or higher posts in the financial institutions; to conduct interviews and tests for recruitment to posts in grades higher than Grade III, except where such recruitment is excluded from the purview of the Commission by the Federal Government; to **conduct tests for promotion** of existing employees from lower cadres to Grade III and above, if so required by a financial institution; and to advise the Federal Government on matters relating to qualifications for, and methods of recruitment to, posts in Grade II or higher grades in the financial institutions, if so required by the Federal Government

Recruitment to posts in Financial Institutions: Sec 8:

Recruitment to all posts in Grade iii or higher grades in a financial institution shall be made on the advice of the Commission:

Provided that the Commission may, on the direction of the Federal Government advise any financial institution for recruitment in any post or grade

The Commission may exempt any professional or class of professionals, like engineers, lawyers and chartered accountants, from appearing in any written test or examination conducted by the Commission.

A financial institution shall not disregard, or act contrary to, the advice of the Commission without the prior approval of the Federal Government, and where the Federal Government grants such approval it shall record its reasons for doing so.

Funds of the Commission: Sec 9

There shall be constituted for the Commission a fund to which shall be credited all sums received under sub-section (2) and out of which shall be defrayed all expenditure incurred by the Commission, including expenditure on the emoluments of the Chairman and members and the officers, employees, experts. And consultants of the Commission

Every financial institution shall make to the Commission such payments to defray its expenses as the Commission may, with the approval of the Federal Government, demand

Appointment of officers, employees, etc: Sec 10

For the efficient performance of its functions, the Commission may appoint its officers, employees, experts and consultants on such terms and conditions as may be prescribed.

Report of the Commission: Sec 11

The Commission will submit to the President annually a report on the work done by the Commission.

Power to amend Schedule: Sec 12

The Federal Government may, keeping in view the purposes of this Act, by notification in the official Gazette, amend the Schedule so as to add any entry thereto or omit or modify any entry therein.

Act to override other laws: Sec 13

The provisions of this Act shall have effect notwithstanding anything contained in any other law, or in any instrument, deed or other documents relating to a financial institution.

Power to make rules: Sec 14

The Commission may, with the approval of the Federal Government, by notification in the official Gazette, make rules, for carrying out the purposes of this Act.

Since the scenario in the banking sector has undergone, transformation and shifted from governmental control and nationalization to a privatized sector. Hence designing and implementing the recruitment policies of the respected banks is now the sole prerogative of the

Board of Directors of the respective Banks. Hence the importance of this Ordinance is overshadowed by the new realities.

The co-operative societies and co-operative banks (repayment of loans) ordinance, 1966

This Ordinance extends to the whole of the province of the Punjab, except the Tribal Areas. It shall come into force at once.

The concept of co-operative and formation of Co-operative societies and Co-operative bank appears to be a priority area for the governments to support and provide institutional framework to those persons and segments of the society which do not hold sufficient assets and collaterals to offer to the banks and financial institutions for securing loans/ advances.

In this Act we shall cover the following aspects/ statutory provisions:

- Definitions
- Repayment of loans
- Supply of information to the Registrar
- Service of notice to the borrowers
- Determination of liability when loan is not admitted
- Securing and repayment of loans
- Recovery of loans
- Restrictions on registration of documents:
- Restrictions on alienations
- Power of Registrar when making inquiry
- Penalty
- Procedure
- Power to make rules
- Bar of Jurisdiction

Definitions: the definitions as contained in the Act are given hereunder:

“Act” means the Co-operative Societies Act, 1925 (Sind VII of 1925);

“Assistant Registrar” means an Assistant Registrar of Co-operative Societies appointed or deemed to have been appointed under the Act to assist the Registrar;

“Benami loan” means a loan the real beneficiary or recipient whereof a person other than the person is in whose name the loan is advanced or granted;

“Borrower” includes in case of a benami loan, the real beneficiary or recipient of the loan;

“co-operative bank” means a co-operative society established for carrying on banking business and having as its principal object the financing of other co-operative societies registered or deemed to be registered under the Act;

“co-operative society” means a society which having as its object the promotion of economic interest of its members in accordance with co-operative principles, is registered or deemed to be registered under the Act;

“Government” means the Provincial Government of the Punjab

- i. **“loan”** means a loan (including [a benami loan or] any transaction which in the opinion of the Registrar is in substance a loan), whether of money or in kind, which is not secured or is insufficiently secured, and taken from a co-operative society by any person, whether a member of such society or not, or from a co-operative bank by any person but not an Agricultural Co-operative Society, Dairy Farming Co-operative Society or Poultry Farming Cooperative Society having in each case a working capital not exceeding five hundred thousand rupees], and includes,—
- ii. Finance as defined in the Banking Tribunals Ordinance, 1984.
- iii. Any amount which is due from any such person to a co-operative society or a co-operative bank, whether taken as a loan or not;

- iv. any amount due from any such person to a co-operative society or a co-operative bank under a decree passed by a Civil Court or an award given by an arbitrator or a decision of the Registrar, whether in exercise of his original or appellate jurisdiction; and
- v. any loan due from any such person to a co-operative society or a co-operative bank which is the subject matter of any pending suit, arbitration proceedings, appeal or revision, whether under the Act or before any Court.

Explanation— A loan is “insufficiently secured” if it is not secured by mortgage, pledge, hypothecation or assignment of such property of the borrower or of his surety or of both, as in the case of a loan not exceeding **five** hundred thousand] rupees, the Assistant Registrar, and in the case a loan exceeding **five** hundred thousand] rupees, the Registrar may think adequate;

“Registrar” means a Registrar of Co-operative Societies appointed or deemed to have been appointed under the Act, and includes a person upon whom all the powers of a Registrar have been conferred under the Act.

Repayment of loans: Sec 3:

Notwithstanding anything contained in any other law for the time being in force or in any agreement or other instrument, award or decree of any Court, every loan outstanding, whether barred by limitation or not, in whole or in part and every loan, any installment whereof is outstanding shall, unless repaid earlier, be repaid and secured in the manner provided in section 7].

Supply of information to the Registrar: Sec 4

Every co-operative society and co-operative bank, through its Manager or Secretary, shall—when a loan obtained from it is not repaid by the date on which it is due for repayment, bring such fact, together with full details of the case and the particulars of the borrower (including in the case of a *benami* loan, the real beneficiary or recipient of the loan) and surety to the notice of Assistant Registrar, when the amount of the loan does not exceed five hundred thousand] rupees; and to the notice of the registrar, when the amount of the loan exceeds five hundred thousands rupees; and

when so directed by the Registrar or the Assistant Registrar, as the case may be, within thirty days of receipt of such direction, furnish to the Registrar, or the Assistant Registrar, as the case may be, furnish full information in respect of all cases of loans falling under section 3 required to be repaid or secured under section 7.

Service of notice to the borrowers: Sec 5

On receipt of information under section 4 [or on his own information] in respect of any loan, the Registrar or the Assistant Registrar, as the case may be, shall issue or cause to be issued a notice to the borrower and his surety requiring them to repay and secure the loan in accordance with the provisions of section 7.

A notice under sub-section (1) may be served

- (a). By giving or tendering it to the person named in the notice; or
- (b). By enclosing it in a cover and sending such cover by registered post, acknowledgment due, to the last known address of the person named in the notice; or
- (c). By affixing such notice on a conspicuous part of the last known residence of the person named in the notice; or
- (d). By publication of the notice in a newspaper.

Determination of liability when loan is not admitted: Sec 6:

Where any borrower or his surety, to whom notice under section 5 is issued, does not admit the loan or any liability arising there from, such borrower or surety, as the case may be, shall, within thirty days of the receipt of the notice, submit, either personally or by registered post (acknowledgment due), a written statement to that effect to the Registrar or the Assistant Registrar, by whom such notice was issued or caused to be issued, and such Registrar or Assistant Registrar, as the case may be, thereupon shall cause

notice to be issued to the co-operative society, or the co-operative bank, as the case may be, and in the case of a *benami* loan, to the alleged beneficiary, and shall, after making such inquiry as he may consider necessary and giving the parties a reasonable opportunity of being heard, decide the matter.

Securing and repayment of loans: Sec 7

Within thirty days of the service of the notice under section 5, in a case where the borrower does not deny the loan or the liability arising there from, and in other cases, within thirty days of the decision of the Registrar or the Assistant Registrar, as the case may be, under section 6, the borrower and his surety shall— secure the loan or the liability arising there from by mortgage, pledge, hypothecation or assignment of such property of the borrower or his surety or of both as in the case of a loan not exceeding five hundred thousand rupees, the Assistant Registrar, and in the case of a loan exceeding five hundred thousand rupees, the Registrar, may think adequate; and

repay the loan after thirty days of the service of notice under section 5 when he does not deny the loan or the liability arising there from, and in any other case, after thirty days of the decision of the Registrar or the Assistant Registrar, as the case may be, in eight months in four equal installments, the first installment being due on the day immediately succeeding the one month period of notice or, as the case may be, the decision of the Registrar or the Assistant Registrar specified above.

Recovery of loans: Sec 8:

If the amount of any loan or any part thereof to be repaid in accordance with the provisions of section 7 is not paid within the period or the periods specified in the said section, the same may, without prejudice to the provisions of section 10, be recovered according to the law and under the rules for the time being in force for the recovery of arrears of land revenue.]

Where the borrower is a firm, partnership, company or other association of persons (not being a company registered under the Companies Act, 1913, the liability of the members whereof is limited), the loan or any part thereof due from such borrower may be recovered from the assets of such firm, partnership, company or other association of persons, as the case may be, or from the members or partners thereof.

Restrictions on registration of documents: Sec 8-A

Notwithstanding anything contained in any other law for the time being in force no registering officer shall register any document relating to property, which is required to be registered under the provisions of clause (a), (b), (c) or (e) of section 17 of the Registration Act, 1908, or which is produced before him for voluntary registration, nor shall any Revenue Officer on the basis of any such document effect any mutation in the record of rights under the provisions of any law for the time being in force, unless—

(1) (a) the person whose right, title or interest in the property is or will be transferred, assigned, limited or extinguished under the terms of the document or on the basis of the mutation in the record of rights, as the case may be, furnishes an affidavit to the registering officer or the revenue officer, as the case may be, to the effect that he does not owe any loan, whether due immediately or on a future date, to a co-operative society or a cooperative bank; or

(b) where such person owes a loan to a co-operative society or a co-operative bank, whether due immediately or on a future date, it is certified by the Registrar where the loan owed by such person exceeds rupees five hundred thousand, and by the Assistant Registrar where the loan owed by such person does not exceed rupees five hundred thousand, that either satisfactory arrangements have been made for the repayment of the loan or that the loan has been secured in accordance with the provisions of section 7.

Where an application is made to the Registrar or an Assistant Registrar, as the case may be, for issuing a certificate under the provisions of sub-section (1), he shall not refuse to issue the certificate unless he has first given the applicant an opportunity of being heard and adducing evidence to show that either satisfactory arrangements have been made for the repayment of the loan owed by the applicant or that the loan has been secured in accordance with the provisions of section 7.

An order made by the Registrar or an Assistant Registrar under sub-section (2) refusing to issue a certificate, shall be final and not open to question in any manner.

Restrictions on alienations: Sec 8-B

Where any person owing a loan, whether due immediately or on a future date, to a co-operative society or a co-operative bank has, on or after the twenty-seventh day of April, 1966, alienated any immovable property, by sale, exchange, gift, mortgage or will, otherwise than by or under an order or decree of a Civil, Revenue or Criminal Court, which **alienation** is fraudulent with intent to defeat the claim of a co-operative society or a co-operative bank, such alienation shall not operate to transfer any right, title or interest in the property of the debtor, unless—

- a. The loan due from the debtor has been repaid; or
- b. It is certified by the Registrar, where the loan exceeds rupees [five hundred thousand], and by the Assistant Registrar, where the loan does not exceed rupees [five hundred thousand], that either satisfactory arrangements have been made for the repayment of the loan or that the loan has been secured in accordance with the provisions of section 7.

An alienation of immovable property shall be deemed to be fraudulent with intent to defeat the claim of a co-operative society or a co-operative bank for the purposes of sub-section (1), if the Registrar, after giving the person by whom the alienation has been made, and the person or persons in whose favor the alienation has been made an opportunity of being heard, issues a declaration to the effect that the alienation is fraudulent with intent to defeat the claim of a co-operative society or a co-operative bank.

Any party aggrieved by a decision made by the Registrar under sub-section (2) may prefer an appeal to Government against such decision, and the order made by Government, on such appeal passed after giving an opportunity of being heard to the appellant shall be final and shall not be open to question in any manner.

Power of Registrar when making inquiry: Sec 9

The Registrar or the Assistant Registrar, as the case may be, shall, for the purpose of making any inquiry under this Ordinance, have the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908 (Act V of 1908), when trying a suit, in respect of the following matters, namely:-

- (a) Summoning and enforcing the attendance of any person and examining him on oath;
 - (b) Requiring the discovery or production of any document;
 - (c) Requisitioning any public record from any Court or office;
 - (d) Issuing commissions for the examination of witnesses;
 - (e) Appointing guardians or next friends of persons who are minors or of unsound mind;
 - (g) Adding legal representatives of deceased borrowers or sureties;
 - (h) Substituting the names of rightful parties, including the beneficiaries of *benami* loans;
- Consolidation of cases;
- (i) Any other matter which may be prescribed by rules made under section 12; and
 - (j) Enforcing any order made by him under the provisions of this Ordinance or the rules framed there under.

Penalty: Sec 10

Whoever contravenes any of the provisions of this Ordinance or the rules made there under shall be punishable with imprisonment for a term which may extend to seven years, or with fine, which, in the case of default in the repayment of a loan, shall not be less than one-fourth of the amount of the loan outstanding against him, or with both.

Procedure: Sec 11

(1) No Court shall take cognizance of any offence under this Ordinance except on a complaint in writing made by the Registrar or an Assistant Registrar, or by a person duly authorized by the Registrar or Assistant Registrar.

(2) Notwithstanding anything to the contrary contained in the Code of Criminal Procedure, 1898, the provisions of Chapter XX of the said Code shall apply to the trial of cases under this Ordinance.]

Power to make rules: Sec 12

Government may, by notification in the official Gazette, make rules, to carry out the purposes of this Ordinance.

Bar of Jurisdiction: Sec 13

No Court or other authority shall have jurisdiction—

(a). To entertain or adjudicate upon any matter which [Government, the Registrar] or the Assistant Registrar is empowered by or under this Ordinance or the rules framed there under to dispose of or determine; or

(b). To question the legality or validity of anything done under this Ordinance or the rules framed there under by [Government, the Registrar] or Assistant Registrar.

No Court or other authority shall be competent to grant an injunction or other order in relation to any proceedings before the Registrar or the Assistant Registrar, or anything done or to be done by or at the instance of the Registrar or the Assistant Registrar under this Ordinance or the rules framed there under.

From the above, we understand that provision of law is a very important aspect of the cooperative banking but at the same time recovery of the loan disbursed is equally important. The above statutory provisions provide a legal framework for recovery granted by cooperative banks.

Establishment of Federal Bank for Co-Operative and regulation of Co-Operative Banking Act, 1977

This Act may be called the establishment of the Federal Bank for Co-Operative and regulation of Co-operative Banking Act, 1977. It extends to the whole of Pakistan and also applies to the business of the Bank transacted outside Pakistan and to persons conducting such business. It shall come into force at once and shall be deemed to have taken effect on the 9th day of October, 1976.

In this Act we shall cover the following aspects/ statutory provisions:

Definition:

“Approved securities” means securities in which a trustee may invest money under clause (a), clause (b), clause (bb), clause (c) or clause (d) of section 20 of the Trusts Act, 1882, and such other securities as the Federal Government may, by notification in the official Gazette, declare to be approved securities for purposes of this Act;

“Bank” means the **Federal Bank for Co-operatives** established under section 5;

“Board” means the **Board of Directors** constituted under section 9;

“Chairman” means the Chairman of the Board;

“Co-operative bank” means a banking society as defined in the Explanation to the sub-section (2) of section 7 of the Co-operative Societies Act, 1925, other than a provincial Co-operative Bank;

“Co-operative society” means a society registered in Pakistan under any law for the time being in force relating to registration of co-operative societies and a “primary co-operative society” means such a society of which no other society is a member;

“Borrower” means a person who has obtained a loan from the Bank of a Provincial Co-operative Bank and includes a surety or an indemnifier, but does not include the Federal Government or a Provincial Government.

“Demand Liabilities” means liabilities which are to be met on demand and “time liabilities” means liabilities which are not demand liabilities;

“Director” means a Director for the time being of the Board;

“District Judge” in respect of areas where a District Judge does not have unlimited pecuniary jurisdiction in original civil suits, a high Court exercising original civil jurisdiction;

“Family members” in relation to a person means his spouse, dependent lineal ascendants and descendants and dependent brothers and sisters;

“Loans, advances and credit” includes finance as defined in the Banking Tribunals Ordinance, 1984, and all cognate expressions shall be construed accordingly;

“Managing Director” means Managing Director of the Bank and includes any person for the time being discharging the functions of the Managing Director”

“Multi-unit co-operative society” means a co-operative society to which the multi-Unit Co-operative Societies Act, 1942 applies

“Prescribed” means prescribed by rules;

“Provincial Co-operative Bank” means a co-operative society the primary object of which is to make loans to the co-operative societies which are its members and which is notified, for the purposes of this Act,

to the Bank by the Provincial Government of the Province within which the co-operative society is registered or, until a co-operative society is so notified, any one of the following namely:

The Baluchistan Provincial Co-operative Bank Ltd

The Frontier Provincial Co-operative Bank Ltd

The Punjab Provincial Co-operative Bank Ltd

The Sindh Provincial Co-operative Bank Ltd

“Regulation” means a regulation made under this Act;

“Scheduled Bank” has the same meaning as in State Bank of Pakistan Act, 1956

“State Bank” means the State Bank of the Pakistan established under the State Bank of Pakistan Act, 1956

Establishment of the Bank: Sec 5

As soon as may be after the coming into force of this Act, the Federal Government shall take steps to establish, in accordance with the provisions of this Act, a Bank to be called “ The Federal Bank for co-operatives” to carry out the purposes of this Act,

The Bank shall be a body corporate having perpetual succession and a common seal, with powers to acquire, own, hold and dispose of any property, and shall by the name assigned to it by sub-section (1) sue and be sued. The Bank shall be deemed to be a banking company for the purposes of the State Bank of Pakistan Act, 1956, the banking Companies Ordinance, 1962 and any other law for the time being in force relating to banking companies, excepting the Banks (Nationalization) Act, 1974

Share Capital: Sec 6

The initial share capital of the Bank shall be twenty crors of rupees divided into tow thousand fully paid up shares of the nominal value of one hundred thousand rupees each shall be fully subscribed by the Federal Government, the provincial Governments and the State Bank of Pakistan in the following manner:---

(a) Federal Government	Rs 2.00 crores
(b) State Bank	Rs 15.00 crores
(c) Government of the Punjab	Rs 1.00 crores
(d) Government of Sindh	Rs 1.00 crores.
(e) Government of N.W.F.P	Rs 0.50 crores
(f) Government of Baluchistan	Rs 0.50 crores

The share capital may be increased from time to time by a resolution of the Board with the approval of the Federal Government and the capital so increased shall be fully subscribed by the Federal Government, the provincial Governments and the State Bank of Pakistan.

Direction and superintendence: Sec 8

The general direction and superintendence of the affairs and business of the bank shall vest in a **Board of Directors** constituted in accordance with section 9, which may exercise all such powers and do all such acts and things as may be exercised or done by the Bank, subject to the provisions of this Act.

Board: Sec 9

The Board shall consist of:

The Chairman;

All the directors for the time being of the Central board of Directors of the State Bank;

The Managing Director;

Two directors to be nominated by the Federal Government, of whom one shall be officer of ministry of GOP and other a non-official; and

The Board shall consist of:

e. Two directors from each Province to be nominated by the Federal Government on the recommendation of each Provincial Government, of whom on shall be a non-official.

The Governor for the time being of the State Bank shall be the Chairman of the Board.

Unless the Federal Government otherwise directs in any case, a non-official Director referred to in clause (d) or clause (e) of sub-section 1 shall hold office for a period of three **years** and shall, subject toe the provision of this Act be eligible for re-appointment.

Managing Director (Sec 10) – shall be appointed by the federal government. Shall be whole time chief executive.

Disqualifications of Managing Director and Directors (Sec 11)– legislators, insolvent, minor, of unsound mind, govt. servant, not citizen.

Indemnity of Directors (Sec 14)– if acted in good faith.

Business and Functions: Sec 17

The Bank shall be the principal financing institution for meeting the credit needs of provincial Co-operative Banks and multi-unit co-operative societies.

The bank may carry on, transact or do the several kinds of business and acts hereinafter specified namely:--

Accept money on deposit;

Borrow funds from the Federal Government, financial institutions

Raise funds for the purpose of the Bank's operation through issue and sale of bonds -- debentures;

Obtain or raise funds on the basis of participation in profit and loss, **mark-up** and mark---down in price, **hire-purchase, rent sharing, licensing etc**

Make secured loans and advances to provincial Co-operative Bank, multi-unit co-operative societies and, subject to the regulations framed for the purpose, to the officers and staff of the Bank;

Draw, accept, discount, buy or sell or rediscount bills of exchange or promissory notes bearing two or more good signatures, one of which shall be that of scheduled bank of a provincial Co-operative Bank;

Issue guarantees and give indemnities in relation to its business;

Subscribe to the debentures (Participation term certificates, term finance certificates etc) repayable within a period not exceeding 10 years

Deliver, receive, collect and remit any securities

Purchase or otherwise acquire **in the normal course** of its banking business any

Moveable or immovable property, residential or commercial etc

Open accounts or enter into any agency arrangement with any bank or financial institution in or outside Pakistan.

Invest its funds in Government Securities and other approved securities and if so directed by the Board and with the approval of the Federal Government, in the share capital of:

A Provincial Co-operative Bank (so that the amount so invested is not less than) twenty-five percent of the fresh capital contributed by the Provincial Government

A multi-unit co-operative society up to an amount not exceeding 25% of its paid-up capital

Sell and realize property, movable or immovable, patents, designs, trade marks, which may in any way come into the ownership, possession or control of the Bank in the satisfaction or part satisfaction of any of its claims.

Assist Provincial Co-operative Banks in preparing their seasonal and developmental loaning programs and conduct appraisal and undertake feasibility study of projects covered by such loaning programs

Encourage the development of special co-operative projects.

Establish independent subsidiaries.

Organize training in co-operative banking for the employees of the Provincial Co-operative banks and other co-operative societies

Ensure proper utilization of loans obtained from the bank

Carry out research on problems of rural credit

Lend money in the inter-bank call money market

Issue letters of credit

Appoint attorney and agents;

Maintain and operate the provident fund and other funds created for the benefit of its employees

Perform such functions and exercise such powers as may be entrusted to or conferred upon it by or under any law; and

Generally do all such matters and things as may be necessary, incidental to or consequential upon exercise of its powers or the discharge of its duties or functions under this Act or any other law.

Power to borrow or obtain finance (Sec 19)—the bank made for the purpose of its business borrow or obtain funds.

Power to call for payment before agreed period (Sec 21)—the bank may by notice may require any borrower to which it has granted any loan to repay the same in full forth with.

Power to inspect (Sec 25)—the bank may at any time under directions of the State Bank of Pakistan shall inspect any provincial cooperative bank or multi-unit cooperative society including its branches and offices and its books, accounts and documents.

Power to prohibit acceptance of deposits (Sec 26)—the State Bank on recommendations of the bank may prohibit or restrict the acceptance of deposits by provincial cooperative bank or multi-unit cooperative society. However no such order shall be passed without prior approval in writing on the federal government.

Maintenance of liquid assets (Sec 29)—every provincial cooperative bank shall be required to maintain the prescribed liquid assets

Power to remove Directors, other managerial persons from office and to supersede Board of Directors, of Provincial Co-operative Bank (Sec 30)—the bank shall have same powers as are conferred on the State Bank, in this regard.

Power of the Bank to call for statements and return, etc., and to publish information (Sec 31)

Duty of the officers and servants to maintain secrecy (Sec 32)

Liquidation of the Bank (Sec 41)—No provisions of law relating to the winding up of the companies or banks shall apply to the bank and the bank shall not be wound up but by the order of federal government on the recommendation of State Bank.

Federal Bank for Co-Operative and Regulation of Co-Operative Banking (Account) Rules

These rules may be called the Federal Bank for Co-Operatives and Regulation of Co-operative Banking (Account) Rules, 1977

Preparation of statements of accounts:

Immediately after the close of each financial year, the bank shall prepare a balance sheet and the statement of profit and loss, as nearly as may be, in the form set out in the Second Schedule to the Banking Companies Ordinance, 1962, for examination of the auditors and provided under section 37 of the Establishment of the Federal Bank for Co-operative and Regulation of Co-operative Banking Act, 1977

The audited balance sheet and the statement of profit and loss shall be submitted to the Board for approval not later than the fifteenth of September each year.

The balance sheet and the statement of profit and loss as approved by the Board, shall be signed by the at least two Directors nominated by the Board for this purpose and the Managing Directors.

Within three months of the close of each financial year, the Board shall submit a copy of each of the approved balance sheet, the statement of profit and loss account and the report of the auditors to the Ministry of Finance, Government of Pakistan, for publication in the official Gazette.

LESSON 19**MICROFINANCE INSTITUTIONS ORDINANCE, 2001****The Corporate and Industrial Restructuring Corporation Ordinance, 2000****Microfinance Institutions Ordinance, 2001**

It extends to the whole of Pakistan. This Ordinance contains provisions with regard to microfinance institution. Some of the important aspects are discussed hereunder.

Definitions: the definitions as contained in the Ordinance are given hereunder:

“Auditor” means any person who is appointed in accordance with the provisions of this Ordinance for the audit of the accounts of a microfinance institution;

“Banking Company's ordinance” means the Banking Companies Ordinance, 1962.

“Company” means a company incorporated under the Companies Ordinance, 1984. Or any other law for the time being in force;

“Customer” means any person or group of persons availing the services of a microfinance institution;

“Deposit” means the deposit of money, repayable on demand or otherwise, accepted by a microfinance institution from the public for the purpose of providing microfinance services;

“Depositor” means a person in whose name a deposit is held by a microfinance institution;

“License” means the license issued by the State Bank and the expression “licensed” should be construed accordingly;

“Member” means the member or shareholder who has contributed or subscribed to the capital of a microfinance institution;

“Microfinance institution” means a company that accepts deposits from the public for the purpose of providing microfinance services;

“Microfinance services” means the financial and other related services specified in section 6, the value of which does not exceed such amount as the State Bank may, from time to time, determine;

“Poor persons” means persons who have meager means of subsistence and whose total income or receipt during a year is less than the minimum taxable limit set out in the law relating to income-tax;

“Prescribed” means prescribed by rules made under this Ordinance;

“Specified area” means the district, province or other specified area within which a microfinance institution is licensed to operate; and

“State bank” means the State Bank of Pakistan established under the State Bank Act,

The provisions of this Ordinance shall be in addition to, and, save as hereinafter provided, not in derogation of, any other law for the time being in force.

Restrictions on establishment and operations: Sec 4

No person, other than a company, shall be established as a microfinance institution.

No microfinance institution shall commence, or carry on, the business of taking deposits unless and until such institution has been licensed in accordance with the provisions of this Ordinance.

Name: Sec 5

No person other than a licensed microfinance institution shall use with its name the words “Microfinance Bank”, “MFB”, “Microfinance Institution” or “MFI” or derivatives or any words or letters which suggest that it is a microfinance institution.

Whoever, without being licensed, uses the name “Microfinance Bank”, “MFB”, “Microfinance Institution” or “MFI” or derivatives or any word or letters which suggest that it is a microfinance institution shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to one hundred thousand rupees.

Functions and powers: Sec 6

A microfinance institution shall, in accordance with prudential regulations and subject to the terms and conditions of the license issued by the State bank, render assistance to micro-enterprises and provide

microfinance services in a sustainable manner to poor persons, preferably poor women, with a view to alleviating poverty

Without prejudice to the generality of the foregoing provisions, the powers and functions of microfinance institutions shall be:-

- a. To provide financing facilities, with or without collateral security, in cash or in kind, for such terms and subject to such conditions as may be prescribed, to poor persons for all types of economic activities including housing, but excluding business in foreign exchange transactions;
- b. To accept deposits;
- c. To accept pledges, mortgages, hypothecations or assignments to it of any kind of movable or immovable property for the purpose of securing loans and advances made by it;
- d. To undertake the management, control and supervision of any organization, enterprise, scheme, trust fund or endowment fund for the benefit and advancement of poor persons;
- e. To buy, sell and supply on credit to poor persons industrial and agricultural inputs, livestock, machinery and industrial raw materials, and to act as agent for any Organization for the sale of such goods or livestock;
- f. To invest in shares of any body corporate, the objective of which is to provide microfinance services to poor persons;
- g. To provide storage and safe custody facilities;
- h. To carry out survey and research, and to issue publication and maintain statistics relating to the improvement of economic condition of poor persons;
- i. To provide professional advice to poor persons regarding investments in small business and such cottage industries as may be prescribed;
- j. To encourage investments in such cottage industries and income generating projects for poor persons as may be prescribed
- k. To provide services and facilities to customers to hedge various risks relating to microfinance activities;
- l. To render managerial, marketing, technical and administrative advice to customers and assisting them in obtaining services in such fields;
- m. To borrow and raise money and open bank accounts;
- n. To purchase, take on lease, or otherwise acquire, sell, exchange, surrender, lease, mortgage, dispose of and deal in any movable and immovable property and rights of all kinds for and on behalf of its customers for the purpose of promoting development opportunities, building of assets, resource allocation, promotion of markets, and adoption of better technology for economic growth and development;
- o. To establish subsidiaries, whether wholly or partly owned, and to appoint agents in various locations for various activities which it may consider necessary for the proper discharge of its functions;
- p. To pay, receive, collect and remit money and securities within the country;
- q. To acquire, maintain and transfer all movable and immovable property including residential premises, for carrying on its business;
- r. To open account or make any agency arrangement **with, and to act as agent or correspondent of, any bank or financial institution;**
- s. To invest its surplus funds in Government securities;
- t. To impose and receive fees, charges, profits or return for its services;
- u. To mobilize and provide financial and technical assistance and training to micro enterprises;
- v. To undertake mobile banking to expedite transactions and reduce costs;
- w. To establish trust and endowment funds;
- x. To receive grants from the government and any other sources permitted by the State Bank; and
- y. To generally do and perform all such acts, deeds and things as may be necessary, incidental or conducive to the fulfillment of their functions and the attainment of their objectives;

Prohibition and restrictions: Sec 7

A microfinance institution shall not undertake or transact any kind of business other than that authorized by, or under, this Ordinance.

In performance of its functions under this Ordinance, a microfinance institution shall have proper regard to the economic and commercial merits of any or the transactions or activities it plans to undertake or assist. Where a microfinance institution is required by any authority to undertake or assist a micro enterprise or other such activities which it considers economically or otherwise unsound, the microfinance institution shall not undertake or assist such activity until and unless the said authority has provided adequate guarantee to the microfinance institution or indemnify any losses that it may incur in the undertaking of such activity.

No microfinance institution shall create a floating charge on the undertaking or any of its assets or part thereof, unless the creation of such floating charge is certified in writing by the State Bank as not being detrimental to the interest of the depositors of such institution.

Any such charge created without obtaining the certificate of the State Bank shall be invalid.

Any microfinance institution aggrieved by the refusal of a certificate under sub-section (4) may, within thirty days from the date on which such refusal is communicated to it, prefer an appeal to the Central Board of the State Bank whose decision thereon shall be final.

Area of operation: Sec 9

A microfinance institution shall be licensed to operate in an area which may consist of,-

A district;

A province; or

The whole of Pakistan

Capitalization: Sec 10

No microfinance institution shall operate unless it has a paid up capital of not less than,-

(a) One hundred million rupees or such higher amounts, as may be prescribed from time to time, for microfinance institutions to whom a license to operate in a specified district is issued.

(b) two hundred and fifty million rupees or such higher amount as may be prescribed from time to time, for microfinance institutions to whom a license to operate in a specified province is issued; and

(c) five hundred million rupees or such higher amount as may be prescribed from time to time, microfinance institutions to whom a license to operate nationally is issued.

Not less than fifty-one per cent of the paid up capital of a microfinance institution shall be subscribed by the promoters or sponsor members and the shares subscribed to by the promoters or sponsor members shall remain in the custody of State Bank and shall neither be transferable nor encumbrance of any kind shall be created thereon without prior permission, in writing, of the State Bank.

Winding Up: Sec 11

The provisions of Banking Companies Ordinance for winding up of banking companies shall, *mutatis mutandis*, apply to microfinance institutions for the purpose of their winding up.

Existing microfinance institutions: Sec 12

Any person performing the functions of a microfinance institution on the commencement of this Ordinance shall on such form accompanying such information and fee as may be prescribed, make an application to the State Bank for issuance of a license to take deposits.

The State Bank may, on receipt of the application, make such enquiries as it considers necessary and either grant a license as specified in sub-sections (2) and (3) of section 13 or, for reason to be recorded in writing, reject the application for the license.

Any person performing the functions of a microfinance institution on the commencement of this Ordinance shall on such form accompanying such information and fee as may be prescribed, make an application to the State Bank for issuance of a license to take deposits.

The State Bank may, on receipt of the application, make such enquiries as it considers necessary and either grant a license as specified in sub-sections (2) and (3) of section 13 or, for reason to be recorded in writing, reject the application for the license.

Where an application for a license has been made in respect of a microfinance institution in existence on the commencement of this Ordinance, and such application is rejected, the operations of the microfinance

institution may be continued for a period of thirty days from the date on which its application is rejected, or if an appeal is referred under subsection (4), until such appeal is disposed of.

If the State Bank rejects an application for a license in respect of a microfinance in existence on the commencement of this Ordinance, the applicant may, within thirty days from the date of the order of the State Bank, prefer an appeal to the Central Board of the State Bank, and the order passed by the Central Board shall be final.

Licensing: Sec 13

Before taking deposits, a microfinance institution shall apply to the State Bank, on such form accompanying such information and fee as may be prescribed, for issuance of a license to take deposits.

The State Bank may issue license to operate in a specific district, province or other area, subject to such conditions as the State Bank may think fit to impose.

Before granting any license under this section, the State Bank shall satisfy itself by an inspection of the books of the microfinance institution or otherwise that all or any of the following conditions are fulfilled, namely:-

- (a) That the microfinance institution is, or will be, in a position to meet its liabilities to the present or future customers in full as and when such liabilities accrue; and
- (b) that the affairs of the microfinance institution are not being, or are not likely to be, conducted in a manner detrimental to the interests of its members and present or future customers.

The State Bank may suspend or cancel a license granted to a microfinance institution if such institution:

- (a) At any time fails to comply with any of the conditions imposed upon it under sub-section (2); or
- (b) Fails to fulfill, at any time, any of the conditions referred to in sub-section (3);
- (c) Has furnished false or misleading information in its application for a license; or

No license shall be suspended or cancelled under subsection (4) unless and until the microfinance institution is called upon by a notice in writing by the State Bank to show cause within fifteen days as to why its license should not be suspended or cancelled.

In the event of suspension or cancellation of a license the microfinance institution concerned shall be notified forthwith and, from the date of such notification, shall cease to transact any business other than that required to wind up its affairs with the approval of the State Bank. The State Bank shall publish notice of such suspension or cancellation in one leading Urdu language newspaper and one English language newspaper in addition to its publication in the official Gazette.

The provisions of sub-section (4) shall not prejudice the rights or claims of any person against the microfinance institution or of the microfinance institution against any person.

A microfinance institution aggrieved by the decision of the State Bank for suspension or cancellation of its license may, within thirty days from the date on which such decision is communicated to it, apply for review to the Central Board of the State Bank.

The decision of the State Bank, subject to the result of review by the Central Board of the State Bank under sub-section (8), shall be final.

Management and administration: Sec 14

The general superintendence and management of the affairs of a microfinance institution shall vest in its Board of Directors which shall manage its business and affairs in accordance with the principles of good governance.

There shall be a chief executive officer who shall work full time and be responsible for the day-to-day administration of microfinance institution.

The State Bank shall ensure that the persons serving on the Board of Directors and the chief executive officer of a microfinance institution are persons of integrity and have good financial reputation.

Accounts: Sec 15

A microfinance institution shall maintain proper books of accounts and, at the expiration of each calendar year, prepare annual statement of accounts including the profit and loss account and balance sheet as may be prescribed.

A microfinance institution shall, in respect of such accounts, comply with such general directions as the State Bank may, from time to time, issue.

Audit: Sec 16

The accounts of a microfinance institution for each accounting year ending 31st December shall be audited by one or more auditors who are chartered accountants within the meaning of the Chartered Accountants Ordinance, 1961 (X of 1961), and whose names are included in the panel of approved auditors maintained by the State Bank.

The auditor or auditors shall be appointed for such terms and on such remuneration, to be paid by the microfinance institution, as the Board of Directors of such institution may fix:

Provided that the auditors once appointed shall not be removed before three years without the prior approval of the State Bank and no auditor shall serve as external auditor of a microfinance institution consecutively for more than three years.

Every auditor, appointed under sub-section (2), shall be given a copy of the annual balance sheet and other accounts of the microfinance institution who shall examine it, together with the accounts and vouchers relating thereto, and shall have a list delivered to him of all books kept by the microfinance institution

The auditors shall report to the Board of Directors of the microfinance institution upon the annual accounts and balance sheet and in their report they shall state whether, in their opinion, the balance sheet contains all necessary particulars and is properly drawn up so as to exhibit a true and correct view of the state of affairs of the microfinance institution and, in case they have called for any explanation or information from the microfinance institution, whether it has been given and whether it is satisfactory.

The audited financial statements shall be published within three months of close of its financial year and microfinance institution shall cause its accounts to be published in a daily newspaper having wide circulation in the specified area.

A microfinance institution shall submit audited financial statements along with auditors' report to the State Bank within three months of the close of its financial year

Nothing in this Ordinance shall apply to the preparation of accounts by a microfinance institution and its audit in respect of any accounting year which has expired prior to the commencement of this Ordinance, and notwithstanding the other provision of this Ordinance such accounts shall be prepared, audited and submitted in accordance with the law in force immediately before such commencement.

Returns: Sec 17

A microfinance institution shall furnish to the State Bank such returns, reports and information as may be prescribed.

Without limitation to the foregoing, a microfinance institution shall,-

- (a) Maintain a register of its members, Board of Directors and the chief executive officer and provide information thereof to the State Bank at such time and in such manner as may be prescribed;
- (b) Maintain accounts and have the same audited at such time and in such manner as may be prescribed; submit its annual report and audited accounts to the State Bank and publish the same for general information at such time and in such manner as may be prescribed; and
- (d) Furnish to the State Bank such particulars with regard to accounts and other records as the State Bank may from time to time require.

The State Bank, or any officer duly authorized by it in this behalf, may at all reasonable times inspect the books of account and other records of a microfinance institution, the securities, cash and other properties held by such institution, and all documents relating thereto.

Depositors' protection fund: Sec 19

(1) A microfinance institution shall, as required by the State Bank, establish and maintain depositors' protection fund or scheme for the purpose of providing security or guarantee to persons depositing money in such institution.

Five per cent of the annual after tax profits of a microfinance institution and profits earned on the investments of the fund shall be credited to the depositors' protection Fund and such fund shall either be invested in Government securities or deposited with State Bank in a remunerative account.

The depositors' protection fund shall be used to make payment to the individual depositors with aggregate deposits of up to ten thousand rupees in case of liquidation of the microfinance institution.

The depositors' protection fund shall be operative with effect from the expiry of five years from the date of first Annual Balance Sheet of the microfinance institution and shall remain unencumbered at all times.

Power to call for information: Sec 20

Where it appears to the State Bank that a person is carrying on the business of a microfinance institution in contravention of section 4, the State Bank may:

- (a). Direct such person or any other person who is, or has at any time, been dealing, doing business or associating in any manner with such person, to give or furnish to the State Bank within a specified period such books, accounts, information, documents or records as may be within the custody, possession or control of such person;
- (b). Authorize any person to enter and search any premises and seize books, accounts or other documents or records relating to such business;
- (c). Inspect and examine any of the books, accounts, documents or records referred to in clause (a); and
- (d). Exercise as far as may be applicable the powers conferred on the State Bank under section 22.

Inspection and investigation: Sec 21

- (1) The State Bank may, at any time, inspect books of accounts and records of any microfinance institution to evaluate its financial viability and may, of its own or on receipt of complaint investigate the affairs of such institution.
- (2) The inspection or investigation shall be carried out by such officer of the State Bank or by such other person as the State Bank may authorize.
- (3) It shall be the duty of every officer and employee of a microfinance institution or any other person dealing with or connected with the operations of the microfinance institution to produce to any officer, making an inspection or investigation under this section
- (4) The inspecting officer may examine on oath any officer or employee of the microfinance institution in relation to its business and may administer an oath accordingly.
- (5) The State Bank shall supply to the microfinance institution a copy of its report on the inspection made under this section.
- (6) The State Bank shall systematically monitor and evaluate the performance of a microfinance institution to ensure that it is complying with the applicable criteria and prudential rules and regulations:

Powers to give directions: Sec 22

Where the State Bank is satisfied that,

- (a). In the public interest; or
- (b). To prevent the affairs of a microfinance institution being conducted in a manner detrimental to the interest of the depositors or in a manner prejudicial to the interest of a microfinance institution; or
- (c). In furtherance of monetary or financial sector policy;
- (d). To secure the proper management of a microfinance institution, it is necessary to issue directions to microfinance institutions generally or to any microfinance institution in particular, it may, from time to time, issue such directions as it may deem fit and the microfinance institutions or the microfinance institution, as the case may be, shall comply with such directions.

The State Bank may, on representation made to it or of its own motion, modify or cancel any direction issued under subsection (1), and in so modifying or canceling any direction may impose such condition, as it thinks fit, subject to which the modification or cancellation shall have effect.

Penalties: Sec 23

Whoever carries on the business of a microfinance institution without having been licensed to do so or who carries on such business after the license therefore has been suspended or cancelled shall be punished with imprisonment for a term which shall not be less than five years.

Any person who willfully withholds or fails to deliver any document or information or makes a statement in any return, balance sheet or other document or in any information required or furnished under, or for the purpose of any provision of, this Ordinance which to the knowledge of such person is false in any material respect, shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to one hundred thousand rupees, or with both.

Any person who contravenes any other provision of this Ordinance or does not comply with any requirement of this Ordinance or any rule, regulation, order, instruction, condition made, given or imposed hereunder shall be liable to such fine as the State Bank may, from time to time determine.

If any officer of a microfinance institution, mismanages the affairs of the microfinance institution or misuses his position for gaining direct or indirect benefit for himself or any of his family members, he shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine which may extend to one hundred thousand rupees, and shall be ordered, by the court trying the case, to deliver or Contd.. or refund within a time to be fixed by the court any property acquired or gained by him in his own name or in the name of his family members by using his position or, in default, to suffer further imprisonment for a term which may extend to six years.

A microfinance institution, which fails to maintain liquid assets and reserves in accordance with the provisions of this Ordinance, shall be punished with a fine equivalent to one per cent of the shortfall for every day in which the failure occurs.

Continuance of charge and priority: Sec 24

Where a charge over any property has been, or is, created by any person in favour of a microfinance institution to secure any of the services extended by the microfinance institution to such person, such charge shall continue to remain valid and shall maintain its priority in favour of the microfinance institution against all charges created by such person in favour of any other person subsequent to the original date of registration of such charge.

Restrictions on removal of records and documents: Sec 25

No microfinance institution shall remove from the specified area, to a place outside the specified area, any of its records and documents relating to its business without the prior permission in writing of the State Bank.

Non-disclosure of information: Sec 26

- (1) Except as otherwise required under this Ordinance, no information or data provided by a person, applying to the microfinance institution for financial assistance or any other service, shall be disclosed or used by any officer or employee of the microfinance institution for any purpose other than the purpose for which it was intended.
- (2) Whoever contravenes any of the provisions of sub-section (1) shall be guilty of an offence punishable with imprisonment for a term which may extend to six months or with fine which may extend to one hundred thousand rupees, or with both.

False information: Sec 27

Whoever in any application for obtaining assistance or in any balance sheet, statement of profit and loss, declaration or any other document submitted to the microfinance institution for the purpose of obtaining any financial aid sought or granted under this Ordinance, willfully makes false statement or knowingly permits any false statement to be made or to remain, or uses or permits to be used any financial facility for any purpose other than that for which it is granted by the microfinance institution shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one hundred thousand rupees, or with both.

Cognizance of offences: Sec 28

No court shall take cognizance of an offence under this Ordinance except on complaint in writing made by an officer of the State Bank authorized in this behalf.

Notwithstanding anything in the Code of Criminal Procedure, 1898 (Act V of 1898),-

- (1) No court other than that of a Judicial Magistrate of the first class shall try an offence under this Ordinance; and
- (2) It shall be lawful for the Judicial Magistrate to pass any sentence authorized by this Ordinance.

Indemnity: Sec 29

No suit or other legal proceeding shall lie against the Federal Government, the State Bank or any officer of the Federal Government or the State Bank for anything which is in good faith done, or intended to be done, under this Ordinance or of any rules, regulations or orders made hereunder.

Power to make rules: Sec 30

The State Bank may, with the approval of the Federal Government, by notification in; the official Gazette, make rules for carrying out the purposes and provisions of this Ordinance.

In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:-

Specifying the portion of profits, if any and other income of a microfinance institution required to be utilized to promote the objective of the microfinance institution;

Regarding the term and conditions for providing microfinance services to be extended by microfinance institutions;

- (a). Regarding investments in small business and such cottage industries;
- (b). Regarding investments in cottage industries and income-generating projects for poor persons;
- (c). Specifying criteria for operation in the specified area;
- (d). Regarding capitalization;
- (e). Regarding the forms, fees and procedures for licensing;
- (f). Specifying principles of good governance;
- (g). Regarding audit, accounts, and returns to be filed by microfinance institutions; and
- (h). Regarding liquidity and reserve requirements.

Power to make regulations: Sec 31

The State Bank may make regulations, not inconsistent with the provisions of this Ordinance and the rules, to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Ordinance and efficient conduct of the affairs of a microfinance institution.

Removal of difficulties

Subject to sub-section (2), if any difficulty arises in giving effect to any of the provisions of this Ordinance, the Federal Government may make such order, not inconsistent with the provisions of this Ordinance, as may appear to it to be necessary for the purpose of removing the difficulty.

No order under sub-section (1) shall be made after expiry of two years from the commencement of this Ordinance.

The Corporate and Industrial Restructuring Corporation Ordinance, 2000.

This Ordinance may be called the Corporate and Industrial Restructuring Corporation Ordinance, 2000. It extends to the whole of Pakistan. It shall come into force at once.

Definitions

- (a). "**Administration Committee**" means the administration committee established under section 12 ;
- (b). "**Board**" means the Board of directors constituted under section 6 ;
- (c). "**bonds**" means bonds, debentures, participation term certificates, term finance certificates, redeemable capital certificates of similar instruments providing for scheduled or contingent payment of debt obligations ;

- (d). **"book value"** means the rupee amount, inclusive of principal and accrued profit, owed by any obligor in connection with any financial asset as reflected on the books and records of the financial institution, as of the transfer date ;
- (e). **"Chairman"** means the chairman of the Board ;
- (f). **"Chief Executive"** means the Chief Executive Officer of the Corporation
- (g). **"collateral"** means any asset, property, right, claim, entitlement, share undertaking, guarantee, agreement, document or instrument, security interest, charge, mortgage, lien, hypothecation, pledge or assignment in respect of or as security for any financial asset ;
- (h). **"Commission"** means the Securities and Exchange Commission of Pakistan established under section 3 of the Securities and Exchange Commission of Pakistan Act, 1997 (XLII of 1997) ;
- (i). **"Corporation"** means the Corporate and Industrial Restructuring Corporation established under section 4 ;
- (j). **"director"** means a director of the Board ;
- (k). **"financial asset"** means any short, medium or long term interest and non-interest bearing loan, finance, advance, lease-installment, term finance certificate, participation term certificate, musharaka, modaraba, profit and loss sharing agreement, redeemable capital, guarantee or contractual right to receive payment of money in respect of sums advanced or committed to an obligor by a financial institution including collateral pertaining thereto ;
- (l). **"financial institution"** means any bank or other financial institution operating in Pakistan wherein the Federal Government holds overwhelming equity in excess of eight-five per cent as specified in the Schedule ;
- (m). **"Government entity"** means any Ministry, Division, Department or office of the Federal Government or any corporation, company, trust, statutory body or other entity of which more than fifty per cent of the equity or beneficial interest is directly or indirectly owned or controlled by the Federal Government ;
- (n). **"non-performing asset"** means any financial asset :

Which is held as an asset on the books of a financial institution.

With respect to which the obligor has been in arrears on any payment obligation for a period more than three hundred and sixty-five days, including-

collateral with respect to any financial asset, and a whole or partial right or interest of a financial institution in any financial asset, that otherwise constitutes a non-performing asset including a financial asset with respect to which the financial institution has an ongoing funding obligation; and

With respect to which the obligor's outstanding payment obligation to any financial institution exceeds ten million rupees or more;

- (o). **"obligor"** means any individual, proprietorship concern, company or other body corporate, trust, partnership or other entity that has, with respect to a non-performing asset, a contractual or legal obligation or duty to make payment, effect performance, provide security, or collateral with respect to any financial asset whether as principal, surety, guarantor or otherwise and whether such obligation is primary, secondary, matured or contingent ;
- (p). **"outstanding amount"** means the book value of a non-performing asset of the financial institution less:

(a) Any amount on the books of the financial institution appearing as a specific reserve applicable to that non-performing asset;

(b) any amount on the books of the financial institution appearing in a general loan loss and/or other reserve applicable to that non-performing asset ; and if, in the opinion of the Board, the book value of the non-performing asset, as adjusted in sub-clauses (a) and (b), is higher than the estimated market price of the non-performing asset, the Board shall commission an independent evaluator to determine such market price and in the event that the market price as determined by the independent evaluator is lower than the book value as adjusted in sub-clauses (a) and (b), such market price shall be deemed to be the outstanding amount

(q). **"regulations"** means regulations made under this Ordinance ;

(r). **"rules"** means rules made under this Ordinance ;

(s). **"Schedule"** means the Schedule to this Ordinance ; and

(t). **"State Bank"** means the State Bank of Pakistan.

Establishment of the Corporation: Sec 4

A corporation called the Corporate and Industrial Restructuring Corporation is hereby established for carrying out the purposes of the Ordinance.

The Corporation shall be a body corporate having a common seal with powers, subject to the provisions of the Ordinance, to hold and dispose of property and shall by its name sue and be sued.

The headquarters of the Corporation shall be Islamabad or such other place as may be determined by the Board.

Board and its powers: Sec 5

The overall direction, management, control and superintendence of the affairs of the Corporation shall vest in the Board which may exercise all such powers and do all such acts and things as may be exercised and done by the Corporation as set out in section 18.

In discharging its functions, the Board shall act with prudence and sound business and financial considerations for and on behalf of all persons who have beneficial interest as creditors or otherwise are beneficiaries, including the financial institutions and Government entity.

Composition of the Board: Sec 6

The Board shall consist of the following directors, namely:-

- (a) The Minister for Finance, Government of Pakistan;
- (b) The Minister of Commerce and Industry, Government of Pakistan;
- (c) The Governor, State Bank of Pakistan;
- (d) The Chairman, Privatization Commission of Pakistan
- (e) The Secretary General, Ministry of Finance;
- (f) The Chief Executive as defined in clause (1) of section 2 ; and
- (g) A minimum of four and a maximum of eight persons of repute from the private sector and as far as possible from each Province - one of whom shall be from the banking sector.

The directors referred to in clauses (a) to (f) of sub-section (1) shall be ex-officio directors.

The directors under clause (g) of sub-section (1) shall be appointed by the Federal Government, who shall hold office for a term of two years and shall be eligible for re-appointment for additional terms of two years each.

No act or proceedings of the Board shall invalid merely on the ground of the existence of any vacancy in or defect in the constitution of the Board.

No director shall have any direct or indirect financial interest in or have business connection with any obligor or financial institution whose non-performing assets are the subject of this Ordinance.

The director shall not, for two years after the expiry of their term of office, enter into the employment of or accept any advisory or consultancy relationship with any obligor or financial institution whose non-performing assets are the subject of this Ordinance.

Chief Executive of the Corporation: Sec 8

The Chief Executive shall be appointed by the Federal Government who shall be the whole time Chief Executive Officer of the Corporation.

The Chief Executive shall hold office for a term of two years and shall be eligible for re-appointment for additional terms of two years each.

Subject to its superintendence, direction and control the Board may authorize in writing the Chief Executive to exercise and perform any or all of the following **powers and functions** as the Board deems fit, namely :-

3.

- (a). To deal with, negotiate, enter into and sign agreements and contracts with any obligor or financial institution in respect of the non-performing assets or related collateral and to take any and all actions, in any manner to advance the business of the Corporation as specified in section 18;
- (b). To institute, finance, manage, oversee and terminate rehabilitation plans and schemes for the non-performing assets or the obligor, as the case may be;
- (c). To pay the cost, charges and expenses for the day to day business of the Corporation;

- (d). To receive money or goods on behalf of the Corporation;
 - (e). To sell, deal in and dispose of all articles and goods of the Corporation;
 - (f). to engage, employ, fix and pay the remuneration and dismiss or discharge all managers, agents, secretaries, clerks, servants, workmen and other persons employed in or in connection with the Corporations business ;
 - (g). To appoint any person or persons to be attorney or attorneys of the Corporation for such purposes and with such powers authorities and discretion's and for such period and subject in such conditions as he may from time to time think fit;
 - (h). To make and give receipt, release and discharge all moneys payable to the Corporation or for the claims and demands of the Corporation;
 - (i). To draw, accept, endorse and negotiate all such cheques, bills of exchange, promissory notes and Government and other securities as shall be necessary in or for carrying on the affairs of the Corporation whether the account may be overdrawn or not ;
 - (j). To institute, compromise, withdraw or abandon any legal proceedings by or against the Corporation or its officers or otherwise concerning the affairs of the Corporation;
 - (k). To provide for the welfare of employees or ex-employees of the Corporation and the wives, widows or families or the dependants of such persons in such manner as he may thing fit ;
 - (l). To open, maintain and operate accounts or letters of credit for any amount with any bank or banks and to give instructions for operation of such accounts;
 - (m). To appear before any court law, civil, criminal, revenue, excise, income-tax including banking courts and tribunals established for recovery of bank dues and loans, whether original or appellate, High Courts and Supreme Court of Pakistan and other authorities for and on behalf of the Corporation and to institute, apply for transfer of suits and other proceedings, conduct, prosecute and defend
 - (n). to enter into all such negotiations and contracts and rescind or vary all such contracts and do all acts, deeds and things in the name and on behalf of the Corporation as he may consider necessary, expedient or proper, or in relation to any of the matters aforesaid or otherwise, for the purposes of the Corporation ;
 - (o). To give effectual discharge for moneys payable to the Corporation and for its claims and demands
 - (p). to purchase or take on lease or otherwise acquire for the Corporation, land, buildings, rights and privileges for its purpose of offices or premises of the Corporation at such prices and generally on such terms as he may think necessary and expedient, to build, alter and furnish offices, houses or premises and let or sub-let any such houses or premises in portion or otherwise
 - (q). to demand and enforce payment, delivery, transfer of any dues for recovery and receive from all and every persons, body corporate or corporations, firm or companies whatsoever, all money, securities for money, debts and claims of all kinds and demand, enforce, deliver and receive and take possession of money, securities, shares, and goods produced and property of all kinds whether belonging to the Corporation as security or in trust or held by any person or company in trust or by way of security for the Corporation
 - (r). to deal with, make arrangements, sign contracts with Government, semi Government, autonomous bodies, corporations, local Government and other institutions ; and
 - (s). To appoint attorneys, agents, managers and authorize them to exercise any or all such powers and functions as are mentioned in clauses (a) to (r) above.
4. The Federal Government may, by notification in the official Gazette remove the Chief Executive if, --

- (a). He refuses or fails to discharge or becomes in the opinion of the Federal Government, incapable of discharging his responsibilities under this Ordinance; or
- (b). He has been declared insolvent; or
- (c). He has been declared to be disqualified for employment in or has been dismissed from the service of Pakistan, or has been convicted of an offence involving moral turpitude ; or
- (d). He has knowingly acquired or continued to hold without the permission in writing of the Federal Government, directly or indirectly or through a partner any share or interest in any obligator or financial institution.

Committees: Sec 9

The Board may, for the purpose of obtaining advice and assistance in carrying out the purposes of this Ordinance, constitute one or more committees consisting of members of the Board and any other suitable persons as it may deem fit. Any committee so formed shall, in exercise of the powers delegated to it or conferred on it. Conform to any restrictions that may be imposed on it by the Board.

Verification Committees: Sec 10

For the purposes of this Ordinance and before taking any action there under, the Corporation shall, having regard to the facts and circumstances of the case, refer a question of bona fide dispute relating to liability of the obligor in respect of the non-performing assets or cases relating thereto, including the cases of fraud, misrepresentation, and breach of any provision of law, rule, regulation and circulars of the State Bank, Contd....

Regarding the calculation, existence and repayment of a financial obligation or outstanding loan, mark-up or interest claimed against an obligor, to the Governor State Bank for verification and correct determination and calculation by the Verification Committee as hereafter provided:

The verification, determination and calculation of matters referred to in sub-section (1) shall be made in accordance with the existing law, rules, regulations and circulars of the State Bank in the manner provided herein in regard to the principal amount of loan, mark-up, as claimed by or against the financial institution or the Corporation, as the case may be, in respect of the non-performing assets and the liability of the obligor.

Save as provided in this Ordinance, the provisions of sub-sections (1) and (2) shall not affect the validity, continuance and enforcement of an order of winding-up of a company under the Companies Ordinance, 1984, which has been made before the commencement of this Ordinance except for the purpose of calculating the payment of any financial obligation or verified claim to the creditor or contributory or liability of the guarantor or any other person.

Where a matter is referred to the Governor State Bank under sub-section (1) and (2), he may constitute one or more Verification Committees for the purposes of this Ordinance. The Verification Committee shall consist of a nominee of the Governor State Bank being a senior officer of the State Bank who shall be the Chairman of the Committee, two Chartered Accountants, to be nominated by the Governor State Bank and one Chartered Accountant to be nominated by the Council of the Institute of Chartered Accountants of Pakistan, Karachi, such nomination to be obtained by the Governor State Bank and such other person as the Corporation may require.

The Chairman of the Verification Committee shall convene the meetings, conduct proceedings of the Committee, and maintain record including the evidence submitted before him by the parties and their statements and on their request supply authenticated copies of the record to them.

The Verification Committee after examination of the record of the concerned lending financial institution and the obligor and after due notice by courier service, fax, U.M.S. or any other effective mode to both parties and affording them reasonable opportunity to explain their position and hearing them in person and through liability and matters referred to in sub-sections (1), (2) and (3) in accordance with the law, rules, regulations and circulars of the State Bank.

- (8) Where a party after due notice under sub-section (7) does not appear in person or through chartered accountant before the Verification Committee, it may proceed ex-parte.
- (9) Provided that nothing contained herein shall prevent such party from appearance before the Verification Committee before the conclusion of the proceedings.

- (10) The Verification Committee shall submit its finding and report with recommendations to the Governor State Bank within thirty days of the commencement of the proceedings or such extended period as the Governor State Bank may allow for reasons to be recorded in writing.
- (11) The Governor State Bank shall consider the findings and report and recommendations submitted to him by the Verification Committee under sub-section (9) and may accept or modify the same or may, for reasons to be recorded, make such other appropriate recommendations and findings in respect thereof as he may deem fit.
- (12) The Governor State Bank shall forward his recommendations and findings made under sub-section (10) along with the finding, report, recommendations and record of the Verification Committee to the Corporation and the parties will be entitled to obtain copies thereof from the Corporation.
- (13) The recommendations and finding of the Governor State Bank made on the basis of finding, report and recommendations of the Verification Committee in regard to calculation of liability of obligor shall be final and have presumption of truth unless found to contain manifest error or contrary to law, but the same shall be subject to orders of the High Court.
- (14) The Corporation after considering the recommendations and findings of the Governor State Bank forwarded to it under sub-section (11) will take appropriate action under this Ordinance having regard to the facts of each case.
- (15) In the event of failure either of the Verification Committee to conclude the reference within thirty days of the commencement of the proceeding, or such extended period referred to in sub-section (9) or the failure of the obligor or the financial institution to accept the recommendations and findings of the Governor State Bank, the Corporation may proceed in respect of the non-performing asset under this Ordinance
- (16) Notwithstanding anything contained in any other law for the time being in force, the final recommendations and findings by the Governor State Bank and the finding, report and the recommendations of the Verification Committee under sub-section (11) shall constitute admissible evidence for any legal proceedings.
- (17) Explanation. - For the purpose of this Ordinance any instructions given by the State Bank to any bank or financial institution for writing off any debt for the purpose of accounting of any such bank or financial institution shall not be construed as satisfaction of any debt payable by the obligor.

Guidelines for Corporation and the Governor State Bank: Sec 11

The Corporation and where a matter is referred by it to Governor State Bank under sub-section (1) of section 10, the Governor State Bank, shall take into consideration inter-alia the following factors as the Corporation, or as the case may be, the Governor State Bank, may deem fit having regard to the facts of each case, namely :-

- (a). The practical possibilities of the non-performing asset;
- (b). The possibility of re-scheduling of financial assistance;
- (c). The adequacy of the subsisting securities and the willingness of the obligor to provide sufficient additional security;
- (d). Such other preventive, ameliorative and remedial measures including amalgamation or merger, change in management whether partial or whole or such incidental, consequential or supplemental measures as may be necessary;
- (e). examine the possibility of keeping alive a running project by providing reasonable financial assistance through financial institutions keeping in view the interest of both borrower and lender and avoiding unemployment ;
- (f). where the obligor can make financial arrangement on a joint venture basis with a third person on mutually agreed terms so as to provide sufficient security to the satisfaction of the Governor State Bank or the Board for repayment of the outstanding amount or liability of the non-performing asset to be determined in accordance with the State Bank's circulars, instructions, rules, regulations and the law ; and
- (g). Any other facts and circumstances having regard to public interest and the objectives of the Ordinance.

Qualifications and disqualifications of directors: Sec 15

No person shall be or shall continue to be a director who

Is or at any time has been adjudicated as insolvent;

Is found to be a lunatic or becomes of unsound mind;

Is or has at any time been convicted of any offence which, in the opinion of the Federal Government, is an offence involving moral turpitude;

(d) absents himself from all the meetings of the Board, without leave of absence from the Board, for a continuous period of six months or, if less than three meetings are held within such period, from three consecutive meetings of the Board ; and

(e) Is a salaried official of the Corporation either than the Chief Executive?

Employees of the Corporation to be public servants: Sec 16

Every person in the service of the Corporation shall, when acting or purporting to act in pursuance of any of the provisions of this Ordinance is deemed to be a public servant within the meaning of section 21 of the Pakistan Penal Code 1860.

Business which the Corporation can transact: Sec 18

Without prejudice to the provisions of any other law for the time being in force and subject to the provisions of this Ordinance, the Corporation may exercise powers and functions as under :-

- (a). To acquire, purchase, hold, manage, restructure, rehabilitate, sell and dispose of non-performing assets ;
- (b). To acquire, purchase, manage, restructure, rehabilitate, sell and dispose of any obligor being a corporation or a company;
- (c). to purchase, take over, own, hold, sell, lease, arrange finance for, manage, dispose of, re-organize, restructure, rehabilitate and otherwise, enter into any settlement or contract, realize mortgage, hypothecate, control, manage any loan, finance, advance, commitment, lease installment, sale contract or other activity relating to a non-performing asset ;
- (d). to purchase, take over, own, hold, sell, lease, and otherwise dispose of, re-organize, restructure, rehabilitate and otherwise enter into any settlement or contract, realize, pledge, mortgage, hypothecate, control, manage, and arrange finance for any asset, property, undertaking, collateral or security underlying or relating to or securing any financial asset or instrument, including any intellectual property, trade mark, equity, financial interest, legal and contractual right, asset, guarantee and other undertaking ;
- (e). to initiate, take, continue, resist, implement and perform any and all activities for the recovery of non-performing assets including filing suits and appeals and to enter into settlements, through the courts or outside, in respect thereof ;
- (f). to engage and enter into agreements with financial and other institutions, and financial, legal, accounting, valuation and other specialists, for the purposes of the business of the Corporation ;
- (g). to purchase, amalgamate, enter into partnerships, form joint ventures, make profit sharing arrangements or co-operate or participate with any company or other entity for the business purposes of the Corporation ;
- (h). to sell, improve, manage, develop, exchange, mortgage, let or rent (for profit or royalty or otherwise), grant licenses, easements, options, servitude's and other rights over and in any other manner deal with or dispose the real and personal property, assets, rights and effects of the Corporation ;
- (i). to open and maintain the Corporation's accounts with banks and financial institutions and to draw, make, endorse, accept, discount, execute and issue promissory notes, bills of exchange, bills of lading, warrants, participation term certificates and other negotiable or transferable instruments ;
- (j). to establish or promote, or concur or participate in establishing any corporation or other entity whose objects shall include the acquisition of all or any of the property or liabilities of the Corporation or the promotion of which may seem, directly or indirectly, calculated or benefit the Corporation ;
- (k). to enter into any agreement with any authorities, Federal, Provincial, autonomous, semi-autonomous, municipal, local or otherwise that may seem conducive to the Corporations' objects

or any of them, and to obtain from any such authority, rights, privileges and concessions which the Corporation may deem desirable to obtain and to carry out, exercise and comply with any such arrangements, rights, privileges and concessions ; and

- (1). All powers enumerated in sub-section (3) of section 8 entrusted to the Chief Executive.

Financial Institutions to which the provisions of this Ordinance shall apply: Sec 20

The provisions of this Ordinance shall apply to financial institutions specified in the Schedule to this Ordinance in relation to the non-performing assets as mentioned in their audited balance sheet subject to rights of third parties.

Accounts and audit: Sec 26

(1) The financial year of account of the Corporation shall be the year commencing the first day of July and ending the last day of June.

(2) Subject to sub-section (10), the Corporation shall maintain its accounts in such manner as the Federal Government may, in consultation with the Auditor General of Pakistan prescribe.

(3) The accounts of the Corporation shall be audited by one or more auditors who are chartered accountants within the meaning of the Chartered Accountants Ordinance, 1961 (X of 1961), appointed by the Corporation.

Reserve fund: Sec 27

The Corporation shall establish a reserve fund to which shall be credited its annual recoveries.

Annual report to the Federal Government: Sec 29

Within one hundred and eighty days of the end of each financial year of the Corporation, the Board shall prepare a presentation to the Federal Government with respect to the financial performance and results of operations of the Corporation for the preceding financial year and the overall policies and goals of the Corporation.

Exemption from taxes: Sec 34

Notwithstanding anything contained in any other law for the time being in force, the Federal Government may exempt Corporation from the payment of all or any other taxes, duties, levies, charges and fees payable under or pursuant to any Federal law, on its investment, income, assets or wealth.

Right of recovery as arrears of land revenue: Sec 37

The Corporation shall be entitled to recover all outstanding amounts, subject to law, on the basis of and under any non-performing assets held by the Corporation as if they are arrears of land revenue under the Land Revenue Act, 1967 (West Pakistan Act XVII of 1967).

Power to obtain information and documents etc Sec 38

(1) The Corporation may call upon any person, authority, agency, bank or financial institution to furnish any information, documents, papers and accounts it may require for the purposes of this Ordinance.

(2) Any person who does not or fails to furnish the information, documents, papers and accounts required by the Corporation under sub-section 910 shall be punishable with imprisonment of either description for a term which may extend to one year, or with fine or, with both.

LESSON 20**BANKER-CUSTOMER RELATIONSHIP****Types:**

There are amongst others the following important type of relationships between a banker and his customer:

- Debtor and Creditor
- Creditor and Debtor
- Principal and Agent
- Bailer and Baillie
- Mortgagor and Mortgagee
- Pledger and Pledgee

Before we move on to discuss the above relationships we need to understand certain terms/concepts including banker, customer, banking and banking company. The same are explained in the following paragraphs.

Banker:

Words Banker/Bank/Banking are interchangeably used. Banker not specifically defined. Meanings inferences and definitions are derived from in- depth study of various statutes relating to banking and writings of renowned economists and jurists. However, in different statutes including banking company's ordinance, 1962, concepts such as business of banking/functions of banks and business transacted by banks are contained.

Some of the Definitions of Banker:**According to J.W. Gilbert**

“A banker is a dealer in capital, or, more properly, a dealer in money. He is an intermediate party between the borrower and the lender. He borrows from one party and lends to another”

According to Dr. Herbert L. Hart

“A person carrying on a business of receiving money, and collecting drafts for customers subject to the obligation of honoring cheques drawn upon him from time to time by the customers to the extent of the amounts available on their current accounts

According to Sir John Paget: (considered as an authority on banking law)

“that no person or body corporate or otherwise, can be a banker, who does not (i) take deposit accounts, (ii) take current accounts, (iii) issue and pay cheques and (iv) collects cheques crossed and uncrossed for his customers”

Sir John Paget further adds that one claiming to be a banker must profess himself to be one, and the public must accept him as such, his main business must be that of banking, from which generally he should be able to earn his living. This definition is fairly exhaustive, although it makes no mention of many other important functions of the present day banker, which may be put under two heads (a) agency services, comprising of the collection of bills, promissory notes, coupons, dividends, payment of subscription and insurance premiums, and (b) general utility services, e.g., issue of credit instruments, the transaction of foreign exchange business, the safeguarding of valuables and documents against fire, theft, etc. there seems to be no doubt that according to English Law; a person claiming to be treated as a banker, should perform the functions as given by Sir John Paget.

American Version:

“by “banking” we mean the business of dealing in credits, and by a “bank” we include every person, firm or company having a place of business where credits are opened by deposits or collection of money or currency, subject to be paid or remitted on cheque or order, or money is advanced or loaned on stocks, bonds, bullion, bills of exchange or promissory notes or where these are received for discount or sale”

United Kingdom's Version: (According to bills of exchange Act, 1882)

“A banker is any person who carries on the business of banking”

According to Finance Act, 1915:

“Any person carrying on a bonafide banking business in the United Kingdom is a banker”

According to Negotiable Instruments Act, 1881 (according to Sec 3 (b) of Negotiable Instrument Act) and BCO, 1962

“Banker means a person transacting the business of accepting for the purpose of lending or investment, of deposit of money from the public, repayable on demand, or otherwise or withdraw able by cheque or otherwise, and includes any post office savings bank. ”

In Halsbury's Laws of England:

Banker is defined as an individual, partnership or corporation, whose sole or predominating business is banking, that is, the receipt of money on current or deposit account, and the payment of cheques drawn by and the collection of cheques paid in by the customer.

Conclusion:

We can say that banker is what banker does. It takes us to the business of banking or functions performed by banks

Definition of Banking, Banking Company & Forms of Business-- BCO, 1962 Re-visited

“**Banking** means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdraw able by cheque, draft, payable to order or otherwise;

“**Banking Company**” means any company which transacts the business of banking in Pakistan;

Forms of business carried out by the banking company under section 7 BCO, 1962:

In addition to the business of banking, a banking company may engage in any one or more of the following forms of business, namely:-

- a) Borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scripts Dealing in (participation term certificates, term finance certificates, musharika certificates, modaraba certificates and such other instruments as may be approved by the State Bank) and other instruments, the granting and issuing of letters of credit, issuing of traveler's cheques and circular notes;
- (aa) the providing of finance as defined in the Banking Tribunals.
- b) Acting agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a managing agent or treasurer of a company;
- (bb) acting as “modaraba company” under the provision of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 (XXXI of 1980);
- c) Contracting for public and private loans and negotiation and issuing the same;
- d) The effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue public or private, Government, municipal or other loans or of shares, stock debentures, (debenture stock or other securities)* of any company, corporation or association and the lending of money for the purpose of any such issue
- e) Carrying on and transacting every kind of guarantee and indemnity business;
- (ee) purchase or acquisition in the normal course of its banking business of any property, including commodities, patents, designs, trade-marks and copyrights with or without buy-back arrangements by the

seller, or for sale in the form of hire purchase or on deferred payment basis with mark-up or for leasing or licensing or for rush-sharing or for any other mode of financing;

- f) Managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;
- g) Acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form security or part of the security for any loans or advances or which may be connected with any such security; for any loans or advances or which may be connected with any such security;
- h) Undertaking and executing trusts;
- i) Undertaking the administration of estates as executor, trustee or otherwise;
- j) Establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;
- k) The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purpose of the company;
- l) Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;
- m) Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;
- n) Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;
- o) Any other form of business which the Federal Government may, by notification in the official Gazette, specify as a form of business in which it is lawful for a banking company to engage. (2) No banking company shall engage in any form of business other than those referred to in sub-section (1)

Customer Defined:

The entire law relating to banking rotates on the interplay of forces governing the relationship between a banker and a customer. The question arises as to who may be called a customer and it is most surprising that the word “Customer” has not been defined and at the same time one must know as to who is a customer. In some of the judgments pronounced by different courts an attempt has been made to give definitions of a customer but it is not an exhaustive attempt and they havenot been able to give such definition which may be termed as a satisfactory definition of this word.

According to Heber L. Hart:

A customer is a person who has an account with a banker. Coming to the meaning of the word, Hart says that a person is a “customer” of a bank within the meaning of section 82 of the Bills of Exchange Act, 1882, if he keeps either a current or a deposit account with the bank, or , it would seem if the bank systematically transacts with him, or for him, any kind of banking business.

According to Sec 131 of Negotiable Instruments Act, 1881

In the above cited section a reference has been made with regard to the Customer-- that protection shall be available to a banker collecting cheques on behalf of his customer

According to Sir John Paget:

“To constitute a customer, there must be some recognizable course of habit of dealing in the nature of regular banking business”

According to the judgment in the case cited as “Lad Broke V Todd (1914) given by Justice Bail Hache, customer’s domain is maintained as under

“in my opinion a person becomes a customer of a bank when he goes to the bank with money or a cheque and asks to have an account opened in his name, and the bank accepts the money or cheque and is prepared to open an account in the name of that person; after that he is entitled to be called the customer of bank. It

is further added, "I think such a person becomes a customer the moment the bank receives the money or cheque or agrees to open an account."

Legal Requirements to be qualified as Customer:

Customer should be of age of majority should be of sound mind

Not debarred under any law there must be an offer/ proposal and acceptance of that offer/ proposal.

Rights and Duties of Customer

The customer has the following universally accepted **rights**:

- (a) To draw cheques against his credit balance, or in the absence of credit balance, when there are arrangements for accommodation made with the banker earlier;
- (b) To receive a statement of his account from a banker.
- (c) To sue the bank for any loss and damages.
- (d) To sue the banker for not maintaining the secrecy of his account.

The customer has the following **duties** towards his banker:

- (i) Section 72 of the Negotiable Instruments Act, 1881, lays down that the customer must present the cheques for payment and collection within the business hours of his banker.
- (ii) Section 84 of the Negotiable Instruments Act, 1881, lays down that the customer should see that the cheques and other instruments are presented for payment within a reasonable time from the date of their issue.
- (iii) He should take reasonable care for safe custody of the cheque books. If a customer fails in this duty, he is to be held responsible for his negligence in leaving his cheques unprotected.
- (iv) He should draw the cheques very carefully and in such a way that there is no room left for any fraudulent alternations and additions. In *Yany V Grote*, the Lord Chancellor said:
"A cheque drawn by a customer is in point of law, a mandate to the banker to pay the amount according to the tenor of the cheque. It is beyond dispute that the customer is bound to exercise reasonable care in drawing the cheque to prevent from being misled. If he draws the cheques in a manner which facilitates fraud, he is guilty of a breach of duty to himself and the banker, and he will be responsible to the banker for any loss suffered by the banker as a natural and direct consequence of this breach of duty".

LESSON 21**BANKER-CUSTOMER RELATIONSHIP****Nature of Legal Relationship:**

Basic legal relationship between banker and customer is **contractual relationship**. This relationship is established from the time of opening an account in a bank. This relationship is at the root of all other legal relationships that exist between the banker and customer. As such, scope, essentials and type of contracts have been discussed in the following paragraphs.

Contract-- Defined

Contract is an agreement enforceable at law.

Essentials of a Valid Contract:

To understand a contract, we need to know what an agreement is. The agreement has been defined in section 2 (e) of the Contract Act which is given below.

Agreement

Every promise or every set of promises, forming the consideration for each other is an agreement.

--To understand an agreement, we must know what a promise is. The promise has been defined in section 2 (b) of the Act which is reproduced below:

Promise

When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise.

Proposal and Promise:

The word "proposal" is synonymous in English use with "offer". But the language of these definitions appears to confine "proposal" to an offer to be bound by a promise. Thus a man who offers to sell and deliver, then and there, existing portable goods in his immediate control, such as a book or a jewel, does not offer a promise but an act, and if the other party takes the goods on the spot and becomes liable to pay for them, he (the buyer) is the Promisor. In such a case the seller would seem not to make a proposal within the terms of the Contract Act. A quotation of prices is not an offer, but an invitation for offer; the same is true of many common forms of advertisement. A statement of the lowest price at which a landowner is prepared to sell is not an offer. A term in a partition deed that any of the parties wishing to sell his share will sell to the others at the market value is not an offer but an undertaking to make an offer. The Act does not say, but it seems to imply, that every promise is an accepted proposal. In the Common Law this is not so, for a binding promise may be made by deed, that is, by writing under seal without any communication between the parties at all. This is because the deed, as an ancient formal method of proof, was conclusive against its maker.

Promisor and Promisee has been defined in section 2(c)

The person making the proposal is called **"the Promisor"** and

The person accepting the proposal is called **"the Promisee"**

To transform a promise into an agreement consideration is also an important ingredient. Consideration has been defined in section 2 (d) of the Act which is reproduced below:

Consideration

When at the desire of the Promisor, the Promisee or any other person who has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise.

All agreements are not contracts, meaning thereby that all agreements are not enforceable at law. Such agreements are called void agreements. The same has been defined in section 2 (g) of the Act which is reproduced below:

Legal relationship

Intention to create legal relationship must exist, in commercial transactions it is presumed that such intention always exists. Social agreements do not give rise to any legal relationship, hence no rights or obligations arise/accrue from social agreements, i.e. (Social agreements are not enforceable at law)

Free consent

This is an important essential of a valid contract. It requires that contract should be entered into with free consent of parties.

Consent is said to be free if not caused by:

- Coercion
- Undue influence
- Fraud
- Misrepresentation or
- Mistake

Competent Parties

Another important essential of a valid contract is the legal capacity of the parties to enter into a contract; this has been provided in **section 11** of the Act which is reproduced below:

“Every person is competent to contract who is of the age of majority according to law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject”.

Who are competent to contract?

Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject. This section deals with personal capacity in three distinct branches: (a) disqualification by infancy; (b) disqualification by insanity; (c) other special disqualifications by personal law.

"To Contract."---means, to bind himself by promise. A minor who gives value, without promising any further performance, to a person competent to contract is entitled to sue him for the promised equivalent. This may be properly not in contract but on a quasi-contract under section 70.

Minor's agreement:

If the first branch of the rule laid down in the section be converted into a negative proposition, it reads thus: No person is competent to contract who is of the age of majority according to the law to which he is subject: in other words, a minor is not competent to contract. This proposition is capable of two constructions · either that a minor is absolutely incompetent to contract, in which case his agreement is void, or that he is incompetent to contract only in the sense that he is not liable on the contract though the other party is, in which case there is a voidable contract. If the agreement is void, the minor can neither sue nor be sued upon it, and the contract is not capable of ratification in any manner; if it is voidable, he can sue upon it, though he cannot be sued by the other party, and the contract be ratified by the minor on his attaining majority. Where, an infant retains property obtained under the contract from the other party, the equitable remedy of restitution has been applied, even though the infant made no false representation as to his age.

Payment of debt incurred during minority:

Where a person on attaining majority pays of debt incurred by him during minority, no question of ratification of a contract arises, since an agreement with a minor is merely void and not unlawful, the sum paid cannot be sued for subsequently, and in law it must be regarded on the same footing as a gift. It is within the competence of a certificated guardian appointed by statute, such as the Guardian and Wards Act, 1890, or the various Courts of Wards Acts to enter into a contract for the purchase or sale of immovable property on behalf of the minor with the sanction of the Court. **Persons otherwise "disqualified from contracting."**---The capacity of a woman to contract is not affected by her marriage under the law.

According to above definition the following parameters would determine **the legal capacities of parties to a contract:**

- **Parties to contract are required to be of the age of majority.**
- **Of sound mind**
- **Not barred from entering into contracts by the operation of law.**

Lawful object

Not expressly declared void--- Some instances of void agreement are given below:

Agreements in restraint of marriage (sec 26)

Every agreement in restraint of the marriage of any person, other than minor, is void

Agreements in restraint of trade (sec 27)

Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

Agreements in restraint of legal proceedings (sec 28)

Every agreement, by which any party thereto is restricted absolutely from enforcing his right under or in respect of any contract, by the usual proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent.

Legal formalities

The agreements must fulfill all the requirements all the legal formalities such as:

- (i) Writing
- (ii) Witness
- (iii) Attestation
- (iv) Registration

Classification of contracts:**Valid contract**

Valid contract is an agreement enforceable by law. In such contract all essentials of a contract as mentioned in section 10 are required to be fulfilled. In case breach of contract by one party, the other party has a right to file a suit for this breach.

Illustration:

A contract for the sale of a car between Mr. Yasir and Mr. Waqas has been concluded and all necessary formalities have been completed. The said contract meets all essentials of a valid contract. If either of the two that is Mr. Yasir or Mr. Waqas fails to perform his part of contract, the counter party can sue the other party for the breach of contract.

Voidable contract

A voidable contract is the one which is enforceable by law at the option of one or more of the parties to the contract, but not at the option of the other or others. As long as the contract is not avoided or cancelled by the party who is entitled to do so, the contract shall remain a valid contract. Such contracts are voidable at the option of aggrieved party.

Voidable contract has been defined in **section 2 (i)** of the Contract Act which is reproduced below:

“An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract”

--A contract becomes voidable in the following situations:

Where consent of a contracting party is not free

Where Promisor prevented from performance of the contract.

--An agreement on account of misrepresentation shall be voidable at the option of the person who is misled by such misrepresentation.

--In case a voidable contract is acted upon by a party as valid, that party cannot subsequently deny the validity thereof.

Void contract

A void contract is the one which is not enforceable by law. It has been provided in **section (j)** of the Contract Act.

“A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable. “

A voidable contract is a good contract as long as it is not avoided by the person who has the option to avoid whereas a void contract is not a contract at all from the very beginning in the eye of law.

Example:

Mr. Aslam resident of Lahore entered into an agreement with Mr. Kamal, a rice dealer at Gujranwala for the purchase of 100 tons of rice. District Coordination Officer (DCO) Lahore had imposed restriction on entry of rice in the territorial jurisdiction of District Lahore well before the date of the above agreement. The said agreement is not enforceable at law, hence void.

Situations of void contract

Impossibility of performance. It has been discussed in section 56

Legal contract may become void due to some illegality afterwards.

Revocation of a voidable contract by the party at whose option, the contract is avoidable becomes void contract

Unenforceable Contract

Such contracts are unenforceable before a court of law due to some technical defects such as non-deposit of court fee, submission of unsigned documents, absence of writing, wherever writing required, absence of registration, wherever required under law. On removal of these discrepancies, the contract becomes enforceable.

Express contract

An express promise shall lead to an express contract. Such a contract may be expressed by words spoken or written. Express contracts are contained in the provisions of section 9 of the Act.

Implied contract:

Such contracts are inferred from the acts and conduct of the contracting parties.

Example:

Mr. Aslam was engaged by a business man as a helper at his shop. He has been performing the job assigned to him, however no appointment letter was issued by the shopkeeper. Although there is no express agreement as to the employment of Mr. Aslam but the acts and the conducts of the respective parties shall lead to a conclusion regarding the nature of contract between them. Since the conclusions shall be inferred from the acts and conduct of the respective parties, such contract would be called an implied contract.

--The provisions regarding express and implied contract as contained in section 9 are given below:

“In so far as the proposal or acceptance of any promise is made in words, the promises is said to be express. In so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied. “

We shall continue with further discussion on this topic

LESSON 22**BANKER-CUSTOMER RELATIONSHIP**

We already know that besides other following are important legal relationships between banker and customer.

- Debtor and Creditor
- Creditor and Debtor
- Principal and Agent
- Bailor and Bailee
- Mortgagor and Mortgagee
- Pledger and Pledgee

The above relationships are explained in the following paragraphs.

Debtor and Creditor Relationship

When customer deposits money in a bank the relationship of **debtor** and **creditor** is established, in this case; **Banker is Debtor & Customer is Creditor**

A bank performs a number of functions for the customer. After the account in the bank is opened and the relationship of a banker and customer is established, the bank not only undertakes to collect the cheques which are deposited in the account but also makes the payment on behalf of the customer, whenever there is a mandate from the customer. The cheques which are realized by the bank are deposited in this account of the customer and on many occasions, the bank performs certain other functions on behalf of the customer such as keeping the valuables, etc., deposited by the customer with the bank as a trustee. On many occasions, when the customer gives bills for collection to his bank and the said bank passes the bills for collection to another bank and the amount of the bills is reduced as a result of debiting the customer's account with collection charges as a result of an agreement between two banks, the bank is always acting on behalf of the customer. There are thus too many occasions relating to so many matters which arise during the mutual dealings between the banker and the customer and at each time, a question arises as to what is the relationship between a banker and a customer. It has now been well settled that the first and foremost relationship between the customer and the bank is the relationship of a *Creditor and debtor*.

H.P. Sheldon in his *Practice and Law of Banking* sets out this relationship as follows:

"The banker when he receives money from a customer does not hold the money in a fiduciary capacity. To say that money is Deposited" with a banker is likely to cause misapprehension. What really happens is that the money is not deposited with, but lent to the banker, and all that the banker engages to do is to discharge the debt by paying over an equal amount when called upon.

Halsbury's *Lazus of England*, (Simonds Edn.) Vol. 2, p. 166, states that receipt of money by a banker from or on account of his customer constitutes him the debtor of the customer.

American Jurisprudence discussing the relation between bank and general depositor has the following to say:

Sec. 444. "It is a fundamental rule of banking law that in the case of a general deposit of money in a bank, the moment the money is deposited it becomes the property of a bank, and the bank and the depositor assume the legal relation of debtor and creditor. The legal effect of the transaction is that of a loan to the bank upon the promise and obligation, usually implied by law, to pay or repay the amount deposited usually upon demand; there is nothing of a trust or fiduciary nature of a bailment in the transaction or relationship or in the nature of any right to specific money deposited...."

Corpus Juris gives the following information:

Sec. 326. "The contract between a bank and a depositor is not materially different from any other contract by which one person becomes bound to take charge of and repay another's, funds, and there is no trust relation between a bank and a general depositor. The relation between a bank and a depositor may be dual

in character, the bank being the depositor's debtor with respect to one thing and his agent with respect to another, or his debtor at one time and his agent at another; and while the relation between the bank and a depositor in respect to a general deposit is generally regarded as that of a debtor and creditor, yet in another sense the depositor is the owner of the deposit, in that he can demand repayment at any time. It is competent for a bank of deposit to enter into a collateral agreement with the depositor with reference to the disposition of the proceeds of deposits...."

According to **H P Sheldon** in his publication 'practice and law of banking', this relationship has been expressed as under:

"The banker when he receives money from a customer does not hold the money in the fiduciary capacity. To say that the money is deposited with a banker is likely to cause misapprehension. What really happens is that the money is not deposited with, but lent to the banker, and all that the banker engages to do is to discharge the debt by paying over an equal amount when called upon"

Creditor and Debtor Relationship:

When a bank grants loan or other credit facilities to the customer, relationship is reversed, that is now **Customer is Debtor & Banker is Creditor.**

In such cases it is not the money of the customer in the hands of the banker but it is the money of the bank in the hands of the customer but in all such cases when a customer's account is over drawn, the customer does not cease to be a customer.

Principal & Agent Relation

In certain situations, the banker serves as agent of the customer (principal) some of these situations are enumerated below:

- Collection of cheques on behalf of the customer
- Collection of dividends and bills of exchange
- Acting as attorney, executor or representative of a customer
- Buying and selling securities on his behalf.

According to *Skeleton* another service being rendered by a banker to his customer is to collect his customer's cheque and other credit instruments. In these transactions, the relationship between the two parties is that of principal and agent—the banker acting as his customer's agent. This is because in the course of business incidental to banking, a banker undertakes to perform many services for the customer such as:

Buying and selling securities on his behalf; collection of cheques, dividends, bills or promissory notes on his behalf; acting as a trustee, attorney, executor, correspondent or a representative of a customer.

In the performance of all these functions, the banker acts as an agent of the customer.

In general terms, Agency refers to the relationship which exists between two persons, the **Principal** and the **Agent** in which the Agent has to perform different duties/ functions as per instructions of the **principal** and also enters into contract with the third party / parties on behalf of the principal. The relationship of agency plays an important role in business and commercial dealings. This relationship is legal created by virtue of agreement between **Principal** and **Agent**

Definition of Agent and Principal: Sec 182

Agent is a person employed to do any act for another or to represent another in dealing with a third persons. The person for whom such act is done, or who is so represented, is called the **Principal**.

Explanation

The legal relation between a merchant in one country and a commission agent in other is that of principal and agent, and not seller and buyer, though this is consistent with the agent and principal, when the agent consigns the goods to the principal, being in a relation like that of seller and buyer for some purposes. A merchant, therefore, in this country who orders goods through a firm of commission agents in Europe cannot hold the firm liable as if they were vendors for failure to deliver the goods. And the result is the

same if the goods are ordered through a branch in this country of a firm of commission agents in another country. For the same reason, where a commission agent buys goods for a merchant at a price smaller than the limit specified in the indent, he cannot charge any price higher than that actually paid by him, except in the case of a custom to the contrary. An agent may have, and often has, in fact, a large discretion, but he is bound in law to follow the principal's instructions provided they do not involve anything lawful. To this extent an agent may be considered it's a superior kind of servant; and a servant who is entrusted with any dealing with third persons on his master's behalf is to that extent an agent. But a servant may be wholly without authority to do anything as an agent, and agency, in the case of partners, even an extensive agency, may exist without any contract of hiring and service.

Agency may be created in the following ways:

- By consent
- By operation of law
- By estoppel
- By ratification

Agency by Consent:

Consent may be express or implied.

Express Agency:

Such agency is created by words either spoken or written. In business transactions, this relationship is usually established through writing an agreement

Implied Agency:

An authority is referred to as implied when it is inferred from the conduct of the parties or circumstances of the case.

Definitions of express and implied authority as contained in section 187 of the Act is given below:

An authority is said to be express when it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted for circumstances of the case.

Types of Agent:

The agents may be classified as under:

Public Agents- these are representatives of a State

Private Agents—these agents represent individuals or companies

General Agents- these agents pertaining to a business, vocation or profession

Special Agents—such agents are appointed for a specific transaction.

Co-Agents-- Such Agents act along with Principal.

Duties of the Agent:

Duties of agent are contained in sec 211 to 218 of the Contract Act. Some of the important duties are given below:

- To follow principal's instructions
- To show required skill and diligence
- Agent to render proper accounts
- Agent to pass on any benefits derived by him

Agent's duty in conducting principal's business. (sec 211)

An agent is bound to conduct the business of his principal according to the directions given by the principal, or, in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

Illustrations

(a) A, an agent engaged in carrying on for B, a business, in which it is the custom to invest from time to time, at interest, the moneys which may be in hand, omits to make such investments. A must make good to B the interest usually obtained by such investments. (b) B, a broker, in whose business it is not the custom to sell on credit, sells goods of A, on credit to C, whose credit at the time was very high. C before payment becomes insolvent. B must make good the loss to A.

(c) An agent, instructed to warehouse goods at a particular place, warehouse a portion of them at another place, where they are destroyed, without negligence. He is liable to the principal for the value of the goods destroyed. (d) An agent, instructed to insure goods, neglects to do so. He is liable to the principal for their value in the event of their being lost. (e) A broker, entrusted with goods for sale, sells them by auction at an inadequate price, not having made an estimate of the value in accordance with the custom of the particular trade. He must make good the loss. (f) An auctioneer, contrary to the usual custom, takes a bill of exchange in payment of the price of goods sold. He is liable to the principal for the amount of the bill in the event of its being dishonored. (g) An agent, bound by his contract to keep proper books of account, omits to scrutinize, examine or check the accounts of his subordinates whom he implicitly trusts. Taking advantage of this, the subordinates commit gross frauds on him and his employers. The frauds and defalcations being due to the agent's failure to perform his duty he is liable to make good the loss thereby caused.

Skill and diligence required from agent (sec 212)

An agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business, unless the principal has notice of his want of skill. The agent is always bound to act with reasonable diligence, and to use such skill as he possesses; and to make compensation to his principal in respect of the direct consequence of his own neglect, want of skill or misconduct, but not in respect of loss or damage which are indirectly or remotely caused by such neglect, want of skill or misconduct.

Illustrations

(a) A, a merchant in Islamabad, has an agent, B, in London to whom a sum of money is paid on A's account, with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money, becomes insolvent. B is liable for the money and interest from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss---as e.g., by variation of rate of exchange--but not further. (b) A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual inquiries as to the solvency of B. B, at the time of such sale, is insolvent. A must make compensation to his principal in respect of any loss thereby sustained. (c) A, an insurance broker, employed by B to effect an insurance on a ship, omits to see that the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. A is bound to make good the loss to B.) A, a merchant in England, directs B, his agent at Karachi who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival, the price of cotton rises. B is bound to make good to A, the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

Agent's accounts (section 213)

An agent is bound to render proper accounts to his principal on demand.

Agent's duty to communicate with principal (section 214)

It is the duty of an agent, in cases of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions. Agent is under a duty to consult principal in a "difficult" situation so as to save repudiation of his action by principal.

Right of principal when agent deals, on his own account, in business of agency without principal's consent.(sec 215)

If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows either that any material fact has been dishonestly concealed from him by the agent, or that the dealings of the agent have been disadvantageous to him.

Principal's right to benefit gained by agent dealing on his own account in business of agency (sec 216)

If an agent, without the knowledge of his principal, deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction.

Agent's right of retaining out of sums received on principal's account.(sec 217)

An agent may retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business, and also such remuneration as may be payable to him for acting as agent.

Agent's duty to pay sums received for principal (sec 218)

Subject to such deductions, the agent is bound to pay to his principal all sums received on his account.

Rights of the Agent:

These are discussed in the following paragraphs:

When agent's remuneration becomes due-Sec 219:

In the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act; but an agent may detain moneys received by him on account of goods sold, although the whole of the goods consigned to him for sale may not have been sold, or although the sale may not be actually complete.

Agent to be indemnified against consequences of lawful acts (sec 222)

The employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him.

Agent to be indemnified against consequences of acts done in good faith (sec 223)

Where one person employs another to do an act and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it cause an injury to the rights of third persons.

Compensation to agent for injury caused by principal's neglect (sec 225)

The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.

Enforcement and consequences of agent's contracts (sec 226)

Contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner, and will have the same legal consequences as if the contracts had been entered into and the acts done by the principal in person.

Principal's liability with regard to agreements caused by misrepresentation or fraud by agent: Sec 238

Misrepresentation made, or frauds committed, by agents acting in the course of their business for their principals, have the same effect on agreements made by such agents as if such misrepresentations or frauds had been made or committed by the principals; but misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals.

Scope of duties of Principal:

Duties of the principal are enumerated below:

- Payment of remuneration to the agent
- Not to prevent his agent from performing the duties/ acts assigned to him under the contract and for which remuneration is payable.
- Any legitimate expenses which have been incurred by the agent in the course of performance of his duties are to be indemnified by the principal.

LESSON 23**BANKER-CUSTOMER RELATIONSHIP**

We have already discussed the under noted legal relationships between banker and customer.

- Debtor and Creditor,
- Creditor and Debtor
- Principal and Agent

Now we shall cover the following relationships:

- Bailor and Bailee
- Mortgagor and Mortgagee
- Pledger and Pledgee

Bailor and Bailee Relationship:

In banker customer relationship, bailment is also important types of relations. It may arise in the following situations:

Availing safe custody services (lockers)

Pledge of stocks as security for availing credit from bank. In these cases---

Customer--- Bailor & Bank---- Bailee

Bailment

The definition of bailment as contained in section 148 is given here under:

A “bailment” is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the “bailor”. The person to whom they are delivered is called the “bailee”

Explanation.---If a person already in possession of the goods of another contracts to hold them as a bailee, he thereby becomes the bailee, and the owner becomes the bailor, of such goods although they may not have been delivered by way of bailment.

Essentials of Bailment:

Contract--there is an underlying contract between the bailor and bailee, there may be an explicit contract or it may be an implied contract.

Specific purpose--the bailment of goods is always for some specific purpose.

Delivery of goods--there must be delivery of movable goods in a contract of bailment.

No change of ownership--in a contract of bailment, only the possession of goods is transferred from bailor to the bailee, whereas the bailor has all ownership rights over the goods delivered.

Return of the goods delivered on accomplishment of purpose--**when the purpose for which the goods are delivered is completed, the goods must be returned in the original form or modified form as per instructions of the bailor.**

For the benefit of the bailor-- Mr. Yasir, while going out of city handed over some precious household articles to Mr. Usman for safe custody, without any obligation to pay any fee/ charges. It is a bailment for the benefit of the bailor.

For the benefit of the bailee—Mr. Umer handed over his car to Mr. Ahsan, as he was in need of conveyance for few days. Mr. Umer handed over this car without any obligation on the part of Mr. Ahsan

to pay any rent/ charges for the use of this car. This bailment is exclusively for the benefit of the Mr. Ahsan, the bailee.

For the benefit of bailor and bailee—**Mr. Ahmad availed locker facilities from M/S XYZ bank ltd. Under the terms and conditions of the contract Mr. Ahmad was required to pay Rs.1000/ annual fee on account of availing this facility. This contract is for the benefit of both parties, the bailor and the bailee.**

Explanation:

Scope of bailment and its essentials are explained in detail in the following paragraphs.

Nature of the transaction.---"Bailment" is a technical term of the Common Law. It involves change of possession. One who has custody without possession, like a servant, or a guest using his host's goods, is not a bailee. The constructive delivery will create the relation of bailor and bailee as well as actual delivery. The bailee's duty to deal with the goods according to the bailor's orders is incidental to the contract of bailment, and arises on the delivery of the goods, although those orders may have already been given and accepted in such a manner as to constitute a prior special contract. As a matter of pleading this is no longer material in this country, but it might still be material with regard to the period of limitation. Ailment is necessarily dealt with by the Contract Act only so far as it is a kind of contract. It is not to be assumed that without an enforceable contract there cannot in any case be a bailment. The words. "Otherwise disposed of" in the present section express the common law as now understood. "It seems clear that a bailee is not the less a bailee because he is clothed with authority to sell the thing which is bailed to him," e.g., a factor for sale. On the whole a bailment may be described as a delivery on condition, to which the law usually attaches an obligation to redeliver the goods, or otherwise deal with them as directed, when the condition is satisfied; but there may be, in particular cases, a bailment without an enforceable obligation

Rights and duties of bailee

To take care of goods delivered by bailor—this aspects are contained in the following sections:

--**Sec 151:** in all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

-- **Sec 152:** the bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care of it described in section 151.

Effects of mixture, without bailor's consent when the goods can be separated

--**Sec 156:** if the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expense of separation or division, and any damage arising from the mixture.

Effect of mixture, without bailor's consent, when the goods cannot be separated

--**Sec 157:** if the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

- According to section 154, bailee shall not make un-authorized use of the goods delivered to him.
- According to section 160, bailee is required to return the goods delivered to him for som purpose.
- According to section 163, bailee is required to return an increase or profit in lieu of goods delivered.

Explanation:

The duties of the bailee are explained in greater detail in the following paragraphs:

The bailee has no right to dispose of or sell the property unless specifically authorised to do so. He has only a right to retain the goods bailed with him until he receives due remuneration for the service rendered in respect of the goods. He is responsible for the safe delivery of the goods bailed with him and in default is responsible to the bailor for any loss of goods

Goods given to a person by bank on trust receipt---Person becomes a bailee---Liable for criminal breach of trust in case of non-accounting of goods. The execution of a trust receipt is a recognised mode of making a person bailee of the goods and in such circumstances the Bank must be deemed to be in possession or control of the goods. The validity and efficacy of such instruments of trust are now generally acknowledged. If a person who has signed such a trust receipt, fails to hand over to the Bank the sale-proceeds of the goods sold, the former would be liable for criminal breach of trust
<http://www.paksearch.com/Government/CORPORATE/Contract/P43.htm>

Intentional wrong delivery by carrier---Carrier liable for damages ---Where the carrier has made intentional wrongful delivery of goods, he cannot escape liability to indemnify the plaintiff for the loss caused to him by wrongful deliveries of the
<http://www.paksearch.com/Government/CORPORATE/Contract/P44.htm> consignments

Care to be taken by bailee (sec 151)

In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed

Contract by bailee exempting himself from liability for negligence.---The learned authors considered that a contract by a bailee purporting to exempt himself wholly from liability for negligence was not valid. This opinion is based on the express provisions for contracting out in S. 152, and in fact throughout the Chapter on Bailments wherever a rule of law is to operate only in the absence of a contract to the contrary, it is expressly so stated in sections 163, 165, 170, 171, and 174.

Theft of goods pledged with Bank---Document of pledge containing condition that during the continuance of pledge agreement the borrowers shall be responsible for all loss, damage, or deterioration of security caused by theft, fire, rain or any other cause whatsoever---There being no discrepancy between provisions of S. 151, Contract Act, 1872 and condition of document of pledge, if loss had been caused by theft, fire, rain or any other cause, it would be the duty of the bailee to explain that he had taken care of the goods as a man of ordinary prudence would under similar circumstances take of his own goods and if in spite of that the goods pledged were lost in manner as recorded in the condition of document of pledge, liability of borrower could not be
<http://www.paksearch.com/Government/CORPORATE/Contract/P58.htm> legally denied.

Loss to goods by negligence of ship-owner---Claim for damages against ship-owner sustainable:

The ship-owner committed a breach of the obligation contained in the bill of lading and as such the consignee was entitled to
<http://www.paksearch.com/Government/CORPORATE/Contract/P61.htm> recover damages.

Damage to contents of parcel---Burden of proof is on consignor---Mere damage to containers does not prove damage to contents.

The burden of proof was on the plaintiff to show that the damage to the contents was caused by the negligence of the servants of the Carrier while the Crates were in its custody. No such evidence has been produced by the plaintiff and merely, because some of the wooden crates were externally broken and some card-board cases torn, as stated in the Survey Report, it cannot be inferred, nor is there any evidence to show, that the external damage must have resulted in Damage to the contents

Loss of goods in possession of bailee---Onus of proof as to negligence of bailee:

Where goods are lost or destroyed while in possession of bailee the onus of placing all the materials in his possession or knowledge is on the bailee, while the onus of establishing negligence is on the plaintiff

Carriage of goods by sea from foreign port to Pakistan---Damage to goods---Contract Act applies.-

--The provisions of the rules to the Carriage of Goods by Sea Act, 1925 do not apply in relation to carriage of goods by sea in a ship carrying goods from a foreign port to a port in Pakistan, as is the present case. Therefore, the rights and liabilities of the parties have to be ascertained by reference to the proper law of the contract which in this case, is the Pakistan law

Buyer rejecting goods---If can sell them to recover ware-house charges for storing them.---The buyer rejected the goods and then disposed them of in order to recover the ware-house charges for having stored them. He contended that he as a bailee had the right to do so

Held: The buyer of the goods having rejected them and thereafter selling them as the goods belonging to him, stands on a different footing than the bailee contemplated under sections 151 and 170 of the Contract Act. The principle on which a bailee is entitled to dispose of the goods or has lien on the goods bailed with him are entirely different and are not applicable to the case of the sale of goods. As discussed above, the buyer of the goods after rejecting them, has no lien on the goods in dispute and must place them at the disposal of the seller for dealing with them in any manner which he likes

Loss of goods during transit---Railway liable---Absence of brake---Negligence of railway.---Where goods were lost during transit and it was found that there was no vacuum or brake in the van of the guard so that the train could not be stopped in case of theft in the running train.

Held: There ought to be a vacuum in a train in order that in case of theft while it is running it may be stopped. That a vacuum should be there in the brake of the guard is not denied and the failure to keep a vacuum against the rules would be negligence. Therefore the failure to provide brake should be considered a negligent act on the part of the Railway.

Held further: That there is no satisfactory evidence from which it could be inferred that they had taken proper care of the consignment as bailer of the goods consigned. Therefore, the railway was liable for the loss of goods.

Mortgagor and Mortgagee Relationship

When credit facility is provided by the bank to a customer against the security (collateral) of immovable property, the relationship of Mortgagor and Mortgagee is established.

In this situation:

Mortgagor— Customer

Mortgagee— Bank

Mortgage Defined: sec 58:

(a) A mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.

Mortgagor: The transferor is called a mortgagor

Mortgagee: The transferee a mortgagee

Mortgage Money: The principal money and interest of which payment is secured for the time being are called the mortgage-money

Mortgage Deed: the instrument (if any) by which the transfer is effected is called a mortgage deed.

Nature of Transaction:

In Mortgage, the rights and interests which are vested in Mortgagor are transferred by him in favor of the other person, the Mortgagee.

Mortgage in fact is a transfer of an interest in specific immovable property as security for the repayment of a debt and such an interest is itself immovable property. The nature of the right that is transferred would depend upon the form of Mortgage.

Types of Mortgages:

Registered Mortgage
Equitable Mortgage

Registered or Legal Mortgage

This is created through a formal document called mortgage deed.

Mortgage deed is registered with the Registrar of titles.

It is comparatively expensive as it involves stamp duty and registration fee.

Equitable Mortgage:

This is created by deposit of title deed by the mortgagor.

Memorandum regarding deposit of title deed is also signed by respective parties.

Clear title of the mortgagor must be ascertained by the mortgagee.

Rights of Mortgagee

To sell the mortgaged property in case of default by mortgagor

Right to fore-closure

Right to file suit

Pledger and Pledgee Relationship

When credit facility is provided by a bank to its customers against security (Collateral of movable property) the Relationship of Pledger and Pledgee is established.

In this case:

Pledger—Customer

Pledgee—Bank

Pledge

It has been defined in section 172 of the Contract Act which is given below:

"Pledge," "pawnor," and "pawnee" defined.

The bailment of goods as security for payment of a debt or performance of a promise is called "pledge".

The bailor is in this case called the "pawnor." The bailee is called the "pawnee."

- The pledge has actual control of pledge stocks/goods.
- Pledge can sell pledged stocks by giving reasonable notice to the borrower.
- Before disposal pledge should publish the notice through news papers etc.

Comments

The bailee tendering a contract of pledge does not become owner, but, as having possession and right to possess, he is said to have a special property. Any kind of goods, documents, or valuable things of a personal nature may be pledged. Delivery is necessary to complete a pledge; it may be actual or constructive. It is sufficient if the thing pledged is delivered under the contract within a reasonable time of the lender's advance being made. Pledge---Monthly statements of stocks lying in godown showing goods as pledged with defendant-Bank---All such documents signed by authorized person on behalf of plaintiff---Debit advice vouchers produced by defendants showing conveyance charges paid to Godown Keeper visiting godown, and debited to account of plaintiff---Goods, held, in possession of defendant under pledge and not merely <http://www.paksearch.com/Government/CORPORATE/Contract/Q26.htm> hypothecated.

According to J. Milnes Holden:

"Pledge arises when goods or (documents of title of goods thereto) or bearer securities are delivered by one person (called the Pledger) to another person (called the Pledgee) to be held as a security for the payment of a debt or for the discharge of some other obligation, upon the express or implied understanding that the subject matter of the Pledge is to be restored to the Pledger as soon as the debt or other obligation is discharged.

Where a definite time for payment has been fixed, the Pledgee has an implied power of sale upon default, but if there is no stipulated time for payment, the Pledgee may demand payment and in default thereof may exercise his power of sale after giving notice to the Pledger of his intention to do so. The Pledgee has actual control of pledged stocks/Goods.

Pledgee can sell pledged stocks by giving reasonable notice to the borrower.

Before disposal Pledgee should publish the notice through news papers etc.

Termination of Banker- Customer Relationship:

This relationship that is established by the time an account is opened may be terminated by either party in following manner:

- ☐ By Notice from customer or
- ☐ By notice from banker

LESSON 24**BANKER-CUSTOMER RELATIONSHIP****Types of Customer's Account****General Requirements for opening an account**

-- Completion of Account Opening Form (AOF)
Introduction of the prospective customer and preliminary investigations (know your customer KYC)
Obtaining specimen Signatures
Mandate regarding operation of Account

Allocating Account number**Preliminary investigations /Introduction of Account**

Introduction of a new account refers to proper investigations about the credentials of prospective account holder by the banker. If proper introduction not obtained it would tantamount to **negligence** on the part of banker. Retention of photo copy of CNIC of Account Holder as well as introducer of account after verifying from originals.

Why Introduction & Preliminary Investigation:

- (a). To avoid frauds
- (b). Safeguard against unintended/inadvertent credits to an account by mistake, in case banker has conducted proper preliminary investigations and obtained introduction it would be help in follow up process

Negligence in seeking proper introduction & making necessary preliminary investigations leads to deprivation of banker from seeking protection of law U/S 131 of Negotiable Instruments Act 1881.

Inquiries about client (credit Reports/status inquiries) furnished by banks. In case account opened by a banker without proper inquiries—the bank furnishing status inquiries /etc. may at times launch itself into trouble.

Specimen Signatures:

If forged signatures on a Cheque entertained & Cheque passed by bank--bank shall be legally responsible to make good the loss to Account Holder

Opening of Account of an Illiterate Person:

Photograph on S.S Card
Thumb impression in the presence of bank officer to be affixed.
L.T.I (Gents)
R.T.I (Ladies)

Type of Accounts:

Individual's Account
Joint Account
Minor's Account

Legal Issues with respect to individual's Account:

A banker's authority to pay cheques is revoked in the following situations as per provisions contained in section 122-A of Negotiable Instruments Act, 1881:

Countermand of payment (stop payment)
Notice of customer's death
Notice of Adjudication of the Customer as insolvent

Joint Accounts

These accounts are not to be treated as partnership accounts. These are the accounts opened in the name of two or more persons who are not partners

Operations of Joint Account:

--The mandate must bear the signatures of all the account holders.

Can be operated jointly by all the account holders

Can be operated by any one or more persons authorized to operate the account

Either or Survivor /s mandate.

Stop Payment Instructions in a Joint Account

Any one of the joint account holders can give stop payment instructions of any cheque to the bank; however, for reinstatement of the payment of such cheque, such instructions must bear signatures of all the account holders.

Minor's Account

Minor does not have legal capacity to enter into a contract. As we know that legal relationship between banker and his customer is a contractual relationship, as such minor is not qualified under law to open an account. However, an account in the name of minor can be opened when guardian of the minor shall operate this account. According to law, minor is a person who has not attained the age of 18 years. Further more under section 3 of majority Act 1875, if a guardian is appointed by the court in respect of a person before he attains the age of 18 years, the majority extends to the age of 21 years.

Classified Accounts of the Customers

Partnership Account

Companies Account

Account of Clubs, Societies & Associations.

Agents' Account

Trust Account

Executors & Administrators' Account

Accounts of Local Bodies

Partnership Account:

"Partnership" is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all Right to sue vests in registered firm.

Partner is treated as an agent of firm (Section 18 of Partnership Act. 1932) however; partner has no authority to open an account on behalf of the firm (Section 19-2B)

Survivorship mandate

Joint and several mandates

Admission of new partner—responsibilities of incoming partner start from the date of admission unless not otherwise agreed.

Bankruptcy of a partner-- ordinarily partnership stands dissolved.

Insolvency of firm—business of partnership vests in official receiver appointed by court, operations in account are stopped, personal accounts of partners are also declared inoperative.

Accounts of Companies**Documents Required:**

Resolution passed by Board of Directors for opening the account

Copy of Memorandum of Association

Copy of Articles of Association

Certificate of Incorporation

Certificate of commencement of business

Balance Sheet.

Operation of the account in line with the instructions contained in the board of directors resolution, authorized directors to operate the account.

In case of winding up of a company, bank should stop operations in the account.

Accounts of Clubs, Societies & Association

Resolution passed by managing committee/executive committee/Governing body etc.

Certified copy of by- laws/rules

Signatures of the persons authorized to operate account.

Agent Account

Agent acts on behalf of the principal.

Agent can open an account under the authority of principal—based on power of attorney.

On revocation of power of attorney operation in the account will stand inoperative.

In case death of the agent operations should be stopped immediately however, Principal can sign the cheques and the same are honored by the banks.

Account of Trusts:

Trusts are governed by Trust Act-1882

Any person who is competent to contract may create a trust.

Opening of Account

Account is opened in the name of the Trust.

All trustees to sign account opening form.

Executors & Administrator's Account

Executor is a person who is entrusted responsibilities of executing WILL.

An administrator is a person appointed by a court to look after the estate of a person who died without leaving a WILL or the person appointed as executor is not competent to perform the contract (for example minors, insolvent, lunatics)

The banks must carefully study the contents of the WILL before opening an account of Executor/Administrator.

Accounts of Local Bodies:

The accounts must be in conformity with local bodies law/rules.

The request for opening an account must be made by competent authority.

Difference between Joint Account & Partnership Account (Profit Motive)**Operation of Joint Account:**

Instructions to be obtained by the bank to be operated by one, anyone or jointly by all or some of designated person/persons.

Stop payment legal position:

Any of joint Account holders has the authority to issue such instructions to bank but not revocation thereof.

Authority to Draw Cheque by Third Party/Manager

Such authority--Jointly by all Account Holders

Joint Account:**Above Authority/Mandate Revoked Automatically**

By death

Bankruptcy (insolvency)

Insanity (unsound mind) of either or any account holder/s

Survivorship in case of death of one or more of the Joint A/c Holder:

(Either or Survivor)

Joint responsibility, survivors not responsible for payment of any debt due to bank by deceased account holder, however right of set off can be exercised.

Deceased A/c Holder (in case of joint account)

However, in case of joint & several mandates the amount of debt due to bank by deceased can be set-off / recovered from joint account balance to the extent of amount owed by the deceased.

Bankruptcy of Joint Account Holder

Operations to be stopped & instructions should be sought from solvent customers and official assignee to whom all credit balance will vest.

Types of Customer's Account**Joint Account****In the event of death**

Ownership vests in joint holders/ surviving account holders and not to legal heirs of the deceased.

In the event of Lunacy

These articles on death of a holder should be delivered with the consent of official assignee or Manager of Lunacy.

LESSON 25**NEGOTIABLE INSTRUMENTS****Concept/ Object and Purpose of Negotiable instruments**

The object and purpose of the Act is to legalise the system under which claims upon certain mercantile instruments are treated like ordinary goods passing from hand to hand. The Act is not exhaustive of all matters relating to negotiable instruments nor does it purport to deal with all kinds of negotiable instruments. It merely regulates the issue and negotiations of bills notes and cheques and even as regards them it does not deal with its transmissions of rights in them by operation of law or by assignment by deed. In the absence of any express provisions in this Act to the contrary, the general rules contained in the Contract Act are applicable to such instruments as to obligations of parties to the negotiable instruments are contractual in nature. For example the Act does not declare what consideration is sufficient and valid for a bill or note and therefore any consideration which will support a simple contract will support a bill or a note also.

This clause as provided in section 3 of the Negotiable Instrument Act 1881 is reproduced here under:

In this Act, unless there is anything repugnant in the subject or context:-

"accommodation party" means a person who has signed a negotiable instrument as a marker, drawer acceptor or endorser without receiving the value thereof and for the purpose of lending his name to some other person;

"Banker" means a person transacting the business of accepting, for the purpose of lending or investment, of or deposits of money from the public, repayable on demand otherwise withdraw able by cheque, draft, order, or otherwise, and includes any Post Office Savings Bank;

"Bearer" means a person who by negotiable comes into possession of a negotiable instrument, which is payable to bearer,

"Delivery" means transfer of possession actual or constructive, from one person to another;

"issue" means the first delivery of a promissory notice, bill of exchange of cheque complete in form to a person' who takes it as holder .

"material alteration" in relation to a Promissory note, bill, of exchange or cheque includes an alteration of the date, the sum payable, the time of payment, the of payment, and, where any such instrument has been accepted generally, the addition of a place of payment without the acceptor's assent, and

"Notary public" includes any person appointed by the Central Government to perform the functions of notary public under this Act and a notary appointed under the Notaries Ordinance, 1961.

Explanation

The words "material alteration" is not defined in the Act, but in the definition clause with reference to negotiable instrument these words are followed by "include", which has an effect of enlarging the scope of the already understood meaning of the words. The definitions extends the scope of the words to take into its folds the change or alteration in relation to the date, sum payable, time and place of payment with reference to negotiable instrument. It means any material and substantial change, variation, modification, substitution, insertion, erosion, addition or alteration in the contents or body of the negotiable instrument including any alteration of date, the sum payable, the time and place of payment after its due execution which affects the rights, liabilities or legal position of a party.

Some of the important concepts as discussed in the Act are given below:

Negotiable means the quality of transferability by delivery or by endorsement and delivery.

Instrument means a written document by which a right is created in favor of some person.

Negotiable Instrument means a written document, which is freely transferable and which creates a right in favor of some person to receive some money.

Negotiable Instrument as defined in section 13 of the Act is given below:

“A negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer”.

The Act besides above three negotiable instruments recognizes any other instrument satisfying the characteristics of negotiability, as a Negotiable Instrument.

Quasi Negotiable Instruments—the negotiable Instruments Act, 1881 besides the three negotiable instruments as contained in section 13 also recognizes the following instruments as negotiable instrument. These are called Quasi Negotiable Instruments.

Dividend Warrants

Share Warrants

Bearer Debentures

Government Promissory Notes etc.

Promissory Note

It has been defined in section 4 of the Act which is given here under:

“A promissory note is an instrument in writing (not being a bank note or a currency note) containing unconditional undertaking, signed by the maker to pay on demand or at a fixed or determinable future time a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument.

Specimen of a Promissory

Rs. 100,000/-

Lahore

August 20, 2007

Thirty days after date, I promise to pay Mr. Ahmad Kamal or order the sum of rupees one hundred thousand only for value received.

Signature

Revenue Stamp

Yasir Mehmood
(The Maker)

Explanation

The definition of promissory note as given in the Act is much the same as that in section 83 (1) of the Bills of Exchange Act. This and the following sections attempts to define different kinds of negotiable instruments dealt with by the Act. To understand the essentials of a negotiable instrument we have to bear in mind the purpose of such instruments, which is, that they may represent money and do all the work of money in business transactions. It is obvious, therefore, that the first and essential requisite is certainty. Certainty as to the person to make the payment, the person to receive it, the time and place of payment, the conditions of liability, and also as to the amount to be paid. These sections endeavor to define these certainties not “in such exact and technical way as would only embarrass the transaction of business but substantially, in a perfect and practical way. “A promissory note may be in the form of a letter or in any

other form of words which fulfill the requirements of this section, and from which the intention to make a note appears.

How promissory note differs from agreement:

It depends upon the circumstances and wording in each case as to whether a document is a promissory note or an agreement. One of the tests to be applied to find out is the intention of the parties. The second is whether the document as drawn out can be said to be negotiable, that is to say, could a third person file a suit on the strength of the document. If he could not, then it is a mere agreement, where the document clearly stated that the amount was kept in deposit the mere fact that the document bore twenty five paisa stamps and the impression of the scribe would not make it a promote.

Notice to surety:

Delivery of notice to surety is not a condition precedent for making him liable on a negotiable instrument if the maker does not pay

Proof:

A party seeking to prove a promissory note need not go behind the promissory note, he has only to prove due execution of the note. Where the plaintiff bank produced two witnesses who categorically stated all documents including promissory notes, hypothecation agreement, letter of revival and balance credit slips having been signed by the defendant, no evidence was produced by defendant to discharge the burden placed upon him in the face of the positive evidence produced by the plaintiff, the genuineness of the promissory note stood proven

Under Article 73 of the Limitation Act, a suit based on a promissory note payable on demand has to be filed within 3 years from the date of the note. Under Article 64-A a suit under Order XXXVII of the Code of Civil Procedure, is required to be filed within 3 years from the date when the debt becomes payable immediately where a promissory note makes it obligatory on the holder to sue on expiry of three days after notice to pay was given, limitation of the suit begins three days after the notice to pay was given.

Mere fact that there was an oral understanding between the parties to return the amount within three months, would not take away the unconditional effect of the promote.

Promissory Note:

Proof of promissory note, would be unquestionable when witnesses were subjected to lengthy cross-examination but nothing was extracted to demolish their credibility and neutrality.

Promissory note is not required to be attested. Requirement as to attestation of promissory note prescribed in Art. 17 (2) (a), Qanun-e-Shahadat, 1984, would not override Negotiable Instruments Act, 1881 which does not require attestation of promissory note.

We shall carry on with the negotiable instruments in the coming Lessons.

LESSON 26**NEGOTIABLE INSTRUMENTS****Promissory Note:**

We have already gone through the definition of promissory note and also had a view of a specimen of a promissory note; we shall continue to explore the other aspects of promissory note.

The notes which do not qualify to be called Promissory note:

We are discussing below some of the notes which do not qualify to be called promissory note in the light of definition contained in section 4:

Thirty days after date, I promise to pay Mr. Ahmad Kamal or order the sum of rupees one hundred thousand only and the amounts which may be due to Ahmed Kamal by due date.

--This is not the promissory note since the amount promised is not certain and ascertainable on the date of making the promise/ undertaking.

The notes given below do not qualify to be called promissory note in the light of definition contained in section 4

I owe Rs 100,000 to MR. Ahmad Kamal

--This is not a promissory note since it is just an acknowledgement not an undertaking

I promise to pay Rs 100,000 to Mr. Ahmad Kamal thirty days after getting admission in a University.

--This is not a promissory note since the time of payment is not certain/ ascertainable at the time of making the promise.

The section 4 of the Act recognizes three kinds of promissory notes:-

A promise to pay a certain sum of money to a person.

A promise to pay a certain sum of money to the order of a certain person. This is nevertheless payable to the person named or his order.

A promise to pay the bearer.

The main question in deciding whether a document is a promissory note is to consider not whether it is negotiable or not but to consider whether in substance and primary intention it was a note and whether it contains the necessary recitals and is not intended to record a different kind of transaction altogether. The question whether the words in documents amount to mere acknowledgement or to a promise has to be decided on the intention as mentioned above and the real characteristics of the document. Mere reference to account in the promissory note does not make it any the less a promissory note. When the requirements of the section are satisfied, a promissory note is not the less a note because it contains a recital that the maker has deposited title deeds with the payee; or because it is attested by witnesses, or because it refers to an agreement which does not, however, qualify the note, or because the words "security for overdraft" are found printed upon it or because it contains a promises to pay at certain place.

Parties to the Promissory Note

As we already know that there are following parties in a promissory note

Maker &

Payee

Essentials of a Promissory Note:

A promissory note must fulfill the following requirements:

It should be in writing

There must be promise/ undertaking to pay

The promise/undertaking should be unconditional

It should be signed by maker

Maker must be a certain person

Payee must also be a certain person

The amount to be paid must be certain

Legal tender money is to be paid under a promissory note

Time of payment to be ascertainable

It should be properly stamped under stamp Act.

Promise to pay must be for lawful consideration

Promissory note must maintain the date of issue and place of issue.

Explanation:**Sum to pay must be only money and certain:**

It is also necessary that the medium of payment must be money only that is specie or other legal currency, and not bonds, bills, notes or any article other than money. But it is not necessary that the money to be paid must be that current in the place of payment, or where the bill is drawn, it may be in the money form of any country whatever. The amount promised to be paid must be certain and incapable of being varied by indefinite editions or deductions. If the amount is not capable of being ascertained of the face of the instrument, that instrument will not be a promissory note.

“To or to the order of certain person”

An instrument that does not own it face indicate to whom the money is payable is not a promissory note. But where it is clear from the instrument itself who the payee is, it is not necessary that the name of the payee must appear in that part of the note which expresses a promise to pay. Therefore a promissory note made in favor of a person described by his office is one made in favor of certain person and is valid. A promissory note payable to manager of a bank is payable to a certain person. But where the payee is described only as “you” the instrument is not a promissory note.

Signature:

The Act contains no definition of the term “signature” it includes the mark made by a person who is unable to write his name such signature need not be at the foot or at any particular part of the document. Where the intention of the parties is clear, the position of a signature on a bill is immaterial; if the maker writes his name to a bill or note on any part of it so as to authenticate it and to give effect to the contract by him thereon. It will be sufficient. A signature to a bill may be in pencil; it may be lithographed, and even printed; in which case however, it must be shown to have been adopted and used by the party as his signature, or again, the affixing of the facsimile of a name (e.g. by rubber stamp) is good as signature.

Plaintiff had established his case on the basis of evidence both documentary as well as oral and the Trial Court decreed the suit against the defendant. Contents of the document would bring the document within the definition of promissory note. Heading given to such document was not legally relevant. Document forming basis of the decree against the defendant was in fact a promissory note as defined in section 4 of negotiable instruments Act, 1881, even though the same was described as a pronote.

Writing:

The instrument may be written on paper, parchment, or any other convenient substitute for paper. "Writing" would be held to include printing, engraving, lithographing, and in fact every mode by which words and figures can be expressed on any material. The writing may be in pencil or in ink, but the imperfection of the former mode of writing and its liability to obliteration prevent its being generally adopted.

The fact that a promissory note is written on a page in an account book of the creditor does not make it illegal or any the less a promissory note. There is nothing in the Negotiable Instrument Act to make even a promissory note not negotiable by express terms or by necessary implication.

Signature only on stamp:

Where defendant denied the execution of promissory note but did not deny signature on revenue stamp affixed on the pronote. Contention of defendant was that he did not sign beyond the revenue stamp, his signature was for the payment of salary and promissory note was the result of fraud. The Court rejected the contention.

Unconditional undertaking:

In a promissory note there must be an unconditional undertaking to pay, and the note must be payable at all events. When a promise to pay is said to be conditional and when not, is explained in section 5. A letter requesting a loan, and stating that the amount lent will be repaid is not such an unconditional undertaking, because the repayment is dependent on the advance being made. But mentioning a place of payment is not such a condition under the section as to make it not a promissory note. Mere acknowledgement of indebtedness is not sufficient.

Bill of exchange

It is an important form of a negotiable instrument and has been defined in section 5 of the Act; the said definition is reproduced below:

"A bill of exchange is an instrument in writing containing an unconditional order, signed by maker, directing a certain person, to pay on demand or at fixed or determinable future time a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument".

Specimen of bill of exchange

Rs. 100,000/-

Lahore

August 20, 2007

Ninety days after date, pay to Mr. Ahmad Kamal or order rupees one hundred thousand only for value received

Signature

Yasir Mehmood

(Drawer)

Accepted by

Drawee

XYZ (Drawee)

Revenue Stamp

Essentials of bill of exchange

These are outlined here under:

- In writing
- Order to pay
- Unconditional order
- Signed by the drawer
- Drawee certain person
- Time of payment
- Certain sum
- Legal tender money
- Payee certain person
- Other formalities
- Date
- Place
- Lawful consideration
- Revenue stamp

Explanation of different features of a bill of exchange:

A promise or order to pay is not “conditional, within the meaning of this section and section 4, by reason of the time for payment of the amount or any installment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain.

The sum payable may be “certain” within the meaning of this section and section 4, although it includes future interest or return in any other form or is payable at an indicated rate of exchange, or is payable at the current rate of exchange and although it is to be paid in stated installments and contains a provision that on default of payment of one or more installments or interest. Or return in any other form the whole or the unpaid balance shall become due.

A promise order to pay is not ‘conditional’ nor is the sum payable uncertain within the meaning of this section or section 4 by reason of the sum payable being subject to adjustment for profit or loss, as the case may be of the business of the maker.

Where the person intended can reasonably be ascertained from the promissory note or the bill of exchange; he is a ‘certain person’ within the meaning of this section and section 4, although he is misnamed or designated by description only.

An order to pay out of a particular fund is not unconditional within the meaning of this section; but an unqualified order to pay, coupled with—

an indication of a particular fund out of which the drawee is to reimburse himself or a particular account to be debited to the amount, or

a statement of the transaction which gives rise to the note of bill, in unconditional

An essential character of a bill of exchange is that it shall contain an order to accept or to pay and that acceptor should accept it, in the absence of such a direction to pay the document will not be a bill of exchange or a hundi.

The following are the ingredients of a bill of exchange:

- It must in writing
- It must contain an order to pay and addressed to some person
- The order must be unconditional
- The order must be signed by the maker

The order must direct to pay or demand or at a fixed or determinable future time.

The sum ordered to be paid must be certain.

The payment should be ordered to be paid to a certain person, or to his order, or to the bearer.

Order should be unconditional:

The drawer's order to the drawee must be unconditional and should not make the payment of the bill dependent on a contingency. Where an instrument is expressed to be payable on a contingency, it does not cease to be invalid by the happening of the event before the expiry of the period fixed for the performance of the obligation, for the instrument must be valid ab initio, and carry its validity on its face.

Drafts:

A banker's draft is a bill drawn either on demand or otherwise by one bank on another in favor of third party, or by one branch of a bank on another branch of the same bank, or by the head office on a branch, or vice versa. It is a bill of exchange and therefore a negotiable instrument. The issue of a draft is regarded in banking practice as a matter of purchase and ordinarily the relationship between the holder of a demand draft and the bank issuing it is that of debtor and creditor.

Future interest, etc:

If the sum payable includes future interest, or is payable at an indicated rate of exchange, or is according to course of exchange, the sum payable shall be considered to be "certain" although the instrument may provide that on default of payment of an installment the whole of unpaid balance shall become due.

Certain person:

Although a certain person is misnamed or designated by description only, yet the person shall be "certain" if it is clear as to who is the person to whom direction is given or payment is to be made.

Instrument must contain an order to pay money and money only: In order that an instrument may amount to a promissory note, it is essential that the medium of payment must be money only. It should not consist in any article of food or any animal or in any bonds, simply or coupled with money in specie.

If after issuing a cheque the drawer keeps quiet and takes no steps to inform the bank in time i.e. before the cheque is encashed that the cheque should not be according to section 10 of the Negotiable Instruments Act, means payment in accordance with the apparent tenor of the instrument in good faith, the liability for the drawn cheque shall absolutely and squarely fall on the drawer.

Difference between promissory note and bill of exchange:

In a promissory note the executant promises him to pay while in a bill of exchange he directs another to pay.

In a bill of exchange the person liable is responsible to executants and not scribe.

In a promissory note the maker is the principal debtor. In the case of bill of exchange the drawer is surety.

A bill of exchange can be accepted conditionally while a promissory note cannot be so made.

A promissory note cannot be made payable to the maker himself. In a bill of exchange this is possible and one person may become both drawer and payee or both drawee and payee.

In promissory notes there are two parties—the promisor and the promisee (the maker and the payee). In the case of bills of exchange there are three parties—the drawer (who makes the order), the drawee, the bill is drawn).

The most important distinction is that in the case of a promissory note the maker unconditionally undertakes to pay the amount mentioned in the promissory note while in the case of a bill of exchange the maker gives an unconditional order directing another person to pay.

If Interest on a promissory note is subsequently increased by agreement of the parties. The guarantors of the promissory note are not discharged if the suit is brought on the original promissory note.

LESSON 27**NEGOTIABLE INSTRUMENT**

Another important type of negotiable instrument is cheque. Cheque as defined in section 6 of the Act is given below:

Cheque

“A cheque is a bill of exchange drawn on a specified banker and not expressed to payable otherwise than on demand”.

Parties:

There are three parties in the cheque which are as under:

- o **Drawer**
- o **Drawee (in case of cheque, drawee is always a banker)**
- o **Payee**

Essentials of a Cheque:

A cheque must fulfill the following requirements:

- It must be in writing
- It should contained unconditional order
- It must by signed by drawer
- Cheque is always payable on demand
- The cheque is always drawn on a specified banker
- As a matter of practice, cheque leaves are in printed form
- The amount payable should be specified in the form of legal tender money and is paid accordingly.
- The amount must be certain amount
- The cheque is payable to specified person or order of or to bearer.
- Date of issue must be mentioned on the cheque.

Explanation:

A cheque is a peculiar sort of instrument in many ways resembling a bill of exchange, but in some entirely different. In the ordinary course, it is never accepted, it is not intended for circulation, it is given for immediate payment, it is not entitled to days of grace. In addition, a cheque is presented for payment, whereas a bill in the first instance is presented for acceptance, this is not so in the case of a cheque, because the holder of a cheque, as between himself and the drawer, has no right to require acceptance. A cheque is not intended for circulation; it is given for immediate payment; it is not entitled to days of grace; and though it is, strictly speaking an order upon a debtor by a creditor to pay to a third person the whole or part of a debt, yet, in the ordinary understanding of persons, it is not so considered.

Types of Cheques:

The cheques can be divided in the following forms:

Bearer Cheques:

In this type cash is payable to anyone presenting the cheque for payment at the cash counter of bank?

Order Cheques

Such cheques are payable to the specified person on proper identification of the payee.

Crossed Cheques

Crossing may be of different types, we shall discuss all these types of crossing. However if the cheque is crossed as payees account only such cheques cannot be paid at the cash counter of the bank and these must be credited to the bank account of the payee.

Crossed Cheques and their Collection**Crossing of cheques:**

The cheques are of two types—open (uncrossed) cheques and crossed cheques. Payment of a cheque by the drawee banker depends upon whether the cheque is open or crossed. The payment of open cheque is made at the counter of the banker on its presentation. The open cheque is liable to a great risk in the course of circulation. Since an open cheque is payable to a bearer, it involves a risk of payment to any person, if it is lost. In order to avoid such risk and to protect the interest of the genuine holder, the system of crossing the cheques was introduced.

In case of a crossed cheque, payment can be obtained only through a banker. That is, the payee or the holder, having an account in a bank, has to deposit the crossed cheque for collection, and draw the money when the cheque is collected and the proceeds are credited to his account. It is only with a view to avoiding any such risk of fraud that businessmen introduced the device of crossing. Thus, crossing of a cheque may be defined as, “a direction to the drawee banker to pay the money on a crossed cheque through a banker, so that the party getting the payment of a crossed cheque may be easily traceable.”

Types of Crossing

There are two types of crossing

1. General Crossing
2. Special Crossing.

General Crossing:

A cheque is said to contain a general crossing when two parallel lines are drawn across the face of the cheque. According to Sec. 123. “where a cheque bears across its face an addition of the words “and company” or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words “not negotiable”, that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally.” A cheque is said to be crossed when two parallel transverse lines, with or without any words, are drawn on the left hand top corner of the cheque. It is relevant to state that such lines are essential for general crossing and may not be drawn in case of special crossing.

Special Crossing:

Sec. 124 of the Act defines special crossing as “Where cheque bears across its face an addition of the name of a banker, either with or without the word “not negotiable” that addition shall be deemed a crossing, and cheque shall be deemed to be crossed specially and to be crossed to that banker.” Further, Sec. 126, Para 2 states “Where a cheque is crossed specially the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent, for collection.

In the case of special crossing the paying banker is to honour the cheque only when it is presented through the bank mentioned in the crossing or an agent of such bank, further, sec. 127 states, “Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof. “A special crossing makes the cheque safer than a general crossing because now a thief will have to search an account-holder of that particular bank only whose name appears in the crossing which may only create more difficulty.

Account Payee (Restrictive crossing)

Although the Act is silent with regard to this form of crossing, it has been recognized by custom amongst businessmen and bankers. The words ‘account payee’ within a general or a special crossing, are a direction to the collecting banker to collect and credit the payee’s account with the proceeds of the cheque. It means that a cheque marked ‘account payee only’ or A/c Payee’ or ‘Payee’s A/c’ have same significance. If the

banker goes against this order, he will be guilty of negligence. Hence “accounts payee only” crossing is not negotiable practically, as banks will collect it on behalf of no person other than the payee.

Not Negotiable Crossing:

The words ‘Not negotiable’ may also be written in both types of crossing—general and special and a crossing with these words is said to be ‘Not Negotiable’ crossing. Section 130 states that “A person taking a cheque crossed generally or specially, bearing in either case the words “not negotiable” shall not have, and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had.

The object of ‘not negotiable’ crossing is to afford protection to the holder or drawer of a cheque, because even if such a cheque goes to wrong hands and from there it is transferred to holder in due course, the true owner will not lose his claim against an indorsee. Thus an indorsee of such a crossed cheque must not accept the cheque unless he knows the indorser very well and is convinced about his having a good title thereto.

Who may Cross a Cheque?

Crossing of an uncrossed cheque does not amount to a material alteration so as to affect the validity of the instrument. Apart from the drawer of a cheque crossing it generally or specially at the time of issue, the holder of a cheque and also the banker may cross it. Section 125 permits the crossing being made even after issue of a cheque in the following ways:

1. (Sec 125) “Where a cheque is in crossed, the holder may cross it generally or specially.
2. Where a cheque is crossed generally, the holder may cross it specially.
3. Where a cheque is crossed generally, or specially, the holder may add the word “not negotiable”.
4. Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially, to another banker, his agent, for collection.”

Crossing once made is a material part of the cheque and its alteration except in the above cases will amount to a material alteration. Thus, if a special crossing on a cheque is altered by the holder into a general crossing by striking out the name of the banker, it will be unauthorized. Crossing once made became material part of the cheque and only the drawer of the cheque is entitled to cancel or open the crossing by writing the words “pay cash” and cancelling the crossing along with his fully signature. Thus, where a cheque is crossed ‘account payee’ and the holder alters it into a general crossing by striking out the words ‘account payee’, the alteration is irregular and discharges the instrument.

Various provisions of negotiable instrument Act 1881 with regard to cheque:

The Act deals with various aspects regarding the cheques which are appended hereunder for reference.

Instruments payable on demand: Sec 19

A promissory note or bill of exchange is payable on demand, ---

- (a). Where it is expressed to be so, or to be payable at sight or on presentment; or
- (b). where no time for payment is specified in it; or
- (c). where the note or bill accepted or endorsed after it is overdue, as regards the person accepting or indorsing it

Anti-dating and post-dating: sec 21C

A promissory note, bill of exchange or cheque is not invalid by reason only that it is anti-dated or post-dated; Provided that the anti-dating or post-dating does not involve any illegal or fraudulent purpose or transaction.

Liability of legal representative signing: Sec 29

A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him as such.

Signature essential to liability: sec 29-A

No person is liable as maker, drawer, endorser or acceptor of a promissory note, bill of exchange or cheque who has not signed it as such:

Provided that where a person signs any such instrument in a trade or assumed name he is liable thereon as if he had signed it in his own name.

Forged or unauthorized signature: Sec 29-B

Subject to the provisions of this Act, where a signature on a promissory note, bill of exchange or cheque is forged or placed thereon without the authority of the person whose signature it purports to be, the forged, or unauthorized signature is wholly inoperative, and no right to retain the instrument or to give a discharge therefore or to enforce payment thereof against any party thereto can be acquired through or under that signature, unless the party against whom it is sought to retain or enforce payment of the instrument is precluded from setting up the forgery or want of authority:

Provided that nothing in this section shall effect the ratification of an unauthorized signature not amounting to a forgery.

Stranger signing instrument presumed to be endorser: Sec 29-C

A person placing his signature upon a negotiable instrument otherwise than as maker, drawer or acceptor is presumed to be an endorser unless he clearly indicates by appropriate words his intention to be bound in some other capacity.

Liability of drawee of cheque: Sec 31

The drawer of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default.

When is a banker justified in dishonoring cheques: he will be justified:-

- (a). If the banker has not sufficient funds of the drawer with him.
- (b). If the banker has sufficient funds but they are not properly applicable to the payment of cheque.
- (c). If the cheque is not duly presented for payment.
- (d). If the cheque is not presented within reasonable time after the issuing date. Usually a period of six months has been considered as the reasonable time.
- (e). If the cheque is post-dated and is presented before actual date.
- (f). When the customer draws the cheque on one branch while he has account in another branch of the same bank.
- (g). When the customer countermands payment.

When a bank is bound to dishonor the cheque: he will be bound to dishonor:-

- (a). If the cheque is irregular, ambiguous, etc
- (b). If the customer is dead and the banker has notice of the same.
- (c). If the funds are subject to a lien
- (d). If the customer becomes insolvent of which fact the banker has received notice.
- (e). If the customer becomes lunatic and the banker has notice thereof.

Presentment of cheque to charge drawer: Sec 72

Subject to the provisions of section 84, a cheque must, in order to charge drawer, be presented at the bank upon which it is drawn before the relation between the drawer and his banker has been altered to the prejudice of the drawer.

When cheque not duly presented and drawer damaged thereby: Sec 84

- (1) Where a cheque is not presented for payment within a reasonable time of its issue, and the drawer or person on whose account it is drawn had the right, at the time when presentment ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage through the delay, he is discharged to the extent of such damage, that is to say, to the extent to which such drawer

or person is a creditor of the banker to a larger amount than he would have been if such cheque had been paid.

- (2) In determining what a reasonable time is, regard shall be had to the nature of the instrument, the usage of trade and of bankers, and the facts of the particular case.
- (3) The holder of the cheque as to which such drawer or person is so discharged shall be a creditor, in lieu of such drawer or person, of such banker to the extent of such discharge and entitled to recover the amount from him.

Illustrations

- (a). A draws a cheque for Rs. 1,000 and when the cheque ought to be presented, has funds at the bank to meet it. The bank fails before the cheque is presented. The drawer is discharged, but the holder can prove against the bank for the amount of the cheque.
- (b). A draws a cheque at Sialkot on a Bank in Karachi. The Bank fails before the cheque could be presented in ordinary course. A is not discharged, for he has not suffered actual damage through any delay in presenting the cheque.

Cheque payable to order: Sec 85

- (1) Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course.
- (2) Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due to the bearer thereof, notwithstanding any endorsement whether in full or in blank appearing thereon, and notwithstanding that any such endorsement purports to restrict or exclude further negotiation.

Drafts drawn by one branch of a bank on another payable to order: Sec 85-A

Where any draft, that is, an order to pay money, drawn by one office of a bank upon another office of the same bank for a sum, of money payable to order on demand, purports to be endorsed by or on behalf of the payee, the bank is discharged by payment in due course.

Special provisions relating to cheques as contained in the Act:

Revocation of banker's authority: Sec 122-A

- (1) The duty and authority of a banker to pay a cheque drawn on him by his customer are determined by-
 - (2) Countermand of payment;
 - (3) Notice of the customer's death;
 - (4) Notice of adjudication of the customer as an insolvent.

Cheque crossed generally: Sec 123

Where a cheque bears across its face an addition of the words "and company" or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words "not negotiable", that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally.

Cheque crossed "account payee: sec 123A.

- (1) Where a cheque crossed generally bears across its face an addition of the word "account payee" between the two parallel transverse line constituting the general crossing, the cheque, besides being crossed generally, is said to be crossed "account payee".
- (2) Where a cheque is crossed "account payee"---
 - (a). It shall cease to be negotiable; and
 - (b). It shall be the duty of the banker collecting payment of the cheque to credit the proceeds thereof only to the account of the payee named in the cheque.

Cheque crossed specially: Sec 124.

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

Crossing after issue: Sec 125

- Where a cheque is uncrossed, the holder may cross it generally or specially.
- Where a cheque is crossed generally, the holder may cross specially.
- Where a cheque is crossed generally or especially the holder may add the words "not negotiable".
- Where a cheque is crossed specially, the banker to whom it is crossed may again cross it especially to another banker, his agent, for collection.
- When an uncrossed cheque, or a cheque crossed generally, is sent to a banker for collection he may cross it especially to himself.

Crossing a material part of a cheque: Sec 125-A

A crossing authorized by this Act is a material part of the cheque; it shall not be lawful for any person to obliterate, or, except as authorized by this Act, to add to or alter, the crossing.

Payment of cheque crossed generally: Sec 126

Where a cheque is-crossed generally, the banker on whom it is drawn shall to pay it otherwise than to a banker.

Payment of cheque crossed specially

Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than: to the banker to whom it is crossed, or his agent for collection.

Payment of cheque crossed especially more than once: Sec 127.

Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof.

Payment in the course of crossed cheque: Sec 128

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

Payment of crossed cheque out of due course: Sec 129

Any banker paying a cheque crossed generally otherwise than to a banker, or a cheque crossed specially otherwise than to the banker

Difference between a cheque and a bill of exchange:

- i. A cheque is drawn on a specified banker, but a bill may be drawn on any one including a banker
- ii. A cheque is payable immediately on demand, a bill is entitled to days of grace.
- iii. A cheque requires no acceptance: it is intended for immediate payment whereas a bill of exchange has to be accepted before acceptor can be made liable.
- iv. Failure of presentment for payment discharges the drawer in the case of a bill, but the drawer of a cheque is not discharged by failure of the holder to present it in due time unless the drawer has sustained damage by the delay.
- v. When a cheque is not met, notice of dishonor is not necessary as in the case of bills: want to assets in the hands of the banker is sufficient notice.
- vi. A cheque is revocable while a bill is not.

In case the drawer of the cheque denies its execution, he may take a plea in the alternative that if his signature on the cheque is found to be genuine it may be taken that a signed cheque had been stolen from him and as such he is not liable on it. In such a case it is for the plaintiff to prove that the cheque was actually drawn by the defendant and therefore he was liable on it.

Cheques in the nature of an order from the account—holder to the Bank directing it to pay the specified amount out of his account. Where signature of the account-holder on a cheque is forged then it is not his order to pay. Payment on the basis of a forged cheque is thus payment without authority and would not bind the customer.

The different types of negotiable instruments have been covered in detail; we shall discuss the other aspects regarding these instruments in coming Lessons.

LESSON 28**NEGOTIABLE INSTRUMENTS*****Endorsement: we shall discuss endorsement and its kinds:***

Definition of endorsement as contained in section 15 of the Act is reproduced below:

“When the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to indorse the same, and is called endorser”.

Essentials of an Endorsement: An endorsement must fulfill the following requirements:

It should be on the instrument. If there is no space on it, it may be on a separate slip of paper annexed to the instrument called ‘allonge’.

The endorser should sign the endorsement in the same style and with the same spellings as written in the instrument.

Signatures should be in ink and not by pencil or rubber stamp.

It should be made by the holder or the maker. It cannot be endorsed by a stranger.

The delivery of the instrument with the intention of passing the property in it to the endorsee is important.

A partial endorsement, i.e., an endorsement which purports to transfer to the endorsee a part only of the amount or which purports to transfer the instrument to two or more endorsees severally does not operate as a negotiation of instrument.

An endorsement may be made in blank or full. It may also be restrictive.

The name of a married woman should be accompanied by the name of her husband.

Mere signature of the holder, without any words, also constitutes endorsement. Any number of endorsements may be made on the instrument.

No particular form of words is necessary to create a contractual relationship between endorser and the endorsee.

An endorsement becomes complete only when:

The holder signs on the face or back of the instrument;

The instrument is delivered to the endorsee; and

It is signed and delivered with the intention of vesting the endorsee with the rights of the holder.

Kinds of Endorsement:

The endorsements are divided as under:

Blank or general

Full or special endorsement

Restrictive endorsement

Partial endorsement

The above endorsements are discussed in the following paragraphs:**Instrument endorsed in blank:**

It has been discussed in section 16 which is given below:

If the endorser signs his name only, the endorsement is said to be "**in blank**", and if he adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the endorsement is said to be "**in full**", and the person so specified is called the "endorsee" of the instrument.

In such type of endorsement, endorser just signs his name.

Instrument endorsed in blank: Sec 54

Subject to the provisions hereinafter contained as to crossed cheques, a negotiable instrument endorsed in blank is payable to the bearer thereof even although originally payable to order.

Full or special endorsement:

The said endorsement has been defined in section 16 which is given below:

If the endorser signs his name only, the endorsement is said to be "**in blank**", and if he adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the endorsement is said to be "**in full**", and the person so specified is called the "endorsee" of the instrument.

Conversion of endorsement in blank into endorsement in full: Sec 55

If a negotiable instrument, after having been endorsed in blank, if endorsed in full, the amount of it cannot be claimed from the endorser in full, except by the person to whom it has been endorsed in full, or by one who derives title through such person.

Endorser mentions the name of endorsee and puts his signature.

"Endorsee"

The provisions of this Act relating to a payee shall apply with the necessary modifications to an endorsee.

Restrictive Endorsement:

It has been defined in section 50(2) of the Act which is reproduced below:

An endorsement is restrictive which either--

Restricts or excludes the right to further negotiate the instrument, or

Constitutes the endorsee an agent of the endorser to endorse the instrument or to receive its contents for the endorser or for some other specified person

Such endorsement restricts further negotiation of the instruments, for example

Pay Yasir only

Signature of endorser

Without Recourse Endorsement

It has been defined in section 52 of the Act which is reproduced below:

The endorser of a negotiable instrument may, by express words in the endorsement, exclude his own liability thereon, or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen.

Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all intermediate endorsers are liable to him.

Where the right of an endorsee to receive the amount due on the negotiable instrument is made dependent in the aforesaid manner the condition is valid only as between the endorser and the endorsee.

Where the endorsement of a negotiable instrument purports to be conditional, the payer may disregard the condition and payment to the endorsee is valid whether the condition has been fulfilled or not.

Without responsibility of the endorser. For example:

Pay Yasir without recourse to me

Signature of endorser

Partial Endorsement:

It has been defined in section 56 of the Act which is reproduced below:

Negotiation by endorsement must be of the entire instrument.

An endorsement which purports to transfer to the endorsee only a part of the amount payable, or which purports to transfer the instrument to two or more endorsees severally, is not valid as a negotiable of the instrument; but where such amount has been paid in part, a note to that effect may be endorsed on the instrument, which may then be endorsed for the balance.

The endorser directs the transfer only a part of amount payable on a bill of exchange or promissory note through such endorsement.

Explanation:

A partial endorsement, i.e., an endorsement which purports to transfer to the indorsee a part only of the amount payable, does not operate as a negotiation of the instrument. Such an endorsement is not warranted by the custom of merchants and would be attended with this inconvenience to the prior parties, that it would subject them to a plurality of actions. In the same manner, an endorsement, which purports to transfer the instrument to two or more indorsees severally and not jointly, is also expressly forbidden by this section. The object of the section is to prevent an instrument being transferred for a portion only of the sum at the time due under it, because a personal contract cannot be apportioned. The endorsement must be the endorsement of the instrument.

Illustrations:

A is the holder of a bill for Rs. 1,000. A indorses it thus: "pay Rs 50 to transferred to B and C as each of them is in indorse of only a part of the amount, the endorsement is partial and invalid for the purpose of negotiation.

A is the holder of a bill for Rs. 1,000. A indorses it thus: "pay B or order Rs. 500. This is a partial endorsement and invalid for the purpose of negotiation.

The last part of the section says that if a bill has been paid in part, the fact of the part payment may be indorsed on the instrument, and it may then be negotiated for the residue, e.g., a bill may be indorsed thus: "Pay A or order Rs. 500 being the unpaid residue of the bill". Such an endorsement would be valid.

Effect of endorsement: Sec 50

Subject to the provisions of this Act relating to restrictive, conditional and qualified endorsement, the endorsement of a negotiable in followed by delivery transfers to the endorsee the property therein' with the right of further negotiation.

An endorsement is restrictive which either--

Restricts or excludes the right to further negotiate the instrument, or

Constitutes the endorsee an agent of the endorser to endorse the instrument or to receive its contents for the endorser or for some other specified person.

Provided that the mere absence of words implying, right to negotiate does not make the endorsement restrictive.

Illustrations

B signs the following endorsements on different negotiable instruments payable to bearer-----

"Pay the contents to C only."

"Pay C for any use."

"Pay C or order for the account of B."

"The within just be credited to C."

These endorsements exclude the right of further negotiation by C.

"Pay C."

"Pay C value in account with the Oriental Bank."

"Pay the contents to C, being part of the consideration in a certain deed of assignment executed by C to the endorser and others.

These endorsements do not exclude the right of further negotiation by C.

Who may negotiate: Sec 51

Every sole-maker, drawer, payee or endorsee, or all of several joint makers, drawers, payees or endorsees, of a negotiable instrument may, if the negotiability of such instrument has not been restricted or excluded as mentioned in Section 50, endorse and negotiate the same.

Explanation --- Nothing in this section enables a maker or drawer to endorse or negotiate an instrument, unless he is in lawful possession or is holder thereof or enables a payee or endorsee to endorse or negotiate an instrument, unless he is holder thereof.

Illustration

A bill is drawn payable to A or order, A endorses it to B, the endorsement not containing the words "or order" or any equivalent words. B may negotiate the instrument. .

Requisites of endorsement: Sec 56

Negotiation by endorsement must be of the entire instrument.

An endorsement which purports to transfer to the endorsee only a part of the amount payable, or which purports to transfer the instrument to two or more endorsees severally, is not valid as a negotiable of the instrument; but where such amount has been paid in part, a note to that effect may be endorsed on the instrument, which may then be endorsed for the balance.

Legal representative cannot by delivery only negotiate instrument endorsed by deceased: Sec 57

The legal representative of a deceased person cannot negotiate by delivery only a promissory note, bill of exchange or cheque payable to order and endorsed by the deceased but not delivered.

Maturity of the Instruments**What is Maturity:**

It is the date of a promissory note or bill of exchange, at which it falls due.

(Section 22 defines the maturity)

Days of Grace:

Three days of grace are provided in section 22 for determining pay ability of instrument but said days of grace are not available when instrument is payable on demand or at sight or on presentment

Days of Grace are applicable in case of Promissory note and bill of exchange but not cheque, since it is always payable on demand.

LESSON 29**PARTIES TO PROMISSORY NOTES, BILLS AND CHEQUES**

We have already discussed the parties to promissory note, bill of exchange and cheque,

Various legal aspects with respect to the parties to these instruments are discussed in detail in the following paragraphs:

Every person capable of contracting can be a party to a negotiable instrument that is can be a party by making/ drawing, accepting, endorsing a negotiable instrument.

Capacity to make/draw negotiable instruments:

It has been defined in section 26 of the Act which is reproduced below:

Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Positions of parties who are incompetent to enter into contracts:

Minor:

Where such an instrument is made, drawn or negotiated by a minor, the making, drawing or negotiating entitles the holder to receive payment of such instrument and to enforce it against any party thereto other than minor.

Although the minor cannot bind himself by making/ drawing a negotiable instrument but through such an instrument bind all other parties.

A person of unsound mind is incompetent to enter into a contract

Insolvent: The property belonging to an insolvent vests in an official receiver, hence the insolvent person cannot neither sue nor capable of negotiating/ transfer/ endorse the instrument

Lunatic- Position same as that of minor

Agent /Agency:

It has been defined in section 27 of the Act which is reproduced below:

Every person capable of binding himself or of being bound by the making, drawing, acceptance or negotiation of a negotiable instrument, may so bind him or be bound by a duly authorized agent acting in his name.

A general authority to transact business and to receive and discharge debts does not confer upon an agent the power of accepting or indorsing bills of exchange so as to bind his principal.

An authority to draw bills of exchange does not of itself import an authority to endorse.

Liability of the Agent:

An agent may draw, accept or negotiate an instrument on behalf of the principal so as to bind him.

However this binding is subject to following conditions:

That the agent has been authorized by the principal to that effect:

That the authority has been expressed in clear terms:

That the principal is a competent person to enter into a contract.

That the agent acts in the name of the principal: and

That the agent has not exceeded his authority.

The agent will be personally liable in any of the following cases;

If he does not disclose the name of his principal:
If he does not indicate that he is an agent.
If he executes an instrument without or in excess of his authority.

The above provisions are contained in **section 28** which is reproduced:

Where a person signs a promissory note, of exchange or cheque without adding to his signature words indicating that he signs it as an agent for and on behalf of a principal or in a representative character, he is personally liable thereon but the mere addition to his signature of words describing him as an agent or as filling a representative character does not exempt him from personal liability.

Notwithstanding anything contained in sub-section (1), any person signing a promissory note, bill of exchange or cheque for and on behalf of the principal is not liable to a person who induces him to sign upon the belief that the principal alone would be held liable.

Parties to Promissory Note:

These are discussed below:

Maker:

The person who makes the note and undertakes to pay the amount stated in the promissory note.

Payee:

The person to whom the amount is payable under promissory note.

Holder:

The person who may be the payee or endorsee of the promissory note. Holder is the person who is entitled to the possession of the instrument in his own name and also entitled to receive the amount due under a promissory note.

Endorser

The person who by endorsement transfers the promissory note to another person.

Endorsee

The person to whom the promissory note is transferred by endorsement.

Parties to bill of exchange

These are discussed below:

Drawer

The maker of a bill of exchange is Drawer.

Drawee

The person who is directed by the drawer to pay the amount stated in bill of exchange is called drawee.

Acceptor

The drawee when accepts the **bill of exchange**, he becomes acceptor.

Payee

The person to whom or to whose order the amount stated in bill of exchange is to be paid.

Holder

Explained while discussing promissory note.

Endorser

Explained while discussing promissory note.

Endorsee

Explained while discussing promissory note.

Parties to a Cheque:

These are discussed below:

Drawer

The person who draws/ writes a cheque is called the drawer

Drawee

The person who is directed through a cheque to pay the specified amount is called the drawee, however in case of a cheque, drawee must always be a bank.

Payee

Explained while discussing promissory note.

Holder

Explained while discussing promissory note.

Endorser

Explained while discussing promissory note.

Endorsee

Explained while discussing promissory note.

Holder:

The scope of the holder is contained in section 8 of the negotiable instrument 1881 which is reproduced below:

The "holder" of a promissory note, bill of exchange or cheque means the payee or endorsee that is in possession of it or the bearer thereof but does not include a beneficial owner claiming through a benamidar.

Sec 8

In order to be called a 'Holder', the person must satisfy the following two conditions:

He must be entitled to the possession of the instrument in his own name

He must be entitled to receive or recover the amount due thereon from the parties liable thereto

Holder in Due Course:

Holder in due course has been explained in section 9 of the Act, which is reproduced below:

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

Conditions for a person to be called 'Holder in Due Course':

He must be holder

He obtains the instrument for valuable consideration

He must become the holder of the instrument before maturity

He must have obtained the instrument in good faith

He must take the instrument complete and regular on the face of it.

Acceptor's liability to the Holder in Due Course when endorsement forged: Sec 41

An acceptor of a bill of exchange already endorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe the endorsement to be forged when he accepted the bill.

Privileges of a holder in due course

In case of Inchoate stamped instruments:

An inchoate stamped instrument can be completed by the transferee/ holder in due course and his right is not affected that the instrument was not bearing the required stamps at the time he acquired the instrument.

Prior parties liable to holder in due course:

It has been defined in section 36 which is given below:

Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied

No effect of conditional delivery:

It has been defined in section 46 which is given below:

The making, acceptance or endorsement of promissory note, bill of exchange or cheque is completed by delivery, actual or constructive.

Holder in due Course acquires better title than that of the transferor:

-- He acquires a better title to the instrument despite of the fact that there may be defect in the title of the transferor.

Distinguishing Features between Holder and Holder in due Course

Holder	Holder in Due Course
Title of the holder shall not be good if the title of any prior parties is defective.	Holder in due course shall have a good title even if the title of prior parties is defective. However condition is that he should obtain that title in good faith.

Consideration is not necessary to be a holder of an instrument A holder does not enjoy any special privileges	Consideration is necessary Enjoys special privileges.
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A holder is a person who is entitled in his own name to the possession of the instrument and to recover or receive the amount due thereon from the parties.	He is a person who has taken the instrument in good faith and for value, and also before its maturity.
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Liabilities of the parties to an instrument:

We shall discuss the liabilities of the following parties in the light of relevant legal provisions:

Liability of **Drawer**

Liability of **Drawee** of a cheque

Liability of **maker** of note and **acceptor** of bill

Liability of **Endorser**

Liability of Drawer:

It has been defined in section 30 which is given below:

The drawer of a bill or cheque is bound to compensate the holder in case dishonored by the drawee or acceptor provided due notice of dishonor has been given or received by the drawer.

Before acceptance of a bill, drawer's liability is primary and after acceptance his liability becomes secondary to acceptor's liability.

Liability of drawee of cheque:

It has been defined in section 31 which is given below:

The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default

Liability of maker of note and acceptor of bill:

It has been defined in section 32 which is given below:

In the absence of a contract to the contrary, the maker of a promissory note, by making it, the acceptor before maturity of a bill of exchange by accepting it, engages that he will pay it according to the tenor of the note or his acceptance respectively, and in default of such payment, such maker or acceptor is bound to compensate any party to the note or bill for any loss or damage sustained by him and caused by such default. .

The acceptor of a bill of exchange at or after maturity, by accepting it, **engages to pay** the amount thereof to the **holder on demand**.

Liability of endorser:

It has been defined in section 35 which is given below:

In the absence of a contract to the contrary, the .endorser of a negotiable instrument, by indorsing it, engages that on due presentment it shall be accepted and paid according to its tenor and that if it be dishonored he will compensate the holder or subsequent endorser who is compelled to pay it for any loss or damage caused to him by such dishonor.

Extent of Liability-- Rules as to compensation:

It has been defined in section 117 which is given below:

The compensation payable in case of dishonor of a promissory, bill of exchange or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules:-

The holder is entitled to the amount due upon the instrument; together with the expenses properly incurred in presenting, noting and protesting it;

When the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two places;

An endorser who, being liable, has paid the amount due on the same is entitled to the amount so paid with interest at six per centum per annum from the date of payment until, tender or realization thereof, together with all expenses caused by the dishonor

When the person charged and such endorser reside at different places the endorser is entitled to receive such sum at the current rate of exchange between the two places;

The party entitled to compensation may draw a bill upon the party liable to compensate him, payable at sight or on demand, for the amount due to him, together with all expenses properly incurred by him. Such bill must be accompanied by the instrument dishonored and the protest thereof (if any). If such bill is

dishonored, the party dishonoring the same is liable to make compensation thereof in the same manner as in the case of the original bill.

Negotiation of the instruments

Negotiation:

In general terms, negotiation is the characteristic of transferability possessed by a negotiable instrument.

It has been defined in section 36 which is given below:

When a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated.

This transfer by way of negotiation can take place in the following ways:

Negotiation by delivery

Negotiation by endorsement and delivery

Negotiation of the instruments

Negotiation by delivery:

It has been defined in section 47 which is given below:

Subject to the provisions of section 58, a promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof.

Exception. ---A promissory note bill of exchange or cheque delivered on condition that it is not to take effect except in a certain event is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.

Illustration:

Mr. Aslam is the payee of a bearer cheque amounting Rs 50,000 and this cheque fulfills all essential requirements. Mr. Aslam delivers this cheque to Mr. Yasir. This cheque has been negotiated/ transferred to Mr. Yasir by way of delivery.

Negotiation by Endorsement and Delivery:

It has been defined in section 48 which is given below:

Subject to the provisions of section 58 a promissory note, bill of exchange or cheque payable to order is negotiable by the holder by endorsement and delivery thereof.

Section 58 is regarding defective title.

Who may negotiate the instruments

Maker/ Drawer

Payee

Endorsee

This is provided in **Section 51** of the Act.

Every sole-maker, drawer, payee or endorsee, or all of several joint makers, drawers, payees or endorsees, of a negotiable instrument may, if the negotiability of such instrument has not been restricted or excluded as mentioned in Section 50, endorse and negotiate the same.

Right of the holder of the instrument acquired after dishonor or when overdue:

It has been defined in section 59 which is given below:

The holder of negotiable instrument who has acquired it after dishonor, whether by non-acceptance or non-payment, with notice thereof, or after maturity, has only, as against the other parties, the rights thereon of his transferor and is subject to the equities to which the transferor was subject at the time of acquisition by such holder.

Effect of Defective Title:

It has been defined in section 58 which is given below:

When a promissory note, bill of exchange or cheque has been lost or has been obtained from any maker, drawer, acceptor or holder thereof by means of an offence or fraud, or for an unlawful consideration, neither the person who finds or so obtains the instrument nor any possessor or endorsee who claims through such person is entitled to receive the amount due thereon from such maker, drawer, acceptor or holder, unless such possessor or endorsee is, or some person through whom he claims was, a holder thereof in due course.

Instrument negotiable till payment or satisfaction Sec 60

It has been defined in section 60 which is given below:

A negotiable instrument may be negotiated (except by the maker, drawer or acceptor after maturity) until payment or satisfaction thereof by the maker, drawee or acceptor at or after maturity, but not after such payment or satisfaction.

Presentment of Negotiable Instrument**Presentment for Acceptance:**

It has been defined in section 61 which is given below:

A bill of exchange payable after sight must, if no time or place is specified therein for presentment, be presented to the drawee thereof for acceptance, if he can, after reasonable search, be found, by a person entitled to demand at within a reasonable time after it is drawn and in business hours on a business day. In default of such presentment, no party thereto is liable thereon to the person making such default

Essentials of Valid Acceptance

Must be in writing

Signed by drawee or his agent

Acceptance must appear on the bill

Accepted bill must be delivered to the holder

Who can accept the Bill

Drawee or his agent, in case of several drawees, all the drawees can accept

In case of death of the drawee, bill can be accepted by the legal representative of the deceased drawee

Official receiver, in case drawee declared as insolvent

Presentment for Sight:

It has been defined in section 62 which is given below:

A promissory note payable at a certain period after sight, must be presented to the maker thereof for sight (if he can after reasonable search be found) by a person entitled to demand payment, within a reasonable time after it is made and in business hours on a business day. In default of such presentment, no party thereto is liable thereon to 'the person making such default.

Presentment for Payment:

It has been defined in section 64 which is given below:

Subject to the provisions of section 76, promissory notes, bills of exchange and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively, by or on behalf of the holder as hereinafter provided. In default of such presentment, the other parties thereto are not liable thereon to such holder.

Section 76 underlines situations when presentment is unnecessary e.g. Drawee prevents presentment.

Payment and Interest**To whom payment could be made:**

It has been defined in section 78 which is given below:

Subject to the, provisions of section 82, payment of the amount due on a promissory note, bill of exchange or cheque must, in order to discharge the maker or acceptor, be made **to the holder** of the instrument.

Section 82 underlines the situations when maker, drawer, acceptor of an instrument are discharged from liability.

Interest when rate specified or not specified:

It has been defined in section 79 which is given below:

Subject to the provision of any law for the time being in force relating to the relief of debtors, and without prejudice to the provisions of section 34 of the Code of Civil Procedure, 1908,---

when interest at a specified rate is expressly made payable on a promissory note or bill of exchange and no date is fixed from which interest is to be paid, interest shall be calculated at the rate specified, on the amount of the principal money due thereon, from the date of the note, or, in the case of a bill, from the date on which the amount becomes payable, until tender or realization of such amount, or until the date of the institution of a suit to recover such amount;

where a promissory note or bill of exchange is silent as, regards interest or does not specify the rate of interest, interest on the amount of the principal money due, thereon shall, notwithstanding any collateral agreement relating to interest between any parties to the instrument, be allowed and calculated at the rate of six per centum per annum from the date of the note, or, in the case of a bill, from the date on which the amount becomes payable, amount due thereon, or until the date of the institution of a suit to recover such amount.

Interest when no rate specified:

It has been defined in section 80 which is given below:

When no rate of interest is specified in the instrument, interest on the amount due thereon shall, notwithstanding any agreement relating to interest between any parties to the instrument, be calculated at the rate of six per centum per annum, from the date at which the same ought to. have been paid by the party charged, until tender or realization of the amount due thereon, or until such date after the institution of a suit to recover such amount as the Court directs.

Discharge from liability

Section 82 contains the provisions with regard to discharge of a party from its liability under a negotiable instrument. The said provisions are appended below:

The maker, acceptor or endorser respectively of a negotiable instrument is discharged from liability thereon-

By cancellation; to a holder thereof who cancels such acceptor's or endorser's name with intent to discharge him, and to all parties claiming under such holder;

By release; to a holder thereof who otherwise discharges such maker, acceptor or endorser, and to all parties deriving title under such holder after notice of such discharge; and

By payment; to all parties thereto, if the instrument is payable to bearer, or has been endorsed in blank, and such maker, acceptor or endorser makes payment in due course of the amount due thereon.

LESSON 30**PRINCIPLES AND FORMS OF LENDING****Banking Credit Management**

The basic purpose of a banking business like any other business remains maximization of profits. This is achieved by charging higher rates of profits/ interest on their investments/ financing and paying lower rate of interest to their depositors/ creditors. This process in banking terminology is called '**spread**'.

Since loans are the dominant asset in a commercial bank so it is important to pay greater attention to its management.

Commercial banks extend credit to different types of borrowers for different purposes. For most customers, bank credit is the primary source of available debt financing. For banks good loans are the most profitable assets. As with any investment, extending loans to the businesses and individuals involves taking risk and to earn high returns. Returns comes in the form of profits/ interest, fee income and investment income from due deposits. Banks also use loans to cross sell other fee-generating services. As such the most prominent assumed risk is credit risk. Many factors can lead to loan defaults. An entire industry, such as energy, agriculture, or real estate, can decline because of general economic events. Firm-specific problem may arise from changing technology, strikes, and shifts in consumer preferences or bad management. Individual borrowers find that the ability to repay closely follows the business cycle as personal income rises and falls. Loans as a group thus exhibit the highest charge offs among bank assets, so banks regularly set aside substantial results against anticipated losses.

Interest rate risk also rises from credit decisions. Loan maturities, pricing, and the form of principal repayment affect the timing and magnitude of banks cash inflows. Floating-rate and variable-rate loans, for example, generate cash flows that very closely with variable borrowing cost.

Loans are the dominant assets in most banks' portfolios, representing on average 50% to 75% of total assets. Loan compositions vary greatly among banks depending on size, location, trade area, and lending expertise. Various concentrations in lending activities carry different risk and return. Problem loans and loan losses also vary with the business cycle.

Credit Defined

Credit has been defined as the permission to use another's capital.

The power to obtain goods or services by giving a promise to pay a certain sum of money at a specified date in the future. Credit is a present Right to future Payment.

Stages in risk management process

- Identification of inherent risks. (risk acceptance)
- Developing solution to mitigate the identified risk
- Identifying opportunities (returns)
- Avoiding losses.

Managing risk another approach

- Avoid risk
- Diversify / spread risk among various assets
- Control adverse events
- Share risk with an other party such as insurance
- Transfer risk such as outsourcing
- Accept the risk

Benefits of Risk Management:

- Effective strategic planning
- Better cost control (budgeting)
- Enhancing share holder values
- Creating a best practice and quality organization

- Protecting the organization

Banking environment

Banking environment is very competitive. There is neck to neck competition among banks and with other financial institutions. Banks are required to manage bottom line between deposit rates and lending rates that is risk-adjusted rate of interest for borrowers and competitive interest rate for depositors.

Managing Risk and returns:

The fundamental objective of bank management is to maximize shareholders' wealth. This goal is interpreted to mean maximizing the market value of a firm's common stock. Wealth maximization, in turn, requires that managers evaluate the present value of cash flows under uncertainty with larger, near-term cash flows preferred when evaluated on a risk-adjusted basis. To obtain higher yields, a bank must either take on increased risk or lower operating costs. Greater risk manifests itself in greater volatility of net income and market value of stockholders' equity. Wealth maximization requires the manager to evaluate and balance the trade-offs between the opportunity for higher returns, the probability of not realizing those returns, and the possibility that the bank might fail.

A bank's profitability will generally vary directly with the riskiness of its portfolio and operations. Although some risks can be sought out or avoided, others are inherent in the prevailing economic environment and specific markets served. Banks in agriculture or energy-related areas, for example, lend to businesses involved in cyclical industries. Even though management can control the credit evaluation procedure, returns to the bank vary with returns to its customers, and these returns are heavily dependent on local economic conditions.

Risk management is the process by which managers identify, assess, monitor, and control risks associated with a financial institution's activities. The complexity and range of financial products have made risk management more difficult to accomplish and evaluate. In larger financial institutions, risk management is used to identify all risks associated with particular business activities and to aggregate information such that exposures can be evaluated on a common basis. As formal process enables these institutions to manage risks on both a transactions basis and by portfolio in light of the institution's exposures in a global strategic environment.

There are four types of risks which are as follow:

1. Credit risk
2. Liquidity risk
3. Market risk
4. Operational risk

Credit Risk:

Credit risk is associated with the quality of individual assets and the likelihood of default. It is extremely difficult to assess individual asset quality because limited published information is available. In fact, many banks that buy banks are surprised at the acquired bank's poor asset quality, even though they conducted a due diligence review of the acquired bank prior to the purchase.

Whenever a bank acquires an earning asset, it assumes the risk that the borrower will default, that is, not repay the principal and interest on a timely basis. Credit risk is the potential variation in net income and market value of equity resulting from this nonpayment or delayed payment. Different types of assets and off-balance sheet activities have different default probabilities. Loans typically exhibit the greatest credit risk. Changes in general economic conditions and a firm's operating environment alter the cash flow available for debt service. These conditions are difficult to predict. Similarly, an individual's ability to repay debts varies with changes in employment and personal net worth. For this reason, banks perform a credit analysis on each loan request to assess a borrower's capacity to repay. Unfortunately, loans tend to deteriorate long before accounting information reveals any problems. In addition, many banks enter into off-balance sheet activities, such as loan commitments, guaranty offers, and derivative contract. The prospective borrowers and counterparties must perform or the bank may take a loss. These risks can be substantial, but are difficult to measure from published data.

Liquidity Risk

Liquidity risk is the current and potential risk to earnings and the market value of stockholders' equity that results from a bank's inability to meet payment or clearing obligations in a timely and cost-effective manner. Liquidity risk is greatest when a bank cannot anticipate new loan demand or deposit withdrawals, and does not have access to new sources of cash. This risk can be the result of either funding problems or market liquidity risk. Funding liquidity risk is the inability to liquidate assets or obtain adequate funding from new borrowing. Market liquidity risk is the inability of the bank to easily in wind or offset specific exposures without significant losses from inadequate market depth or market disturbances. This risk is greatest when risky securities are trading at high premiums to low-risk Treasury securities because market participants are avoiding high-risk borrowers.

A firm can provide for its liquidity needs in one of two ways: (i) by holding liquid assets, and (ii) by securing its ability to borrow (issuing new liabilities) at reasonable costs. Thus, when banks need cash, they can either sell liquid assets or increase borrowings. Liquidity risk measures, therefore, focus on the quantity and quality of liquid assets near maturity or available-for-sale at reasonable prices, as well as the bank's ability to cheaply and easily borrow funds to meet cash outflows.

Market Risk:

Market risk is the current and potential risk to earnings and stockholders' equity resulting from adverse movements in market rebates or prices. The three areas of market risk are: interest rate or reinvestment rate risk, equity or security price risk, and foreign exchange risk.

- Interest rate risk is the potential variability in a bank's net interest income and market value of equity due to changes in the level of market interest rates.
- Equity and security price risk is the potential risk of loss associated with the bank's trading account portfolios.
- Foreign exchange risk is the risk to a financial institution's condition resulting from adverse movements in foreign exchange rates.

Interest rate risk:

Interest rate risk analysis compares the sensitivity of interest income to changes in asset yields with the sensitivity of interest expense to changes in the interest costs of liabilities. This is done using GAP and earnings sensitivity analysis. The purpose is to determine how much net interest income will vary with movements in market interest rates. A more comprehensive portfolio analysis approach compares the duration of assets with the duration of liabilities using duration gap and economic value of equity sensitivity analysis to assess the impact of rate changes on net interest income and the market value (or price) of stockholders' equity. Duration is an elasticity measure that indicates the relative price sensitivity of different securities.

Both GAP and duration gap focus on mismatched asset and liability maturities and durations as well as potential changes in interest rates. An asset or liability is rate sensitive if management expects it to be reprised (change of rate) within a certain time period.

Operational risk:

Refers to the possibility that operating expenses might vary significantly from what is expected, producing a decline in net income and firm value. The Basel Committee defines operational risk as:

"The risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events."

Salient Features Of a Bank's Credit Policy:

Before discussing the salient features we must know the purpose of a credit policy. Since loans/ advances are the largest and most significant asset in bank's balance sheet and have a bearing on the profitability and financial health of the bank as such it is very much important that board of a director of a bank formulates a credit policy. It provides the policy frame work as well as a document for implementation at all tiers of the organization. The credit policy must clearly explain the basic principles governing the disbursement of finance/ credit. it lays down a broader framework and helps the banks to carry on its activities over a long period of time. The bank is able to take care of the competitive environment and is also able to safe guard

against future challenges. It also provides encouragement to field officers to discharge their duties within the frame work of the policy without any hesitation. The field officers and other executives can perform their functions within the delegated powers assigned to them under the policy.

- Credit should be in line with the prudential regulations issued by the State Bank of Pakistan
- Credit should be self liquidated that is it should be supported by future cash flows.
- Credit policy should encompass that credit is structured to meet customers need.
- Bankers evaluate the projected cash flows of the prospective borrower before disbursing the loans.
- The credit policy must be diversified with respect to industries/business and regions.
- Credit policy must ensure that request from defaulter of other banks are not entertain.
- To safe guard against expected losses, the bank must obtain collaterals/ securities and also maintain adequate margins. There are two types of margins, one is called the statutory margins which are fixed by the State Bank of Pakistan and it is obligatory on banks to strictly comply with these margins. However it is up to the discretion of the bank to obtain additional margins. The second is the discretionary margin. The credit must be within bank's target market and within risk assets acceptance criteria.

Overview of credit cycle

- First of all the prospective borrower approaches the bank
- The credit officer has to process and evaluate the credit proposal
- The credit evaluation would differ on case to case basis.
- The following steps are taken in credit evaluation process:
 - Applicants' profile and track record
 - Financial analysis on the basis of balance sheet and profit and loss account and other relevant information data.
 - Capacity of the borrower to repay the loan.
 - Technical and economic appraisal, wherever required
 - Approval of the credit request by the competent authority/ committee
 - Completion of documentation formalities and execution of securities/ collaterals
 - Disbursement of loan.
 - However, continuous follow up till the recovery of the entire credit remains an integrals part of the credit cycle.

The process of credit evaluation and other factors shall be discussed in detail in the next Lesson.

LESSON 31**PRINCIPLES AND FORMS OF LENDING****The Credit Process**

Credit is the life line of the banking business. The fundamental objective of a commercial bank is to make profitable loans with minimum risk. Bank management should target specific industries and markets in which lending officers have expertise. However, while competing goals of loan volume and loan quality must be balance with the banks liquidity requirements, capital constraints and rate of return objectives. The credit process relies on each bank's system and controls that allow management and credit officers to evaluate risk and return trade-offs. The credit process includes three functions:

- Business development and credit analysis
- Underwriting or credit execution and administration
- Credit review

A credit policy formalizes lending guidelines that employees follow to conduct bank business. As already pointed out in our previous discussion that it identifies preferred loan qualities and establishes procedures for granting, documenting and reviewing loans.

The managements credit philosophy determines how much risk the bank will take and in what form. Here we need to know a very important concept that is called a bank's credit culture. This refers to the fundamental principles that drive lending activities and how management analysis risk. This lending philosophy would differ from bank to bank.

However there are three loan credit cultures namely: value driven, current-profit driven and market share driven. Salient features of these credit cultures are outlined below:

Values Driven:

- Focus is on credit quality with strong risk management systems and controls.
- Primary emphasis is on bank soundness and stability and a consistent market presence.
- Underwriting is conservative and significant loan concentrations are not allowed.
- Typical outcome is lower current profit from loans with fewer loan losses.

Current-Profit Driven:

- Focus is on short-term earnings
- Primary emphasis is bank's annual profit plan.
- Management is often attracted to high-risk and high-return borrowers.
- Outcome is typically higher profit in good times, followed by lower profit in bad times when loan losses increase.

Market-Share Driven:

- Focus is on having the highest market share of loans among competitors.
- Primary emphasis is on loan volume and growth with the intent of having the largest market share.
- Underwriting is very aggressive and management accepts loan concentrations and above-average credit risk.
- Outcome is that loan quality suffers over time, while profit is modest because loan growth comes from below-market pricing and greater risk taking.

Credit Evaluation/ Credit Analysis

As a customer approaches a bank with a loan request, the credit officers analyze all available information to determine weather the loan meets the bank's risk-return objectives. Credit analysis is essentially default risk analysis in which a loan officer attempts to evaluate a borrower's ability and willingness to repay. In this analysis following important questions arise which are looked into by the credit officer:

1. What risks are inherent in the operations of the business?
2. What have managers done or failed to do in mitigating those risks?
3. How can a lender structure and control its own risks in supplying funds?

The first question forces the credit analyst to generate a risk of factors that indicate what could harm the borrower's ability to repay. The second recognizes that repayment is largely a function of decisions made by a borrower and weather management is aware of the important risk and necessary skills and required systems in place. The last question forces the analyst to specify how risk can be control so the bank can structure an acceptable loan agreement.

The significant factors in credit evaluation/ credit analysis are enumerated below:

- Credit request not contrary to prudential regulation of State Bank of Pakistan.
- Borrower's Credentials
- Amount of Credit
- Borrower's Own Equity
- Repayment Plan

The key risk factors have been classified as three Cs', five Cs' and seven C's. However these factors have explained by the experts are discussed below:

Character refers to the borrower's honesty and trustworthiness. An analyst must assess the borrower's integrity and subsequent intent to repay. If there are any serious doubts, the loan should be rejected.

Capital refers to the borrower's wealth position measured by financial soundness and market standing. Can the firm or individual withstand any deterioration in its financial position? Capital helps cushion losses and reduces the likelihood of bankruptcy.

Capacity involves both the borrower's legal standing and management's expertise in maintaining operations so the firm or individual can repay its debt obligations. A business must have identifiable cash flow or alternative sources of cash to repay debt. An individual must be able to generate income.

Conditions refer to the economic environment or industry-specific supply, production, and distribution factors influencing a firm's operations. Repayment sources of cash often vary with the business cycle or consumer demand.

Collaterals is the lender's secondary source of repayment or security in the case of default. Having an asset that the bank can seize and liquidate when a borrower defaults reduces loss, but does not justify lending proceeds when the credit decision is originally made.

Complacency refers to the tendency to assume that because things were good in the past they will be good in the future. Common examples are an overreliance on guarantors, reported net worth, or past loan repayment success because things have always worked out in the past.

Carelessness involves poor underwriting typically evidenced by inadequate loan documentation, a lack of current financial information or other pertinent information in the credit files, and a lack of protective covenants in the loan agreement. Each of these makes it difficult to monitor a borrower's progress and identify problems before they are unmanageable.

Communication ineffectiveness refers to when a bank's credit objectives and policies are not clearly communicated. This is when loan problems can arise. Management must effectively communicate and enforce loan policies and loan officers should make management aware of specific problems with existing loans as soon as they appear.

Contingencies refer to lenders' tendency to play down or ignore circumstances in which a loan might default. The focus is on trying to make a deal work rather than identifying downside risk.

Competition involves following competitors' behavior rather than maintaining the bank's own credit standards. Doing something because the bank down the street is doing it does not mean it's a prudent business practice.

Credit Analysis:

The formal credit analysis procedure includes a subjective evaluation of the borrower's request and a detailed review of all financial statements. Credit department employees may perform the initial quantitative analysis for the loan officer. The process consists of:

1. Collecting information for the credit file; such as credit history and performance.
2. Evaluating management, the company, and the industry in which it operates; that is, evaluation of internal and external factors.

3. Spreading financial statements; that is, financial statement analysis
4. Projecting the borrower's cash flow and thus its ability to service the debt
5. Evaluating collateral or the secondary source of repayment
6. Writing a summary analysis and making a recommendation.
7. Track record of client
8. Published/unpublished reports regarding business/company
9. Industry analysis.
10. Trade Journals.
11. Level of competition.
12. Private on-line information system.

Credit Execution and Administration:

The loans are approved by competent authorities/ credit committees. After approval of the loan, the borrower is intimated and a loan agreement/ sanction advice is prepaid. This agreement formalizes the purpose of loan, the terms, repayment schedule, collateral required, any term and condition of the loan. The credit officer then checks that all loan documentation has been completed and is in order. Any combination of the following collaterals/ securities is also required to be furnished by the borrower:

Mortgage

Pledge

Hypothecation

Lien

Guarantees

Listed stocks and government securities

On completion of the above, the borrower signs the agreement and the loan is disbursed to the borrower.

Loan Review:

The loan review effort is directed at reducing credit risk as well as handling problem loans and liquidating assets of failed borrowers. Effective credit management separates loan review from credit analysis, execution, and administration. The review process can be divided into two functions: monitoring the performance of existing loans and handling problem loans. Many banks have a formal loan review committee, independent of loan officers, that reports directly to the chief executive officer and directors' loan committee. Loan review personnel audit current loans to verify that the borrower's financial condition is acceptable, loan documentation is in place, and pricing meets return objectives. If the audit uncovers problems, the committee initiates corrective action. Removing the problem may simply involve getting signatures on omitted forms or filing required documents with the state. If the borrower has violated any loan covenants, the loan is in default. The bank can then force the borrower to correct the violation or it can call the loan; that is, request immediate payment. Calling a loan is normally a last resort and done only when the borrower does not voluntarily correct the problem. It allows the bank to request full payment before repayment prospects worsen.

The problem is much more serious when the borrower's financial condition deteriorates. These loans are classified as problem loans and require special treatment. In many cases, the bank has to modify the terms of the loan agreement to increase the probability of full repayment. Modifications include deferring interest and principal payments, lengthening maturities, and liquidating unnecessary assets. The bank may also request additional collateral or guarantees and ask the borrower to contribute extra capital. The purpose is to buy time until the borrower's condition improves. Banks often assign a separate loan work-out specialist to problem loans, rather than traditional loan officers, because they are liquidation oriented and frequently involved in intense negotiations.

Financial Analysis

Types of Financial Analysis:

- o Trend Analysis.
- o Ratio Analysis.
- o Cash Analysis.

Collaterals

Collaterals are discussed in detail in the following paragraphs:

Attributes of good collateral:

Collateral is considered to be good collateral if it possesses the following attributes.

1. Adequate
2. Readily encashable/realizable
3. Sufficient.

Adequate in Value:

Value of security must be adequate to enable the bank to secure the outstanding amount of principal and mark-up (interest). Proper margins to be retained while accepting a security

Readily Encashable /Realizable

Collateral held by the bank should be readily encashable/realizable, in case the borrower defaults without legal complications either by bank itself or through speedy legal process.

Sufficient:

The collateral offered by the borrower must be sufficient to recover the amount of principal/markup and any other liabilities accruing to the bank.

Forms of Securities:

The forms of securities as outlined above are discussed in detail:

Mortgage

Transfer of Property Act, 1882 defines mortgage as under:

“The transfer of an interest in specific immoveable Property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or performance of an engagement which may give rise to a pecuniary liability”.

Rights of Mortgagee (Bank):

The mortgagee is vested with the following rights

- o To sell the mortgaged property in case of default by mortgagor.
- o **Right to fore-closure.**
- o **Right to file suit.**

Types of Mortgage Important types are explained below:

Registered or Legal Mortgage.

This is created through a formal document called mortgage deed.

Mortgage deed is registered with the Registrar of titles.

It is comparatively expensive, involves stamp duty and registration fee.

Equitable Mortgage:

This is created by deposit of title deed by the mortgagor.

Memorandum regarding deposit of title deed is also signed by respective parties.

Clear title of the deed must be ascertained by the bank/mortgagee

Pledge:

According to section 172 of the Contract Act, the pledge is defined as under:

“Pledge is the bailment of goods as security for payment of a debt or performance of a promise”.

Bailment

According to Section 148 of a Contract Act 1872, bailment is defined as under:

“A bailment is the delivery of goods by one person to another for some purpose upon a contract that they shall, when the purpose is accomplished be returned or otherwise disposed of according to the directions of the person delivering them”.

Rights of the Pledgee:

- The pledgee (Bank) has actual control of pledged stocks/Goods.
- Pledgee can sell pledged stocks by giving reasonable notice to the borrower.

Hypothecation:

“Hypothecation is a legal transaction, whereby goods may be made available as security for a debt without transferring possession to the lender”.

Rights of Lender (Bank) in case of hypothecation

To inspect Godowns.

To demand stock reports from the borrower.

To get the stocks insured.

Lien:

“Lien is a charge given by the customer (borrower) to a bank over some securities”.

Letter of lien must be obtained from the borrower (customer). It can be over stocks (shares), fixed deposits, bank accounts etc.

In case the security offered is issued by the third party the notice may be issued to the respective party regarding the same.

Lien to be noted on the said property/security.

According to companies ordinance 1984 “every charge created by a limited company must be registered with the Registrar of Companies.

Contract of Indemnity

A contract, by which one party promises to save the other from loss caused to him by the conduct of the Promisor himself, or by the conduct of any other person, is called a “**contract of indemnity**”.

All Contracts of Insurance are contracts of indemnity except life insurance

In such contracts an insurance company (insurer) undertakes to indemnify the respective party (assured), of the losses suffered by the assured in the manner and to the extent agreed in the contract.

Rights of Indemnity Holder When Sued:

- He can recover all damages incurred /Paid by him.
- He can recover costs incurred.
- He can recover sums paid under compromise, if any.

Rights of Indemnifier

Settled principle of law : it is a settled principle of law that after compensating the loss to indemnity holder, indemnifier is entitled to all the ways and means by which person indemnified might have protected himself for the loss.

Time of Commencement of Indemnifier’s Liability: this commences when indemnity holder incurs an absolute liability though not actual loss.

Guarantee:

It has been defined in section 126 of the Contract Act 1872 which is reproduced below:

“A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default”. The person who gives the guarantee is called the “surety”; the person in respect of whose default the guarantee is given is called the “principal debtor”, and the person to whom the guarantee is given is called the “creditor”. A guarantee may be either oral or written.

Kinds of Guarantee**Specific Guarantee or (Ordinary Guarantee)**

This guarantee is restricted to a specific transaction or engagement. For example availing a loan from a bank.

Continuing Guarantee:

Such guarantee covers a series of transactions. For example guarantee furnished to a supplier for making supplies during the next one year.

Type of Finances/Credits / Forms of Lending

The finances are classified as Fund- Based & Non-Fund Based

Fund- based credits include:

Cash Finance, Overdraft, Loans, Purchase/ Discounting of bill of exchange, Export finance, Import finance, sectoral finance, consortium finance.

Non-Fund Based:

These include letter of credit, bank guarantee, tender guarantee, and performance guarantee.)

Trade Finances with respect to international transactions include the following:

Export finance: In the export finance, the following types of facilities are included:

- Finance against foreign bills.
- Foreign bill purchased.
- Packing credits.
- SBP's export finance scheme

Import Finances. In the import finance, the following types of facilities are included
Import letter of credit.

- Payment against Documents. PAD & also(Forced PAD)
- Finance against Trust Receipt (FTR)
- Finance against Imported Merchandise (FIM).

Sectoral finances Include: Among others these includes the following:

- Industrial Finance.
- Agricultural Finance.
- Finance for Construction/Housing.
- Consumer Finance

In Syndicated finance/Consortium finance

- In syndicated finance, number of banks participate
- There is also a lead Bank and Lead Manager.
- The banks who participate in this type of financing are called Participating Banks.
- In this type of financing large amount of money is involved hence Borrowers comprise of Government/Public sector organizations or corporate entities

As we have already discussed all the steps in loan sanctioning such as credit loan structuring, pricing, Packaging, Documentation, Disbursement, Monitoring & follow-up process as usual are carried on but with special technical skill and professional expertise.

LESSON 32**LETTER OF CREDIT****International Banking and International Trade complementary to each other.**

Facilitating international trade is the most important activity of international banking.

Exporter (seller) and Importer (buyer) are two important players in international trading activity.

What the seller (exporter) wants

Contract fulfillment (payment)

Convenience (of receiving payment in a bank in his own country)

Prompt Payment

Expert Advice.

What the buyer (Importer) wants

Contract fulfillment (Goods)

Convenience of using an intervening third party in whom both have confidence, such as a bank.

Credit -possibility of obtaining finance.

Expert advice and assistance.

Letter of credit provides the mechanism to fulfill the above requirements of exporters and importers.

Letter of Credit

A Letter of Credit is a payment term generally used for international sales transactions. It is basically a mechanism, which allows importers/buyers to offer secure terms of payment to exporters/sellers in which a bank (or more than one bank) gets involved. The technical term for Letter of credit is 'Documentary Credit'. At the very outset one must understand is that Letters of credit deal in documents, not goods. The idea in an international trade transaction is to shift the risk from the actual buyer to a bank. Thus a LC (as it is commonly referred to) is a payment undertaking given by a bank to the seller and is issued on behalf of the applicant i.e. the buyer. The Buyer is the Applicant and the Seller is the Beneficiary. The Bank that issues the LC is referred to as the Issuing Bank which is generally in the country of the Buyer. The Bank that Advises the LC to the Seller is called the Advising Bank which is generally in the country of the Seller. The specified bank makes the payment upon the successful presentation of the required documents by the seller within the specified time frame. Note that the Bank scrutinizes the 'documents' and not the 'goods' for making payment. Thus the process works both in favor of both the buyer and the seller. The Seller gets assured that if documents are presented on time and in the way that they have been requested on the LC the payment will be made and Buyer on the other hand is assured that the bank will thoroughly examine these presented documents and ensure that they meet the terms and conditions stipulated in the LC.

How Letters of Credit Can Help You Build Your Business

Letters of credit are a time-honored instrument for trade finance. We have found them useful for any number of import deals. The usefulness of documentary letters of credit, for instance, derives from the fact that they provide mutual protection for both the importer and the exporter. As everyone engaged in international trade knows, anything that removes headaches is generally a good thing.

Documentary letters of credit are also handy for commodity-type transactions.

Letters of Credit -- a Solution to Many Trade Finance Needs

Letters of credit are tools to aid importers to leverage their capital base and their ability to capture more trading opportunities.

A Letter of Credit allows importers/buyers to offer secure terms of payment to exporters/sellers in which a bank (or more than one bank) gets involved. The technical term for Letter of credit is 'Documentary Letter of Credit'. Letters of Credit (LC's) deal in documents, not goods. The idea in an international trade transaction is to shift the risk from the actual buyer to a bank. Thus an LC is a payment undertaking given by a bank to the Beneficiary (the seller) and is issued on behalf of the applicant (the buyer). The Bank that issues the LC is referred to as the Issuing Bank, generally in the country of the Buyer. The Bank that Advises the LC to the seller is called the Advising Bank which is generally in the country of the seller.

The specified bank makes the payment upon the successful presentation of the required documents by the seller within the specified time frame. Note that the Bank scrutinizes the 'documents' and not the 'goods' for making payment. This process gives both the buyer and the seller comfort that the transfer of ownership to the goods will occur properly and when payment is secure. The seller gets assured that if documents are presented on time and in the way that they have been requested on the LC the payment will be made. The buyer is assured that the bank will thoroughly examine these presented documents and ensure that they meet the terms and conditions stipulated in the LC.

Documents requested in a Letter of Credit would often include: a commercial invoice; a transport document such as a Bill of lading or Airway bill; an insurance document; an inspection certificate; and/or a certificate of origin. Other documents could be required, depending on the underlying transaction.

Keep in mind that the Letter of Credit process revolves around documents, not goods. The LC could be 'irrevocable' or 'revocable'. An irrevocable LC cannot be changed unless both the buyer and seller agree. Whereas in a revocable LC changes to the LC can be made without the consent of the beneficiary. A 'sight' LC means that payment is made immediately to the beneficiary/seller/exporter upon presentation of the correct documents in the required time frame. A 'time' or 'date' LC will specify when payment will be made at a future date and upon presentation of the required documents.

A letter of credit can make a big difference to an importer. Many international deals just can't happen without a letter of credit. And when you cut through all the mumbo-jumbo.....this is a tool that allows buyers and sellers to do business with greater confidence.

Method of Financing International Trade:

Letter of credit is one of the methods of financing international trade, there are other methods of financing international trade and those are outlined and explained below:

- Open account method
- Documentary collection and
- Payment in advance/ Cash in advance

Open Account Method

An open account transaction means that the goods are shipped and delivered before payment is due, usually in 30 to 90 days. Obviously, this is the most advantageous option to the importer in cash flow and cost terms, but it is consequently the highest risk option for an exporter. Because of the intense competition for export markets, foreign buyers often press exporters for open account terms. In addition, the extension of credit by the seller to the buyer is more common abroad. Therefore, exporters who are reluctant to extend credit may face the possibility of the loss of the sale to their competitors. However, while this method of payment will definitely enhance export competitiveness, exporters should thoroughly examine the political, economic, and commercial risks, as well as cultural influences to ensure that payment will be received in full and on time. It is possible to substantially mitigate the risk of nonpayment associated with open account trade by using such trade finance techniques as export credit insurance and factoring. Exporters may also wish to seek export working capital financing to ensure that they have access to financing for both the production for export and for any credit while waiting to be paid.

Key Points

- The goods, along with all the necessary documents, are shipped directly to the importer who agrees to pay the exporter's invoice at a future date, usually in 30 to 90 days.
- Exporter should be absolutely confident that the importer will accept shipment and pay at agreed time and that the importing country is commercially and politically secure.
- Open account terms may help win customers in competitive markets, if used with one or more of the appropriate trade finance techniques that mitigate the risk of nonpayment.

How to Offer Open Account Terms in Competitive Markets

Open account terms may be offered in competitive markets with the use of one or more of the following trade finance techniques: (1) Export Working Capital Financing, (2) Government-Guaranteed Export Working Capital Programs, (3) Export Credit Insurance, (4) Export Factoring, and (5) Forfeiting. More detailed information on each trade finance technique is provided in other sections of the *Trade Finance Guide*

Export Working Capital Financing

To extend open account terms in the global market, the exporter who lacks sufficient liquidity needs export working capital financing that covers the entire cash cycle from purchase of raw materials through the ultimate collection of the sales proceeds. Export working capital facilities can be provided to support export sales in the form of a loan or revolving line of credit.

Government-Guaranteed Export Working Capital Programs

The Export-Import Bank of the United States and the U.S. Small Business Administration offer programs that guarantee export working capital facilities to U.S. exporters. With these programs, U.S. exporters are able to obtain needed facilities from commercial lenders when financing is otherwise not available or when their borrowing capacity needs to be increased.

Export Credit Insurance

Export credit insurance provides protection against commercial losses—default, insolvency, bankruptcy, and political losses—war, nationalization, currency inconvertibility, etc. It allows exporters to increase sales by offering liberal open account terms to new and existing customers. Insurance also provides security for banks providing working capital and financing exports.

Export Factoring

Factoring in international trade is the discounting of a short-term receivable (up to 180 days). The exporter transfers title to its short-term foreign accounts receivable to a factoring house for cash at a discount from the face value. It allows an exporter to ship on open account as the factor assumes the financial ability of the importer to pay and handles collections on the receivables. The factoring house usually works with consumer goods.

Forfeiting

Forfeiting is a method of trade financing that allows the exporter to sell its medium-term receivables (180 days to 7 years) to the forfeiter at a discount, in exchange for cash. With this method, the forfeiter assumes all the risks, enabling the exporter to extend open account terms and incorporate the discount into the selling price. Forfeitters usually work with capital goods, commodities, and large projects.

Documentary Collections

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of payment to the remitting bank (exporter's bank), which sends documents to a collecting bank (importer's bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. D/Cs involve the use of a draft that requires the importer to pay the face amount either on sight (document against payment—D/P) or on a specified date in the future (document against acceptance—D/A). The draft lists instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their

clients under collections, documentary collections offer no verification process and limited recourse in the event of nonpayment. Drafts are generally less expensive than letters of credit (LCs).

Key Points

- D/Cs are less complicated and less expensive than LCs.
- Under a D/C transaction, the importer is not obligated to pay for goods prior to shipment.
- The exporter retains title to the goods until the importer either pays the face amount on sight or accepts the draft to incur a legal obligation to pay at a specified later date.
- Banks that play essential roles in transactions utilizing D/Cs are the remitting bank (exporter's bank) and the collecting bank (importer's bank).
- While the banks control the flow of documents, they do not verify the documents nor take any risks, but can influence the mutually satisfactory settlement of a D/C transaction.

Typical Simplified D/C Transaction Flow

1. The exporter ships the goods to the importer and receives in exchange the documents.
2. The exporter presents the documents with instructions for obtaining payment to its bank.
3. The exporter's remitting bank sends the documents to the importer's collecting bank.
4. The collecting bank releases the documents to the importer upon receipt of payment.
5. Or the collecting bank releases the documents on acceptance of draft from the importer.
6. The importer then presents the documents to the carrier in exchange for the goods.
7. Having received payment, the collecting bank forwards proceeds to the remitting bank.
8. Once payment is received, the remitting bank credits the exporter's account.

Documents against Acceptance (D/A) Collection

Under a D/A collection, the exporter extends credit to the importer by using a time draft. In this case, the documents are released to the importer to receive the goods upon acceptance of the time draft. By accepting the draft, the importer becomes legally obligated to pay at a future date. At maturity, the collecting bank contacts the importer for payment. Upon receipt of payment, the collecting bank transmits the funds to the remitting bank for payment to the exporter.

Time of Payment: On maturity of draft at a specified future date

Transfer of Goods: Before payment, but upon acceptance of draft

Exporter Risk: Has no control of goods and may not get paid at due date

When to Use Documentary Collections

Under D/C transactions, the exporter has little recourse against the importer in case of nonpayment. Thus, the D/C mechanism should only be used under the following conditions:

- The exporter and importer have a well-established relationship.
- The exporter is confident that the importing country is stable politically and economically.
- An open account sale is considered too risky, but an LC is also too expensive for the importer.

Cash-in-Advance

With the cash-in-advance payment method, the exporter can avoid credit risk or the risk of nonpayment, since payment is received prior to the transfer of ownership of the goods. Wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. However, requiring payment in advance is the least attractive option for the buyer, as this method tends to create cash flow problems, and unless the seller sees no other option or the buyer has other vendors to choose from, it often is not a competitive option. In addition, foreign buyers are often concerned that the goods may not be sent if payment is made in advance. Exporters that insist on this method of payment as their sole method of doing business may find themselves losing out to competitors who may be willing to offer more attractive payment terms.

Key Points

- Full or significant partial payment is required, usually via credit card or bank/wire transfer, prior to the transfer of ownership of the goods.
- Cash-in-advance, especially a wire transfer, is the most secure and favorable method of international trading for exporters and, consequently, the least secure and attractive option for importers. However, both the credit risk and the competitive landscape must be considered.
- Insisting on these terms ultimately could cause exporters to lose customers to competitors who are willing offer more favorable payment terms to foreign buyers in the global market.
- Creditworthy foreign buyers, who prefer greater security and better cash utilization, may find cash-in-advance terms unacceptable and may simply walk away from the deal.

Wire Transfer—Most Secure and Preferred Cash-in-Advance Method

An international wire transfer is commonly used and has the advantage of being almost immediate. Exporters should provide clear routing instructions to the importer when using this method, including the name and address of the receiving bank, the bank's SWIFT, Telex, and ABA numbers, and the seller's name and address, bank account title, and account number. This option is more costly to the importer than other options of cash-in-advance method, as the fee for an international wire transfer is usually paid by the sender.

When to Use Cash-in-Advance Terms

- The importer is a new customer and/or has a less-established operating history.
- The importer's creditworthiness is doubtful, unsatisfactory, or unverifiable.
- The political and commercial risks of the importer's home country are very high.
- The exporter's product is unique, not available elsewhere, or in heavy demand.
- The exporter operates an Internet-based business where the use of convenient payment methods is a must to remain competitive.

In International trade, the buyer and the seller who are located in different countries, may not know each other and hence many times the problem of Buyer's Creditworthiness hampers the trade between the buyer and the seller. The main objectives of the buyer and the seller in any international trade and contradictory in terms of Buyer will always try to delay the payment while the seller would like to receive funds at the earliest.

To mitigate this problem, Seller always request Buyer to arrange for a Letter of Credit to be issued by Buyer's Bank. Upon issuance of Letter of Credit, the Buyer's bank replaces its own Creditworthiness to that of the Buyer, it undertakes to reimburse the Seller for the value of the Letter of Credit "Irrevocably" provided two underline conditions are fulfilled by the Seller:

1. All the documents stated in the LC are presented;
2. All the terms and conditions of the LC are complied with.

The beauty of the LC is that if above two conditions are fulfilled, Issuing Bank will effect payment to the Beneficiary, irrespective of Applicant reimburses the Issuing Bank or not. Thus, a Letter of Credit is an undertaking issued by a bank in favor of a Beneficiary (Seller), which substitutes the bank's creditworthiness for that of the Applicant (Buyer).

Why Letter?

It is named a Letter because initially the LCs were issued manually in a Letter format address by Issuing Bank to Beneficiary confirming its conditional undertaking to reimburse the Beneficiary, the amount of the LC provided above 2 basic conditions are fulfilled.

Letter of Credit---General Definition:

'A letter of credit can be defined as an instrument issued by a bank in which the bank furnishes its credit which is both good and well known, in place of the buyer's credit, which may be good but is not so well

known. A bank issues a letter of credit on behalf of one of its customers authorizing an individual or firm to draw draft (bill of exchange) on the bank or one of its correspondents for the bank's account under certain conditions stipulated in the credit.

Definition of L.C (Article 2 of UCP 600)

Credit means any arrangement, however named or described that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation.

Complying presentation: means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice.

Article 2 of the ICC, Uniform Customs and Practices, brochure 500 (UCP-500) defines a letter of credit as:

‘Any arrangement however named or described, whereby a bank issues a letter of credit on behalf of a customer the “Applicant “or on its own behalf,

Is to make payment to or to the order of a third party (the beneficiary) or is to accept and pay bills of exchange (draft) drawn by the beneficiary or Authorizes another bank to effect such payment or to accept and pay such bills of exchange (draft) or Authorizes another bank to negotiate against stipulated documents, provided the terms and conditions of the credit are complied with.

We shall continue with the this topic in coming Lesson

LESSON 33**LETTER OF CREDIT**

We have already gone through general definition of letter of credit. Now we shall look into various aspects of letter of credit as contained in the light of definition contained in UCP 600

LC as defined by UCP 600

Credit means any arrangement, however named or described that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation.

Complying presentation: means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice.

Presentation means either the delivery of documents under a credit to the issuing bank or nominated bank or the documents so delivered.

For the sake of comparison and understanding the need for UCP 600 we give hereunder the definition as contained in Article 2 of the ICC, Uniform Customs and Practices, brochure 500:

‘Any arrangement however named or described, whereby a bank issues a letter of credit on behalf of a customer the “Applicant “or on its own behalf,

Is to make payment to or to the order of a third party (the beneficiary) or is to accept and pay bills of exchange (draft) drawn by the beneficiary or Authorizes another bank to effect such payment or to accept and pay such bills of exchange (draft) or Authorizes another bank to negotiate against stipulated documents, provided the terms and conditions of the credit are complied with.

Bill of Exchange-(Draft)-Defined

“A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person, to pay on demand or at a fixed or determinable future time a certain sum of money only to or to the order of a certain person or to the bearer of the instrument.”

A bill of exchange drawn payable to bearer can not be made payable on demand.

Essentials of bill of exchange

These are outlined here under:

- In writing
- Order to pay
- Unconditional order
- Signed by the drawer
- Drawee certain person
- Time of payment
- Certain sum
- Legal tender money
- Payee certain person
- Other formalities
- Date
- Place
- Lawful consideration
- Revenue stamp

Sight bill of exchange or Time/ Usance bill of exchange:

All letters of credit require the beneficiary to present a draft and specified documents in order to receive payment. A draft is a written order by which the party creating it, orders another party to pay money to a third party. A draft is also called a bill of exchange.

There are two types of drafts: sight and time. A sight draft is payable as soon as it is presented for payment. The bank is allowed a reasonable time to review the documents before making payment.

A time draft is not payable until the lapse of a particular time period stated on the draft. The bank is required to accept the draft as soon as the documents comply with credit terms. The issuing bank has a reasonable time to examine those documents. The issuing bank is obligated to accept drafts and pay them at maturity.

Parties to a Documentary Credit:

Applicant (opener of L.C): means the party on whose request the credit is issued.

Issuing Bank

The issuing bank's liability to pay and to be reimbursed from its customer becomes absolute upon the completion of the terms and conditions of the letter of credit. Under the provisions of the Uniform Customs and Practice for Documentary Credits, the bank is given a reasonable amount of time after receipt of the documents to honor the draft.

The issuing banks' role is to provide a guarantee to the seller that if compliant documents are presented, the bank will pay the seller the amount due and to examine the documents, and only pay if these documents comply with the terms and conditions set out in the letter of credit.

Typically the documents requested will include a commercial invoice, a transport document such as a bill of lading or airway bill and an insurance document; but there are many others. Letters of credit deal in documents, not goods.

Advising Bank

An advising bank, usually a foreign correspondent bank of the issuing bank will advise the beneficiary. Generally, the beneficiary would want to use a local bank to insure that the letter of credit is valid. In addition, the advising bank would be responsible for sending the documents to the issuing bank. The advising bank has no other obligation under the letter of credit. If the issuing bank does not pay the beneficiary, the advising bank is not obligated to pay.

Confirming Bank

The correspondent bank may confirm the letter of credit for the beneficiary. At the request of the issuing bank, the correspondent obligates itself to insure payment under the letter of credit. The confirming bank would not confirm the credit until it evaluated the country and bank where the letter of credit originates. The confirming bank is usually the advising bank.

Nominated Bank/ Paying Bank:

The **Paying Bank** is the bank nominated in the letter of credit that makes payment to the beneficiary, after determining that documents conform, and upon receipt of funds from the issuing bank or another intermediary bank nominated by the issuing bank.

Negotiating bank:

It means the bank where negotiation of documents is carried out.

Negotiation means the purchase by the nominated bank of drafts and/ or documents under a complying presentation by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

Modes of Payment of Letter of Credit

There are following modes of payment against letter of credit:

1. By negotiation

2. By acceptance and payment of usance bill of exchange
3. By sight payment
4. By deferred payment

Available by negotiation

Documents are presented to negotiating bank/ nominated bank after shipment of goods, the said bank makes the payment to the beneficiary. If documents submitted are according to the requirements of L/C and stipulation of L/C are fulfilled, the negotiating bank shall receive the negotiating charges.

Available by acceptance

In such letter of credit, usance bill of exchange/ draft is drawn on the nominated/ issuing bank and the draft is accepted and payment is made on due date.

Available by sight payment

In such situations, the payment is available at sight that is on demand; however required documents are required to be submitted.

Available by deferred payments

Normally the terms of a documentary credit will include an instruction to the beneficiary to draw bills of exchange, and issuing bank will guarantee that such bills will be honored, provided all the other terms of the credit are met. However, in deferred payment credits, there is no need for the exporter to draw a bill of exchange. The issuing bank simply undertakes that payment will be made on a fixed or determinable future date, provided the other conditions have been fulfilled. Although the exporter does not draw a bill of exchange, in all respects these credits are identical to other documentary credits and some banks, in practice, will negotiate the documents providing they are entirely satisfied with the standing of the issuing bank. One benefit of deferred credits is that they avoid the need for payment of stamp duty on bills of exchange. All credits must clearly indicate whether they are available by sight payment, by acceptance or by deferred payment.

Characteristics of Negotiability and Revocability Explained:**Negotiability**

Letters of credit are usually negotiable. The issuing bank is obligated to pay not only the beneficiary, but also any bank nominated by the beneficiary. Negotiable instruments are passed freely from one party to another almost in the same way as money. To be negotiable, the letter of credit must include an unconditional promise to pay, on demand or at a definite time. The nominated bank becomes a holder in due course. As a holder in due course, the holder takes the letter of credit for value, in good faith, without notice of any claims against it. A holder in due course is treated favorably under the UCC.

The transaction is considered a straight negotiation if the issuing bank's payment obligation extends only to the beneficiary of the credit. If a letter of credit is a straight negotiation it is referenced on its face by "we engage with you" or "available with ourselves". Under these conditions the promise does not pass to a purchaser of the draft as a holder in due course.

Revocability

Letters of credit may be either revocable or irrevocable. A revocable letter of credit may be revoked or modified for any reason, at any time by the issuing bank without notification. A revocable letter of credit cannot be confirmed. If a correspondent bank is engaged in a transaction that involves a revocable letter of credit, it serves as the advising bank.

Once the documents have been presented and meet the terms and conditions in the letter of credit, and the draft is honored, the letter of credit cannot be revoked. The revocable letter of credit is not a commonly used instrument. It is generally used to provide guidelines for shipment. If a letter of credit is revocable it would be referenced on its face.

The irrevocable letter of credit may not be revoked or amended without the agreement of the issuing bank, the confirming bank, and the beneficiary. An irrevocable letter of credit from the issuing bank insures the

beneficiary that if the required documents are presented and the terms and conditions are complied with, payment will be made. If a letter of credit is irrevocable it is referenced on its face.

Types of Documentary Credits:

- Revocable Letter of Credit
- Irrevocable Letter of Credit
- Irrevocable Confirmed Letter of Credit
- Revolving Credit
- Transferable Letter of Credit
- Red Clause or Packing Credit
- Stand by Credit

Revocable letter of credit

A revocable letter of credit may be cancelled or modified after its date of issue, by the issuing bank. According to UCP-600, credit shall be irrevocable.

Irrevocable letter of credit

An irrevocable letter of credit can neither be amended nor cancelled without the agreement of all parties to the credit. Under UCP500 all letters of credit are deemed to be irrevocable unless otherwise stated. Here, the importer's bank gives a binding undertaking to the supplier provided all the terms and conditions of the credit are fulfilled.

Confirmed letter of credit

A confirmed letter of credit is one in which the advising bank, on the instructions of the issuing bank, has added a confirmation that payment will be made as long as compliant documents are presented. This commitment holds even if the issuing bank or the buyer fails to make payment. The added security to the exporter of confirmation needs to be considered in the context of the standing of the issuing bank and the current political and economic state of the importer's country. A bank will make an additional charge for confirming a letter of credit. In many cases, the confirming bank is located in Beneficiary's country. Confirmation costs will vary according to the country involved, but for many countries considered a high risk will be between 2%-8%. There also may be countries issuing letters of credit, which banks do not wish to, confirm - they may already have enough exposure in that market or not wish to expose themselves to that particular risk at all.

We shall continue with the remaining types of letter of credit

LESSON 34**LETTER OF CREDIT****Types of Documentary Credits:**

There are following types of Letter of credit:

1. Revocable Letter of Credit
2. Irrevocable Letter of Credit
3. Irrevocable Confirmed Letter of Credit
4. Revolving Credit
5. Transferable Letter of Credit
6. Red Clause or Packing Credit
7. Stand by Credit

We have already explained first three types, rest of the types are explained in following paragraphs:

Revolving Letter of Credit

The revolving credit is used for regular shipments of the same commodity to the same importer. It can revolve in relation to time or value. If the credit is time revolving once utilized it is re-instated for further regular shipments until the credit is fully drawn. If the credit revolves in relation to value once utilized and paid the value can be reinstated for further drawings. The credit must state that it is a revolving letter of credit and it may revolve either automatically or subject to certain provisions. Revolving letters of credit are useful to avoid the need for repetitious arrangements for opening or amending letters of credit.

Transferable Letter of Credit

A transferable letter of credit is one in which the exporter has the right to request the paying, or negotiating bank to make either part, or all, of the credit value available to one or more third parties. This type of credit is useful for those acting as middlemen especially where there is a need to finance purchases from third party suppliers.

Red Clause letter of credit:

Letter of credit allowing an initial advance to the beneficiary before shipment of the goods. In the days of Telex, this clause in the Letter of Credit was printed in red ink.

Standby Letters of Credit

A standby letter of credit is used as support where an alternative, less secure, method of payment has been agreed. They are also used in the United States of America in place of bank guarantees. Should the exporter fail to receive payment from the importer he may claim under the standby letter of credit? Certain documents are likely to be required to obtain payment including: the standby letter of credit itself; a sight draft for the amount due; a copy of the unpaid invoice; proof of dispatch and a signed declaration from the beneficiary stating that payment has not been received by the due date and therefore reimbursement is claimed by letter of credit. The International Chamber of Commerce publishes rules for operating standby letters of credit - ISP98 International Standby Practices.

Back-to-Back Letter of Credit

A back-to-back letter of credit can be used as an alternative to the transferable letter of credit. Rather than transferring the original letter of credit to the supplier, once the letter of credit is received by the exporter from the opening bank, that letter of credit is used as security to establish a second letter of credit drawn on the exporter in favor of his importer. Many banks are reluctant to issue back-to-back letters of credit due to the level of risk to which they are exposed, whereas a transferable credit will not expose them to higher risk than under the original credit.

Procedure for Issuing a Letter of Credit

The procedure for issuing a letter of credit is outlined and explained hereunder:

- L.C Application Form

- Indent Performa invoice/Purchase Order
- Insurance cover note /Marine insurance policy
- Fixation of margin (depending on credit worthiness of applicant & SBP instructions regarding margin requirements)
- Credit report of exporter
- Forward exchange booking (at request of importer)
- Selection of foreign correspondent/Advising bank.
- Transmission of letter of credit.

The applicant would fill out an application detailing the following information:

- Name and address of beneficiary
- Amount for which L/C is to be opened
- Mode of availability of the credit
- Name of the drawee of bill of exchange
- Description of goods documents required to be submitted by beneficiary for seeking payment/negotiation.
- Mentioning port of shipment and port of discharge of goods.
- Terms of payment of freight
- Instructions regarding trans shipment or partial shipment
- Last date for shipment
- The date and place of expiry

The bank would scrutinized the application and after meeting all requisites conditions and taking necessary measures to safe guard the risk exposure of the bank, the bank would issue letter of credit.

Inland Letter of Credit

Procedure for inland letter of credit is same as for international letter of credit. Inland letter of credit is opened in Pak rupees and advised through local branch of issuing bank.

Standard Forms of Documentation

When making payment for product on behalf of its customer, the issuing bank must verify that all documents and drafts conform precisely to the terms and conditions of the letter of credit.

The different types of documents required under letter of credit are outlined and explained below:

- Commercial Invoice
- Bill of lading
- Warrantee of title
- Letter of indemnity

Commercial Invoice

The billing for the goods and services. It includes a description of merchandise, price, FOB origin, and name and address of buyer and seller. The buyer and seller information must correspond exactly to the description in the letter of credit. Unless the letter of credit specifically states otherwise, a generic description of the merchandise is usually acceptable in the other accompanying documents.

Bill of Lading

A document evidencing the receipt of goods for shipment and issued by a freight carrier engaged in the business of forwarding or transporting goods. The documents evidence control of goods. They also serve as a receipt for the merchandise shipped and as evidence of the carrier's obligation to transport the goods to their proper destination.

Warranty of Title

A warranty given by a seller to a buyer of goods that states that the title being conveyed is good and that the transfer is rightful. This is a method of certifying clear title to product transfer. It is generally issued to the purchaser and issuing bank expressing an agreement to indemnify and hold both parties harmless.

Letter of Indemnity

Specifically indemnifies the purchaser against a certain stated circumstance. Indemnification is generally used to guaranty that shipping documents will be provided in good order when available.

Common Defects in Documentation

About half of all drawings presented contain discrepancies. A discrepancy is an irregularity in the documents that causes them to be in non-compliance to the letter of credit. Requirements set forth in the letter of credit cannot be waived or altered by the issuing bank without the express consent of the customer. The beneficiary should prepare and examine all documents carefully before presentation to the paying bank to avoid any delay in receipt of payment. Commonly found discrepancies between the letter of credit and supporting documents include:

- Letter of Credit has expired prior to presentation of draft.
- Bill of Lading evidences delivery prior to or after the date range stated in the credit.
- Stale dated documents.
- Changes included in the invoice not authorized in the credit.
- Inconsistent description of goods.
- Insurance document errors.
- Invoice amount not equal to draft amount.
- Ports of loading and destination not as specified in the credit.
- Description of merchandise is not as stated in credit.
- A document required by the credit is not presented.
- Documents are inconsistent as to general information such as volume, quality, etc.
- Names of documents not exact as described in the credit. Beneficiary information must be exact.
- Invoice or statement is not signed as stipulated in the letter of credit.

When a discrepancy is detected by the negotiating bank, a correction to the document may be allowed if it can be done quickly while remaining in the control of the bank. If time is not a factor, the exporter should request that the negotiating bank return the documents for corrections.

If there is not enough time to make corrections, the exporter should request that the negotiating bank send the documents to the issuing bank on an approval basis or notify the issuing bank by wire, outline the discrepancies, and request authority to pay. Payment cannot be made until all parties have agreed to jointly waive the discrepancy.

Commonsense Rules For Importer (buyer)

- The instructions to the issuing bank must be clear, correct and precise.
- The terms and conditions and documents called for should be in agreement with the contract of sales.
- Any examination/inspection of goods prior to shipment or at the evidenced by a document. The issuer of such inspection document must be stated in the credit.
- The credit should not call for the documents which the seller can not provide, nor set out conditions that he can not meet.

Commonsense Rules For Exporter (seller)

- Communicate with your customers in detail before they apply for letters of credit.
- Consider whether a confirmed letter of credit is needed.
- Upon first advice of the letter of credit, check that all its terms and conditions can be complied with within the prescribed time limits.

- He should study the credit in depth and request the changes at the earliest, if deemed necessary.
- Many presentations of documents run into problems with time-limits. You must be aware of at least three time constraints - the expiration date of the credit, the latest shipping date and the maximum time allowed between dispatch and presentation.
- After dispatch of the goods, check all the documents both against the terms of the credit and against each other for internal consistency.
- **Advantages & Problems/ Risks in letter of credit:**

Advantages of Letter of Credit:

1. General global acceptability by the interacting parties
2. The beneficiary is assured of payment as long as it complies with the terms and conditions of the letter of credit. The letter of credit identifies which documents must be presented and the data content of those documents. The credit risk is transferred from the applicant to the issuing bank.
3. The beneficiary can enjoy the advantage of mitigating the issuing bank's country risk by requiring that a bank in its own country confirm the letter of credit. That bank then takes on the country and commercial risk of the issuing bank and protects the beneficiary.
4. The beneficiary minimizes collection time as the letter of credit accelerates payment of the receivables.
5. The beneficiary's foreign exchange risk is eliminated with a letter of credit issued in the currency of the beneficiary's country.

Risks involved in Letter of Credit.

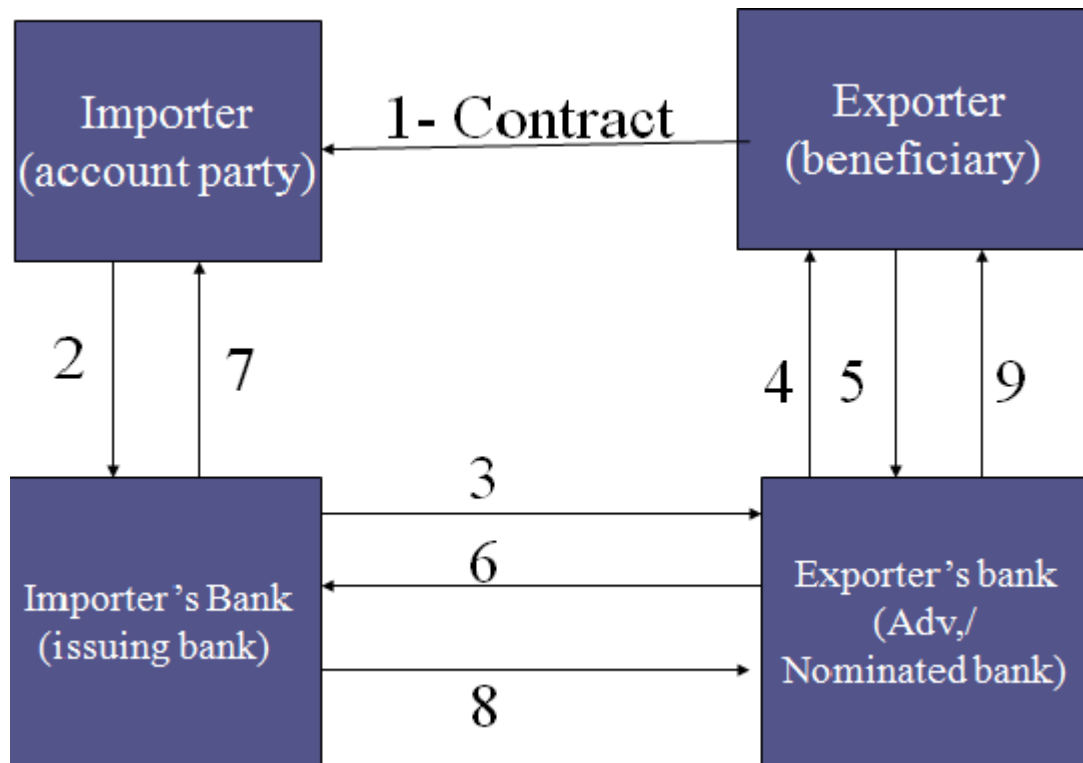
1. Since all the parties involved in Letter of Credit deal with the documents and not with the goods, the risk of Beneficiary not shipping goods as mentioned in the LC is still persists.
2. The Letter of Credit as a payment method is costlier than other methods of payment such as Open Account or Collection
3. The Beneficiary's documents must comply with the terms and conditions of the Letter of Credit for Issuing Bank to make the payment.
4. The Beneficiary is exposed to the Commercial risk on Issuing Bank, Political risk on the Issuing Bank's country and Foreign Exchange Risk in case of Usance Letter of Credits.

How the exporter can minimize the problems/ risk

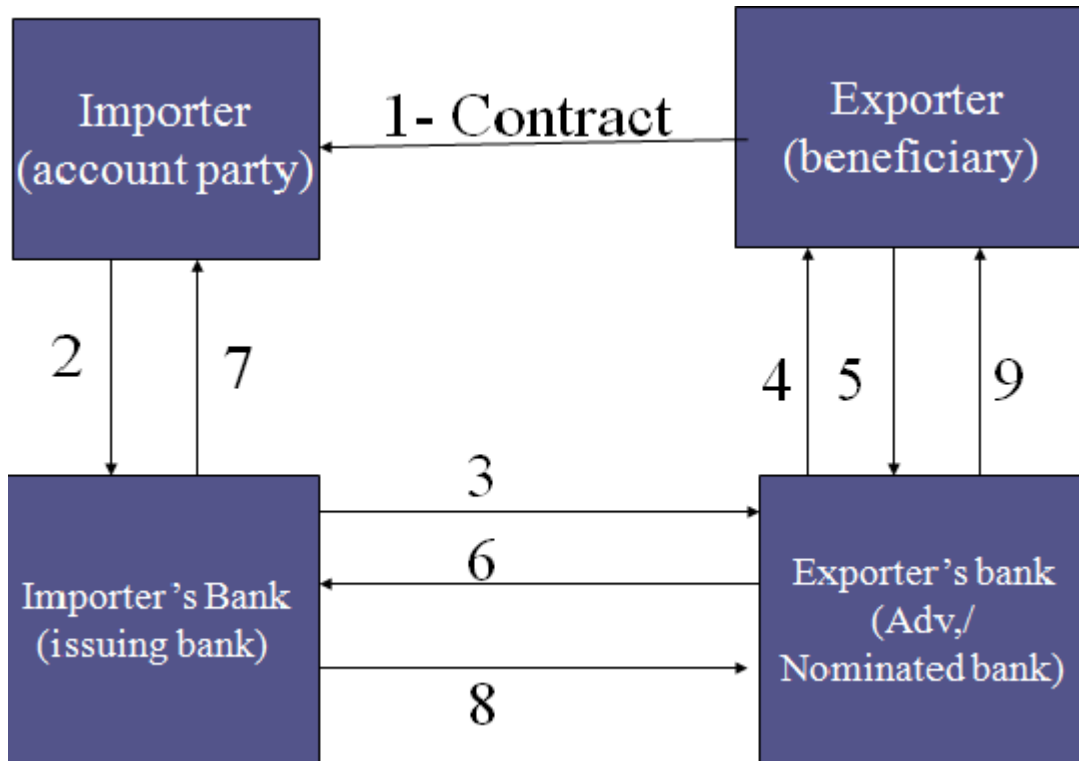
- 0 The exporter can minimize the risk of low rating of the issuing bank or country risk by insisting for issuance of a confirmed letter of credit

Course of action when an exporter has presented documents which do not conform to the credit:

- 0 Exporter may ask the advising bank to send documents to issuing bank on collection basis.
- 0 Exporter can ask the negotiating bank to negotiate the discrepant documents against indemnity or guarantee of the exporter.
- 0 The advising bank can approach the issuing bank for waiver of discrepancies.

Flow Chart of Letter of Credit

We shall continue with explanation of flow chart

LESSON 35**FLOW CHART OF LETTER OF CREDIT—REVISITED****Explanation of Flow chart:**

1. First of all importer and exporter enter into a contract.
2. Applicant (Importer) approaches the bank
3. Importer's bank issues L/C and advises it to the advising bank.
4. Advising bank advises L/C to the exporter
5. After shipment of the consignment, exporter submits document to issuing bank for payment through advising bank. (The exporter may also adopt other measures for of payment such as negotiation of documents through negotiating bank.
6. Advising bank sends documents to issuing bank
7. Issuing bank shall debit account of importer under advice to him and transmit proceeds to advising bank.
8. Advising bank shall credit account of exporter.
9. The advising bank shall intimate the exporter/ customer and send credit advice to him.

Settlements under a Letter of Credit

All commercial letters of credit must clearly indicate whether they are payable by sight payment, by deferred payment, by acceptance, or by negotiation. These are noted as formal demands under the terms of the commercial letter of credit. In a **sight payment**, the commercial letter of credit is payable when the beneficiary presents the complying documents and if the presentation takes place on or before the expiration of the commercial letter of credit.

In a **deferred payment**, the commercial letter of credit is payable on a specified future date. The beneficiary may present the complying documents at an earlier date, but the commercial letter of credit is payable only on the specified future date.

An **acceptance** is a time draft drawn on, and accepted by, a banking institution, which promises to honor the draft at a specified future date. The act of acceptance is without recourse as it is a commitment to pay the face amount of the accepted draft.

Under negotiation, the **negotiating bank**, a third party negotiator, expedites payment to the beneficiary upon the beneficiary's presentation of the complying documents to the negotiating bank. The bank pays the beneficiary, normally at a discount of the face amount of the value of the documents, and then presents the complying documents, including a sight or time draft, to the issuing bank to receive full payment at sight or at a specified future date.

Reimbursement under a Letter of Credit:

Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits, ICC Publication No. 525

GENERAL PROVISION AND DEFINITION

Article 1 - Application of URR

The Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits ("Rules"), ICC Publication No. 525, shall apply to all Bank-to-Bank Reimbursements where they are incorporated into the text of the Reimbursement Authorization. They are binding on all parties thereto, unless otherwise expressly stipulated in the Reimbursement Authorization. The Issuing Bank is responsible for indicating in the Documentary Credit ("Credit") that Reimbursement Claims are subject to these Rules. In a Bank-to-Bank Reimbursement subject to these Rules, the Reimbursing Bank acts on the instructions and/or under the authority of the Issuing Bank. These Rules are not intended to override or change the provisions of the ICC Uniform Customs and Practice for Documentary Credits.

Article 2 - Definitions

As used in these Rules, the following terms shall have the meanings specified in this Article and may be used in the singular or plural as appropriate :

- a. "Issuing Bank" shall mean the bank that has issued a Credit and the Reimbursement Authorization under that Credit.
- b. "Reimbursing Bank" shall mean the bank instructed and/or authorized to provide reimbursement pursuant to a Reimbursement Authorization issued by the Issuing Bank.
- c. "Reimbursement Authorizations" shall mean an instruction and/or authorization independent of the Credit, issued by an Issuing Bank to a Reimbursing Bank to reimburse a Claiming Bank, or, if so requested by the Issuing Bank, to accept and pay a time draft(s) drawn on the Reimbursing Bank.
- d. "Reimbursement Amendment" shall mean an advice from the Issuing Bank to a Reimbursing Bank stating changes to a Reimbursement Authorization.
- e. "Claiming Bank" shall mean a bank that pays, incurs a deferred payment undertaking, accepts draft(s), or negotiates under a Credit and presents a Reimbursement Claim to the Reimbursing Bank. "Claiming Bank" shall include a bank authorized to present a Reimbursement Claim to the Reimbursing Bank on behalf of the bank that pays, incurs a deferred payment undertaking, accepts draft(s), or negotiates

- f. "Reimbursement Claim" shall mean a request for reimbursement from the Claiming Bank to the Reimbursing Bank.
- g. "Reimbursement Undertaking" shall mean a separate irrevocable undertaking of the Reimbursing Bank, issued upon the authorization or request of the Issuing Bank, to the Claiming Bank named in the Reimbursement Authorization, to honor that bank's Reimbursement Claim provided the terms and conditions of the Reimbursement Undertaking have been complied with.
- h. "Reimbursement Undertaking Amendment" shall mean an advice from the Reimbursing Bank to the Claiming Bank named in the Reimbursement Authorization, stating changes to a Reimbursement Undertaking.
- i. For the purposes of these Rules branches of a bank in different countries are considered separate banks.

Article 3 - Reimbursement Authorization Versus Credits

A Reimbursement Authorization is separate from the Credit to which it refers, and a Reimbursing Bank is not concerned with or bound by the terms and conditions of the Credit, even if any reference whatsoever to the terms and conditions of the Credit is included in the Reimbursement Authorization.

B. LIABILITIES AND RESPONSIBILITIES

Article 4 - Honor of a Reimbursement Claim

Except as provided by the terms of its Reimbursement Undertaking a Reimbursing Bank is not obligated to honor a Reimbursement Claim.

Article 5 - Responsibilities of the Issuing Bank

The Issuing Bank is responsible for providing the information required in these Rules in both the Reimbursement Authorization and Credit and is responsible for any consequences resulting from noncompliance with this provision.

C. FORM AND NOTIFICATION OF AUTHORISATIONS, AMENDMENTS AND CLAIMS

Article 6 - Issuance and Receipt of a Reimbursement Authorization or Reimbursement Amendment

- a. All Reimbursement Authorizations and Reimbursement Amendments must be issued in the form of an authenticated tele-transmission or a signed letter.

When a Credit, or amendment thereto which has an effect on the Reimbursement Authorization, is issued by tele-transmission, the Issuing Bank should advise its Reimbursement Authorization or Reimbursement Amendment to the Reimbursing Bank by authenticated tele-transmission. The tele-transmission will be deemed the operative Reimbursement Authorization or the operative Reimbursement Amendment and no mail confirmation should be sent. Should a mail confirmation nevertheless be sent, it will have no effect and the Reimbursing Bank will have no obligation to check such mail confirmation against the operative Reimbursement Authorization or the operative Reimbursement Amendment received by tele-transmission.

- b. Reimbursement Authorizations and Reimbursement Amendments must be complete and precise. To guard against confusion and misunderstanding, Issuing Bank must not send to Reimbursing Banks:
 - i. a copy of the Credit or any part thereof or a copy of an amendment to the Credit in place of, or in addition to, the Reimbursement Authorization or Reimbursement Amendment. If such copies are

- received by the Reimbursing Bank they shall be disregarded;
 - ii. Multiple Reimbursement Authorizations under one tele-transmission or letter, unless expressly agreed to by the Reimbursing Bank.
- c. Issuing Bank shall not require a certificate of compliance with the terms and conditions of the Credit in the Reimbursement Authorization.
- d. All Reimbursement Authorizations must (in addition to the requirement of Article 1 for incorporation of reference to these Rules) state the following :
 - i. Credit number ;
 - ii. currency and amount ;
 - iii. additional amounts payable and tolerance, if any ;
 - iv. Claiming Bank or, in the case of freely negotiable credits, that claims can be made by any bank. In the absence of any such indication the Reimbursing Bank is authorized to pay any Claiming Bank ;
 - v. Parties responsible for charges (Claiming Bank's and Reimbursing Bank's charges) in accordance with Article 16 of these Rules.

Reimbursement Amendments must state only the relative changes to the above and the Credit number.
- e. If the Reimbursing Bank is requested to accept and pay a time draft(s), the Reimbursement Authorization must indicate the following, in addition to the information specified in (d) above : i. tenor of draft(s) to be drawn ; ii. Drawer; iii. Party responsible for acceptance and discount charges, if any. Reimbursement Amendment must state the relative changes to the above. Issuing Banks should not require a sight draft(s) to be drawn on the Reimbursing Bank.
- f. Any requirement for :
 - i. pre-notification of a Reimbursement Claim to the Issuing Bank must be included in the Credit and not in the Reimbursement Authorization ;
 - ii. Pre-debit notification to the Issuing Bank must be indicated in the Credit.
- g. If the Reimbursing Bank is not prepared to act for any reason whatsoever under the Reimbursement Authorization or Reimbursement Amendment, it must so inform the Issuing Bank without delay.
- h. In addition to the provisions of Articles 3 and 4, Reimbursing Banks are not responsible for the consequences resulting from non-reimbursement or delay in reimbursement of Reimbursement Claims, where any provision contained in this Article is not followed by the Issuing and/or Claiming Bank.

Article 7 - Expiry of a Reimbursement Authorization

Except to the extent expressly agreed to by the Reimbursing Bank, the Reimbursement Authorization must not have an expiry date or latest date for presentation of a claim except as indicated in Article 9. Reimbursing Banks will assume no responsibility for the expiry date of Credit and if such date is provided in the Reimbursement Authorization it will be disregarded. The Issuing Bank must cancel its Reimbursement Authorization for any unutilized portion of the Credit to which it refers, informing the Reimbursing Bank without delay

Article 8 - Amendment or Cancellation of Reimbursement Authorizations

Except where the Issuing Bank has authorized or requested the Reimbursing Bank to issue a Reimbursement Undertaking as provided in Article 9 and the Reimbursing Bank has issued a Reimbursement Undertaking :

- a. The Issuing Bank may issue a Reimbursement Amendment or cancel a Reimbursement Authorization at any time upon sending notice to that effect to the Reimbursing Bank.
- b. The Issuing Bank must send notice of any amendment to a Reimbursement Authorization that has an effect on the reimbursement instructions contained in the Credit to the nominated bank or, in the case of a freely negotiable Credit, the advising bank. In the case of cancellation of the Reimbursement Authorization prior to expiry of the Credit, the Issuing Bank must provide the nominated bank or the advising bank with new reimbursement instructions.
- c. The Issuing Bank must reimburse the Reimbursing Bank for any Reimbursement Claims honored or draft(s) accepted by the Reimbursing Bank prior to the receipt by it of notice of cancellation or Reimbursement Amendment.

Article 9 - Reimbursement Undertakings

- a. In addition to the requirements of sub-Article 6 (a), (b) and (c) of these Rules, all Reimbursement Authorizations authorizing or requesting the issuance of a Reimbursement Undertaking must comply with the provisions of this Article.
- b.
 - i. An authorization or request by the Issuing Bank to the Reimbursing Bank to issue a Reimbursement Undertaking is irrevocable ("Irrevocable Reimbursement Authorization") and must (in addition to the requirement of Article 1 for incorporation of reference to these Rules) contain the following:
 - i. Credit number ;
 - ii. Currency and amount;
 - iii. Additional amounts payable and tolerance, if any;
 - iv. full name and address of the Claiming Bank to whom the Reimbursement Undertaking should be issued ;
 - v. latest date for presentation of a claim including any usance period ;
 - vi. Parties responsible for charges (Claiming Bank's and Reimbursing Bank's charges and Reimbursement Undertaking fee) in accordance with Article 16 of these Rules.
- c. If the Reimbursing Bank is requested to accept and pay a time draft(s), the Irrevocable Reimbursement Authorization must also indicate the following, in addition to the information contained in (b) above :
 - i. tenor of draft(s) to be drawn ;
 - ii. Drawer;
 - iii. Party responsible for acceptance and discount charges, if any. Issuing Bank should not require a sight draft(s) to be drawn on the Reimbursing Bank.
- d. If the Reimbursing Bank is authorized or requested by the Issuing Bank to issue its Reimbursement Undertaking to the Claiming Bank but is not prepared to do so, it must so inform the Issuing Bank without delay.
- e. A Reimbursement Undertaking must indicate the terms and conditions of the undertaking and :
 - i. Credit number and Issuing Bank.
 - ii. currency and amount of the Reimbursement Authorization ;
 - iii. additional amounts payable and tolerance, if any ;
 - iv. currency and amount of the Reimbursement Undertaking ;
 - v. latest date for presentation of a claim including any usance period ;
 - vi. Party to pay the Reimbursement Undertaking fee, if other than the Issuing bank. The Reimbursing Bank must also include its charges, if any that will be deducted from the amount claimed.

- f. If the latest date for presentation of a claim falls on a day on which the Reimbursing Bank is closed for reasons other than those mentioned in Article 15, the latest date for presentation of a claim shall be extended to the first following day on which the Reimbursing Bank is open.
- g.
 - i. An irrevocable Reimbursement Authorization cannot be amended or cancelled without the agreement of the Reimbursing Bank.
 - ii. When an Issuing Bank has amended its irrevocable Reimbursement Authorization, a Reimbursing Bank which has issued its Reimbursement Undertaking may amend its undertaking to reflect such amendment. If a Reimbursing Bank chooses not to issue its Reimbursement Undertaking Amendment it must so inform the Issuing Bank without delay.
 - iii. An Issuing Bank which has issued its Irrevocable Reimbursement Authorization Amendment shall be irrevocably bound as of the time of its advice of the Irrevocable Reimbursement Authorization Amendment.
 - iv. The terms of the original Irrevocable Reimbursement Authorization (or an Authorization incorporating previously accepted Irrevocable Reimbursement Authorization Amendments) will remain in force for the Reimbursing Bank until it communicates its acceptance of the amendment to the Issuing Bank.
 - v. A Reimbursing Bank must communicate its acceptance or rejection of an Irrevocable Reimbursement Authorization Amendment to the Issuing Bank. A Reimbursing Bank is not required to accept or reject an Irrevocable Reimbursement Authorization Amendment until it has received acceptance or rejection from the Claiming Bank to its Reimbursement Undertaking Amendment.
- h.
 - i. A Reimbursement Undertaking cannot be amended or cancelled without the agreement of the Claiming Bank.
 - ii. A Reimbursing Bank which has issued its Reimbursement Undertaking Amendment shall be irrevocably bound as of the time of its advice of the Reimbursement Undertaking Amendment.
 - iii. The terms of the original Reimbursement Undertaking (or a Reimbursement Undertaking incorporating previously accepted Reimbursement Amendments) will remain force for the Claiming Bank until it communicates its acceptance of the Reimbursement Undertaking Amendment to the Reimbursing Bank.
 - iv. A Claiming Bank must communicate its acceptance or rejection of a Reimbursement Undertaking Amendment to the Reimbursing Bank.

Article 10 - Standards for Reimbursement Claims

- a. The Claiming Bank's claim for reimbursement :
 - i. Must be in the form of a tele-transmission, unless specifically prohibited by the Issuing Bank, or an original letter. A Reimbursing Bank has the right to request that a Reimbursement Claim be authenticated and in such case the Reimbursing Bank shall not be liable for any consequences resulting from any delay

- incurred. If a Reimbursement Claim is made by tele-transmission, no mail confirmation is to be sent. In the event such a mail confirmation is sent, the Claiming Bank will be responsible for any consequences that may arise from a duplicate reimbursement ;
- ii. must clearly indicate the Credit number and Issuing Bank (and Reimbursing Bank's reference number, if known) ;
 - iii. must separately stipulate the principal amount claimed, any additional amount(s) and charges ;
 - iv. must not be a copy of the Claiming Bank's advice of payment, deferred payment, acceptance or negotiation to the Issuing Bank ;
 - v. must not include multiple Reimbursement Claims under one tele-transmission or letter ;
 - vi. Must, in the case of a Reimbursement Undertaking, comply with the terms and conditions of the Reimbursement Undertaking.
- b. in cases where a time draft is to be drawn on the Reimbursing Bank, the Claiming Bank must forward the draft with the Reimbursement Claim to the Reimbursing Bank for processing, and include the following in its claim if required by the Credit and/or Reimbursement Undertaking :
- i. general description of the goods and/or services ;
 - ii. country of origin ;
 - iii. place of destination/performance ; and if the transaction covers the shipment of merchandise,
 - iv. date of shipment ;
 - v. place of shipment
- c. Claiming Banks must not indicate in a Reimbursement Claim that a payment, acceptance or negotiation was made under reserve or against an indemnity.
- d. Reimbursing Banks assume no liability or responsibility for any consequences that may arise out of any non-acceptance or delay of processing should the Claiming Bank fail to follow the provisions of this Article.

Article 11 - Processing Reimbursement Claims

- a.
 - i. Reimbursing Banks shall have a reasonable time, not to exceed three banking days following the day of receipt of the Reimbursement Claim, to process claims.
Reimbursement Claims received outside banking hours are deemed to be received on the next banking day. If a pre-debit notification is required by the Issuing Bank, this pre- debit notification period shall be in addition to the processing period mentioned above.
 - ii. If the Reimbursing Bank determines not to reimburse, either because of a non-conforming claim under a Reimbursement Undertaking, or for any reason whatsoever under a Reimbursement Authorization, it shall give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay, but no later than the close of the third banking day following the day of receipt of the claim (plus any additional period mentioned in sub-Article (i) above).
Such notice shall be sent to the Claiming Bank and the Issuing Bank and, in the case of a Reimbursement Undertaking, it must state the reasons for non-payment of the claim.

- b. Reimbursing Banks will not process requests for back value (value dating prior to the date of a Reimbursement Claim) from the Claiming Bank?
- c. Where a Reimbursing Bank has not issued a Reimbursement Undertaking and reimbursement is due on a future date :
 - i. The Reimbursement Claim must specify the predetermined reimbursement date.
 - ii. The Reimbursement Claim should not be presented to the Reimbursing Bank more than ten (10) of its banking days prior to such predetermined date. If a Reimbursement Claim is presented more than ten (10) banking days prior to predetermine date, the Reimbursing Bank may disregard the Reimbursement Claim. If the Reimbursing Bank disregards the Reimbursement Claim it must so inform the Claiming Bank by tele-transmission or other expedition's means without delay.
 - iii. If the predetermined reimbursement date is more than three banking days following the day of receipt of the Reimbursement Claim, the Reimbursing Bank has no obligation to provide notice of non-reimbursement until such predetermined date, or no later than the close of the third banking day following the receipt of the Reimbursement Claim plus any additional period mentioned in (a) (i) above, whichever is later.
- d. Unless otherwise expressly agreed to by the Reimbursing Bank and the Claiming Banks, Reimbursing Banks will effect reimbursement under a Reimbursement Claim only to the Claiming Bank.
- e. Reimbursing Banks assume no liability or responsibility if they honor a Reimbursement Claim that indicates that a payment, acceptance or negotiation was made under reserve or against an indemnity and shall disregard such indication. Such reserve or indemnity concerns only the relations between the Claiming Bank and the party towards whom the reserve was made, or from whom, or no whose behalf, the indemnity was obtained.

Article 12 - Duplications of Reimbursement Authorizations.

An Issuing Bank must not, upon receipt of documents, give a new Reimbursement Authorization, or additional instructions, unless they constitute an amendment to, or a cancellation of an existing Reimbursement Authorization. If the Issuing Bank does not comply with the above and a duplicate reimbursement is made, it is the responsibility of the Issuing Bank to obtain the return of the amount of the duplicate reimbursement. The Reimbursing Bank assumes no liability or responsibility for any consequences that may arise from any such duplication.

D. MISCELLANEOUS PROVISIONS

Article 13 - Foreign Laws and Usages

The Issuing Bank shall be bound by and shall indemnify the Reimbursing Bank against all obligations and responsibilities imposed by foreign laws and usages.

Article 14 - Disclaimer on the Transmission of Messages

Reimbursing Banks assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of any message(s), letter(s) or document(s), or for delay, mutilation or other errors arising in the transmission of any telecommunication. Reimbursing Banks assume no liability or responsibility for errors in translation.

Article 15 - Force Majeure

Reimbursing Banks assume no liability or responsibility for the consequences arising out

There are complete set of rules under URR 525 (uniform rules for bank to bank reimbursement under letter of credit). These rules for interbank reimbursements as contained in URR 525 are given hereunder :

of the interruption of their business by Acts God, riots, civil commotions, insurrections, wars or any other causes beyond their control, or by any strikes lockouts.

Article 16 - Charges

- a. The Reimbursing Bank's charges should be for the account of the Issuing Bank. However, in cases where the charges are for the account of another party, it is the responsibility of the Issuing Bank to so indicate in the original Credit and in the Reimbursement Authorization.
- b. When honoring a Reimbursement Claim, a Reimbursing Bank is obligated to follow the instructions regarding any charges contained in the Reimbursement Authorization.
- c. In cases where the Reimbursing Bank's charges are for the account of another party they shall be deducted when the Reimbursement Claim is honored. Where a Reimbursing Bank follows the instructions of the Issuing Bank regarding charges (including commissions, fees, costs or expenses) and these charges are not paid or a Reimbursement Claim is never presented to the Reimbursing Bank under the Reimbursement Authorization, the Issuing Bank remains liable for such charges.
- d. Unless otherwise stated in the Reimbursement Authorization, all charges paid by the Reimbursing Bank will be in addition to the amount of the Authorization provided that the Claiming Bank indicates the amount of such charges.
- e. If the Issuing Bank fails to provide the Reimbursing Bank with instructions regarding charges, all charges shall be for the account of the Issuing Bank.

Article 17 - Interest Claims/Loss of Value

All claims for loss of interest, loss of value due to any exchange rate fluctuations, revaluations or devaluations are between the Claiming Bank and the Issuing Bank, unless such losses result from the non-performance of the Reimbursing Bank's obligation under a Reimbursement Undertaking.

Letters of Credit -- a Solution to Many Trade Finance Needs

Letters of credit are tools to aid importers to leverage their capital base and their ability to capture more trading opportunities.

A Letter of Credit allows importers/buyers to offer secure terms of payment to exporters/sellers in which a bank (or more than one bank) gets involved. The technical term for Letter of credit is 'Documentary Letter of Credit'. Letters of Credit (LC's) deal in documents, not goods. The idea in an international trade transaction is to shift the risk from the actual buyer to a bank. Thus an LC is a payment undertaking given by a bank to the Beneficiary (the seller) and is issued on behalf of the applicant (the buyer). The Bank that issues the LC is referred to as the Issuing Bank, generally in the country of the Buyer. The Bank that Advises the LC to the seller is called the Advising Bank which is generally in the country of the seller.

The specified bank makes the payment upon the successful presentation of the required documents by the seller within the specified time frame. Note that the Bank scrutinizes the 'documents' and not the 'goods' for making payment. This process gives both the buyer and the seller comfort that the transfer of ownership to the goods will occur properly and when payment is secure. The seller gets assured that if documents are presented on time and in the way that they have been requested on the LC the payment will be made. The buyer is assured that the bank will thoroughly examine these presented documents and ensure that they meet the terms and conditions stipulated in the LC.

Documents requested in a Letter of Credit would often include: a commercial invoice; a transport document such as a Bill of lading or Airway bill; an insurance document; an inspection certificate; and/or a certificate of origin. Other documents could be required, depending on the underlying

transaction.

Keep in mind that the Letter of Credit process revolves around documents, not goods. The LC could be 'irrevocable' or 'revocable'. An irrevocable LC cannot be changed unless both the buyer and seller agree. Whereas in a revocable LC changes to the LC can be made without the consent of the beneficiary. A 'sight' LC means that payment is made immediately to the beneficiary/seller/exporter upon presentation of the correct documents in the required time frame. A 'time' or 'date' LC will specify when payment will be made at a future date and upon presentation of the required documents.

A letter of credit can make a big difference to an importer. Many international deals just can't happen without a letter of credit. And when you cut through all the mumbo-jumbo.....this is a tool that allows buyers and sellers to do business with greater confidence.

Uniform Customs and Practice for Documentary Credits (UCP 600)

- International Chamber of Commerce (ICC), is a World Business Organization, its headquarters are based at Paris, it has developed and designed standards, rules and reference guides for international trade. UCP 600 is also designed by ICC and the rules contained therein govern letter of credit transactions worldwide.
- UCP 600 became effective from 1st July 2007
- UCP 600 is comprised of 39 Articles. These are a comprehensive and practical working aid to bankers, lawyers, importers, and exporters, transport executives, educators, and all others who are engaged and interested in letter of credit transactions.

We shall discuss some of the important provisions of UCP 600 in the next Lesson.

LESSON 36

UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (UCP 600)

- International Chamber of Commerce (ICC), is a World Business Organization, its headquarters are based at Paris, it has developed and designed standards, rules and reference guides for international trade. UCP 600 is also designed by ICC and the rules contained therein govern letter of credit transactions worldwide.
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- UCP 600 is comprised of 39 Articles. These are a comprehensive and practical working aid to bankers, lawyers, importers, and exporters, transport executives, educators, and all others who are engaged and interested in letter of credit transactions.

Some of the important Articles of UCP 600

Article 1

The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication no. 600 ("UCP") **are rules** that apply to any documentary credit ("credit") (including, to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates that it is subject to these rules. They are **binding on all parties** thereto unless expressly modified or excluded by the credit.

Article 2

It comprises definitions of certain expressions which are given below:

Advising bank: means the bank that advises the credit at the request of the issuing bank.

Applicant: means the party on whose request the credit is issued.

Banking day: means a day on which a bank is regularly open at the place at which an act subject to these rules is to be performed

Beneficiary: means the party in whose favor a credit is issued.

Complying presentation: means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice.

Confirmation: means a definite undertaking of the confirming bank, in addition to that of the issuing bank, to honor or negotiate a complying presentation.

Confirming bank: means the bank that adds its confirmation to a credit upon the issuing bank's authorization or request.

Credit: means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation.

Honour means:

- To pay at sight if the credit is available by sight payment
- To incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment
- To accept a bill of exchange ("draft") drawn by the beneficiary and pay at maturity if the credit is available by acceptance

Issuing bank: means the bank that issues a credit at the request of an applicant or on its own behalf.

Negotiation: means the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

Nominated Bank: means the bank with which the credit is available or any bank in the case of a credit available with any bank.

Presentation: means either the delivery of documents under a credit to the issuing bank or nominated bank or the documents so delivered.

Presenter: means a beneficiary, bank or other party that makes a presentation.

Article 3

A **credit is irrevocable** even if there is no indication to that effect.

A document may be signed by handwriting, facsimile signature, perforated signature, stamp, symbol or any other mechanical or electronic method of authentication.

Article 4

Credits v. Contracts

A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honor, to negotiate or to fulfill any other obligation under the credit is not subject to claims or defenses by the applicant resulting from its relationships with the issuing bank or the beneficiary.

A beneficiary can in no case avail itself of the contractual relationships existing between banks or between the applicant and the issuing bank.

An issuing bank should discourage any attempt by the applicant to include, as an integral part of the credit, copies of the underlying contract, Performa invoice and the like.

Article 5

Documents v. Goods, Services or Performance

Banks deal with documents and not with goods, services or performance to which the documents may relate.

Article 7

Issuing Bank Undertaking

Provided that the stipulated documents are presented to the nominated bank or to the issuing bank and that they constitute a complying presentation, the issuing bank must honor if the credit is available by:

- i. Sight payment, deferred payment or acceptance with the issuing bank;
- ii. Sight payment with a nominated bank and that nominated bank does not pay;
- iii. Deferred payment with a nominated bank and that nominated bank does not incur its deferred payment undertaking or, having incurred its deferred payment undertaking, does not pay at maturity;
- iv. Acceptance with a nominated bank and that nominated bank does not accept a draft drawn on it or, having accepted a draft drawn on it, does not pay at maturity;
- v. Negotiation with a nominated bank and that nominated bank does not negotiate.
- vi. An issuing bank is irrevocably bound to honor as of the time it issues the credit.

An issuing bank undertakes to reimburse a nominated bank that has honored or negotiated a complying presentation and forwarded the documents to the issuing bank. Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not the nominated bank prepaid or purchased before maturity.

An issuing bank's undertaking to reimburse a nominated bank is independent of the issuing bank's undertaking to the beneficiary.

Article 8**Confirming Bank Undertaking**

Provided that the stipulated documents are presented to the confirming bank or to any other nominated bank and that they constitute a complying presentation, the confirming bank must:

- i. Honor, if the credit is available by
 - a. Sight payment, deferred payment or acceptance with the confirming bank;
 - b. Sight payment with another nominated bank and that nominated bank does not pay;
 - c. Deferred payment with another nominated bank and that nominated bank does not incur its deferred payment undertaking or, having incurred its deferred payment undertaking, does not pay at maturity;
 - d. Acceptance with another nominated bank and that nominated bank does not accept a draft drawn on it or, having accepted a draft drawn on it, does not pay at maturity;
 - e. Negotiation with another nominated bank and that nominated bank does not negotiate.
- ii. Negotiate, without recourse, if the credit is available by negotiation with the confirming bank.
- iii. A confirming bank is irrevocably bound to honor or negotiate as of the time it adds its confirmation to the credit.

A confirming bank undertakes to reimburse another nominated bank that has honored or negotiated a complying presentation and forwarded the documents to the confirming bank. Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not another nominated bank prepaid or purchased before maturity.

A confirming bank's undertaking to reimburse another nominated bank is independent of the confirming bank's undertaking to the beneficiary.

Confirming Bank Undertaking

If a bank is authorized or requested by the issuing bank to confirm a credit but is not prepared to do so, it must inform the issuing bank without delay and may advise the credit without confirmation.

UCP 600 - Article 11**Tele-transmitted and Pre-Advised Credits and Amendments**

An authenticated tele-transmission of a credit or amendment will be deemed to be the operative credit or amendment, and any subsequent mail confirmation shall be disregarded.

If a tele-transmission states "full details to follow" (or words of similar effect), or states that the mail confirmation is to be the operative credit or amendment, and then the tele-transmission will not be deemed to be the operative credit or amendment. The issuing bank must then issue the operative credit or amendment without delay in terms not inconsistent with the tele-transmission.

A preliminary advice of the issuance of a credit or amendment ("pre-advice") shall only be sent if the issuing bank is prepared to issue the operative credit or amendment. An issuing bank that sends a pre advice is irrevocably committed to issue the operative credit or amendment, without delay, in terms not inconsistent with the pre-advice.

Article 14**Standard for Examination of Documents**

Nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.

Nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank shall each have a maximum of five banking days following the day of presentation to determine if a presentation is complying. This period is not curtailed or otherwise affected by the occurrence on or after the date of presentation of any expiry date or last day for presentation.

A presentation including one or more original transport documents subject to articles 19, 20, 21, 22, 23, 24 or 25 must be made by or on behalf of the beneficiary not later than 21 calendar days after the date of shipment as described in these rules, but in any event not later than the expiry date of the credit.

Data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit.

In documents other than the commercial invoice, the description of the goods, services or performance, if stated, may be in general terms not conflicting with their description in the credit.

f. If a credit requires presentation of a document other than a transport document, insurance document or commercial invoice, without stipulating by whom the document is to be issued or its data content, banks will accept the document as presented if its content appears to fulfill the function of the required document and otherwise complies with sub-article 14 (d).

A document presented but not required by the credit will be disregarded and may be returned to the presenter.

If a credit contains a condition without stipulating the document to indicate compliance with the condition, banks will deem such condition as not stated and will disregard it.

A document may be dated prior to the issuance date of the credit, but must not be dated later than its date of presentation.

When the addresses of the beneficiary and the applicant appear in any stipulated document, they need not be the same as those stated in the credit or in any other stipulated document, but must be within the same country as the respective addresses mentioned in the credit.

The shipper or consignor of the goods indicated on any document need not be the beneficiary of the credit.

A transport document may be issued by any party other than a carrier, owner, master or charterer provided that the transport document meets the requirements of articles 19, 20, 21, 22, 23 or 24 of these rules.

Article 15

Complying Presentation

When an issuing bank determines that a presentation is complying, it must honor.

When a confirming bank determines that a presentation is complying, it must honor or negotiate and forward the documents to the issuing bank.

When a nominated bank determines that a presentation is complying and honors or negotiates, it must forward the documents to the confirming bank or issuing bank.

Article 18

Commercial Invoice

A commercial invoice:

- i. Must appear to have been issued by the beneficiary (except as provided in article 38);
- ii. Must be made out in the name of the applicant (except as provided in sub-article 38 (g));
- iii. Must be made out in the same currency as the credit; and
- iv. Need not be signed.

A nominated bank acting on its nomination, a confirming bank, if any, or the issuing bank may accept a commercial invoice issued for an amount in excess of the amount permitted by the credit, and its decision will be binding upon all parties, provided the bank in question has not honored or negotiated for an amount in excess of that permitted by the credit.

The description of the goods, services or performance in a commercial invoice must correspond with that appearing in the credit.

Article 20

Bill of Lading

A bill of lading, however named, must appear to:

- i. Indicate the name of the carrier and be signed by:
 - The carrier or a named agent for or on behalf of the carrier, or
 - The master or a named agent for or on behalf of the master

Any signature by the carrier, master or agent must be identified as that of the carrier, master or agent.
Any signature by an agent must indicate whether the agent has signed for or on behalf of the carrier or for or on behalf of the master.

A bill of lading, however named, must appear to:

ii. Indicate that the goods have been shipped on board a named vessel at the port of loading stated in the credit by:

Pre-printed wording, or

ii. An on board notation indicating the date on which the goods have been shipped on board.

The date of issuance of the bill of lading will be deemed to be the date of shipment unless the bill of lading contains an on board notation indicating the date of shipment, in which case the date stated in the on board notation will be deemed to be the date of shipment.

If the bill of lading contains the indication "intended vessel" or similar qualification in relation to the name of the vessel, an on board notation indicating the date of shipment and the name of the actual vessel is required.

Indicate shipment from the port of loading to the port of discharge stated in the credit.

iii. Be the sole original bill of lading or, if issued in more than one original, be the full set as indicated on the bill of lading.

V. contain terms and conditions of carriage or make reference to another source containing the terms and conditions of carriage (short form or blank back bill of lading). Contents of terms and conditions of **carriage will not be examined.**

vi. Contain no indication that it is subject to a charter party.

For the purpose of this article, transshipment means unloading from one vessel and reloading to another vessel during the carriage from the port of loading to the port of discharge stated in the credit.

i. A bill of lading may indicate that the goods will or may be transshipped provided that the entire carriage is covered by one and the same bill of lading.

ii. A bill of lading indicating that transshipment will or may take place is acceptable, even if the credit prohibits transshipment, if the goods have been shipped in a container, trailer or LASH barge as evidenced by the bill of lading.

Clauses in a bill of lading stating that the carrier reserves the right to transship will be disregarded.

Article 23

Air Transport Document

An air transport document, however named, must appear to:

i. Indicate the name of the carrier and be signed by:

The carrier, or

a. A named agent for or on behalf of the carrier

b. Any signature by the carrier or agent must be identified as that of the carrier or agent.

c. Any signature by an agent must indicate that the agent has signed for or on behalf of the carrier.

ii. Indicate that the goods have been accepted for carriage.

iii. Indicate the date of issuance. This date will be deemed to be the date of shipment unless the air transport document contains a specific notation of the actual date of shipment, in which case the date stated in the notation will be deemed to be the date of shipment.

Any other information appearing on the air transport document relative to the flight number and date will not be considered in determining the date of shipment.

iv. Indicate the airport of departure and the airport of destination stated in the credit.

Be the original for consignor or shipper, even if the credit stipulates a full set of originals.

v. Contain terms and conditions of carriage or make reference to another source containing the terms and conditions of carriage. Contents of terms and conditions of carriage will not be examined.

For the purpose of this article, transshipment means unloading from one aircraft and reloading to another aircraft during the carriage from the airport of departure to the airport of destination stated in the credit.

c.

- i. An air transport document may indicate that the goods will or may be transshipped, provided that the entire carriage is covered by one and the same air transport document.
- ii. An air transport document indicating that transshipment will or may take place is acceptable, even if the credit prohibits transshipment.

Article 27

Clean Transport Document

A bank will only accept a clean transport document. A clean transport document is one bearing no clause or notation expressly declaring a defective condition of the goods or their packaging. The word "clean" need not appear on a transport document, even if a credit has a requirement for that transport document to be "clean on board".

Article 31

Partial Drawings or Shipments

Partial drawings or shipments are allowed.

A presentation consisting of more than one set of transport documents evidencing shipment commencing on the same means of conveyance and for the same journey, provided they indicate the same destination, will not be regarded as covering a partial shipment, even if they indicate different dates of shipment or different ports of loading, places of taking in charge or dispatch.

If the presentation consists of more than one set of transport documents, the latest date of shipment as evidenced on any of the sets of transport documents will be regarded as the date of shipment.

A presentation consisting of one or more sets of transport documents evidencing shipment on more than one means of conveyance within the same mode of transport will be regarded as covering a partial shipment, even if the means of conveyance leave on the same day for the same destination.

A presentation consisting of more than one courier receipt, post receipt or certificate of posting will not be regarded as a partial shipment if the courier receipts, post receipts or certificates of posting appear to have been stamped or signed by the same courier or postal service at the same place and date and for the same destination.

Article 33

Hours of Presentation

A bank has no obligation to accept a presentation outside of its banking hours.

Article 36

Force Majeure

A bank assumes no liability or responsibility for the consequences arising out of the interruption of its business by Acts of God, riots, civil commotions, insurrections, wars, acts of terrorism, or by any strikes or lockouts or any other causes beyond its control.

A bank will not, upon resumption of its business, honor or negotiates under a credit that expired during such interruption of its business.

Article 38

Transferable Credits

A bank is under no obligation to transfer a credit except to the extent and in the manner expressly consented to by that bank.

For the purpose of this article:

Transferable credit means a credit that specifically states it is "transferable". A transferable credit may be made available in whole or in part to another beneficiary ("second beneficiary") at the request of the beneficiary ("first beneficiary").

Transferring bank means a nominated bank that transfers the credit or, in a credit available with any bank, a bank that is specifically authorized by the issuing bank to transfer and that transfers the credit. An issuing bank may be a transferring bank.

Transferred credit means a credit that has been made available by the transferring bank to a second beneficiary.

Unless otherwise agreed at the time of transfer, all charges (such as commissions, fees, costs or expenses) incurred in respect of a transfer must be paid by the first beneficiary.

A credit may be transferred in part to more than one second beneficiary provided partial drawing or shipments are allowed.

A transferred credit cannot be transferred at the request of a second beneficiary to any subsequent beneficiary. The first beneficiary is not considered to be a subsequent beneficiary.

Any request for transfer must indicate if and under what conditions amendments may be advised to the second beneficiary. The transferred credit must clearly indicate those conditions.

If a credit is transferred to more than one second beneficiary, rejection of an amendment by one or more second beneficiary does not invalidate the acceptance by any other second beneficiary, with respect to which the transferred credit will be amended accordingly. For any second beneficiary that rejected the amendment, the transferred credit will remain un-amended.

The transferred credit must accurately reflect the terms and conditions of the credit, including confirmation, if any, with the exception of:

- The amount of the credit,
- Any unit price stated therein,
- The expiry date,
- The period for presentation, or
- The latest shipment date or given period for shipment,

The first beneficiary has the right to substitute its own invoice and draft, if any, for those of a second beneficiary for an amount not in excess of that stipulated in the credit, and upon such substitution the first beneficiary can draw under the credit for the difference, if any, between its invoice and the invoice of a second beneficiary.

If the first beneficiary is to present its own invoice and draft, if any, but fails to do so on first demand, or if the invoices presented by the first beneficiary create discrepancies that did not exist in the presentation made by the second beneficiary and the first beneficiary fails to correct them on first demand, the transferring bank has the right to present the documents as received from the second beneficiary to the issuing bank, without further responsibility to the first beneficiary.

The first beneficiary may, in its request for transfer, indicate that honor or negotiation is to be effected to a second beneficiary at the place to which the credit has been transferred, up to and including the expiry date of the credit. This is without prejudice to the right of the first beneficiary in accordance with sub-article 38 (h). Presentation of documents by or on behalf of a second beneficiary must be made to the transferring bank.

Article 39

Assignment of Proceeds

The fact that a credit is not stated to be transferable shall not affect the right of the beneficiary to assign any proceeds to which it may be or may become entitled under the credit, in accordance with the provisions of applicable law. This article relates only to the assignment of proceeds and not to the assignment of the right to perform under the credit.

Uniform Rules for Contract Guarantee ICC publication # 325

These rules apply to any guarantee, bond, indemnity, surety or similar undertaking (guarantee) which states that it is subject to uniform rules for contract guarantee of the international chamber of commerce (publication # 325)

The important rules are given hereunder:

Tender Guarantee— In this type of guarantee, the guarantor undertakes that in the event of default by the tendered (Principal) in fulfillment of his obligations resulting from submission of tender, to make payment to the beneficiary within the limits of a stated sum of money.

Uniform Rules for Contract Guarantee

Tender guarantees ensure that the party submitting the tender will not withdraw his tender before adjudication and that he will accept and sign the contract if and when awarded to him.

The beneficiary that is the party awarding the contract may claim under the guarantee up to the stated sum in the event of default by the contractor.

Uniform Rules for Contract Guarantee

The tender guarantee is issued by the contractor's bank at his request in favor of contract awarding party (the beneficiary)

It is usually one percent to five percent of tender value

Tender guarantee has a fixed expiry date

Performance Guarantee:

It is an undertaking given by a bank etc., (Guarantor) whereby the guarantor undertakes to make payment to the beneficiary within the limits of stated sum of money on non performance of certain contractual obligations of the contract. It is usually for a fixed percentage of 5 % to 10% of contract value.

Uniform Rules for Contract Guarantee**Parties in performance Guarantee**

Guarantor

Principal (Tenderer)

Beneficiary (the Party inviting tender)

Uniform Rules for Demand Guarantees—(URDG 458)

These rules are contained in ICC brochure # 458. Important rules are given hereunder:

A demand is required to be made by the beneficiary to the issuing bank in accordance with terms of guarantee and before its expiry.

Duty of Guarantor

To pay to beneficiary the amount stated on demand

Rules as contained in various articles:

Counter guarantee to be furnished by the principal in favor of guarantor

All instructions should be **clear** and **precise**

All guarantees should stipulate the following parties:

Principal (contractor)

Beneficiary (the party to whom payment is to be made by bank etc on demand in case of default by the principal)

Guarantor (Bank/ Insurance Company etc.)

Specify the underline transaction for which the guarantee issued:

Maximum amount along with the currency in which the amount is payable

- Expiry date / event
- Terms for demanding payment
- All guarantees and counter guarantees shall be irrevocable
- Guarantee shall be effective from the date of issue
- Documents inconsistent with terms shall be refused by the guarantor.
- Examination of documents by guarantor in reasonable time.
- In case of deciding refusal by the guarantor, beneficiary should be notified immediately

- Guarantor to act in good faith and with reasonable care
- Liability of guarantor to the extent of terms specified in guarantee
- In case of demand received by the guarantor, principal to be informed by guarantor.
- Termination of guarantee on payment of entire amount/ demand
- Demand shall be made before expiry date, in accordance with the terms
- Demand to be made/ documents to be presented at the place of issue of guarantee
- Demand for payment should be made in writing and required documents to be attached there with.
- Guarantees shall be governed by the law applicable at the place of issue of guarantee

LESSON 37**DESIGNING LEGAL DOCUMENTS****Hire-Purchase Agreement**

Hire-Purchase agreement is the basis of facility/ finance provided by the bank to the hirer. In these cases, the party availing the facility or the borrower is the hirer and the party providing the facility/ credit is the purchase. In this arrangement, the bank in the capacity of purchaser purchases the articles from the supplier and the borrower/ hirer agrees to hire the said articles from the bank and bank agrees to let out said articles to the hirer. The hirer is required to pay monthly/ or periodic rent under hire- purchase agreement. The specimen of hire-purchase agreement is appended below:

Specimen of Hire-Purchase agreement

This agreement made at----- this the 2nd day of March, 2008 between ABC bank hereinafter called “**The Bank**” and M/S XYZ----- called “**The Hirer**”

Whereas the hirer has agreed to acquire the Articles as per agreement and also agreed to hire from the Bank the said articles and the bank at the request and for the use of the Hirer has agreed to purchase the said Articles from its supplier after paying the cost, charges etc. and has entered into Hire- Purchase agreement.

Hirer has agreed to pay monthly rent of Rs.---

It is agreed between the parties as mentioned in forthcoming Articles.

The Bank at the request of and after having received **an** initial deposit of Rs. from the hirer(s) shall purchase the said articles from its supplier by making payment of the price of Rs. and/or entering into an agreement with the supplier in this regard and shall acquire all the ownership, proprietary rights, title and interest in the 'said articles and every part thereof in its own favor.

The Bank shall procure the documents evidencing its title to 'the said articles' and shall get all the formalities completed in this regard.

That **the** hirer(s), against a delivery order of the Bank, shall obtain/procure the physical delivery and possession of 'the said articles directly from the supplier after holding thorough inspection/examination (hereof and having been fully satisfied that (the said articles are in accordance with the specification approved by (he hirers)

The Bank shall not be liable for any shortfall, defect or lacuna whatsoever which may be subsequently discovered by me hirer in (the said articles and the hirer shall solely be responsible for (the same and shall indemnify the Bank against any losses or damage that the Bank may incur as a consequence of any shortfall, defect or lacuna that may be found in the said articles.

The hirer(s) confirm that the said articles shall continue to be the sole and exclusive property of me Bank and the hirer(s) shall have no right, interest and claim therein by reason of the original contract arrangement having been entered into by them with the supplier or due to any reason whatsoever and until 'the said articles' are specifically conveyed by the Bank unto the hirer(s) and the same during the subsistence of this agreement shall be held by the hirer merely as bailee with no authority whatsoever to mortgage, pledge, sub let or otherwise use the same for any purpose other than for which it was hired by and delivered to the hirer(s).

ARTICLE - II Security for Intermediate Period

That until the acquisition of "the said articles' in favor of the Bank is completed in all respect, the Bank's commitment shall amount to an accommodation or a facility or an investment for the purposes and use of the hirer(s) and the hirers undertake to indemnify the Bank from all risks and losses due to any default or by reason of any omissions and commissions leading to any such risks and losses to the Bank directly or indirectly.

That the hirers in order to assure the better performance of the hirer's obligations hereunder shall execute and furnish such securities and guarantees in favor of the Bank as may deem fit within the sole discretion of the Bank from time to time.

ARTICLE-III Hire-Purchase Covenant

1. The hirer has agreed to take and the Bank has agreed to let on hire 'the said articles' on payment of monthly rent/hire installment of Rs.15, 000/for a period of...48...;.....months each payable by (the hirer(s) to (he Bank on and before 10th day of each month without default or delay commencing from the month of.....2008.

That the hirer.(s) shall obtain the delivery of 'the said articles' directly from the supplier or their agent against a delivery order issued by (the Bank and shall manage for installation, fixation, storage and transportation thereof and shall hold and enjoy the peaceful and quite possession thereof as a bailee and shall be entitled to use '(the said articles) or the purpose it was hired without any let and hindrance whatsoever until (the Bank terminates (the arrange-ment with prior notice or otherwise re-lakes (the possession/custody thereof.

In the event of regular payment of the hire money in monthly installments for the full and entire hire period as stipulated herein and compliance of the term and conditions hereto during (the agreed period by (the hirer the said articles shall at (the hirer's option become the absolute property of the hirer on payment of a token amount of Rs. 100/ to the Bank and the Bank shall transfer the ownership unto the hirer.

3. Notwithstanding the above the hirer shall have the option of purchasing 'the said article' at any time during the subsistence of the agreement by paying tile; hire installments for the remaining hire period in lump sum together with other expenses as may have been incurred by the Bank.

That during the subsistence hereof the aforementioned monthly rent/hire installments shall not be subject to suspension or delay due to any reason including any force major circumstances nor shall be withheld or delayed due to 'the said articles' being out of operation and/or becoming non-productive and/or breakage and/or mechanical fault and/or non-receipt of "Insurance claim(s) for non-installation and/or due to any other cause whatsoever.

The hirer shall, during the subsistence of the arrangement evidenced by these presents keep the said articles in its sole custody and control in good working condition at the specific address of die hirer and at no other place unless otherwise permitted by the Bank if writing and shall not allow the said articles to be used by any body else nor shall without written consent of the Bank employ the same for the purposes other than the purpose for which the said articles were originally acquired by the hirer

The hirer shall be obliged to allow the Bank's Officers aid nominees to inspect, survey and examine the said articles at any time without prior notice to the hirer and shall also furnish periodical reports to the Bank in such form as may be required by the Bank.

The hirer(s) shall not during (he subsistence of these pre-sents and until final conveyance of the said articles by the Bank to me hirer, mortgage, transfer, hypothecate, pledge, gift, lease or sublet the said articles or part thereof to any one nor shall the hirer create any charge, encumbrances or burdens in any manner against the said articles or part thereof.

.The hirer shall keep the said articles in good repairable condition and working order and shall take all appropriate measures to save the same from any sort of defect, loss, injury and damage and depreciation" to the said article and accessories thereto. And such defect, loss, damage and injury and whenever so occurred and caused thereto during the currency of the arrangement shall be forthwith removed by the hirer at his own cost and risk

The hirer shall always keep (he said articles duly insured in the name of the Bank with such Insurance Company (ies) as may be approved by the Bank against loss due to fire/storm, theft, accident, natural calamities and other risks and shall pay the premium there against prior to the expiry of the existing insurance and/or before the taking of the delivery of the said articles.

9. In case the hirer fails to purchase such Insurance Policy the Bank shall be entitled but shall not be bound, to get the said articles duly insured at the cost of the hirer.

The hirer shall pay all the rates, taxes, tolls, license fee, charges, fine, cuss and other imposition which may be payable to any Government and Semi-Government Agency, authority, body and/or private person whosoever.

ARTICLE-IV—IN THE EVENT OF DEFAULT

Any of the following shall be considered to be an event of default. If the hirer:-

- Commits default in payment of the monthly rent/hire installment within the stipulated time or
 - Fails to observe all or any of the covenants hereof and the terms hereafter prescribed by the bank or
 - Neglects to maintain and/or fails to keep the said articles during the subsistence of the arrangements to the satisfaction of the bank or admits and commits such act which may jeopardize the interest of the bank in any manner whatsoever or
 - Fails to furnish me securities/guarantees to the satisfaction of the bank or
 - Commits any act of insolvency and/or happens to be adjudicated insolvent or enters into an arrangement with its/his creditors or
 - Makes or has made nay statement or declaration, information and representation which is or appears to be false and incorrect or
 - Allows any of his moveable and immoveable properties to be attached in execution of a decree.
 - Allows any of his moveable and immoveable properties to be attached in execution of a decree.
2. In any of the above events the Bank shall be entitled to terminate miss agreement and may at its absolute discretion proceed to re-take the possession of the 'said articles' and also to recover the defaulted hire installments/rents from (the hirer together with such expenses, costs and damages as may have accrued, incurred and sustained by the Bank and shall also impose and recover such additional penalties as may deem fit and proper to the Bank.
 3. In the event of the termination of (he hire agreement before the expiry of the hire period the hirer shall immediately handover the physical possession of the said articles with all its accessories to the Bank's nominees in good working condition and shall not claim any compensation or refund of any sum or sums paid by him, nor shall demand any expenses made by the hirer in maintaining of the said articles.

And (he hirer until actual delivery of the said articles to the Bank shall also be responsible to pay me compensation for holding over to (the Bank as may be determined by the Bank within its absolute discretion which demand shall deem to be conclusive and binding on the hirer(s) without reference to any one and/or scrutiny and objection whatsoever.

ARTICLE-V Termination of the Agreement:

The Bank, on occurrence of any event of default may terminate the agreement and proceed forthwith for taking the deliv-ery of the said article and recovery of arrears of the hire money, compensation, penalties, expenses, losses and damages etc. without prejudice to other recourses available *to* the Bank against the hirer and their guarantors.

ARTICLE-VI INDEMNITY CLAUSE

The hirer shall always keep the Rank duly indemnified from all risks to which (the Bank may be exposed due to (the reason of purchasing tile said articles at the instance of the hirer and by reason of entering into hire purchase arrangements with the hirer or because of any matters incidental thereto.

The hirer(s) further undertake to pay all hire money as per stipulation and together with all sums which the Bank may demand on account of losses, charges, ex-penses, compensation, damages, penalties, accrued, incurred and/or sustained or apprehend to be accrued or sustained by the Bank due to the said arrangements and the things allied thereto within seven days from (the receipt of a demand from the Bank which demand snail be conclusive and binding on the hirers without reference and recourse to anyone and/or objection and scrutiny whatsoever.

In witnesses whereof, the parties hereto have respectively set and subscribed their hands and seal this day, month and year first above written.

SIGNATURES

-- On behalf of the Bank
-- Of the hirer.

WITNESSES;

-- For and on behalf of the BANK
-- For and on behalf of HIRER

IRREVOCABLE GUARANTEE/SURETY UNDER HIRE-PURCHASE AGREEMENT:

In consideration of your having entered into the hire-purchase agreement/arrangement with Mr./M/s.....

(hereinafter referred to as hirers) at our request, I/we

(1) son of resident of

(2) **son of** resident of

Do hereby undertake as follows:—

1. I/we jointly and severally undertake to stand surety/sureties for and on behalf of the hirer and guarantee the true and specific performance of all the covenants envisaged in the said hire-purchase agreement dated.....with your Bank within such time and manner as may be stipulated in the agreement and as may be prescribed by your
2. In the event of default and delay in the discharge of the obligations of (the hirers, we shall pay all the sums to you within the period of three days from the demand made by you from us without reference to any one.
3. Each demand made by the Bank here under shall be deemed to be conclusive and binding on me/us and my/our legal heirs.
4. The total liabilities here under shall be limited to the extent of Rs.....Notwithstanding any indulgence arrangement entered into between the Bank and the hirers
5. The obligations arising herein against me/us shall be continuing and subsisting until the same is/s-fully specifically discharged by the Bank and it shall always be deemed (to be in addition of the other securities, if any, provided by the hirer.
2. IN WITNESSES hereof the sureties named above have signed and subscribed their respective hand on this.....day
3. of.....2008...at

SIGNATURE

1. **Surety**_____

2. **Surety**_____

1-----

2-----

WITNESSES:

Specimen of Deed of Mortgage

This deed of Mortgage is made this 22nd day of April, 2008 between Mr. Y Resident of Gulberg, Lahore hereinafter referred to as the Mortgagor of the ONE PART and M/S XYZ BANK LAHORE, a limited banking company having its registered office at I.I Ghundrigarh Road, Karachi (hereinafter referred to as Mortgagee) of the OTHER PART.

The 'Mortgagor' and Mortgagee shall where the context so requires or permits, be deemed to include their respective heirs, legal representatives, assignees and successors-in-interest or persons deriving title from or under them.

Whereas mortgagor is the lawful owner of the property described at schedule-11 and whereas mortgagor has availed finance as mentioned in Schedule-1 from the mortgagee/ bank.

Now therefore, this deed witnesses as follows:

That the mortgagor declares and confirms that he is seized and possessed of and otherwise well sufficiently entitled to the Mortgaged Property and same is free from any charges or encumbrances.

In consideration of the bank having sanctioned finance amounting to Rs. 1,500,000 the mortgagor hereby mortgages the property described at schedule-11 to hold the same until the payment/ repayment of entire amount due under the agreement up to maximum of Rs. 1,500,000/- with cost, charges, marks-up, expenses and liquidated damages payable to the bank or incurred by the bank.

Schedule –I

Amount of finance Rs 1,500,000/-

Amount of Mark up Rs 150,000/-

Schedule –II

All the piece and parcel of plot of land Measuring 20 Marlas bearing # 241-Z Johar Town, Lahore, together with building, Walls, structures, Fixtures, Attachments, Walls and bounded as under:

On or towards north by: Street-named Kashmir Road

On or towards south by : House No 140

On or towards east by: House No 240

On or towards west by: House No 242

Deed of Mortgage

In witness whereof the Mortgagor has set and subscribed his hands on the day, month and year, first herein above written.

Signed and delivered
By the Mortgagor in the
presence of following

Signature
Mortgagor

Witnesses:

Witness 1 _____

Witness 2 _____

Letter of Hypothecation**Specimen of Letter of Hypothecation:**

In consideration of The XYZ Bank Ltd. ---- . (hereinafter called the “Bank” which expression shall include its Successors and Assigns) granting/agreeing to grant/continue granting loans/advances/credit banking facilities (hereinafter called the “Facilities”) amounting to Rs.--- to me/ us to such extent and for so long as the Bank may think fit, I/We the undersigned

_____-P.O.Box No _____

(hereinafter called the “Borrower” which expression shall include me/us and my/our legal heirs, Successors and Assigns) hereby hypothecate, in favour of the Bank by way of first charge , as security, for full repayment of the facilities to the Bank together with all charges, all things and stocks as described in general terms in the schedule hereto, (hereinafter called the “Goods”), which expression shall include all products and stocks and moveable property, of any kind and whether raw or in process of manufacture and all things or articles manufactured there from which now or thereafter from time to time during the process shall be brought into store(s) or be in or about the Borrower’s godown(s) or premises at different places including in course of transit or delivery .

The Borrower hereby undertakes and covenants the following with the Bank:

- a. The Borrower shall not at any time so long as there shall be any amount due by the Borrower to the Bank remove or cause or permit to be removed from the premises and /or godowns where the goods are stored nor divert or otherwise dispose of or encumber, charge or pledge or mortgage the Goods or any part thereof to any other party nor do any act whereby the Bank’s security shall in any way be prejudiced or affected.

The Borrower hereby undertakes and covenants the following with the Bank:

- b. The Borrower shall deposit with the Bank all sale proceeds of the Goods and insurance proceeds and recoveries thereof, which shall always constitute an integral part of the security.

The Borrower hereby undertakes and covenants the following with the Bank:

- c. In the event of committing any default of any of the provisions of this Hypothecation Deed, the Borrower shall pledge the Goods to the Bank by way of a floating charge and all goods and moveable property of any kind and nature belonging to the Borrower which now or thereafter or from time to time during the continuance of this security be brought in, stored in the premises or go downs as mentioned in the schedule hereto and/or elsewhere on in the course of transit as a security for the Borrower’s indebtedness to the Bank.

The expression Borrower's "indebtedness" to the Bank shall include the principal amounts from time to time due on Borrower's facilities together with all interest and all other charges which the Bank may pay or incur in connection with the Goods, or the sale or disposal thereof and all other moneys whether hereof or by law payable by the Borrower to the Bank in connection with or relation to the Goods.

3. The Borrower shall make and provide to the Bank statement periodical reports and returns in respect of the cost and market value of the goods and a detailed description thereof and produce such evidence in support thereof as the Bank may from time to time require. That the amount of Borrower's total indebtedness to the Bank for the time being together with mark up /interest and other charges shall all time during the period of this hypothecation have a margin not less than _____ % of the market value of the hypothecated goods.

Such market value shall be decided from time to time by the bank which decision shall be final and binding on the Borrower. The difference between the Borrower's indebtedness to the Bank and the market value of the goods shall be maintained either by providing further security as may be approved by the Bank or by cash payment. The Bank at its sole discretion may employ the services of any independent Survey the value of hypothecated goods and the cost of such evaluation shall be borne by the Borrower.

The Borrower shall insure and keep insured the hypothecated goods for their full market value against fire, pilferage, theft, damage, loss and all other risks with an Insurance Company approved by the Bank with the Banks as First Beneficiary, in the name and the sole benefit of the Bank, and the Borrower will assign and deliver to the Bank, all the insurance policies and deliver the premium receipts paid for such insurance.

The Bank may at any time at its sole discretion, affect such insurance at the sole expense of the Borrower, if the Borrower fails to insure the Goods as aforementioned within 12 (twelve) hours after notice of demand served on the Borrower. All sums received under insurance (s) as aforesaid, shall be applied towards the liquidation of the Borrower's indebtedness to the Bank.

The goods hypothecated to the Bank shall be kept at the sole risk and responsibility of the Borrower wherever and in whatever godowns, premises, sheds or places they maybe stored. The Borrower shall pay all rents, rates, taxes and other outgoings, of the godowns and premises wherein the goods are stored and shall keep the goods and marketable condition.

The Bank or their representatives or nominees shall be entitled at any time without notice to enter any place where the goods are located or stored for inspection and examination.

Event of Default

Without prejudice to the generality of the foregoing, the Bank shall have the absolute right at anytime without notice to take charge and possession of the Goods upon occurrence of any of the following events:

-

- a. If the borrower fails to maintain the margin (s) as aforementioned.
- b. If the borrower fails to pay the balance (s) due to the bank on demand.
- c. If the borrower commits breach of any of the terms and conditions herein contained.
- d. If the borrower suffers distress or execution to be levied or enforced upon or against all or any of the borrower's property.
- e. If the borrower fails to effect any payment of the indebtedness on its/their due dates.

The Bank upon taking charge and possession of the goods in terms of clause 7 shall have exclusive right and discretion to sell the goods and to appropriate the sale proceeds towards satisfaction of the Borrower's indebtedness to the Bank. The Bank shall have the right to claim from the Borrower any shortfall if the sale proceeds do not fully satisfy the Borrower's indebtedness to the Bank.

The Bank records and statements made by the Bank showing the indebtedness of the Borrower shall be and continue to be final and conclusive evidence as to the correctness of such indebtedness.

The Borrower hereby declares that all the goods are free from any prior lien, charge or encumbrance, whether legal or equitable and that the Borrower holds lawful authority to hypothecate the Goods.

The Borrower agrees and undertakes to repay to the Bank the entire indebtedness on receipt of first demand shall be a conclusive and final evidence that the repayment of the indebtedness of the Borrower to the bank is due. The Borrower hereby agrees and undertakes to carry out and his/their obligations hereof. This hypothecation shall operate as a continuing security for all the indebtedness or liabilities owing by the

Borrower to the Bank notwithstanding any partial or intermediate repayment(s) or adjustment(s) made at any time, without prejudice to the other rights and remedies open to the Bank under the Law. Any violation of the terms and conditions hereof shall render the credit facilities liable to be cancelled.

Every demand or notice served or communicated by the Bank to the Borrower shall be considered to have been duly served and communicated to the Borrowers if sent to the recorded address of the Borrower either by hand delivery, ordinary or registered mail, telex and/or any other usual and practiced means of transmission / delivery. Every demand or notice sent in this manner by the Bank to the Borrower or any of the persons constituting the Borrower shall be deemed to have been sent to each and all of such persons.

Should this Deed be signed by more than one person, all signatories hereto shall be jointly and severally liable to Bank for all the liabilities herewith.

Should the Borrower be a company or a firm, the liability of such company or firm towards the Bank shall remain effective despite any change in the constitution, memorandum and/or articles of association of the said company or firm.

Without prejudice to the Bank's absolute right to submit to any other law or jurisdiction, this document shall be governed construed and interpreted in accordance with the law of the country.

Signatures of Witnesses

Signature of the borrower.

Witness—1

Witness---2

LESSON 38**PRUDENTIAL REGULATIONS OF SBP****SBP Prudential Regulations**

In order to promote good governance in the banking system, the State Bank of Pakistan announced a set of prudential regulations on August 29, 1991. These regulations were made effective from 1st of July, 1992. Non-Bank Financial Institution (NBFIs) have also been placed under regulatory regime of SBP.

Considerations & Factors for introducing Prudential Regulations:

The said regulations were introduced keeping in view the following factors;

- Creation of healthy lending as well as borrowing culture.
- Protection of depositors as well as share holders interests.
- Improvement in banking management & governance standards, ensuring a strong, viable and disciplined growth of banking sector.
- Designing minimum criteria for credit risk management.
- Prevention of misuse of banking facilities and channels. (e.g. Anti money laundering regulations).

Regulations for Corporate/Commercial Banking

Main contents are outlined hereunder:

Part A—Definitions'

Part B—Regulations.

- Risk Management.

R1 To R13

Corporate Governance Regulations

G1 to G4

KYC & Anti Money Laundering Regulations.

M1 & M2

Operations

0-1 To 0-5

Annexure.

B) Regulations For Small & Medium Enterprises Financing

Regulations

R 1 To R 11

Annexure

Prudential Regulation for Consumer Financing Regulations for consumer financing. R1 to 6

Regulations for Credit cards.

O1 to O7

& R.7 & R8

Regulations for Auto Loan.

R-9 to R14

Regulation for Housing Finance.

R15 to R23

Regulations for Personal Loan Including Loans for Purchase of Consumer durables.

R24 to R28

Annexure-1- Margin Requirements under Regulation #6

Prudential Regulations for Consumer Financing

Consumer financing means any financing allowed to individuals for their personal, family or house hold needs including the following:

- **Credit cards**

- **Auto loans**
- **Housing finance**
- **Personal loans**

Definitions as contained in these regulations are given hereunder:

Bank means a banking company as defined in the Banking Companies Ordinance, 1962.

Borrower means an individual to whom a bank / DFI has allowed any consumer financing during the course of business.

Consumer Financing means any financing allowed to individuals for meeting their personal, family or household needs.

Credit Cards mean cards which allow a customer to make payments on credit. Supplementary credit cards shall be considered part of the principal borrower for the purposes of these regulations.

Corporate Cards will not fall under this category and shall be regulated by Prudential Regulations for Corporate / Commercial Banking or Prudential Regulations for SMEs Financing as the case may be. The regulations for credit cards shall also be applicable on charge cards, debit cards, stored value cards and BTF (Balance Transfer Facility).

Auto Loans mean the loans to purchase the vehicle for personal use.

Housing Finance means loan provided to individuals for the purchase of residential house / apartment / land. The loans availed for the purpose of making improvements in house / apartment / land shall also fall under this category.

Personal Loans mean the loans to individuals for the payment of goods, services and expenses and include Running Finance / Revolving Credit to individuals.

DFI means Development Financial Institution and includes the Pakistan Industrial Credit and Investment Corporation (PICIC), the Saudi Pak Industrial and Agricultural Investment Company Limited, the Pak Kuwait Investment Company Limited, the Pak Libya Holding Company Limited, and any other financial institution notified under Section 3-A of the Banking Companies Ordinance, 1962.

Documents include vouchers, cheques, bills, pay-orders, and promissory notes, securities for leases / advances and claims by or against the bank / DFI or other papers supporting entries in the books of a bank / DFI.

Equity of the Bank / DFI means Tier-I Capital or Core Capital and includes paid-up capital, general reserves, balance in share premium account, and reserve for issue of bonus shares and retained earnings / accumulated losses as disclosed in latest annual audited financial statements. In case of branches of foreign banks operating in Pakistan, equity will mean capital maintained, free of losses and provisions, under Section 13 of the Banking Companies Ordinance, 1962.

Financial Institutions mean banks, Development Financial Institutions (DFIs) and Non-Banking Finance Companies (NBFCs).

Government Securities shall include such types of Pak. Rupee obligations of the Federal Government or a Provincial Government or of a Corporation wholly owned or controlled, directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government as the Federal Government may, by notification in the Official Gazette, declare, to the extent determined from time to time, to be Government Securities.

Liquid Assets are the assets which are readily convertible into cash without recourse to a court of law and mean encashment / realizable value of government securities, bank deposits, certificates of deposit, shares of listed companies which are actively traded on the stock exchange, NIT Units, certificates of mutual funds, Certificates of Investment (COIs)

issued by DFIs / NBFCs rated at least 'A' by a credit rating agency on the approved panel of State Bank of Pakistan, listed TFCs rated at least 'A' by a credit rating agency on the approved panel of State Bank of Pakistan and certificates of asset management companies for which there is a book maker quoting daily offer and bid rates and there is active secondary market trading.

These assets with appropriate margins should be in possession of the banks / DFIs with perfected lien.

Guarantees issued by domestic banks / DFIs when received as collateral by banks / DFIs will be treated at par with liquid assets whereas, for guarantees issued by foreign banks, the issuing banks' rating, assigned either by Standard & Poors, Moody's should be 'A' and above or equivalent.

The inter-branch indemnity / guarantee issued by the bank's overseas branch in favor of its sister branch in Pakistan, would also be treated at par with liquid assets, provided the bank is rated and above or equivalent either by Standard & Poors, Moody's .

NBFC means Non-Banking Finance Company and includes a Modaraba, Leasing Company, Housing Finance Company, Investment Bank, Discount House, Asset Management Company and a Venture Capital Company.

Secured means exposure backed by tangible security with appropriate margins (in cases where margin has been prescribed by State Bank of Pakistan, appropriate margin shall at least be equal to the prescribed margin). Exposure without any tangible security is defined as clean.

Tangible Security means liquid assets (as defined in these Prudential Regulations), mortgage of land and building, hypothecation or charge on vehicle, but does not include hypothecation of household goods, etc.

Minimum requirements for consumer financing:

Before embarking upon or undertaking consumer financing, the banks / DFIs shall implement / follow the guidelines given below. The banks / DFIs already involved in the consumer financing will ensure compliance with these guidelines within six months of the date of issuance of Prudential Regulations for Consumer Financing .

1. Banks / DFIs shall establish separate Risk Management capacity for the purpose of consumer financing, which will be suitably staffed by personnel having sufficient expertise and experience in the field of consumer finance / business.
2. The banks / DFIs shall prepare comprehensive consumer credit policy duly approved by their Board of Directors (in case of foreign banks, by Country Head and Executive / Management Committee), which shall inter alia cover loan administration, including documentation, disbursement and appropriate monitoring mechanism. The policy shall explicitly specify the functions, responsibilities and various staff positions' powers / authority relating to approval / sanction of consumer financing facility.
3. For every type of consumer finance activity, the bank / DFI shall develop a specific program. The program shall include the objective / quantitative parameters for the eligibility of the borrower and determining the maximum permissible limit per borrower.
4. Banks / DFIs shall put in place an efficient computer based MIS for the purpose of consumer finance, which should be able to effectively cater to the needs of consumer financing portfolio and should be flexible enough to generate necessary information reports used by the management for effective monitoring of the bank's / DFI's exposure in the area.
5. The banks / DFIs shall develop comprehensive recovery procedures for the delinquent consumer loans. The recovery procedures may vary from product to product. However, distinct and objective triggers should be prescribed for taking pre-planned enforcement / recovery measures.
6. The banks / DFIs desirous of undertaking consumer finance will become a member of at least one Consumer Credit Information Bureau. Moreover, the banks / DFIs may share information / data among themselves or subscribe to other databases as they deem fit and appropriate.
7. The financial institutions starting consumer financing are encouraged to impart sufficient training on an ongoing basis to their staff to raise their capability regarding various aspects of consumer finance
8. The banks / DFIs shall prepare standardized set of borrowing and recourse documents (duly cleared by their legal counsels) for each type of consumer financing.

Operations:

1. Consumer financing, like other credit facilities, must be subject to the bank's / DFI's risk management process setup for this particular business. The process may include, identifying source of repayment and

assessing customers' ability to repay, his / her past dealings with the bank / DFI, the net worth and information obtained from a Consumer Credit Information Bureau

2. At the time of granting facility under various modes of consumer financing, banks / DFIs shall obtain a written declaration from the borrower divulging details of various facilities already obtained from other financial institutions. The banks / DFIs should carefully study the details given in the statement and allow fresh finance / limit only after ensuring that the total exposure in relation to the repayment capacity of the customer does not exceed the reasonable limits as laid down in the approved policies of the banks / DFIs.
3. The declaration will also help banks / DFIs to avoid exposure against a person having multiple facilities from different financial institutions on the strength of an individual source of repayment.
4. Before allowing any facility, the banks / DFIs shall preferably obtain credit report from the Consumer Credit Information Bureau of which they are a member. The report will be given due weight age while making credit decision.
5. Internal audit and control function of the bank / DFI, apart from other things, should be designed and strengthened so that it can efficiently undertake an objective review of the consumer finance portfolio from time to time to assess various risks and possible weaknesses.
6. The internal audit should also assess the adequacy of the internal controls and ensure that the required policies and standards are developed and practiced. Internal audit should also comment on the steps taken by the management to rectify the weaknesses pointed out by them in their previous reports for reducing the level of risk.
7. The banks / DFIs shall ensure that their accounting and computer systems are well equipped to avoid charging of mark-up on mark-up. For this purpose, it should be ensured that the mark-up charged on the outstanding amount is kept separate from the principal.
8. The banks / DFIs shall ensure that any repayment made by the borrower is accounted for before applying mark-up on the outstanding amount.

Prudential Regulations for Consumer Financing

REGULATION R-1

Facilities to Related Persons and Utilization of Clean Loans for Initial Public Offerings (IPOs)

Facilities to Related Persons:

The consumer finance facilities extended by banks / DFIs to their directors, major shareholders, employees and family members of these persons shall be at arms length basis and on normal terms and conditions applicable for other customers of the banks / DFIs. The banks / DFIs shall ensure that the appraisal standards are not compromised in such cases and market rates are used for these persons. The facilities extended to the employees of the banks / DFIs as a part of their compensation package under Employees Service Rules shall not fall in this category.

Utilization of Clean Loans for Initial Public Offerings IPOs:

While the State Bank's intent is not to create any undue hindrance in the smooth flow of consumer financing to the borrowers, the banks / DFIs are, however, advised to institute necessary checks, so that clean loans are not used for subscription in Initial Public Offerings (IPOs). In this connection, State Bank of Pakistan suggests the following two minimum requirements:

At the time of sanction of a clean consumer loan / credit line, the banks / DFIs should obtain an undertaking from the client, that the drawings from the loan account will not be used for subscription in an IPO.

The banks / DFIs should introduce an internal system, whereby, no cheques, drafts and / or payment instructions will be made for an IPO subscription account from a clean personal loan / credit line account.

REGULATION R-2

LIMIT ON EXPOSURE AGAINST

TOTAL CONSUMER FINANCING

Banks / DFIs shall ensure that the aggregate exposure under all consumer financing facilities at the end of first year and second year of the start of their consumer financing does not exceed 2 times and 4 times of

their equity respectively. For subsequent years, following limits are placed on the total consumer financing facilities:

REGULATION R-3

TOTAL FINANCING FACILITIES TO BE COMMENSURATE WITH THE INCOME

While extending financing facilities to their customers, the banks / DFIs should ensure that the total installment of the loans extended by the financial institutions is commensurate with monthly income and repayment capacity of the borrower.

This measure would be in addition to banks' / DFIs' usual evaluations of each proposal concerning credit worthiness of the borrowers, to ensure that the banks' / DFIs' portfolio under consumer finance fulfills the prudential norms and instructions issued by the State Bank of Pakistan and does not impair the soundness and safety of the bank / DFI itself.

REGULATION R-4

GENERAL RESERVE AGAINST CONSUMER FINANCE

The banks / DFIs shall maintain a general reserve at least equivalent to 1.5% of the consumer portfolio which is fully secured and 5% of the consumer portfolio which is unsecured, to protect them from the risks associated with the economic cyclical nature of this business.

The above reserve requirement will, however, be maintained for the performing portion only of consumer portfolio.

We shall continue with the rest of the regulations for consumer financing in the coming Lesson.

LESSON 39**PRUDENTIAL REGULATIONS OF SBP****PRUDENTIAL REGULATIONS FOR CONSUMER FINANCING**

Contents to be covered in this Lesson:

- REGULATION R-5 :
 - BAR ON TRANSFER OF FACILITIES FROM ONE CATEGORY TO ANOTHER TO AVOID CLASSIFICATION
 - REGULATION R-6:
 - MARGIN REQUIREMENTS
 - REGULATIONS FOR CREDIT CARDS
 - REGULATION O-1
 - REGULATION O-2
 - REGULATION O-3
 - REGULATION O-4
 - REGULATION O-5
 - REGULATION R-7

MAXIMUM CARD LIMIT**REGULATION R-8****CLASSIFICATION AND PROVISIONING**

We have discussed some aspects/regulation of consumer financing in the previous Lesson, we shall continue with the rest of regulations/ aspects in this Lesson.

REGULATION R-5**BAR ON TRANSFER OF FACILITIES FROM ONE CATEGORY TO ANOTHER TO AVOID CLASSIFICATION**

The banks / DFIs shall not transfer any loan or facility to be classified, from one category of consumer finance to another, to avoid classification.

REGULATION R-6**MARGIN REQUIREMENTS**

Banks / DFIs are free to determine the margin requirements on consumer facilities provided by them to their clients taking into account the risk profile of the borrower(s) in order to secure their interests. However, this relaxation shall not apply in case of items, import of which is banned by the Government.

Banks / DFIs will continue to observe margin restrictions on shares / TFCs as per existing instructions under Prudential Regulations for Corporate / Commercial Banking (R-6). Further, the restrictions prescribed under paragraph 1.A of Regulation R-6 of the Prudential Regulations for Corporate / Commercial Banking will also be applicable in case of Consumer Financing.

State Bank of Pakistan shall continue to exercise its powers for fixation / reinstatement of margin requirements on consumer facilities being provided by banks/DFIs for various purposes, as and when required.

REGULATIONS FOR CREDIT CARDS**Prudential Regulations for Consumer Financing – Credit Cards- O-1 to O-5****REGULATION O-1**

The banks / DFIs should take reasonable steps to satisfy themselves that card holders have received the cards, whether personally or by mail. The banks / DFIs should advise the card holders of the need to take reasonable steps to keep the card safe and the PIN secret so that frauds are avoided.

REGULATION O-2

Banks / DFIs shall provide to the credit card holders, the statement of account at monthly intervals, unless there has been no transaction or no outstanding balance on the account since last statement.

REGULATION O-3

Banks / DFIs shall be liable for all transactions not authorized by the credit card holders after they have been properly served with a notice that the card has been lost / stolen. However, the bank's / DFI's liability shall be limited to those amounts wrongly charged to the credit card holder's account. In order to mitigate the risks in this respect, the banks / DFIs are encouraged to take insurance cover against wrongly charged amounts, frauds, etc.

The bank/DFI shall, however, not charge the borrowers' account with any amount under the head of "insurance premium" (by whatsoever name called) without obtaining consent of each existing & prospective customer in writing. In addition to obtaining consent in writing, the banks/DFIs may also use the following modes for obtaining prior consent of their customers provided proper record is maintained by banks/DFIs:-

- i. Customer's consent on recorded lines via out bound/in bound call center (after due verification)
- ii. ATM screens – screen pop up before conducting transaction and after inputting pin code
- iii. Signed consent acquired with credit card application or as separate form
- iv. IVR (Integrated Voice Recording)

REGULATION O-4

In case the cardholders make partial payment, the banks / DFIs should take into account the partial payment before charging service fee / mark-up amount on the outstanding / billed amount so that the possibility of charging excess amount of mark-up could be avoided.

REGULATION O-5

Due date for payment must be specifically mentioned on the accounts statement. If fine / penalty is agreed to be charged in case the payment is not made by the due date, it should be clearly mentioned in the agreement.

Prudential Regulations for Consumer Financing– Credit Card- R-7 & R-8**REGULATION R-7****MAXIMUM CARD LIMIT**

Maximum unsecured limit under credit card to a borrower (supplementary cards shall be considered part of the principal borrower) shall generally not exceed Rs 500,000/.

Banks / DFIs may, however, assign a clean limit beyond Rs 500,000 but not in excess of Rs 2 million to their prime customers who have extraordinary strong repayment capacity, moderate debt burden and a clean track record.

But the aggregate outstanding in this respect should not exceed 10% of the total outstanding credit card portfolio at any point in time. However, while availing benefit of this provision, banks / DFIs would place on record well defined criteria for terms "Prime Customers" and "Moderate Debt Burden" approved by their Board of Directors / Chief Executive.

Banks / DFIs may also allow financing under the credit card scheme in excess of Rs 500,000/- (up to Rs 2 million) to other customers as well, provided the excess amount is appropriately secured according to the definition given in Part A of these regulations.

The loan secured against liquid securities shall, however, be exempted from the above limit.

The loans against the securities issued by Central Directorate of National Savings (CDNS) shall be subject to such limits as are prescribed by CDNS / Federal Government / State Bank of Pakistan from time to time.

For Charge Cards, pre-set spending limits generated by the standardized systems, as is the global practice, shall be allowed.

REGULATION R-8**CLASSIFICATION AND PROVISIONING**

The credit card advances shall be classified and provided for in the following manner:

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISION TO BE MADE*
(1)	(2)	(3)	(4)
Loss.	Where mark-up / interest or	Unrealized mark-up / interest to be	Provision of 100% of the difference

Principal is overdue by 180 days or more from the due date. Put in Suspense Account and not to be credited to Income Account except when realized in cash. Resulting from the outstanding balance of principal less the amount of liquid securities with the bank / DFI.

It is clarified that the lenders are allowed to follow more conservative policies. Further, provisioning may be created and maintained by the bank / DFI on a portfolio basis provided that the provision maintained by the bank / DFI shall not be less than the level required under this Regulation.

We shall continue with other categories of consumer financing in the coming Lesson.

LESSON 40**PRUDENTIAL REGULATIONS OF SBP**

We shall continue with the remaining regulations/ aspects for consumer financing:

Contents to be covered in this Lesson:

Regulations for auto loans

- REGULATION R-9
- REGULATION R-10
- REGULATION R-11
- REGULATION R-12
- REGULATION R-13
- REGULATION R-14
- REGULATION O-6
- REGULATION O-7
- REGULATION O-8
- REGULATION O-9
- REGULATION R-14- Classifications

REGULATIONS FOR HOUSING FINANCE

- REGULATION R-15

REGULATIONS FOR AUTO LOANS

R-9 to R- 13, O-6 to O-9 & R-14

REGULATION R-9

The **vehicles to be utilized for commercial purposes shall not be covered** under the Prudential Regulations for Consumer Financing. Any such financing shall ensure compliance with Prudential Regulations for Corporate / Commercial Banking or Prudential Regulations for SMEs Financing. These regulations shall only apply for financing vehicles for personal use including light commercial vehicles also used for personal purposes.

REGULATION R-10

The maximum tenure of the auto loan finance shall not **exceed seven years**.

REGULATION R-11

While allowing auto loans, the banks / DFIs shall ensure that the minimum down payment does not fall below 10% of the value of vehicle. Further, banks / DFIs shall extend auto loans only for the ex-factory tax paid price fixed by the car manufacturers. In other words, banks / DFIs cannot finance the premium charged by the dealers and / or investors over and above the ex-factory tax paid price of cars, fixed by the manufacturers.

REGULATION R-12

In addition to any other security arrangement on the discretion of the banks/ DFIs, the vehicles financed by the banks / DFIs shall be properly secured by way of hypothecation. Payments against the sale orders issued by the manufacturers are allowed till the time of delivery of the vehicle subject to the condition that payment will directly be made to the manufacturer / authorized dealer by the bank/ DFI and upon delivery, the vehicle will immediately be hypothecated to the bank/ DFI.

REGULATION R-13

The banks / DFIs shall ensure that the vehicle remains **properly insured** at all times during the tenure of the loan.

REGULATION O-6

The **clause of repossession in case of default** should be clearly stated in the loan agreement mentioning specific default period after which the repossession can be initiated. The repossession expenses charged to the borrower shall not be more than actual incurred by the bank / DFI.

However, the maximum amount of repossession charges shall be listed in the schedule of charges provided to customers. The banks / DFIs shall develop an appropriate procedure for repossession of the vehicles and shall ensure that the procedure is strictly in accordance with law.

REGULATION O-7

A detailed repayment schedule should be provided to the borrower at the outset. Where alterations become imminent because of late payments or prepayments and the installment amount or period changes significantly, the revised schedule should be provided to the borrower at the earliest convenience of the bank / DFI but not later than 15 days of the change.

Further, even in case of insignificant changes, upon the request of the customer, the bank / DFI shall provide him revised repayment schedule free of cost.

REGULATION O-8

The banks / DFIs desirous of **financing the purchase of used cars** shall **prepare uniform guidelines** for determining the value of the used vehicles. However, in no case the bank / DFI shall finance the cars **older than five years**.

REGULATION O-9

The banks / DFIs should ensure that a good number of authorized auto dealers are placed at their panel to eliminate the chances of collusion or other unethical practices.

REGULATION R-14- Classifications

The auto loans shall be classified and provided for in the following manner:

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE ¹
{1}	{2}	{3}	{4}
1. Substandard.	Where mark-up/ interest or principal is overdue by 90 days or more from the due date.	Unrealized mark-up/interest to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized mark up/interest already taken to income account to be reversed and kept in Memorandum Account.	Provision of 10% (25% from 31st December 2006) of the difference resulting from the outstanding balance of principal less the amount of liquid assets.

2. Doubtful.	Where mark-up/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and adjusted forced sale value of mortgaged/ pledged assets (subject to Note 1 below) as valued by valuers on the approved panel of PBA.
3. Loss.	Where mark-up/ interest or principal is overdue by one year or more from the due date	As above.	Provision of 100% of the difference resulting from the outstanding balance of principal less the amount of liquid assets.

REGULATIONS FOR HOUSING FINANCE– R-15 to R-21, & R-22 Classifications

REGULATION R-15

Banks / DFIs shall determine the housing finance limit, both in urban and rural areas, in accordance with their internal credit policy, credit worthiness and loan repayment capacity of the borrowers. At the same time, while determining the credit worthiness and repayment capacity of the prospective borrower, banks / DFIs shall ensure that the total monthly amortization payments of consumer loans, inclusive of housing loan, should not exceed 50% of the net disposable income of the prospective borrower.

Banks / DFIs will not allow housing finance purely for the purchase of land / plots; rather, such financing would be extended for the purchase of land / plot and construction on it.

Accordingly, the sanctioned loan limit, assessed on the basis of repayment capacity of the borrower, value of land / plot and cost of construction on it etc., should be disbursed in tranches, i.e. up to a maximum of 50% of the loan limit can be disbursed for the purchase of land/ plot, and the remaining amount be disbursed for construction there-upon.

Further, the lending bank / DFI will take a realistic construction schedule from the borrower before allowing disbursement of the initial loan limit for the purchase of land / plot.

Banks / DFIs may allow housing finance facility for construction of houses against the security of land / plot already owned by their customers. However, the lending bank / DFI will ensure that the loan amount is utilized strictly for the construction purpose and loan is disbursed in tranches as per construction schedule.

Loans against the security of existing land / plot, or for the purchase of new piece of land / plot, for commercial and industrial purposes may be allowed. But such loans will be treated as Commercial Loans,

which will be covered either under Prudential Regulations for Corporate / Commercial Banking or Prudential Regulations for SMEs Financing.

Banks / DFIs may allow Housing Loans in the rural areas provided all relevant guidelines/regulations on the subject are complied with by them.

We shall continue with the rest of the regulations for consumer financing in the coming Lesson.

LESSON 41**PRUDENTIAL REGULATIONS OF SBP**

We shall continue with the remaining regulations/ aspects for consumer financing in this Lesson:

Contents to be covered in this Lesson:

REGULATIONS FOR HOUSING FINANCE

- **REGULATION R-15**
- **REGULATION R-16**
- **REGULATION R-17**
- **REGULATION R-18**
- **REGULATION R-19**
- **REGULATION R-20**
- **REGULATION R-21**
- **REGULATION R-22**

REGULATIONS FOR PERSONAL LOANS INCLUDING LOANS FOR THE PURCHASE OF CONSUMER DURABLES

- **REGULATIONS R-23**
- **REGULATIONS R-24**
- **REGULATIONS R-25**
- **REGULATIONS R-26**
- **REGULATIONS R-27**

REGULATIONS FOR HOUSING FINANCE– R-15 to R-21, & R-22**REGULATION R-15**

Banks / DFIs shall determine the housing finance limit, both in urban and rural areas, in accordance with their internal **credit policy, credit worthiness** and loan repayment capacity of the borrowers. At the same time, while determining the credit worthiness and repayment capacity of the prospective borrower, banks / DFIs shall ensure that the total monthly amortization payments of consumer loans, inclusive of housing loan, should not exceed 50% of the net disposable income of the prospective borrower.

Banks / DFIs will not allow housing finance purely for the purchase of land / plots; rather, such financing would be extended for the purchase of land / plot **and construction** on it.

Accordingly, the sanctioned loan limit, assessed on the basis of repayment capacity of the borrower, value of land / plot and cost of construction on it etc., should be disbursed in tranches, i.e. up to a maximum of 50% of the loan limit can be disbursed for the purchase of land/ plot, and the remaining amount be disbursed for construction there-upon.

Further, the lending bank / DFI will take a realistic construction schedule from the borrower before allowing disbursement of the initial loan limit for the purchase of land / plot.

Banks / DFIs may allow housing finance facility for construction of houses against the security of land / plot already owned by their customers. However, the lending bank / DFI will ensure that the loan amount is utilized strictly for the construction purpose and loan is disbursed in tranches as per construction schedule.

Loans against the security **of existing land** / plot, or for the purchase of new piece of land / plot, for commercial and industrial purposes may be allowed. But such loans will be treated as Commercial Loans, which will be covered either under Prudential Regulations for Corporate / Commercial Banking or Prudential Regulations for SMEs Financing.

Banks / DFIs may allow Housing Loans in the rural areas provided all relevant guidelines/regulations on the subject are complied with by them.

REGULATION R-16

The housing finance facility shall be provided at a maximum **debt-equity ratio of 85:15**

REGULATION R-17

Banks / DFIs are free to extend **mortgage loans** for housing, for a period **not exceeding twenty years**. Banks / DFIs should be mindful of adequate asset - **liability matching**.

REGULATION R-18

The house financed by the bank / DFI shall be mortgaged in bank's / DFI's favour by way of **equitable or registered mortgage**.

REGULATION R-19

Banks / DFIs shall either **engage professional expertise** or **arrange sufficient training** for their **concerned officials** to **evaluate the property**, assess the genuineness and integrity of the title documents, etc.

It may, however, be noted that the requirement of full-scope and desk-top evaluation, as required under R-8 and R-11 of Prudential Regulations for Corporate / Commercial Banking and SMEs Financing respectively, will not be applicable on housing finance.

REGULATION R-20

The bank's / **DFI's management** should **put in place a mechanism to monitor conditions in the real estate** market (or other product market) at least on quarterly basis to ensure that its policies are aligned to current market conditions.

REGULATION R-21

Banks / DFIs are encouraged to **develop floating rate products** for extending housing finance, thereby managing interest rate risk to avoid its adverse effects. Banks / DFIs are also encouraged to develop in-house system to stress test their housing portfolio against adverse movements in interest rates as also maturity mismatches.

REGULATION R-22

The mortgage loans shall be classified and provided for in the following manner:

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE*
(1)	(2)	(3)	(4)
1. Substandard.	Where mark-up/ interest or principal is overdue by 90 days or more from the due date.	Unrealized mark-up/interest to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized mark up/interest already taken to	Provision of 10% (25% from 31st December 2006) of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law
2. Doubtful.	Where mark-up/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and adjusted forced sale value of mortgaged/ pledged assets (subject to Note 1 below) as valued by valuers on the approved panel of PBA.
3. Loss.	Where mark-up/ interest or principal is overdue by one year or more from the due date	As above.	Provision of 100% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and adjusted forced sale value of mortgaged/ pledged assets

;

**REGULATIONS FOR PERSONAL LOANS INCLUDING
LOANS FOR THE PURCHASE OF CONSUMER DURABLES- R-23 to R-27**

REGULATION R-23

The clean limit per person for personal loans will **generally not exceed Rs 500,000/-**.

Banks / DFIs may assign a clean limit beyond Rs 500,000 but **not in excess of Rs 2 million** to their **prime customers** who have extraordinary **strong repayment capacity**, moderate debt burden and a **clean track record**. But aggregate outstanding in this respect should not exceed 10% of the total outstanding personal loans at any point in time

However, while availing benefit of this provision, banks / DFIs would place on record well defined criteria for terms "Prime Customers" and "Moderate Debt Burden" approved by their Board of Directors / Chief Executive.

Banks / DFIs may also allow financing under Personal Loans in excess of Rs 500,000 (**up to Rs. 1,000,000**) to **other customers** as well, provided the loan is **appropriately secured** according to the definition given in Part A of these regulations.

The loan secured against liquid securities shall, however, be exempted from this limit.

The loans against the securities issued by Central Directorate of National Savings (CDNS) shall be subject to such limits as are prescribed by CDNS / Federal Government / State Bank of Pakistan from time to time.

REGULATION R-24

In cases, where the loan has been extended to purchase some **durable goods / items**, including personal computers and accessories thereof, the same **will be hypothecated with the bank / DFI** besides other securities, which the bank / DFI may require on its own.

REGULATION R-25

The maximum tenure of the loan shall **not exceed 5 years**. However, this period may be extended to **7 years for loans / advances given for educational purposes**, provided that disbursement of such loans shall directly be made by the bank / DFI **to the educational institution** and the borrower shall not be allowed to utilize / withdraw cash directly from the bank / DFI under this head for any other purpose.

The maximum tenure of the loan shall not exceed 5 years. However, this period may be extended to 7 years for loans / advances given for educational purposes, provided that disbursement of such loans shall directly be made by the bank / DFI to the educational institution and the borrower shall not be allowed to utilize / withdraw cash directly from the bank / DFI under this head for any other purpose.

REGULATION R-26

In case of Running Finance / Revolving Finance, it shall be ensured that at least 15% of the maximum utilization of the loan during the year is cleaned up by the borrower for a minimum period of one week. In case the clean up is not made by the borrower, the loan will be appropriately classified.

However, banks / DFIs who require their customers to repay a minimum amount each month, will be considered compliant with this regulation subject to the condition that the aggregate cumulative monthly installments exceed the 15% clean up requirement and accordingly the loans where the specified minimum repayments are being made by the borrowers regularly, will not require classification under this regulation.

REGULATION R-27

The personal loans shall be classified and provided for in the following manner:

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE*
(1)	(2)	(3)	(4)
1. Substandard.	Where mark-up/ interest or principal is overdue by 90 days or more from the due date.	Unrealized mark-up/interest to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized mark up/interest already taken to income account to be reversed and kept in Memorandum Account.	Provision of 10% (25% from 31st December 2006) of the difference resulting from the outstanding balance of principal less the amount of liquid assets.
2. Doubtful.	Where mark-up/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets.
3. Loss.	Where mark-up/ interest or	As above.	Provision of 100% of the difference

PRUDENTIAL REGULATIONS FOR SMALL AND MEDIUM ENTERPRISES FINANCING

Introduction:

Keeping in view the important role of Small and Medium Enterprises (SMEs) in the economic development of Pakistan and to facilitate and encourage the flow of bank credit to this sector, a separate set of Prudential Regulations specifically for SME sector has been issued by State Bank of Pakistan. This separate set of regulations, specifically tailored for SMEs, is aimed at encouraging banks / DFIs to develop new financing techniques and innovative products which can meet the financial requirements of SMEs and provide a viable and growing lending outlet for banks / DFIs.

Banks / DFIs should recognize that success in SME lending requires much more extensive involvement with the SMEs than the traditional lender-borrower relationship envisages. The banks / DFIs are, thus, encouraged to work in close association with SMEs. The banks / DFIs should assist and guide the SMEs to develop appropriate systems and effectively manage their resources and risks.

The banks / DFIs are encouraged to prepare a lending program (including detailed eligibility criteria) for each specific sub-sector of SME in which they want to take exposure in a significant manner. For this purpose, the banks / DFIs may conduct / arrange surveys and research to determine the status and potential of specific SME sub-sectors. It is expected that banks / DFIs would prepare comprehensive

guidelines / manuals and put in place suitable mechanism / structure, aided by proper MIS, to carry out the activities related to SME financing in an effective way. This should, however, not stop banks / DFIs from lending to SMEs before undertaking the steps mentioned above as the banks / DFIs may start soft lending operations or test marketing campaigns, as they feel appropriate, to gain experience and necessary know how. The factors mentioned above gain more importance and become critical for the success of a bank / DFI in SME lending, as the exposure of the bank / DFI on SMEs becomes a significant portion of its loan portfolio.

State Bank of Pakistan encourages banks / DFIs to lend to SMEs on the basis of assets conversion cycle and future cash flows. A problem, which the banks / DFIs may encounter in this respect, is the lack of adequate information. In order to overcome this problem, banks / DFIs may also like to prepare general industry cash flows and then adjust those cash flows for the specific borrowers keeping in view their conditions and other factors involved.

As mentioned above, presently most of the SMEs in Pakistan lack sophistication to have reliable and sufficient data and financial information. In order to capture this data and information, banks / DFIs will need to assist and guide their SME customers. The banks / DFIs may come up with the minimum information requirements and standardized formats for this purpose as per their own discretion. For better understanding and to facilitate their SME customers, banks/ DFIs are encouraged to translate their loan application formats and brochures in Urdu and other regional languages.

Banks / DFIs should realize that delay in processing the cases might frustrate the SMEs. Banks / DFIs are therefore encouraged to process the loan cases expeditiously and convey the decision to the SME borrowers as early as possible

In order to encourage close coordination of the officials of the banks / DFIs and SMEs, the banks / DFIs may require the concerned dealing officer to regularly visit the borrower. For this purpose, at a minimum, the dealing officer may be required to pay at least one quarterly visit and document the state of affairs of the SME. In addition, an officer senior to the ones conducting these regular visits may also visit the SME at least once in a year. The banks may, at their own discretion, correlate the frequency of visits with their total exposure to the SME borrower.

State Bank of Pakistan will closely monitor the situation on an ongoing basis and work proactively with banks / DFIs to make SME financing a success. During this process, we will keep on reviewing regulatory framework to ensure that any impediment is immediately removed while ensuring that banks / DFIs observe due prudence and necessary oversight.

Definitions:

Bank means a banking company as defined in Banking Companies Ordinance, 1962.

Borrower means a SME on which a bank / DFI has taken any exposure during the course of business.

Corporate Card means credit card issued to the employees of a SME where the repayment is to be made by the said SME.

Contingent liability means:

- (a). A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non- occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
- (b). A present obligation that arises from past events but is not recognized because:
 - i. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - ii. The amount of the obligation cannot be measured with sufficient reliability; and includes letters of credit, letters of guarantee, bid bonds / performance bonds, advance payment guarantees and underwriting commitments.

Small and Medium Enterprise (SME) means an entity, ideally not a public limited company, which does not employ more than 250 persons (if it is manufacturing/service concern) and 50 persons (if it is trading concern) and also fulfills the following criteria of either 'a' and 'c' or 'b' and 'c' as relevant:

- (a). A trading/service concern with total assets at cost excluding land and building up to Rs 50 million.
- (b). A manufacturing concern with total assets at cost excluding land and building upto Rs 100 million.

- (c). Any concern (trading, service or manufacturing) with net sales not exceeding Rs 300 million as per latest financial statements.
- (d). An Individual, if he or she meets the above criteria, can also be categorized as an SME.

We shall continue with regulations for SMEs in the next Lesson.

LESSON 42**PRUDENTIAL REGULATIONS OF SBP****PRUDENTIAL REGULATIONS
FOR SMALL AND MEDIUM ENTERPRISES FINANCING**

In this Lesson, we shall cover the following:

- Prudential Regulations for small and medium enterprises finance.
- Prudential Regulations for Corporate/ Commercial Banking

First of all we give hereunder an overview of prudential regulations for small & medium enterprises financing.

REGULATIONS FOR SMALL & MEDIUM ENTERPRISES FINANCING:**REGULATION R-1****SOURCE AND CAPACITY OF REPAYMENT
AND CASH FLOW BACKED LENDING****REGULATION R-2**

Personal guarantees

REGULATION R-3

Limit on clean facilities

REGULATION R-4

Securities

REGULATION R-5

Margin requirements

REGULATION R-6

Per party exposure limit

REGULATION R-7

Aggregate exposure of a bank / dfi on sme sector

The aggregate exposure of a bank / DFI on SME sector shall not exceed the limits as specified below:

PERCENTAGE OF CLASSIFIED SMEs ADVANCES TO TOTAL PORTFOLIO OF SMEs ADVANCES	MAXIMUM LIMIT
a. Below 5%	No limit
b. Below 10%	3 times of the equity
c. Below 15%	2 times of the equity
d. Upto and Above 15%	Upto the equity

REGULATION R-8

Minimum conditions for taking exposure

REGULATION R-9

Proper utilization of loan

REGULATION R-10

Restriction on facilities to related parties

Regulation R-11**CLASSIFICATION AND PROVISIONING FOR ASSETS, As Prescribed in Annexure-111**

LOANS / ADVANCES

Banks / DFIs shall observe the prudential guidelines given at Annexure-III in the matter of classification of their SME asset portfolio and provisioning there-against.

All financing facilities (including short, medium and long term)

2. Doubtful.	Where mark-up/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and adjusted forced sale value of mortgaged/ pledged assets (subject to Note 1 below) as valued by valuers on the approved panel of PBA.
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CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE*
(1)	(2)	(3)	(4)
1. Substandard.	Where mark-up/ interest or principal is overdue by 90 days or more from the due date.	Unrealized mark-up/interest to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized mark up/interest already taken to	Provision of 10% (25% from 31st December 2006) of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law

3. Loss.	Where mark-up/ interest or principal is overdue by one year or more from the due date	As above.	Provision of 100% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and adjusted forced sale value of mortgaged/ pledged assets
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Note:

The benefit of FSV is allowed against NPLs of over Rs 5 million only and from December 31, 2006 against NPLs of over Rs 10 million only.

Classified loans / advances that have been guaranteed by the Government would not require provisioning, however, mark up / interest on such accounts to be taken to Memorandum Account instead of Income Account.

Prudential Regulations for Corporate/ Commercial Banking

Definitions:

“Key Executive” means key executives of banks/DFIs and includes the following functional responsibilities for the present:-

- (a). Any executive, acting as second to CEO including Chief Operating Officer, Deputy Managing Director or by whatever name called
- (b). Chief Financial Officer / Head of Finance / Head of Accounts
- (c). Head of Internal Audit
- (d). Country Treasurer

“Key Executive”

- (e). Head of Credit/ Risk Management
- (f). Head of Operations
- (g). Head of Compliance
- (h). Head of Human Resource
- (i). Head of Information Technology
- (j). Head of Islamic Banking

Regulations

Regulation r-1

Limit on exposure to a single person

Regulation r-2

Limit on exposure against contingent liabilities

Regulation r-3

Minimum conditions for taking exposure

Regulation r-4

Limit on exposure against

Unsecured financing facilities

Regulation r-5

Linkage between financial indicators of the borrower and total exposure from financial institutions

Regulation r-6

Exposure against shares / tfcs

And acquisition of shares

Regulation r-7

Guarantees

Regulation r-8

Classification and provisioning for assets

Regulation r-9

Assuming obligations on behalf of nbfc's

Banks / DFIs shall not issue any guarantee or letter of comfort nor assume any obligation whatsoever in respect of deposits, sale of investment certificates, issue of commercial papers, or borrowings of any non-banking finance company.

Regulation r-10

Facilities to private limited company

Regulation r-11

Payment of dividend

Regulation r-12

Monitoring

Regulation r-13

Margin requirements

Regulation g-1

Corporate governance / board

Of directors and management

The following guidelines are required to be followed by banks / DFIs incorporated in Pakistan. They will also follow 'Code of Corporate Governance' issued by the Securities & Exchange Commission of Pakistan (SECP) so long as any provision thereof does not conflict with any provision of the Banking Companies Ordinance, 1962, Prudential Regulations and the instructions / guidelines issued by the State Bank of Pakistan.

Foreign banks are required to adhere to these guidelines wherever feasible and applicable. However, they need not necessarily seek approval of their Board of Directors, as stipulated below in the case of local banks / DFIs:

FIT AND PROPER TEST

-- The "Fit and Proper Test" (FPT) is applicable on the sponsors (both individual & companies) who apply for a commercial banking license, the investors acquiring strategic/controlling stake in the banks/DFIs, major shareholders of the banking companies and for the appointment of Directors, CEO, and Key Executives of the banks/DFIs. The fitness & propriety will be assessed on the following broad elements (Annexure VII-B): Contd...

- a. Integrity, Honesty & Reputation
- b. Track Record
- c. Solvency & Integrity
- d. Qualification & Experience
- e. Conflict of Interest
- f. Others

2. First three elements are applicable to all categories of individuals, whereas the last three elements will be considered while assessing the FPT of Directors, CEO & Key Executives of banks/DFIs.

2. In addition to above requirements, sponsors and strategic investors are evaluated respectively in terms of “Guidelines & Criteria for setting up of a Commercial Bank” & “Criteria for Establishment of Islamic Commercial Banks” issued by SBP and Code of Corporate Governance issued by SECP.

3. The sponsors, the strategic investors, and appointment of the Directors and CEO require prior clearance in writing from SBP. The CEO and Key Executives shall be full time employees of the bank/DFI. The Directors and CEO will not assume the charge of their respective offices until their appointments are approved in writing by SBP.

3. All the requests for seeking approval of SBP for appointment of Directors & CEO of the banks/DFIs should be routed through respective banks/DFIs along with information on Annexures-VI-A & VI-B.

4. The appointment of Key Executives will not require prior clearance of SBP. However, the banks/DFIs must themselves ensure while appointing Key Executives that they qualify FPT in letter and spirit.

5. The sponsors are required to seek prior approval of SBP along with the information at Annexure- VI-B and other information as required in the “Guidelines & Criteria for Setting up a Commercial Bank” and “Criteria for Establishment of Islamic Commercial Banks”.

The strategic investors contemplating to acquire strategic/controlling stake are required to seek prior approval from SBP either directly or through the concerned department/Ministry of Government executing strategic sale transaction of the bank as required and provided in the transaction structure.

The bank should also ensure to give prior intimation to SBP before dealing with any investors/bank/institutions/person for sale/purchase of sponsors/ strategic shares and seek approval of SBP for conducting due diligence of bank/DFI in terms of BPD Circular No. 8 of 2003.

6. The major shareholders are required to seek prior approval in writing from SBP for acquiring 5% or more shares along-with information on Annexure- VI-B, with proper justification for holding more than 5% shares of the paid up capital. All the banks/DFIs are required to ensure that major shareholders have sought such an approval from SBP and place it on record.

7. Fit & Proper Test prescribed in the guideline is continuous in nature. All persons subject to FPT should immediately submit any change in the information already submitted (at the time of clearance) either through Company Secretary or Human Resources Department to Banking Policy and Regulations Department.

7. Violation of the instructions, circumvention, concealment, misreporting and delay in submission of information to SBP may result in withdrawal of SBP approval, besides penal action under the provisions of BCO, 1962.

Regulation g-2

Dealing with directors, major share-holders
And employees of the banks / dfis

Regulation g-3

Contributions and donations for charitable, social, educational and public welfare purposes

Regulation g-4

Credit rating

ANNEXURE – VI-A**PROFORMA – FIT & PROPER TEST**

Photo 1 x 1 1/2	Full Name		
	Father's Name		
	Date of Birth	Place of Birth (City and Country)	
	Nationality (ies)	NTN Number	
	C.N.I.C. No	N.I.C. No (Old)	
	Passport Number (for foreign national)		
	Present Residential Address in Full		
	Permanent Residential Address in Full		
	Residential Telephone Number(s)	Mobile Number	
	If you have changed your name, state previous name and reason for change		
Academic Education			
Qualification	Name & Address of Degree Awarding Institution	Date of Completion	
Professional Education			

BA

Qualification	Name & Address of Institution/ Professional Body	Date of Completion
Training(s); if any		
Existing Employment		
Present Designation		Present Department
Official Address		
Telephone Number (s)		Email
Please provide complete and true particulars of all business(es), including proprietary concern/partnership firms, companies, in which you have been associated as a proprietor, partner or a director thereof during the last ten years and the accounts maintained by them:		
Name of the Proprietary Concern/Partnership Firm/ Company	Name of Bank and/or NBFI's Together with Name of Branches	Account Number(s)
Position held during the last ten years (along with name and address of company / institution/ body where appointment held, nature of the company/institution/body and dates of appointment)		
Position of the shares held in the bank		Number of shares held as of _____
As a Sponsor Shareholder		
• Own name • In name of your company • In name of your family member		
Other than Sponsor Shareholder		
• Own name • In name of your company • In name of your family member		

SIGNATURE OF CONCERNED OFFICIAL

ANNEXURE VI-B

Affidavit
(On Non-Judicial Stamp Paper)

I, _____ son/daughter/wife of _____ adult,
 resident _____ of _____

_____ and holding CNIC No. _____ do hereby state on
 solemn affirmation as under:-

- a. that the deponent hereby confirm that the statement made and the information supplied in the attached questionnaire and the Annexure-VIA and the answers thereof are correct and that there are no other facts that are relevant for "Fit and Proper Test"
- b. that the deponent undertake that the State Bank of Pakistan may seek additional information from any third party it deems necessary in view of assessing "Fit and Proper Test"
- c. that the deponent undertake to bring to the attention of the State Bank of Pakistan any matter which may potentially affect my status as being someone fit and proper as and when it crops up; and
- d. that whatever is stated above is correct to the best of my knowledge and belief and nothing has been concealed therefrom.

DEPONENT

The Deponent is identified by me

Signature

ADVOCATE
(Name and Seal)

Solemnly affirmed before me on this _____ day of _____ at _____ by the Deponent above named who is identified to me by _____, Advocate, who is known to me personally.

Signature _____
OATH COMMISSIONER FOR TAKING AFFIDAVIT
(Name and Seal)

QUESTIONNAIRE FOR ACCESSING “FIT & PROPER TEST”

Please answer the following questions by entering a tick (✓) in the appropriate box. If answer of any of these questions in YES and need explanation, use a separate sheet with proper reference to the question.

		Yes	No
1.	Have you ever been convicted/involved in any fraud/forgery, financial crime etc. in Pakistan or else where, or is being subject to any pending proceedings leading to any conviction?	☐	☐
2.	Have you ever been associated with any illegal activity concerning banking business, deposit taking, financial dealing and other business?	☐	☐
3.	Have you ever been subject to any adverse findings or any settlement in civil/criminal proceedings particularly with regard to investments, financial/business, misconduct, fraud, formation or management of a corporate body etc by SBP, other regulators, professional bodies or government bodies/agencies?	☐	☐
4.	Have you ever contravened any of the requirements and standards of regulatory system or the equivalent standards or requirements of other regulatory authorities?	☐	☐
5.	Have you ever been involved with a company or firm or other organization that has been refused registration/licence to carry out trade, business etc?	☐	☐
6.	Have you ever been involved with a company/firm whose registration/licence has been revoked or cancelled or gone into liquidation or other similar proceedings?	☐	☐
7.	Have you ever been debarred for being Chief Executive, Chairman, Director or Sponsor/Strategic Investor of a company, especially financial institutions?	☐	☐
8.	Have you ever been dismissed/ asked to resign/resigned in Pakistan or elsewhere in order to avoid legal or disciplinary action?	☐	☐
9.	Have you ever resigned from a professional or regulatory body in Pakistan or elsewhere in order to avoid legal or disciplinary action?	☐	☐
10.	Have you ever been disqualified/ removed by regulators/Government bodies/ agencies?	☐	☐
11.	Have you ever been in default of payment of dues owed to any financial institution in individual capacity or as proprietary concern or any partnership firm or in any private unlisted/listed company?	☐	☐
12.	Have you ever been in default of taxes in individual capacity or as proprietary concern or any partnership firm or in any private listed/unlisted company?	☐	☐

- | | | | |
|-----|--|--------------------------|--------------------------|
| 13. | Have you ever been associated as director and/or chief executive with the corporate bodies whose corporate and tax record, including custom duties, central excise and sales tax has been unsatisfactory? | ☐ | ☐ |
| 14. | Have you entered into any agreement with any other person (natural or legal) which will influence the way in which you exercise your voting rights or the way in which you otherwise behave in your relationship with the authorized entity? | ☐ | ☐ |
| 15. | Are you a director on the Board of Directors of any other Financial Institution(s)? | ☐ | ☐ |
| 16. | Are you a Chairman, Chief Executive, Chief Financial Officer, Chief Internal Auditor, Research Analyst or Trader (by whatever name/designation called) of a Exchange Company (firm or sole proprietorship), member of a Stock Exchange, Corporate Brokcrage House? | ☐ | ☐ |
| 17. | Are you owing/controlling any Exchange Company or Corporate Entity? | ☐ | ☐ |
| 18. | Have you been or are you working as consultant or adviser of bank/DFI in which you intend to become a director? | ☐ | ☐ |
| 19. | Are you employee of the bank/DFI? | ☐ | ☐ |
| 20. | Are you employee of a company/entity/organization where sponsor shareholders of bank/DFI have substantial interest? | ☐ | ☐ |
| 21. | Are you a member/office bearer of any political party or member of Senate/National/Provincial Assembly/Local Body? | ☐ | ☐ |
| 22. | If independent director, have you enclosed declaration in this behalf? | ☐ | ☐ |
| 23. | Any other information that is relevant for the purpose of SBP and needs to be mentioned? | ☐ | ☐ |

Signature _____
 Name _____
 Position _____
 Date _____

ANNEXURE VII-A

PROFORMA - FITNESS & PROPRIETARY OF KEY EXECUTIVES

Photo 1 x 1½	Position and Grade held by the Executive	
	Date of assumption of current position (dd/mm/yyyy)	
	Full Name	
	Father's Name	
Date of Birth		Place of Birth (City and Country)
Nationality (ies)		NIN Number
C.N.I.C. No		N.I.C. No (Old)

If yes, reasons for adverse findings and amount of penalty imposed (if any)

Has ever been dismissed from employment?	Yes	No
--	-----	----

If yes, name of the employer and reason for dismissal

(Signature of the concerned official) (Signature and Stamp of Employer)

Regulation M-1 Know your customer (KYC).

Regulation M-2 Anti-money laundering measures.

Regulation M-3 Record retention.

Regulation M-4 Correspondent banking.

Regulation M-5 Suspicious transactions.

- | | |
|-----------------------|---|
| Regulation O-1 | Undertaking of cash payments outside the bank's authorized place of business. |
| Regulation O-2 | Window dressing. |
| Regulation O-3 | Reconciliation of inter-branch accounts and settlement of suspense account entries. |
| Regulation O-4 | Maintenance of assets in Pakistan. |
| Regulation O-5 | Foreign currency deposits under FE-25 -1998. |

With the introduction of prudential regulations, a healthy lending and borrowing culture has been developed in our banking sector.

LESSON 43**GUIDELINES FOR BANKS BY SBP**

The State Bank of Pakistan has issued guidelines for banks with a view to take necessary remedial measures and install required systems so as to safeguard against undue risk exposures by developing necessary risk management mechanism. The guidelines of SBP are given in the following paragraphs:

Risk:

For the purpose of these guidelines financial risk in banking organization is possibility that the outcome of an action or event could bring up adverse impacts. Such outcomes could either result in a direct loss of earnings / capital or may result in imposition of constraints on bank's ability to meet its business objectives. Such constraints pose a risk as these could hinder a bank's ability to conduct its ongoing business or to take benefit of opportunities to enhance its business.

Risk Management:

Risk Management is a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile. It involves identification, measurement, monitoring and controlling risks to ensure that:

- a. The individuals who take or manage risks clearly understand it.
- b. The organization's Risk exposure is within the limits established by Board of Directors.
- c. Risk taking Decisions are in line with the business strategy and objectives set by BOD.
- d. The expected payoffs compensate for the risks taken
- e. Risk taking decisions are explicit and clear.
- f. Sufficient capital as a buffer is available to take risk

The acceptance and management of financial risk is inherent to the business of banking and banks' roles as financial intermediaries. Risk management as commonly perceived does not mean minimizing risk; rather the goal of risk management is to **optimize risk-reward trade -off**.

-- Notwithstanding the fact that banks are in the business of taking risk, it should be recognized that an institution need not engage in business in a manner that unnecessarily imposes risk upon it: nor it should absorb risk that can be transferred to other participants. Rather it should accept those risks that are uniquely part of the array of bank's services.

In every financial institution, risk management activities broadly take place simultaneously at following different hierarchy levels.

- a. **Strategic level:**
 - b. **Macro Level:**
 - c. **Micro Level:**
- a. Strategic level: It encompasses risk management functions performed by senior management and BOD. For instance definition of risks, ascertaining institutions risk appetite, formulating strategy and policies for managing risks and establish adequate systems and controls to ensure that overall risk remain within acceptable level and the reward compensate for the risk taken.
 - b. Macro Level: It encompasses risk management within a business area or across business lines. Generally the risk management activities performed by middle management or units devoted to risk reviews fall into this category.
 - c. Micro Level: It involves 'On-the-line' risk management where risks are actually created. This is the risk management activities performed by individuals who take risk on organization's behalf such as front office and loan origination functions. The risk management in those areas is confined to following operational procedures and guidelines set by management.

Risk Management framework

A risk management framework encompasses the scope of risks to be managed, the process/systems and procedures to manage risk and the roles and responsibilities of individuals involved in risk management.

The framework should be comprehensive enough to capture all risks a bank is exposed to and have flexibility to accommodate any change in business activities.

An effective risk management framework includes:

- a. Clearly defined risk management policies and procedures covering risk identification, acceptance, measurement, monitoring, reporting and control.
- b. A well constituted organizational structure defining clearly roles and responsibilities of individuals involved in risk taking as well as managing it. Banks, in addition to risk management functions for various risk categories may institute a setup that supervises overall risk management at the bank. Such a setup could be in the form of a separate department or bank's Risk Management Committee (RMC) could perform such function.

The structure should be such that ensures effective monitoring and control over risks being taken. The individuals responsible for review function (Risk review, internal audit, compliance etc) should be independent from risk taking units and report directly to board or senior management who are also not involved in risk taking.

- c. There should be an effective management information system that ensures flow of information from operational level to top management and a system to address any exceptions observed. There should be an explicit procedure regarding measures to be taken to address such deviations.
- d. The framework should have a mechanism to ensure an ongoing review of systems, policies and procedures for risk management and procedure to adopt changes.

Managing Credit Risk

Credit risk arises from the potential that an obligor is either unwilling to perform on an obligation or its ability to perform such obligation is impaired resulting in economic loss to the bank.

In a bank's portfolio, losses stem from **outright default** due to inability or unwillingness of a customer or counter party to meet commitments in relation to lending, trading, settlement and other financial transactions. Alternatively losses may result from reduction in portfolio value due to actual or perceived deterioration in credit quality. Credit risk emanates from a bank's dealing with individuals, corporate, financial institutions or a sovereign.

For most banks, loans are the largest and most obvious source of credit risk; however, credit risk could stem from activities both on and off balance sheet.

In addition to direct accounting loss, credit risk should be viewed in the context of economic exposures. This encompasses opportunity costs, transaction costs and expenses associated with a non-performing asset over and above the accounting loss.

Credit risk can be further sub-categorized on the basis of reasons of default. For instance the default could be due to country in which there is exposure or problems in settlement of a transaction.

Credit risk not necessarily occurs in isolation. The same source that endangers credit risk for the institution may also expose it to other risk. For instance a bad portfolio may attract liquidity problem.

Components of credit risk management

A typical Credit risk management framework in a financial institution may be broadly categorized into following main components.

- a. **Board and senior Management's Oversight**
- b. **Organizational structure**
- c. **Systems and procedures for identification, acceptance, measurement, monitoring and control risks.**

Credit Risk Monitoring & Control

Credit risk monitoring refers to incessant monitoring of individual credits inclusive of Off-Balance sheet exposures to obligors as well as overall credit portfolio of the bank. Banks need to enunciate a system that enables them to monitor quality of the credit portfolio on day-to-day basis and take remedial measures as and when any deterioration occurs.

Such a system would enable a bank to ascertain whether loans are being serviced as per facility terms, the adequacy of provisions, the overall risk profile is within limits established by management and compliance

of regulatory limits. Establishing an efficient and effective credit monitoring system would help senior management to monitor the overall quality of the total credit portfolio and its trends. Consequently the management could fine tune or reassess its credit strategy /policy accordingly before encountering any major setback. The banks credit policy should explicitly provide procedural guideline relating to credit risk monitoring.

At minimum it should lay down procedure relating to

- a. The roles and responsibilities of individuals responsible for credit risk monitoring
- b. The assessment procedures and analysis techniques (for individual loans & overall portfolio)
- c. The frequency of monitoring

At minimum it should lay down procedure relating to:

- d. The periodic examination of collaterals and loan covenants
- e. The frequency of site visits
- f. The identification of any deterioration in any loan

Some key indicators that depict the credit quality of a loan:

a. Financial Position and Business Conditions.

The most important aspect about an obligor is its financial health, as it would determine its repayment capacity. Consequently institutions need carefully watch financial standing of obligor.

While making such analysis due consideration should be given to business/industry risk, borrowers position within the industry and external factors such as economic condition, government policies, regulations.

For companies whose financial position is dependent on key management personnel and/or shareholders, for example, in small and medium enterprises, institutions would need to pay particular attention to the assessment of the capability and capacity of the management/shareholder(s).

b. Conduct of Accounts.

In case of existing obligor the operation in the account would give a fair idea about the quality of credit facility. Institutions should monitor the obligor's account activity, repayment history and instances of excesses over credit limits. For trade financing, institutions should monitor cases of repeat extensions of due dates for trust receipts and bills.

c. Loan Covenants.

The obligor's ability to adhere to negative pledges and financial covenants stated in the loan agreement should be assessed, and any breach detected should be addressed promptly.

d. Collateral valuation.

Since the value of collateral could deteriorate resulting in unsecured lending, banks need to reassess value of collaterals on periodic basis. The frequency of such valuation is very subjective and depends upon nature of collaterals. For instance loan granted against shares need revaluation on almost daily basis whereas if there is mortgage of a residential property the revaluation may not be necessary as frequently.

In case of credit facilities secured against inventory or goods at the obligor's premises, appropriate inspection should be conducted to verify the existence and valuation of the collateral. And if such Goods are perishable or such that their value diminish rapidly (e.g. electronic parts/equipments), additional precautionary measures should be taken.

Risk review

The institutions must establish a mechanism of independent, ongoing assessment of credit risk management process. All facilities except those managed on a portfolio basis should be subjected to individual risk review at least once in a year.

The results of such review should be properly documented and reported directly to board, or its sub committee or senior management without lending authority. The purpose of such reviews is to assess the credit administration process, the accuracy of credit rating and overall quality of loan portfolio independent of relationship with the obligor.

Institutions should conduct credit review with updated information on the obligor's financial and business conditions, as well as conduct of account. Exceptions noted in the credit monitoring process should also be evaluated for impact on the obligor's creditworthiness. Credit review should also be conducted on a consolidated group basis to factor in the business connections among entities in a borrowing group.

As stated earlier, credit review should be performed on an annual basis; however more frequent review should be conducted for new accounts where institutions may not be familiar with the obligor, and for classified or adverse rated accounts that have higher probability of default.

For consumer loans, institutions may dispense with the need to perform credit review for certain products. However, they should monitor and report credit exceptions and deterioration.

Managing Market Risk

It is the risk that the value of on and off-balance sheet positions of a financial institution will be adversely affected by movements in market rates or prices such as interest rates, foreign exchange rates, equity prices, credit spreads and/or commodity prices resulting in a loss to earnings and capital.

Financial institutions may be exposed to Market Risk in variety of ways. Market risk exposure may be explicit in portfolios of securities / equities and instruments that are actively traded. Conversely it may be implicit such as interest rate risk due to mismatch of loans and deposits.

Besides, market risk may also arise from activities categorized as off-balance sheet item. Therefore market risk is potential for loss resulting from adverse movement in market risk factors such as interest rates, forex rates, and equity and commodity prices. The risk arising from these factors have been discussed on following pages.

Interest rate risk:

Interest rate risk arises when there is a mismatch between positions, which are subject to interest rate adjustment within a specified period. The bank's lending, funding and investment activities give rise to interest rate risk. The immediate impact of variation in interest rate is on bank's net interest income, while a long term impact is on bank's net worth since the economic value of bank's assets, liabilities and off-balance sheet exposures are affected.

Liquidity Risk:

Liquidity risk is the potential for loss to an institution arising from either its inability to meet its obligations or to fund increases in assets as they fall due without incurring unacceptable cost or losses.

Liquidity risk is considered a major risk for banks. It arises when the cushion provided by the liquid assets are not sufficient enough to meet its obligation. In such a situation banks often meet their liquidity requirements from market. However conditions of funding through market depend upon liquidity in the market and borrowing institution's liquidity.

Accordingly an institution short of liquidity may have to undertake transaction at heavy cost resulting in a loss of earning or in worst case scenario the liquidity risk could result in bankruptcy of the institution if it is unable to undertake transaction even at current market prices.

Banks with large off-balance sheet exposures or the banks, which rely heavily on large corporate deposit, have relatively high level of liquidity risk. Further the banks experiencing a rapid growth in assets should have major concern for liquidity.

Liquidity risk may not be seen in isolation, because financial risk are not mutually exclusive and liquidity risk often triggered by consequence of these other financial risks such as credit risk, market risk etc. For instance, a bank increasing its credit risk through asset concentration etc may be increasing its liquidity risk as well.

Similarly a large loan default or changes in interest rate can adversely impact a bank's liquidity position. Further if management misjudges the impact on liquidity of entering into a new business or product line, the bank's strategic risk would increase.

Managing Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and system or from external events.

Operational risk is associated with human error, system failures and inadequate procedures and controls. It is the risk of loss arising from the potential that inadequate information system; technology failures, breaches in internal controls, fraud, unforeseen catastrophes, or other operational problems may result in unexpected losses or reputation problems. Operational risk exists in all products and business activities.

Operational risk event types that have the potential to result in substantial losses includes Internal fraud, External fraud, employment practices and workplace safety, clients, products and business practices, business disruption and system failures, damage to physical assets, and finally execution, delivery and process management.

The objective of operational risk management is the same as for credit, market and liquidity risks that is to find out the extent of the financial institution's operational risk exposure; to understand what drives it, to allocate capital against it and identify trends internally and externally that would help predicting it. The management of specific operational risks is not a new practice; it has always been important for banks to try to prevent fraud, maintain the integrity of internal controls, and reduce errors in transactions processing, and so on.

However, what is relatively new is the view of operational risk management as a comprehensive practice comparable to the management of credit and market risks in principles. Failure to understand and manage operational risk, which is present in virtually all banking transactions and activities, may greatly increase the likelihood that some risks will go unrecognized and uncontrolled.

The above guidelines provide a working document to safeguard the interests of the bank and other stake holders.

LESSON 44**THE FINANCIAL INSTITUTIONS (RECOVERY OF FINANCES) ORDINANCE, 2001**

In case loan workout effort through negotiation, restructuring, rescheduling, and other methods are not workable then option of filing a recovery suit may be exercised by banks/ financial institutions as a last resort. The law governing recovery of finances is governed by the financial institutions (recovery of finance) Ordinance, 2001, important aspects of this ordinance are covered in the following paragraphs.

Contents

Definitions: Sec 2

Duty of a customer: Sec 3

Establishment of Banking Court under Sec 5

Powers of Banking Courts outlined in sec 7

Suit for recovery of written off finances: Sec 8

Procedure of Banking Courts: Sec 9

Leave to defend unique concept: Sec 10

Sale of mortgaged property: Sec 15

Attachment before judgment, injunction and appointment of Receivers: Sec 16

Provisions relating to certain offences: Sec 20 Application of fines and costs: Sec 21

Appeal: Sec 22

Restriction on transfer of assets & properties: Sec 23

Indemnity: Sec 28

Definitions:

b) "Banking Court" means:

(i) In respect of a case in which the **claim does not exceed fifty million rupees** or for the trial of **offences** under this Ordinance, the Court established under section 5; and

(ii) In respect of any other case, **the High Court**.

(c) "customer" means a person to whom finance has been extended by a financial institution and includes a person on whose behalf a guarantee or letter of credit has been issued by a financial institution as well as a surety or an indemnifier;

Duty of a customer: Sec 3

- (1) It shall be the duty of a customer to fulfill his obligations to the financial institution.
- (2) Where the customer defaults in the discharge of his obligation, he shall be liable to pay, for the period from the date of his default till realization of the cost of funds of the financial institution as certified by the State Bank of Pakistan from time to time, apart from such other civil and criminal liabilities that he may incur under the contract or rules or any other law for the time being in force.
- (3) For purposes of this section a judgment against a customer under this Ordinance shall mean that he is in default of his duty under sub-section (1), and the ensuing decree shall provide for payment of the cost of funds as determined under sub-section (2).

Establishment of Banking Court: Sec 5

- (1) The Federal Government may, by notification in the Official Gazette, establish as many Banking Courts as it considers necessary to exercise jurisdiction under this Ordinance and appoint a Judge for each of such Courts and where it establishes more Banking Courts than one, it shall specify in the notification the territorial limits within which each of the Banking Courts shall exercise its jurisdiction.
- (2) Where more Banking Courts than one have been established to exercise jurisdiction in the same territorial limits, the Federal Government shall define the territorial limits of each such Court.
- (3) Where more Banking Courts than one have been established in the same or different territorial limits, the High Court may, if it considers it expedient to do so in the interest of justice or for the convenience of the parties or of the witnesses, transfer any case from one Banking Court to another.

- (4) **A Judge** of a Banking Court shall be appointed by the Federal Government after consultation with the Chief Justice of the High Court of the Province in which the Banking Court is established and no person shall be appointed a Judge of a Banking Court unless he has been a Judge of a High Court or is or has been a District Judge.
- (5) A Banking Court shall hold its sitting at such places within its territorial jurisdiction as may be determined by the Federal Government.
- (6) A Judge of Banking Court, not being a District Judge, shall be appointed for a term of three years from the date on which he enters upon his office.
- (7) The salary, allowances and other terms and conditions of service of a person appointed as a Judge of Banking Court shall be such as the Federal Government may determine.
- (8) The Banking Court may, if it so requires, be assisted in technical aspects of banking transactions involved in any case by an **amicus curiae** who has at least ten years experience of banking at a senior management level in a financial institution of repute or the State Bank of Pakistan and has the following qualifications, namely:-
 - i. A degree in Commerce and Accounts or in Economics; or
 - ii. A degree in Business Administration; or
 - iii. Has completed a course in banking from the Institute of Bankers, Pakistan.

Remuneration of the amicus curiae, and the party or parties by whom it will be payable, will be determined by the Banking Court, keeping in view the circumstances of each case.

Suit for recovery of written off finances: Sec 8

(1) Subject to sub-section (2), and notwithstanding anything contained in the Limitation Act, 1908 (IX of 1908) or any other law, **a financial institution** may, within three years from the date of coming into force of this Ordinance, file a suit for the recovery of any amount written off, released or adjusted under any agreement, contract, or consent, including a compromise or withdrawal of any suit or legal proceedings or adjustment of a decree between a financial institution and a customer on any day on or after the first day of January, 1990 and before the coming into force of this Ordinance, **if it can establish** that the amount was written off, released or adjusted **for political reasons** or considerations other than bona fide business considerations.

- (2) No suit under sub section (1) shall be filed unless its filing has been approved by:
 - (a) The Board of Directors, in the case of a financial institution incorporated within Pakistan,
 - (b) Or the chief executive (by whatever name called or designated) of the financial institution in Pakistan, in the case of a financial institution incorporated outside Pakistan.

Leave to defend: Sec 10

- a. In any case in which the summons has been served on the defendant as provided for in sub-section (5) of section 9, the defendant shall not be entitled to defend the suit unless he obtains leave from the Banking Court as hereinafter provided to defend the same and, in default of his doing so, the allegations of fact in the plaint shall be deemed to be admitted and the Banking Court may pass a decree in favour of the plaintiff on the basis thereof or such other material as the Banking Court may require in the interests of justice.
 - b. The defendant shall file the application for leave to defend within thirty days of the date of first service by any one of the modes laid down in sub-section (5) of section 9:-
- (2) Provided that where service has been validly affected only through publication in the newspapers, the Banking Court may extend the time for filing an application for leave to defend if satisfied that the defendant did not have knowledge thereof.
 - (3) The application for leave to defend shall be in the **form of a written statement**, and shall contain a summary of the substantial questions of law as well as fact in respect of which, in the opinion of the defendant, evidence needs to be recorded. .
 - (4) In the case of a suit for recovery instituted by a financial institution the application for leave to defend shall also specifically state the following :

- (a). The amount of finance availed by the defendant from the financial institution; the amounts paid by the defendant to the financial institution and the dates of payments;
- (b). The amount of finance and other amounts relating to the finance payable by the defendant to the financial institution up to the date of institution of the suit;
- (c). The amount if any which the defendant disputes as payable to the financial institution and facts in support thereof.

The application for leave to defend shall be accompanied by all the relevant documents.

- (5) An application for leave to defend which does not comply with the requirements of sub-sections (3), (4) where applicable and (5) shall be rejected, unless the defendant discloses therein sufficient cause for his inability to comply with any such requirement. Questions of law or fact raised by him.
- (6) The plaintiff shall be given an opportunity of filing a reply to the application for leave to defend, in the form of a replication.
- (7) Subject to section 11, the Banking Court shall grant the defendant leave to defend the suit if on consideration of the contents of the plaint, the application for leave to defend and the reply thereto it is of the view that substantial questions of law or fact have been raised in respect of which evidence needs to be recorded.
- (8) In granting leave under sub-section (8), the Banking Court may impose such conditions as it may deem appropriate in the circumstances of the case, including conditions as to deposit of cash or furnishing of security.
- (9) Where the application for leave to defend is accepted, the Banking Court shall treat the application as a written statement, and in its order granting leave shall frame issues relating to the substantial questions of law or fact, and, subject to fulfillment of any conditions attached to grant of leave, fix a date for recording of evidence thereon and disposal of the suit.
- (10) Where the application for leave to defend is rejected or where a defendant fails to fulfill the conditions attached to the grant of leave to defend, the Banking Court shall forthwith proceed to pass judgment and decree in favor of the plaintiff against the defendant.
- (11) Where an application for leave to defend has been filed before the coming into force of this Ordinance, the defendant shall be allowed a period of twenty-one days from the date of coming into force of this Ordinance, or from the date of first hearing thereafter, whichever is later, for filing an amended application for leave to defend in accordance with the provisions of this Ordinance.

Disposal of suit: Sec 13

- (1) A suit in which leave to defend has been granted to the defendant shall be disposed of within ninety days from the day on which leave was granted, and in case proceedings continue beyond the said period the defendant may be required to furnish security in such amount as the Banking Court deems fit, and on the failure of the defendant to furnish such security, the Banking Court shall pass an interim or final decree in such amount as it may deem appropriate.
- (2) The requirement of furnishing security under sub-section (1) shall be dispensed with if, in the opinion of the Banking Court, the delay is not attributable to the conduct of the defendant.
- (3) Suits before a Banking Court shall come up for regular hearing as expeditiously as possible and except in extraordinary circumstances and for reasons to be recorded, a Banking Court shall not allow adjournments for more than seven days.
- (4) Where leave to defend is granted and evidence is to be recorded, the parties may file affidavits in respect of the examination-in-chief of any witness who is not to be summoned through the Banking Court, and where such affidavits are filed, the Banking Court shall give notice thereof to the other contesting parties and on the date fixed for recording evidence, shall, subject to such modification as may be required for purposes of production and exhibiting of documents, or otherwise in accordance with law, treat the affidavit as examination-in-chief and allow the contesting parties an opportunity for cross-examination on the basis thereof.

Final Decree: Sec 17

- (1) The final decree passed by a Banking Court shall provide for payment from the date of default of the amounts found to be payable on account of the default in fulfillment of the obligation, and for costs including, in the case of a suit filed by a financial institution cost of funds determined under section 3.

- (2) The Banking Court may, at the time of passing a final decree, also pass an order of the nature contemplated by sub-section (1) of section 16 to the extent of the decial amount.

Provisions relating to certain offences: Sec 20

(1) Whoever:

- (a). dishonestly commits a breach of the terms of a letter of hypothecation, trust receipt or any other instrument or document executed by him whereby possession of the assets or properties offered as security for the re-payment of finance or fulfillment of any obligation are not with the financial institution but are retained by or entrusted to him for the purposes of dealing with the same in the ordinary course of business subject to the terms of the letter of hypothecation or trust receipt or other instrument or document or for the purpose of effecting their sale and depositing the sale proceeds with the financial institution; or
- (b). makes fraudulent mis-representation or commits a breach of an obligation or representation made to a financial institution on the basis of which the financial institution has granted a finance; or
- (c). subsequent to the creation of a mortgage in favor of a financial institution, dishonestly alienates or parts with the possession of the mortgaged property whether by creation of a lease or otherwise contrary to the terms thereof, without the written permission of the financial institution; or
- (d). subsequent to the passing of a decree under section 10 or 11, sells, transfers or otherwise alienates, or parts with possession of his assets or properties acquired after the grant of finance by the financial institution, including assets or properties acquired benami in the name of an ostensible owner shall, without prejudice to any other action which may be taken against him under this Ordinance or any other law for the time being in force, be punishable with imprisonment of either description for a term which may extend to three years and shall also be liable to a fine which may extend to the value of the property or security as decreed or the market value whichever is higher and shall be ordered by the Banking Court trying the offence to deliver up or refund to the financial institution, within a time to be fixed by the Banking Court, the property or the value of the property or security.

Explanation:

- (1) Dishonesty may be presumed where a customer has not deposited the sale proceeds of the property with the financial institution in violation of the terms of the agreement between the financial institution and the customer.
- (2) Whoever knowingly makes a statement which is false in material respects in an application for finance and obtains a finance on the basis thereof, or applies the amount of the finance towards a purpose other than that for which the finance was obtained by him, or furnishes a false statement of stocks in violation of the terms of the agreement with the financial institution or falsely denies his signatures on any banking document before the Banking Court, shall be guilty of an offence punishable with imprisonment of either description for a term which may extend to three years, or with fine, or with both.
- (3) Whoever resists or obstructs, either by himself or on behalf of the judgment debtor, through the use of force, the execution of a decree, shall be punishable with imprisonment, which may extend to one year, or with fine, or with both.
- (4) Whoever dishonestly issues a cheque towards re-payment of a finance or fulfillment of an obligation which is dishonored on presentation, shall be punishable with imprisonment which may extend to one year, or with fine or with both, unless he can establish, for which the burden of proof shall rest on him, that he had made arrangements with his bank to ensure that the cheque would be honored and that the bank was at fault in not honoring the cheque.
- (5) Where the person guilty of an offence under this Ordinance is a company or other body corporate, the chief executive by whatever name called, and any director or officer involved shall be deemed to be guilty of the offence and shall be liable to be prosecuted against and punished accordingly.
- (6) All offences under this Ordinance shall be bailable, non-cognizable and compoundable.

Application of fines and costs: Sec 21

- (1) A Banking Court may direct that the whole or part of any fine or costs imposed under this Ordinance shall be applied in or towards:
 - a) Payment of costs of all or any proceedings under this Ordinance; and
 - b) Payment of compensation to an aggrieved party.
- (2) An order under sub-section (1) shall be deemed to be a decree passed under this Ordinance for purposes of execution.

Appeal: Sec 22

- (1) Subject to sub-section (2), any person aggrieved by any judgment, decree, sentence, or final order passed by a Banking Court may, within thirty days of such judgment, decree, sentence or final order prefer an appeal to the High Court.
- (2) The appellant shall give notice of the filing of the appeal in accordance with the provisions of Order XLIII Rule 3 of the Code of Civil Procedure (Act V of 1908) to the respondent who may appear before the Banking Court to contest admission of the appeal on the date fixed for hearing.
- (3) The High Court shall at the stage of admission of the appeal, or at any time thereafter either suo moto or on the application of the decree holder, decide by means of a reasoned order whether the appeal is to be admitted in part or in whole depending on the facts and circumstances of the case, and as to the security to be furnished by the appellant:
- (4) An appeal under sub-section (1) shall be heard by a bench of not less than two Judges of the High Court and, in case the appeal is admitted, it shall be decided within 90 days from the date of admission.
- (5) An appeal may be preferred under this section from a decree passed ex-parte.
- (6) No appeal, review or revision shall lie against an order accepting or rejecting an application for leave to defend, or any interlocutory order of the Banking Court which does not dispose of the entire case before the Banking Court other than an order passed under sub-section (11) of section 15 or sub-section (7) of section 19.
- (7) Any order of stay of execution of a decree passed under sub-section (2) shall automatically lapse on the expiry of six months from the date of the order whereupon the amount deposited in Court shall be paid over to the decree-holder or the decree-holder may enforce the security furnished by the judgment-debtor.

Through this law, the banks and financial institutions can approach the banking courts for recovery of the finances/ facilities from the defaulters.

LESSON 45**ANCILLARY STATUTES**

There are certain statutes/ law which have bearing on banking transactions and as such have their importance to all stake holders. Keeping in view the importance of these statutes we shall discuss the following statutes in this Lesson:

- Limitation Act, 1908
- Stamp Act, 1889
- Arbitration Act, 1940
- Contract, 1872

Limitation Act, 1908**Contents:**

- Objects, concept
- Provision to be applied without equitable consideration: Sec 1
- Raising of Plea of Limitation: Sec 3
- Restriction of time (limitation Period)
- Condonation of delay—where sufficient cause existed to the satisfaction of court.
- Legal disability: Sec 6
- Exclusion of time while computing time of limitation (Sec 12 to 16)
- First schedule contains period of limitation in different suits.

Objects:

It governs the process of litigation and limits the time after which a suit or other proceeding cannot be maintained (enforced) in a court of law.

It requires promptness in the prosecution of remedy because law assists those who are vigilant and not those who sleep over their rights (Rights to seek remedy—Prosecution to seek remedy within period prescribed by limitation Act.

Statute of limitation has been termed as statute of repose, peace and justice.

Doctrine of limitation is formed on public policy and expediency.

Removes constant uncertainty, doubt and suspense.

Condonation of delay by court. Where just and sufficient cause has been shown to court, to condone the delay

Act has two parts:

First part consist of –Sections

Second part cover schedules

(First Division) Schedules Article 1 to 149---suits of various descriptions mentioned.

(Second Division) Article 150 to 157---deals with Appeals.

(Third Division) Article 158 to 183---deals with certain applications of various types.

In all these articles is mentioned the requisite period of limitation within which relevant appeal or application can be made.

However, provisions of special law to prevail over general law (banking Cos' Ordinance, Income Tax Ordinance, Family Law etc are examples of Special Laws).

The inherent power of the court cannot override the statute of limitation.

It is also not open to parties to alter the prescribed period of limitation or to contract themselves out of statute of limitation, can never have the effect of preventing the period of limitation from running out (PLD 1989 Lahore 390).

When a plea of limitation is raised and is rejected, it cannot be re-agitated in appeal because of the fact that previous finding has attained finality (1986 PLC 1031).

Concept:

Statute of limitation is a procedural statute. Its application does not always mean to usurp or help usurp a right. It rather operates on the principle that if a claimant waived his right or was not serious and rather indolent so as to have acquiesced, he will be hit by the doctrine of limitation

The concept of law is only that the authority created or appointed for helping a claimant (banking court e-g) in such a situation will not help if the claimant knowing the position of law does not ask for it within the prescribed period.

We shall discuss important provisions contained in this Act in the following paragraphs:

Section 1:

Provision to be applied without equitable consideration

However, suspension of application of provisions of statute of limitation only in cases where court by its own Act or oversight causes any injury or injustice to a particular party.

Limitation Act (1908)

Provisions of limitation Act (1908) are not applicable to the following:

- Land Acquisition Act of 1894
- Proceeding under Frontier Crimes Regulation (of 1901)(FCR)

Section 3:**Raising Plea of Limitation:**

A suit instituted, appeal preferred an application made after period of limitation prescribed therefore—shall be dismissed although limitation has not been set up as defense.

Court to examine the question of limitation even if not raised—it is the duty of court to decide question of limitation on merits; ignorance to do so is a legal error.

Section 5:**Restriction of time (limitation Period) is an outcome of public policy. (exceptions in suitable cases).**

Condonation of delay—to advance cause of substantial justice—plausible explanation of delay

Sufficient Cause—is genuine or good cause, because that is beyond the control of the party, unavoidable despite care and attention.

- Abnormal conditions of the country.
- Disturbed state of a country
- Judgment announced in absence of the party (Condemned unheard).
- Person entitled to notice etc.)

Legal disability: Sec 6

(1) Where a person entitled to institute a suit [or proceeding] or make an application for the execution of a decree is, at the time from which the period of limitation is to be reckoned a minor, or insane, or an idiot, he may institute the suit [or proceeding] or make the application within the same period after the disability has ceased, as would otherwise have been allowed from the time prescribed.

(2) Limitation Act (1908)

(3) Where such person is, at the time from which the period of limitation is to be reckoned, affected by two such disabilities, or where, before his disability has ceased, he is affected by another disability, he may institute the suit or make the application within the same period, both disabilities have ceased, as would otherwise have been allowed from the time so prescribed.

(4) Where the disability continues up to the death of such person, his legal representative may institute the suit or make the application within the same period after the death as would otherwise have been allowed from the time so prescribed.

(5) Where such representative is at the date of the death affected by any such disability, the rules contained in subsections (1) and (2) shall apply.

Suits on foreign contracts: Sec 11

Suits instituted in Pakistan on contracts entered into in a foreign country are subject to the rules of limitation contained in this Act.

No foreign rule of limitation shall be a defence to a suit instituted in [Pakistan] on a contract entered into in a foreign country, unless the rule has extinguished the contract and the parties were domiciled in such country during the period prescribed by such rule.

Exclusion of time in legal proceedings: Sec 12**Exclusion of time of defendant's absence from Pakistan etc. and certain other territories: Sec 13****Exclusion of time of proceeding bona fide in Court without jurisdiction: Sec 14****Exclusion of time during which proceedings are suspended: Sec 15****Exclusion of time during which proceedings to set aside execution sale are pending: Sec 16****Effect of death before right to sue accrues: Sec 17**

Where a person, who would, if he were living, have a right to institute a suit or make an application, dies before the right accrues, the period of limitation shall be computed from the time when there is a legal representative of the deceased capable of instituting or making such suit or application. Where a person against whom, if he were living, a right to institute a suit or make an application would have accrued dies before the right accrues, the period of limitation shall be computed from the time when there is a legal representative of the deceased against whom the plaintiff may institute or make such suit or application.

Nothing in subsections (1) and (2) applies to suits to enforce rights of pre-emption or to suits for the possession of immovable property or of an hereditary office.

Limitation Act (1908)

Effect of fraud: Sec 18

Where any person having a right to institute a suit or make an application has, by means of fraud, been kept from the knowledge of such right or of the title on which it is founded. or where any document necessary to establish such right has been fraudulently concealed from him.

The time limited for instituting a suit or making an application---

- Against the person guilty of the fraud or accessory thereto, or
- Against any person claiming through him otherwise than in good faith and for a valuable consideration, shall be computed from the time when the fraud first became known to the person injuriously affected thereby, or, in the case of the concealed document, when he first had the means of producing it or compelling its production

Effect of acknowledgment in writing: Sec 19

Where, before the expiration of the period prescribed for a suit or application in respect of any property or right, an acknowledgment of liability in respect of such property or right has been made in writing signed by the party against whom such property or right is claimed, or by some person through whom he derives title or liability, a fresh period of limitation shall be computed from the time when the acknowledgment was so signed.

Where the writing containing the acknowledgment is undated; oral evidence may be given of the time when it was signed; but, subject to the provisions of the Evidence Act, 1872, oral evidence of its contents shall not be received

Effect of payment on account of debt or of interest on legacy: Sec 20

Where payment on account of a debt or of interest on a legacy is made before the expiration of the prescribed period by the person liable to pay the debt or legacy, or by his duly authorised agent, a fresh period of limitation shall be computed from the time when the payment was made:

- (2) Effect of receipt of produce of mortgaged land.---Where mortgaged land is in the possession of the mortgagee, the receipt of the rent or produce of such land shall be deemed to be a payment for the purpose of subsection (1).

The first schedule to limitation Act 1809 is appended below:

THE FIRST SCHEDULE (See section 3) FIRST DIVISION: SUITS

Description of suit	Period of limitation	Time from which period begins to run
1. To contest an award of the Board or Revenue under the Waste Lands (Claims) Act, 1863.	Part I.---Thirty days Part II.---Ninety days	When notice of the award is delivered to the plaintiff.
2. For compensation or doing or for omitting to do an act alleged to be in pursuance of any enactment in force for the time being in [Pakistan].	Ninety days Part III.---Six months Six months	When the act or omission takes place
3. Under the Specific Relief act , 1877, section 9 to recover possession of immovable property.	Part IV ---One Year	When the dispossession occurs.
5. Under the summary procedure referred to in section 128(2)(f) of the Code of Civil Procedure, 1908 [where the provision of such summary procedure does not exclude the ordinary procedure in such suits	[One year]	When the debt or liquidated demand becomes payable or when the property becomes recoverable.
6. Upon a Statute, Act Regulation or Bye-law, of a penalty or forfeiture.	One year	When the penalty or forfeiture is incurred.
7. For the wages of a household servant, artisan or laborer	[One year].	When the wages accrue due
8. For the price of food or drink sold by the keeper of a hotel, tavern or lodging house.	[One year].	When the food or drink is delivered.
9. For the price of lodging.	[One year]	When the price becomes payable.
10. To enforce a right of pre-emption whether the right is founded on law, or general usage, or on special contract.	[One year]	When the purchaser takes, under the sale sought to be impeached, physical possession of the whole of the property sold, or, where the subject of the sale does not admit of physical possession, when the instrument of sale is registered.
11. By a person against whom any of the following orders has been made to establish the right which he claims to the property comprised in the order: (1) Order under the Code of Civil Procedure, 1908, on a claim preferred to, or an objection made to the attachment of, property attached in execution of a decree;	[One year]..	The date of the order.
11-A. By a person against whom an order has been made under the Code of Civil Procedure, 1908, upon an application by the holder or a decree for the possession of immovable property or by the purchaser of such property sold in execution of a decree,	[One year]..	The date of the order.

complaining of resistance or obstruction to the delivery of possession thereof, or upon an application by any person dispossessed of such property in the delivery of possession thereof to the decree-holder or purchaser, to establish the right which he claims to the present possession of the property comprised in the order.		
12. To set aside any of the following sales:-- (a) Sales in execution of a decree of a Civil Court; (b) sale in pursuance of a decree or order of a Collector or other officer of revenue (c) sale for arrears of Government revenue, or for any demand recoverable as such arrears; (d) sale of a patni taluq sold for current arrears of rent. Explanation. ---In this article "patni" includes any intermediate tenure saleable for current arrears of rent.	[One year]	When the sale is confirmed, or would otherwise have becomingly and conclusive had no such suit been brought.
13. To alter or set aside a decision or order of a Civil Court in any proceeding other than a suit.	[One year]	The date of the final decision or order in the case by a Court competent to determine if finally
14. To set aside any act or order of an officer of Government in his official capacity, not herein otherwise expressly provided for.	[One year].	The date of the act or order.
15. Against Government to set aside any attachment, lease or transfer of immovable property by the Revenue Authorities for arrears of Government revenue.	[One year]	When the payment is made..
16. Against Government to recover money paid under protest in satisfaction of a claim made by the revenue authorities on account of arrears of revenue or on account of demands recoverable as such arrears.	[One year]	When the payment is made.
17. Against Government for compensation for land acquired for public purposes.	[One year]	The date of determining the amount of the compensation.
18. Like suit for compensation (when the acquisition is not completed).	[One year]	The date of the refusal to complete.
19. For compensation for false imprisonment.	[One year]	When the imprisonment ends.
20. By executors, administrators or representatives under the Legal Representatives Suits Act , 1855.	[One year]	The date of the death of the person wronged.
21. By executors, administrators or representatives under the Fatal Accidents act , 1855.	[One year]	The date of the death of the person killed.
22. For compensation for any other injury to the person.	[One year]	When the injury is committed.
23. For compensation for malicious	[One year]	When the plaintiff is a acquitted,

prosecution		or the prosecution is otherwise terminated.
24. For compensation for libel.	[One year]	When the libel is published.
25. For compensation for slander.	[One year]	When the words are spoken spoken or, if the words are not actionable in themselves, when the special damage complained of results.
26. For compensation for loss of service occasioned by the seduction of the plaintiff's servant or daughter.	[One year]	When the loss occurs.
27. For compensation for including a person to break a contract with the plaintiff.	[One year]	The date of the breach
28. For compensation for an illegal, irregular or excessive distress.	[One year]	The date of the distress.
29. For compensation for wrongful seizure of movable property under legal process.	[One year]	The date of the seizure.
30. Against a carrier for compensation for losing or injuring goods.	[One year]	When the loss of injury occurs
31. Against a carrier for compensation for non-delivery of, or delay in delivering goods.	[One year]	When the goods ought to be delivered.
	[One year]	
	[One year]	
	[One year]	
	Part V.---Two Years	
32. Against one who, having a right to use property for specific purposes, perverts it to other purposes.	Two years	Officer of Raven When the perversion first becomes known to the person injured thereby.
33. Under the Legal Representatives' Suit Act, 1855, against an executor.	Two years	When the wrong complained of is done.
34. Under the same Act against an administrator.	Two years	-Ditto-
35. Under the same Act against any other representative.	Two years	-Ditto-
36. For compensation for any malfeasance misfeasance or non-feasance independent of contract and not herein specially provided for.	Two years	When the malfeasance, misfeasance or nonfeasance takes place.
	PART IV.---Three Years	
37. For compensation for obstructing a way for a watercourse.	Three years Three years	The date of the obstruction. The date of the diversion
38. For compensation for	Three years	The date of the diversion

diverting a watercourse.		
39. For compensation for ... trespass upon immovable property.	Three years	The date of trespass.
40. For compensation for infringing copyright or any other exclusive privilege.	Three years	The date of the infringement.
41. To restrain waste.	Three years	When the waste begins.
42. For compensation for injury caused by an injunction wrongfully obtained.	Three years	When the injunction ceases.
43. Under the 50[Succession Act, 1925, section 360 or section 361,] by a person to whom an executor or administrator has paid a legacy or distributed assets.	Three years	The date of the payment or distribution
44. By a ward who has attained majority, to set aside a transfer of property by his guardian.	Three years	When the ward attains majority.
47. By any person bound by an order respecting the possession of immovable property made under the Code of Criminal Procedure Code, 1898, 53[**] or by any one claiming under such person, to recover the property comprised in such order.	Three years	The date of the final order in the case
48. For specific movable property lost or acquired by theft, or dishonest misappropriation or conversion, or for compensation for wrongfully taking or detaining the same.	Three years	The possession of the property first learns in whose possession it is.
55[48-A. To recover movable property conveyed or bequeathed in trust, deposited or pawned, and afterwards bought from the trustee, depository or Pawnee for a valuable consideration.	Three years	When the same becomes known to the plaintiff.
56[48-B. To set aside sale of movable property comprised in a Hindu, Muhammadan or Buddhist religious or charitable endowment made by a manager thereof for a valuable consideration.	Three years	When the sale becomes known to the plaintiff]
49. For other specific movable property, or for compensation for wrongfully taking or injuring or wrongfully detaining the same.	Three years	When the property is wrongfully taken or injured, or when the detainer's possession becomes unlawful.
50. For the hire of animals, vehicles, boats or household furniture.	Three years	When the hire becomes payable.
51. For the balance of money advanced in payment of goods to be delivered.	Three years	When the goods ought to be delivered.
5852. For the price of goods sold and delivered, where no fixed period of credit is agreed upon.	Three years	The date of the delivery of the goods.
5953. For the price of goods sold and delivered to be paid for after the expiry	Three years	When the period of credit expires.

of a fixed period of credit.		
54. For the price of goods sold and delivered to be paid for by a bill of exchange, no such bill being given	Three years	When the period of the proposed bill elapses
55. For the price of trees or growing crops sold by the plaintiff to the defendant where no fixed period of credit is agreed upon.	Three years	The date of the sale.
56. For the price of work done by the plaintiff for the defendant at his request, where no time has been fixed for payment.	Three years	When the work is done
6157. For money payable for money lent.	Three years	When the loan is made
58. Like suit when the lender has given a cheque for the money.	Three years	When the cheque is paid
6259. For money lent under an agreement that it shall be payable on demand.	Three years	When the loan is made.
60. For money deposited under an agreement that it shall be payable on demand including money of a customer in the hands of his banker so payable.	Three years	When the demand is made.
6461. For money payable to the plaintiff for money paid for the defendant.	Three years	When the money is paid.
62. For money payable by the defendant to the plaintiff for money received by the defendant for the plaintiff's use.	Three years	When the money is received.
6563. For money payable for interest upon money due from the defendant to the plaintiff.	Three years	When the interest becomes due.
6664. For money payable to the plaintiff for money found to be due from the defendant to the plaintiff on accounts stated between them.	Three years	When the accounts are stated in writing signed by the defendant or his agent duly authorized in this behalf, unless where the debt is, by a simultaneous agreement in writing signed as aforesaid, made payable at a future time, and then when that time arrives.
6764A. Under Order XXXVII of the Code of Civil Procedure.	Three years	When the debt becomes payable.
65. For compensation for breach of a promise to do anything at a specified time, or upon the happening of a specified contingency.	Three years	When the time specified arrives or the contingency happens.
6966. On a single bond,	Three years	The day so specified.

where a day is specified for payment.		
7067. On a single bond, where no such day is specified.	Three years	The date of executing the bond.
7168. On a bond subject to a condition.	Three years	When the condition is broken.
7269. On a bill of exchange or promissory note payable at a fixed time after date.	Three years	When the bill or note falls due.
7370. On a bill of exchange payable at sight or after sight, but not at a fixed time.	Three years	When the bill is presented.
7471. On a bill of exchange accepted payable at a particular place.	Three years	When the bill is presented at that place.
7672. On a bill of exchange or promissory note payable at a fixed time after sight or after demand.	Three years	When the fixed time expires.]
7773. On a bill of exchange or promissory note payable on demand and not accompanied by any writing restraining or postponing the right to sue.	Three years	The date of the bill or note.
7874. On a promissory note or bond payable by installments.	Three years	The expiration of the first term of payment as to the part then payable; and for the other parts the expiration of the respective terms of payment.
7975. On a promissory note or bond payable by installment, which provides that if default be made in payment of one or more installments, the whole shall be due.	Three years	When the default is made, unless where the payee or obligee waives the benefit of the provision, and then when fresh default is made in respect of which there is no such waiver
8076. On a promissory note given by the maker to a third person to be delivered to the payee after a certain event should happen.	Three years	The date of the delivery to the payee.
8277. On a dishonored foreign bill where protest has been made and notice given.	Three years	When the notice is given.
8378. By the payee against the drawer of a bill of exchange which has been dishonored by non-acceptance.	Three years	The date of the refusal to accept.
8479. By the acceptor of an accommodation bill against the drawer.	Three years	When the acceptor pays the amount of the bill.
8580. Suit on a bill of exchange, promissory note, or bond not herein expressly provided for	Three years	When the bill, note or bond becomes payable.
81. By a surety against the principal debtor.	Three years	When the surety pays the creditor.
82. By a surety against a co-surety.	Three years	When the surety pays anything in

		excess of his own share.
83. Upon any other contract to indemnify.	Three years	When the plaintiff is actually dandified.
84. By an attorney or vakil for his costs of a suit or a particular business, there being no express agreement as to the time when such costs are to be paid.	Three years	The date of the termination of the suit or business, or (where the attorney or vakil properly discontinues the suit or business) the date of such discontinuance.
85. For the balance due on a mutual, open and current account, where there have been reciprocal demands between the parties.	Three years	The close of the years in which the last item admitted or proved is entered in the account; such year to be computed as in the account.
86. 87[(a) On a policy of insurance when the sum insured is payable after proof of the death has been given to or received by the insurers.	Three years	88[(a) The date of the death of the deceased.
(b) On a policy of insurance when the sum insured is payable after proof of the loss has been given to or received by the insurers).	(b) The date of the occurrence causing the loss.]	
87. By the assured recover premier paid under a policy voidable at the election of the insurers.	Three years	When the insurers elect to avoid the policy.
88. Against a factor for an account.	Three years	When the account is, during the continuance of the agency, demanded and refused or, where no such demand is made, when the agency terminates.
89. By a principal against his agent for movable property received by the latter and not accounted for.	Three years	Ditto
90. Other suits by principals against agents for neglect or misconduct.	Three years	When the neglect or misconduct becomes known to the plaintiff.
91. To cancel or set aside an instrument not otherwise provided for.	Three years	When the facts entitling the plaintiff to have the instrument cancelled or set aside become known to him.
92. To declare the forgery of an instrument issued or registered.	Three years	When the issue or registration becomes known to the plaintiff.
93. The declare the forgery of an instrument attempted to be enforced against the plaintiff.	Three years	The date of the attempt.
94. For property which the plaintiff has conveyed while insane.	Three years	When the plaintiff is restored to sanity, and has knowledge of the conveyance.

95. To set aside a decree obtained by fraud, or for other relief on the ground of fraud.	Three years	When the fraud becomes known to the party wronged.
96. For relief on the ground of mistake.	Three years	When the mistake becomes known to the plaintiff.
97. For money paid upon an existing consideration which afterwards fails.	Three years	The date of the failure.
98. To make good out of the general estate of a deceased trustee the loss occasioned by a breach of trust.	Three years	The date of the trustee's death, or, if the loss has not then resulted the date of the loss.
99. For contribution by a party who has paid the whole or more than his share of the amount due under a joint decree, or by a sharer in a joint estate who has paid the whole or more than his share of the amount of revenue due from himself and his co-shares.	Three years	The date of the payment in excess of the plaintiff's own share.
100. By a co-trustee to enforce against the estate of the deceased trustee a claim for contribution.	Three years	When the right to contribution accrues.
101. For a seaman's wages.	Three years	The end of the voyage during which the wages are earned.
102. For wages not otherwise expressly provided for by this Schedule.	Three years	When the wages accrue due
103. By 93[Muslim] for eligible dower (muajjal). (Where, during the continuance of the marriage no such demand has been made) when the marriage is dissolved by death or divorce.	Three years	When the dower is demanded and refused or
104. By a 94[Muslim] for deferred dower (muajjal).	Three years	When the marriage is dissolved by death or divorce.
105. By a mortgagor after the mortgage has been satisfied, to recovery surplus collections received by the mortgagee	Three years	When the mortgagor re-enters on the mortgaged property.
106. For an account and a share of the profits of a dissolved partnership.	Three years	The date of the dissolution.
107. By the manager of a joint estate of an undivided family for contribution, in respect of a payment made by him on account of the estate.	Three years	The date of the payment.
108. By a lesser for the value of trees cut down by his lessee contrary to the terms of the lease.	Three years	When the trees are cut down.
109. For the profits of immovable property belonging to the plaintiff which have been wrongfully received by the defendant.	Three years	When the profits are received.
110. For arrears of	Three years	When the arrears become due.

rent.		
111. By a vendor of immovable property for personal payment of unpaid purchase-money.	Three years	The time fixed for completing the sale, or (where the title is accepted after the time fixed for completion) the date of the acceptance.
112. For a call by a company registered under any Statute or Act.	Three years	When the call is payable.
113. For specific performance of a contract.	Three years	The date fixed for the performance, or if no such date is fixed, when the plaintiff has notice that performance is refused.
114. For the rescission of a contract.	Three years	When the facts entitling the plaintiff to have the contract rescinded first become known to him.
115. For compensation for the breach of any contract, express or implied, not in writing registered and not herein specially provided for.	Three years	When the contract is broken, or (where there are successive breaches) when the breach in respect of which the suit is instituted occurs, or (where the breach is continuing) when it ceases.
Part VII. ---Six years.		
116. For compensation for the breach of a contract in writing registered.	Six years	When the period of limitation would begin to run against a suit brought on a similar contract not registered
117. Upon a foreign judgment as defined in the Code of Civil Procedure, 1908.	Six years	The date of the judgment
118. To obtain a declaration that an alleged adoption is invalid, or never, in fact, took place.	Six years	When the alleged adoption becomes known to the plaintiff.
119. To obtain a declaration that an adoption is valid.	Six years	When the rights of the adopted son, as such are interfered with.
120. Suit for which no period of limitation is provided elsewhere in this schedule.	Six years	When the right to sue accrues.
121. To avoid encumbrances or conclusive. Under tenures in an entire estate sold for arrears of Government revenue, or in a patni taluq or other saleable tenure sold for arrears of rent.	Twelve years	When the sale becomes final and conclusive
122. Upon a judgment obtained in 97[Pakistan] or a recognizance.	Twelve years	The date of the judgment or recognizance.
123. For a legacy or for a share of a residue bequeathed by a testator, or for a distributive share of the property of	Twelve years	When the legacy or share becomes payable or deliverable.

an intestate.		
124. For possession of hereditary office	Twelve years	When the defendant takes possession of the office adversely to the plaintiff.
		Explanation. ---An hereditary office is possessed when the profits thereof are usually received, of (if there are no profits) when the duties thereof are usually performed.
125. Suit during the life of a Hindu or 1[Muslim] female by a Hindu or 1[Muslim] who, if the female died at the date of instituting the suit would be entitled to the possession of land, to have an alienation of such land made by the female declared to be void except for her life or until her remarriage.	Twelve years	The date of the alienation.
126. By a Hindu governed by the law of the Mitakshara to set aside his father's alienation of ancestral property.	Twelve years	When the aliened takes possession of the property
127. By a person excluded from joint family property to enforce a right to share therein.	Twelve years	When the exclusion becomes known to the plaintiff.
128. By a Hindu for arrears of maintenance	Twelve years	When the arrears are payable.
129. By a Hindu for a declaration of his right to maintenance.	Twelve years	When the right is denied.
130. For the resumption or assessment of rent-free land.	Twelve years	When the right to resume or assess the land first accrues.
131. To establish a recurring right.	Twelve years	When the plaintiff is first refused the enjoyment of the right.
132. To enforce payment of money charged upon immovable property.	Twelve years	When the money sued for becomes due
4[Explanation,--- For the purposes of this article--- (a) the allowance and fees respectively called malikana and haqq, and (b) the value of any agricultural or other produce the right to receive which is secured by a charge upon immovable property, 5[and (c) advances secured by mortgage by deposit of title deeds]. shall be deemed to be money charged upon immovable property.		

6[*****]		
134. To recover possession of immovable property conveyed or -bequeathed in trust or mortgaged and afterwards transferred by the trustee or mortgagee for a valuable consideration.	Twelve years	7[When the transfer becomes known to the plaintiff.]
8[134A. To set aside a transfer of immovable property comprised in a Hindu, 9[Muslim] or Buddhist religious or charitable endowment made by a manager thereof for a valuable consideration.	Twelve years	When the transfer becomes known to the plaintiff.
134B. BY the manager of a Hindu, 9[Muslim] or Buddhist religious or charitable endowment to recover possession of immovable property comprised in the endowment which has been transferred by previous manager for a valuable consideration.	Twelve years	The death, resignation or removal of the transferor
134C. By the manager of a Hindu, 9[Muslim] or Buddhist religious or charitable endowment to recovery possession of movable property comprised in the endowment which has been sold by a previous manager for a valuable consideration.	Twelve years	The death, resignation or removal of the seller.
135. Suit instituted in a Court 11[other than a High Court] by a mortgagee for possession of immovable property mortgaged.	Twelve years	When the mortgagor's right to possession determines.
136. By a purchaser at a private sale for possession of immovable property sold when the vendor was out of possession at the date of the sale.	Twelve years	When the vendor is first entitled to possession.
137. Like suit by a purchaser at a sale in execution of a decree when the judgment-debtor was out of possession at the date of the sale.	Twelve years	When the judgment-debtor is first entitled to possession.
138. Like suit by a purchaser at a sale in execution of a decree when the judgment-debtor was in possession at the date of the sale.	Twelve years	The date when the sale becomes absolute.
139. By a landlord to recover possession from a tenant.	Twelve years	When the tenancy is determined.
140. By a remainder man, a reversionary (other than a landlord) or a devisee, for possession of immovable property.	Twelve years	When his estate falls into possession.
141. Like suit by a Hindu or 14[Muslim]	Twelve years	When the female dies.

entitled to the possession of immovable property on the death of a Hindu or 14[Muslim] female.		
142. For possession of immovable property when the plaintiff, while in possession of the property, has been dispossessed or has discontinued the possession.	Twelve years	The date of the dispossession or discontinuance.
143. Like suit, when the plaintiff has become come entitled by reason of any forfeiture or breach of condition. 15[Omitted].	Twelve years	When the forfeiture is incurred or the condition is broken.
145. Against a depository or Pawnee to recover movable property deposited or pawned.	Thirty years	The date of the deposit or pawn.
146. Before a 16[High Court] in the exercise of its ordinary original civil jurisdiction by a mortgagee to recover from the mortgagor the possession of immovable property mortgaged.	Thirty years	When any part of the principal or interest was last paid on account of the mortgage-debt.
146A. By or on behalf of any local authority for possession of any public street or road or any part thereof from which it has been dispossessed or of which it has discontinued the possession.	Thirty years	The date of the dispossession or discontinuance
147. By a mortgagee for foreclosure or sale.	Sixty years	When the money secured by the mortgage becomes due.
148. Against a mortgagee to redeem or to recover possession of immovable property mortgaged.	Sixty years	When the right to redeem or to recovery possession accrues: Provided that all claims to redeem arising under instruments of mortgage of immovable property situate in Lower Burma which had been executed before the first day of May, 1863, shall be governed by the rules of limitation in force in that Province immediately before the same day.
149. 19[Any suit by "or on behalf of the Federal]20 Government or any Provincial Government] 21[except a suit before the 22[Supreme Court] in the exercise of its original jurisdiction].	18[Sixty years]	When the period of limitation would begin to run under this Act against a like suit by a private person.
150. Under the Code of Criminal Procedure, 1898 from a sentence of death passed by a Court of Session 23[or by a High Court in the exercise of its original Criminal Jurisdiction].	Seven days	The date of the sentence.
151. From a decree or order of 25[a High Court] in the exercise of its original jurisdiction.	Twenty days	The date of the decree or order.

152. Under the Code of Civil Procedure, 1908 to the Court of a District Judge.	Thirty days	The date of the decree or order appealed from.
153. Under the same Code to High Court from an order of a Subordinate Court refusing leave to appeal to 26[Supreme Court].	27[Third days]	The date of the order.
154. Under the Code of Criminal Procedure 1898, to any Court other than a High Court.	28[Thirty days]	The date of the sentence or order appealed from.
155. Under the same Code to a High Court, except in the cases provided for by Article 150 and Article 157.	Sixty days	The date of the sentence or order appealed from
156. Under the Code of Civil Procedure, 1908, to a High Court, except in the cases provided for by Article 151 and Article 153.	Ninety days	The date of the decree or order appealed from.
157. Under the Code of Criminal Procedure, 1898, from an order of acquittal.	Six months	The date of the order appealed from.
29[158. Under the Arbitration Act, 1940, to set aside an award or to get an award remitted for reconsideration.	Thirty days	The date of service of the notice of filing of the award.
159. For leave to appear and defend a suit under summary procedure referred to in section 128 (2)(f) 30[or under Order XXXVII of the 31[Code of Civil Procedure, 1908].	32[Ten days]	When the summons is served.
160. For an order under the same Code, to restore to the file an application for review rejected in consequence of the failure of the applicant to appear when the application was called on for hearing.	Fifteen days	When the application for review is rejected.
161. For a review of judgment by a 33* Court of small Causes 34**** or by a Court invested with the jurisdiction of a 35* Court of Small Causes when exercising that jurisdiction.	32[Fifteen days]	The date of the decree or order.
162. For a review of judgment by 36[a High Court in the exercise of its original jurisdiction. 37162-A. [Repealed].	Twenty days	The date of the decree or order.
163. By a plaintiff for an order to set aside a dismissal for default of appearance or for failure to pay costs of service of process or to furnish security for costs.	Thirty days	The date of the dismissal
164. By a defendant, for an order to set aside a decree passed ex parte.	Thirty days	The date of the decree or where the summons was not duly served, when the applicant has knowledge of the decree.
165. Under the Code of Civil Procedure, 1908 by a person dispossessed of immovable property and disputing the right of the decree-holder or purchaser at a sale in execution of a decree to be put into possession.	39[Thirty days]	The date of the dispossession.
166. Under the same Code to set aside a sale	39[Thirty days]	The date of the sale.

in execution of a decree 40[including any such application by a judgment-debtor].		
167. Complaining of resistance of obstruction to delivery of possession of immovable property decreed or sold in execution of a decree.	39[Thirty days]	The date of the resistance or obstruction
168. For the readmission of an appeal dismissed for want of prosecution	39[Thirty days]	The date of the dismissal.
169. For the re-hearing of an appeal heard ex parte.	39[Thirty days]	The date of the decree in appeal, or, where notice of the appeal was not duly served, when the applicant has knowledge of the decree.
170. For leave to appeal as a pauper.	39[Thirty days]	The date of the decree appealed from.
171. Under the Code of Civil Procedure, 1908, 42[by the legal representative of a deceased plaintiff or defendant for setting aside an order or judgment made or pronounced in his absence].	Sixty days	43[The date of the order or judgment].
172. Under the same Code by the assignee or the receiver of an insolvent plaintiff or appellant for an order to set aside the dismissal of a suit or an appeal.	Sixty days	The date of the order of dismissal.
173. For a review of judgment except in the cases provided for by Article 161 and Article 162.	Ninety days	The date of the decree or order.
174. For the issue of a notice under the same Code, to show cause why any payment made out of Court of any money payable under a decree or any adjustment of the decree should not be recorded as certified.	Ninety days	When the payment or adjustment is made.
175. For payment of the amount of a decree by installments.	Six months	The date of the decree.
176. Under the same Code to have the legal representative of a deceased plaintiff or of a deceased appellant made a party.	45[Ninety days]	The date of the death of the deceased plaintiff or appellant.
177. Under the same Code to have the legal representative of a deceased defendant or of a deceased respondent made a party.	45[Ninety days]	The date of the death of the deceased defendant correspondent
46[178. Under the Arbitration Act, 1940, for the filing in Court of an award.	Ninety days	The date of service of the notice of the making of the award].
179. By a person desiring to appeal under the 47[Code of Civil Procedure, 1908] to 48[the Supreme Court] for leave to appeal.	Ninety days	The date of the decree appealed from.
180. By a purchaser of immovable property at a sale in execution of a decree for delivery of possession.	Three years	When the sale becomes absolute.
181. Applications for which no period of limitation is provided elsewhere in this	Three years	When the right to apply accrues.

schedule or by section 48 of the Code of Civil Procedure, 1908. 50[182. [* * * * *]]		
183. To enforce a judgment, decree or order of any 51[High Court] in the exercise of its ordinary original civil jurisdiction, or an order of 52(the Supreme Court).	53[Six years]	When a present right to enforce the judgment, decree or order accrues to some person capable of releasing the right: Provided that when the judgment, decree or order has been revived, or some part of the principal money secured thereby, or some interest on such money has been paid, or some acknowledgment of the right thereto has been given in writing signed by the person liable to pay such principal of interest, or his agent to the person entitled thereto or his agent, the twelve years shall be computed from the date of such revival payment or acknowledgment or the latest of such revivals, payment or acknowledgments, as the case may be.

The second schedule--- [territories referred to in section 31.] Rep. By the repealing and amending act, 1930 (viii of 1930),

STAMP ACT, 1899

Contents

- Definitions: Sec 2
- Instruments chargeable with duty: Sec 3
- Power to reduce, remit or compound duties: Sec 9
- Duties how to be paid: Sec 10
- Use of adhesive stamps: Sec 11
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- Stamp where value of subject-matter is indeterminate: Sec 26
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- Collector's power to refund penalty paid under section 38, sub-section (1): Sec 39
- Prosecution for offence against Stamp-law: Sec 43
- Prosecution for offence against Stamp-law: Sec 48
- Penalty for executing, etc., instrument not duly stamped: Sec 62
- Jurisdiction of Magistrates

- (1) This Act may be called the Stamp Act, 1899.
- (2) It extends to the whole of Pakistan].
- (3) It shall come into force on the first day of July, 1899.

The significant provisions of Stamp Act, 1809 are given in the following paragraphs

Definitions: Sec 2

“Collector”–

Means the Collector of a district; and includes a [District Officer (Revenue)] and any officer whom [the Provincial Government] may, by notification in the Official Gazette, appoint in this behalf;

“duly stamped”, as applied to an instrument, means that the instrument bears an adhesive or impressed stamp of not less than the proper amount and that such stamp has been affixed or used in accordance with the law for the time being in force in [Pakistan];

“Executed” and “execution”, used with reference to instruments, mean “signed” and “signature”

“impressed stamp” includes–

Labels affixed and impressed by the proper officer, and

Stamps embossed or engraved on stamped paper;

“power-of-attorney” includes any instrument (not chargeable with a fee under the law relating to court-fees for the time being in force) empowering a specified person to act for and in the name of the person executing it;

“Receipt” includes any note, memorandum or writing–

Whereby any money, or any bill of exchange, cheque or promissory note is acknowledged to have been received, or

Whereby any other movable property is acknowledged to have been received in satisfaction of a debt, or

Whereby any debt or demand, or any part of a debt or demand, is acknowledged to have been satisfied or discharged, or

Which signifies or imports any such acknowledgment and whether the same is or is not signed with the name of any person

ARBITRATION ACT, 1940

Main Contents:

- History/ Evolution
- Object
- Interpretation
- Application
- Role of Arbitrator
- Definitions—Arbitration Agreement, Award, Umpire
- Provisions implied in arbitration agreement: Sec 3
- Agreement that arbitrators be appointed by third party: Sec 4
- Authority of appointed arbitrator or umpire irrevocable except by leave of Court: Sec 5
- Provision as to appointment of three or more arbitrators: Sec 10
- Power to Court to remove arbitrators or umpire in certain circumstances: Sec 11
- Powers of arbitrator: Sec 13
- Award to be signed and filed: Sec 14
- Power of Court to modify award: Sec 15
- Judgment in terms of award: Sec 17
- Power of Court to pass interim orders: Sec 18
- Application to file in Court arbitration agreement: Sec 20
- Parties to suit may apply for order of reference: Sec 21
- Appointment of arbitrator: Sec 22
- Power to stay legal proceedings where there is an arbitration agreement: Sec 34

Object of the Act:

Enforcement of arbitration agreement whereby the parties have bound themselves down, to have their disputes arising out of transaction to which such an agreement is applicable, adjudicated upon and decided by the domestic tribunal.

Interpretation:

Arbitration Act does not restrict the contractual rights of the parties. It only gives effect to the choice of the parties as regards the forum to which their disputes shall be taken.

Application of the Act:

This act lays down the rules to be followed by the parties, arbitrators and courts.

The Arbitration Act (1940)

Role of Arbitrator:

Arbitrator is to settle dispute between parties amicably by avoiding all type of technicalities of procedural law but within the four corners of substantive law and to provide a domestic forum for speedy disposal of dispute. Arbitration is undertaken through persons to whom both the parties repose their trust.

Comments:

Existence of a dispute is essential for a reference to be resolved through adjudication of such dispute culminating in an award.

Definitions

Arbitration Agreement: means written agreement to submit present or future differences to arbitration, whether an arbitrator was named therein or not.

Court: would mean a civil court having jurisdiction to decide the subject matter.

Award: means arbitration award. The decision of arbitration or arbitrator is called Award.

“legal representative” means a person who in law represents the estate of a deceased person, and includes any person who intermeddles with the estate of the deceased, and, where a party acts in a representative character, the person on whom the estate devolves on the death of the party so acting;

Reference: means reference to arbitration any disputes. Arbitrators to make decision within four months.

Umpire: is a person, or body of persons (often appointed by the arbitrators themselves) who is to settle any difference that may arise between the arbitrators.

Authority of appointed arbitrator or umpire irrevocable except by leave of Court: Sec 5

The authority of an appointed arbitrator or umpire shall not be revocable except with the leave of the Court, unless a contrary intention is expressed in the arbitration agreement

Power to Court to remove arbitrators or umpire in certain circumstances: Sec 11

- (1) The Court may, on the application of any party to a reference, remove an arbitrator or umpire who fails to use all reasonable dispatch in entering on and proceeding with the reference and making an award.
- (2) The Court may remove an arbitrator or umpire who has misconduct himself or the proceedings.
- (3) Where an arbitrator or the umpire is removed under this section, he shall not be entitled to receive any remuneration in respect of his services.
- (4) For the purposes of this section the expression “proceeding with the reference” includes, in a case where reference to the umpire becomes necessary, giving notice of that fact to the parties and to the umpire.

Powers of arbitrator: Sec 13

- (a). The arbitrators or umpire shall, unless a different intention is expressed in agreement, have power to (a) administer oath to the parties and witnesses appearing;
- (b). state a special case for the opinion of the Court on any question of law involved, or state the award, wholly or in part, in the form of a special case of such question for the opinion of the Court;

- (c). The arbitrators or umpire shall, unless a different intention is expressed in agreement, have power to (c) make the award conditional or in the alternative;
- (d). Correct in an award any clerical mistake or error arising from any accidental slip or omission;
- (e). Administer to any party to arbitration such interrogatories as may, in the opinion of the arbitrators or umpire, be necessary

Award to be signed and filed: Sec 14

- (1) When the arbitrators or umpire have made their award, they shall sign it and shall give notice in writing to the parties of the making and signing thereof and of the amount of fees and charges payable in respect of the arbitration and award.
- (2) The arbitrators or umpire shall, at the request of any party to the arbitration agreement or any person claiming under such party or if so directed by the Court and upon payment of the fees and charges due in respect of the arbitration and award and of the costs and charges of filing the award, cause the award or a signed copy of it, together with any depositions and documents which may have been taken and proved before them, to be filed in the Court, and the Court shall thereupon give notice to the parties of the filing of the award.
- (3) Where the arbitrators or umpire state a special case under clause (b) of Section 13, the Court, after giving notice to the parties and hearing them, shall pronounce its opinion thereon and such opinion shall be added to, and shall form part of, the award.

Power of Court to modify award : Sec 15

The Court may by order modify or correct an award

Where it appears that a part of the award is upon a matter not referred to arbitration and such part can be separated from the other part and does not affect the decision on the matter referred; or

Where the award is imperfect in form, or contains any obvious error which can be amended without affecting such decision; or

Where the award contains a clerical mistake or an error arising from an accidental slip or omission.

Judgment in terms of award: Sec 17

Where the Court sees no cause to remit the award or any of the matters referred to arbitration for reconsideration or to set aside the award, the Court shall, after the time for making an application to set aside the award has expired, or such application having been made, after refusing it, proceed to pronounce judgment according to the award, and upon the judgment so pronounced a decree shall follow and no appeal shall lie from such decree except on the ground that it is in excess of, or not otherwise in accordance with, the award.

Contract act

Main Content:

- Scope and its significance
- Consideration
- Definition of contract
- Contracts—Essentials and Kinds

Contract—scope and its kinds

The law relating to contracts in Pakistan is governed by Contract Act, 1872. It extends to the whole of Pakistan; and it came into force on 1st September, 1872. At the time of promulgation, this Act comprised of 266 sections.

Scope and Significance:

The law of contract is at the root of any business transaction. We have already discussed that it affects every person in one way or the other. We enter into different kinds of contracts in our day today affairs. The law of contracts is applicable not only to the business community but also to others. When a person rides a

public transport or gets admission in an educational institution or avails loan from a bank or delivers cloth to a tailor for stitching, he is in fact entering into a contract, knowingly or unknowingly. By virtue of a contract legal rights and obligations are created between the contracting parties. The law of contracts is concerned with self-imposed obligations. The parties to a contract do enjoy freedom of contract and the rights and duties created by them can be enforced even though the terms of the contract are harsh or unfair to one party. When people enter into a contract they make private law binding on each other. The parties to a contract, in a sense, make the law for themselves. It consists of a number of limiting principles, subject to which the parties may create rights and duties for themselves which the law will uphold. Thus we can say that the parties to a contract, in a sense, make the law for themselves. When contracts were entered into freely and voluntarily they would be enforceable by courts of law. The law of contract determines the circumstances under which a promise or an agreement shall be legally binding on the persons making it. It also provides the remedies which are available in a court of law against a person who fails to fulfill his contract and other conditions. The object and function of law of contract is to see that promises made by the contracting parties are fulfilled.

Contract—defined

“An agreement enforceable by law is a contract”

Agreement—defined Sec 2(e)

Every promise or every set of promises, forming the consideration for each other, is an agreement.

Promise—defined Sec 2 (b)

When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise.

Consideration—defined Sec 2 (d)

When at the desire of the Promisor, the Promisee or any other person who has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise.

Important ingredients of Contract:

To understand the definition of contract we need to understand the following definitions on which a contract is based.

- Proposal
- Acceptance
- Promise
- Promisor
- Promisee
- Consideration
- Agreement

According to section 10 of Contract Act 1872;

All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void.

Essentials of valid Contract

- Offer and acceptance
- Legal relationship
- Legal consideration
- Competent parties
- Free consent of the parties

Concept of competent parties

Parties to contract are required to be of the age of majority.

Of sound mind & Not barred from entering into contracts by the operation of law.

Contracts—Essentials

Concept of free consent:

Consent shall be treated as free if not obtained by:

- Coercion
- Undue influence
- Fraud
- Misrepresentation