BNK601
Banking Laws & Practices
Short Notes-Final Term
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Consortium finance

Under consortium financing, several banks (or financial institutions) finance a single borrower with common appraisal, common documentation, joint supervision and follow-up exercises. It is a subsidiary bank owned by several different banks. Each owner bank has an equal share so that no bank is the majority shareholder. The owner banks are often in different countries. A consortium bank is created to finance a specific project; once the project is complete, the consortium bank dissolves itself. While they are not as common as they once were, they are useful when a project involves multiple currencies.

Hypothecation

Hypothecation is a legal transaction, whereby goods may be made available as security for a debt without transferring possession to the lender. Hypothecation is the practice where a borrower pledges collateral to secure a debt. The borrower retains ownership of the collateral, but it is "hypothetically" controlled by the creditor in that he has the right to seize possession if the borrower defaults.

Money market

Money Market is a financial market which deals in short term debt instruments. The money market is a component of the financial markets for assets involved in short-term borrowing and lending with original maturities of one year or shorter time frames.

Differentiation between blank and full endorsement

“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".

An endorsement may be made in blank or full. It may also be restrictive.

Kinds of Endorsement:
The endorsements are divided as under:
Blank or general
Full or special endorsement
Restrictive endorsement
Partial endorsement

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: Sec 16

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.

R14 Auto Loans

Auto Loans mean the loans to purchase the vehicle for personal use.
REGULATION R-14- Classifications:
The auto loans shall be classified and provided for in the following manner:
Classification: Substandard.
Determinant: where mark up interest or principle is overdue by 90 days or more from the due date.
Treatment of Income: 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.
Provisions to be made: Provision of 10% (25% from 31st December 2006) of the difference resulting from the outstanding balance of principal less the amount of liquid assets.

R-8-CLASSIFICATION AND PROVISIONING

The credit card advances shall be classified and provided for in the following manner:
Classification: Loss.
Principal is overdue by 180 days or more from the due date.

Determinant: Where mark-up / interest.

Treatment of Income: Unrealized mark-up / interest to be

Provisions to be made: Provision of 100% of the difference.

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.

Differentiation between Sight and Usance Letter of credit

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.

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.
Whereas Usance Letter of Credit (L/C) is a Letter of credit that calls for payment at a future date. It is generally within six months and requires a draft drawn on the issuing/paying bank for the amount of the invoice.

Endorsement

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".

Differentiation between liquidity risk & operational 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.

Where 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. Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events.

Advantages of letter of credit risk

Following are the advantages of LC:

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.

SME

Small and medium enterprises are companies whose headcount or turnover falls below certain limits. The companies are usually defined as an organization with fewer than 10 employees.

Powers of arbitrator

(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.

Attributes of good collateral

Collateral is considered to be good collateral if it possesses the following attributes.
1. Adequate
2. Readily en cashable realizable
3. Sufficient.

Bank

Bank means a banking company as defined in the Banking Companies Ordinance, 1962.

Borrower

Borrower means an individual to whom a bank / DFI has allowed any consumer financing during the course of business.

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.

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.

Why preferred bond is called hybrid security

Hybrid securities are a broad group of securities that combine the elements of the two broader groups of securities, debt and equity.

Preferred stock is a hybrid security because it combines features of common stocks and bonds. At the same time, it has several unique features that set it apart from both.