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OPEN BOOK EXAMINATION

Time allowed : 3 hours ***Maximum marks : 100***

Total number of questions : 6 ***Total number of printed pages : 8***

NOTE : *Answer* ***ALL*** *Questions.*

1. Case Study :

COMPLIANCE IN BANKS

A quick view of banking and finance sector would show that the sector has recorded substantial growth in the business, the number of products has exploded, the number of delivery points (Branch, ATM, Internet, Mobile, Business Correspondent/Business Facilitator) have increased manifold, the geographical and client outreach has multiplied and above all the number of risks have gone up as well. As a consequence, risks have increased. Technology has come to play an important role in all these including making compliance happen. This has resulted in spiralling up of compliance costs in recent years. But one should not be worried about the cost of compliance. A perusal of the RBI/SEBI/IRDA websites would also show that a number of banks and institutions have been levied regulatory penalties in recent years. This is the cost of non-compliance which is on the increase. Unlike the past where non-compliance was not much noticed, today, it may lead to stiff monetary fines, legal and regulatory sanctions. The media is more active today in reporting such events which could lead to a loss of reputation and may be loss of business as well. In the past regulators were perceived being soft on non-compliance. The significant increase in the size of the penalties announced by the regulators around the world in the recent years clearly shows that they shifting their stance and are getting tough as non-compliance could have serious implications for stability of financial sector as a whole. It is for this reason that the compliance function is very important.

Another reason why the compliance function is important is the increase in the risks faced by the banks. Banks have to manage risk. In their anxiety to manage risks, banks are known to have taken up hedge products which have proved harmful bringing the banking system to a halt. The regulator is however worried about the need to maintain financial stability. There is the issue of depositor protection. There is the worry that the banking sector may unwittingly use for terrorist funding and money laundering activities. All of these have resulted in regulations in the form of Capital Adequacy norms, IRAC norms, AML/KYC norms, disclosure norms, Customer Service Code etc. Banks will have to know for themselves as also tell the regulators that these norms are being adhered to. It is the compliance function which monitors these aspects and gives a feedback both to the regulator and the Board.

In this regard, the Compliance Function has to ensure strict observance on the following :

(*a*) That the bank has full knowledge of all relevant provisions contained in various legislations such as Banking Regulation Act and rules framed for the purpose in respect of Reserve Bank of India Act, Foreign Exchange Management Act, and Prevention of Money Laundering Act and that these norms have been factored in developing internal rules for doing the business of banking.

(*b*) Ensure observance of regulatory guidelines issued from time to time by RBI.

(*c*) Ensure adherence to standards and codes, fair practices code prescribed by BCSBI, IBA, FEDAI and FIMMDA etc.

(*d*) Ensure adherence to listing related guidelines issued by SEBI.

(*e*) Ensure observance to bank's internal policies.

The above mentioned legislation and guidelines are concerned not only with business matters but also focus on observing appropriate standards of market conduct, managing conflicts of interest, treating customers fairly, and ensuring the correctness of customer advice. These have implications for the structuring of banking products and/or selling and rendering financial counselling to the customer. Compliance is not strictly what is stated in the Acts and Guidelines. Compliance has to go beyond what is the legal minimum applicable to the bank and walk the extra mile towards achieving better minimum applicable to the bank and walk the extra mile towards achieving better standards of integrity and ethical conduct. Thus Governance has an important role in compliance. It is the management that has to set the standards of compliance by showing a willingness to comply and internalize compliance in the day to day business.

The Compliance Department at the Head Office of the Bank should play the central role in the area of identifying the level of compliance risk in each business line, products and processes and issue instruction to operational functionaries/formulate proposals for mitigation of such risk. It should periodically circulate the instances of compliance failures among staff along with preventive instructions.

An Annual Report on compliance failure/breaches should be complied and placed before the Board/ACB/Board Committee and circulated to all the functional heads. Non-compliance with any regulatory guidelines and administrative actions initiated against the bank and or corrective steps taken to avoid recurrence of the lapses should be disclosed in the annual report of the banks.

The code of conduct for employees should envisage working towards earning the trust of the society by dealing with customers in a fair manner and conducting business operations consistent with rules and regulations. Due weightage could be given to record of compliance during performance appraisal of staff at various levels. Staff accountability should be examined for all compliance failure.

In this backdrop, you are required to give answers in the context of prevailing banking practices and various RBI compliances to the following :

(*a*) Explain the difference between Early Warning Signals (EWS) and Red Flagged Accounts (RFA).

(*10 marks*)

(*b*) (*i*) What is meant by Central Fraud Registry (CFR) ?

(*ii*) M/s Super Great & Company, a partnership firm is maintaining a satisfactory Current Account for the last five years with PQR bank branch. An accountant of M/s Super Great & Company, who is the regular visitor to the branch, presents two cheques of ₹ 25,000/- each signed by a partner. The branch as a matter of routine paid the cheques. The firm, on reconciliation of their accounts, informs the branch that the accountant was removed a month back and the cheques which were paid by the bank were not signed by the partners. As such the firm demands that the debit entries be removed from the account. Give your decision on the case with reasons.

(*5+5 marks*)

(*c*) Explain briefly :

(*i*) The rationale behind the reporting the Frauds to Reserve Bank of India.

(*ii*) Reserve Bank of India guidelines of Reporting Bank Fraud to Police/CBI.

(*5+5 marks*)

(*d*) Explain the risk which arises out of the external factors like non-compliance of regulatory and legal framework in banks. Describe the different approaches as per BASEL II framework for estimating capital charge for this risk.

(*10 marks*)

(*e*) Explain the following terms relating to compliance in banks :

(*i*) Reputational Risk

(*ii*) Compliance Audit.

(*5+5 marks*)

2. (*a*) From the financial statements given below for AB Ltd., calculate the following ratios and give your comments as a loan processing officer of the bank :

(*i*) Current Ratio

(*ii*) Acid Test Ratio

(*iii*) Stock Turnover Ratio

(*iv*) Debt Equity Ratio

(*v*) Interest Coverage Ratio

Income statement of AB Ltd. for the year ending 31st March, 2019 :

	₹ in lakh	**₹ in lakh**
Sales		500
Cost of Goods Sold :		
Stock, 1st April, 2018	40	
Add : Purchase	245	
Direct Expenses	25	
	310	
Less : Stock, 31st March, 2019	60	250
Gross Profit		250
Operating Expenses	110	
Interest Expenses	20	130
Net profit before tax		120
Provision for Income tax		60
Net Profit		60

Balance Sheet of AB Ltd. as at 31st March, 2019

Liabilities	**₹ in Lakh**	**Assets**	**₹ in Lakh**
Equity Share Capital	150	Fixed Assets	400
Reserves and Surplus	300	Stock	60
10% Debentures	200	Debtors	230
Creditors	180	Cash at Bank	155
Bills Payables	70	Bills Receivable	43
		Prepaid Expenses	12
Total	**900**	**Total**	**900**

(*20 marks*)

(*b*) On 31st March, 2019, North Indian Bank Ltd. finds its non-performing advances classified as follows :

	₹ in '000
Sub-standard Assets (Secured)	46400
Doubtful Assets : Upto one year (Secured)	12830
Doubtful Assets : one year to three (Secured)	7820
Doubtful Assets : Above three years (Secured)	3290
Loss Assets	5175

Calculate the following as on 31st March, 2019 :

(*i*) The amount of provision to be made against the advances.

(*ii*) Provision Coverage Ratio (PCR).

(*5+5 marks*)

3. Explain in brief the following :

(*a*) Reverse Mortgage (RM) is specially designed by the banks for certain category of the customers.

(*b*) Marginal Cost of Funds Based Lending Rate (MCLR).

(*3+2 marks*)

4. Give your decision on the following cases with reasons :

(*a*) Mr. Agassi is a trustee for M/s Nadal with a substantive balance in a Bank. The Branch Manager of the Bank asks Mr. Agassi to repay the overdraft granted to him in his personal account. He gives a cheque for the amount from his Trust Account to him. What should the Branch Manager do ?

(*b*) Mr. Pyarelal a Saving Bank Account holder of a branch had given a mandate to the branch to credit proceeds of Dividend/Interest warrants as and when received from companies. These instructions were being carried out regularly by the branch. Mr. Pyarelal suddenly passed away last month and after his death the branch received a dividend warrant for ₹ 2,000 for credit to his account. What should the Branch Manager do ?

(*3+2 marks*)

5. Briefly Differentiate between :

(*a*) Data Warehouse and Data Mining

(*b*) Business Continuity Plan (BCP) and Disaster Recovery Management Plan (DRMP).

(*2+3 marks*)

6. Write short notes on the following :

(*a*) Capital Conservation Buffer

(*b*) Countercyclical Buffer

(*c*) Net Stable Fund Ratio (NSFR).

(*1+2+2 marks*)

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