annual report 2006

Banking Mohtasib Pakistan بینکنگ محتسب پاکستان

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A complaint was lodged with us May 2006.

Whilst examining the case, we noted that the ex-officer, when confronted by the bank's fraud unit, had actually admitted his guilt. The bank was told by us that it could not be absolved of its liability because in handing over the credit card to an authorized officer of the bank, the customer had acted in good faith and expected the bank to follow the correct procedure for card cancellation and destruction.

The bank was clearly responsible for the fraudulent transactions conducted by its staff member and was therefore asked to bear the entire billing made to the customer.

In June 2006 i.e. within a month from the date the case was reported to us, the issue was resolved and the bank absorbed the entire accumulated liability of Rs. 295,753/-.

abridged version

Contents

Note from the Banking Mohtasib Pakistan

The Banking Mohtasib function was introduced in Pakistan on May 2, 2005.

This abridged copy of our second Annual Report covers our activities during the year ended December 31, 2006. The Report was submitted to the Governor, State Bank of Pakistan on March 15, 2007 in terms of Section 82G Chapter IV A of the Banking Companies Ordinance 1962 (BCO).

This copy is abridged to the extent that it respects the confidentiality associated with bank and customer relationships.

During the last few years, through a well defined road map aimed at creating a robust and buoyant financial sector, the government has undertaken a process of privatization, deregulation, streamlining of the tax structure, and has introduced effective recovery and cheque dishonor laws. These steps have had the desired impact on the industry with the banking sector responding positively and recording phenomenal growth, both in products and profitability.

The robust environment thus created, coupled with a large untapped consumer market, has encouraged large global financial institutions to explore wider opportunities within the country and the year saw a major bank acquisition, worth almost USD 500 million, by a prominent UK bank. A major Saudi financial institution has also recently acquired a private bank within the country.

A leading European financial institution and a highly reputable Far Eastern investment house are reportedly conducting due diligence at two private banks within the country. Finding the market attractive, other overseas investors, as well as prominent local business houses, are also reportedly exploring investment and acquisition opportunities in Pakistan's banking sector.

The remarkable growth in the banking sector has come largely through a sharper focus on consumer products. During the last 4 years, loans under Rs. 500,000/- increased by over 140% and the number of small borrowers, by over 100%. The relatively recent shift towards consumer business has resulted in a significant diversification of scheduled banks' balance sheets, with small borrowers now constituting 15% of scheduled bank advances.

Similarly, according to market estimates, nearly 2 million credit cards are currently on issue compared with around 500,000 during 2002. Auto loans have also witnessed a significant rise. It is estimated that an excess of 1 million auto loans appear in the books of scheduled banks in the country, as against a figure of around 300,000 during 2002.

In order to capture market share, banks have enticed consumers through aggressive marketing and attractively packaged products, but lacking in product knowledge, consumers are unable to make informed decisions and are seen to be facing difficulties and in many cases, financial hardship. Sadly, consumer education initiatives are seen to be lacking within the industry.

In order to educate consumers, the State Bank of Pakistan has repeatedly asked banks to ensure advertisement transparency and has instructed banks to prominently display lending and deposit rates on all consumer products as well as posting the information on their websites. In addition, banks have been asked to advise their customers of the intricacies of ATM, ATM Cards, Debit Cards and Credit Cards.

Currently, almost all consumer loans are on the basis of variable mark up rates. The recent surge in rates has severely affected consumers' loan servicing capability, which, in some cases, has led to loan default.

In order for small borrowers to be aware of their future financial liability, a long term debt market needs to be developed so that banks can access term funding and introduce fixed rate loan products.

During our investigations, we have come across some procedural and systemic weaknesses and the report includes recommendations for the State Bank of Pakistan to consider and issue necessary directives to banks so that areas of dissent between banks and their customers can be minimized in the future.

Azhar Hamid
March 2007

Core Values

We function as a closely-knit team and take collective responsibility for individual decision-making. We have full ownership of our Core Values and firmly believe that by living these values, both in our professional and personal lives, we can make a difference.

Responsive

We receive a large number of disputes daily. We will use a practical and rational approach to find fair and amicable outcomes in a manner that is informal and speedy.

Compassionate

Disputes, howsoever petty, cause unnecessary pain and stress. We will analyze each dispute with an open mind and if necessary listen to parties concerned, patiently and sympathetically, so as to find a practical and equitable solution.

Flexible

We believe that most disputes can be resolved in a friendly and amicable manner. We will not allow rigidity to dictate the dispute resolution process. Instead, we will endeavor to create an environment where all concerned are encouraged to be reasonable and conciliatory.

Trustworthy

We will treat all those we meet with respect, courtesy and compassion because only by doing so will we gain their confidence and trust.

Transparent

We are neither consumer champions nor advocates. Neutrality and openness will underpin our deliberations. Our service is free of charge. We will respect confidentiality in all disputes and will institute a process of conciliation that is acceptable to both parties. Decisions, whenever taken by us, will be consistent, clear and balanced so that any rational mind can appreciate the reasoning behind our findings.

Scope of financial sector Ombudsman Schemes

The Ombudsman's role in the financial services industry is to resolve disputes through a process which is largely conciliatory and, where mediation is unsuccessful, to pass a reasoned order for the settlement of a dispute.

Financial services ombudsmen schemes worldwide have had a salutary influence on the financial system, where banks have become increasingly conscious of their responsibilities as service providers, and on the need to satisfy and meet customer demands professionally and efficiently. Indeed in some countries banks have appointed their own ombudsmen, independent of management.

Ombudsman's scope and jurisdiction varies across countries. The majority of schemes cater to individuals and small businesses. The Greek banking ombudsman, for example, is established within the private sector and accepts complaints from non-legal entities, i.e. individuals only.

Along with the UK, the Australian scheme is considered an industry benchmark. Both cater to small businesses and individuals. The Australian scheme has an award limit of AUD 250,000 and the UK scheme, GBP 100,000.

Banking Mohtasib (Ombudsman) in Pakistan and the banking environment

The enabling law for the establishment of the Banking Mohtasib Pakistan (BMP) was enacted on May 5, 1997 through Chapter IV A in the BCO. However, a Banking Mohtasib was not appointed at the time.

Meanwhile market size and potential, privatization, the process of liberalization and streamlining of the tax structure has encouraged banks to rapidly expand products and services, primarily consumer oriented. The robust environment thus created, has encouraged large global financial institutions to explore wider opportunities in the country and the year saw fresh banking licenses to two regional Islamic banks and a major bank acquisition, worth almost USD 500 million, by a large UK based bank which provided critical mass to its existing prominent operations within the country. A major Saudi financial institution has also recently acquired a private bank within the country.

A major European financial institution and a leading Far Eastern investment house are reportedly conducting due diligence at two private banks within the country. Finding the market attractive, other overseas investors as well as prominent local business houses are also reportedly exploring investment and acquisition opportunities in Pakistan's banking sector.

The paradigm shift in the financial services sector has not only encouraged healthy competition within banks, it has resulted in substantial growth in consumer banking activities with banks frequently launching new and innovative products which are marketed aggressively and packaged attractively. For consumers, the "buy now - pay later" syndrome promises better quality of life and even though exact cost and allied charges are not always transparent in bank advertising, the lure is far too strong to resist.

In order to educate consumers and allow them to make informed decisions, SBP has repeatedly asked banks to ensure advertisement transparency, and indeed in July 2006 SBP instructed banks to prominently display their lending and deposit rates on all consumer products as well as posting the information on their websites. In addition, banks have been asked to inform their customers of the intricacies of ATM, ATM Cards, Credit Cards and obligations of cardholders.

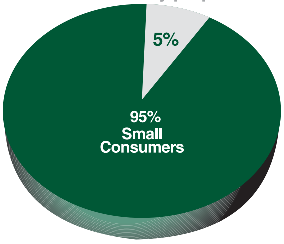
Regulatory intervention for increased transparency and consumer awareness became necessary following recent noticeable increase in small consumer loans default rate and customer complaints attributed to misleading product information provided at sale stage.

The table below illustrates the quantum of small loans and number of borrowers of scheduled banks in Pakistan:

	As at June 2005	As at June 2006
Advances below Rs. 500,000	Rs.313 billion	Rs. 368 billion
Number of borrowers	4,012,299	4,545,000

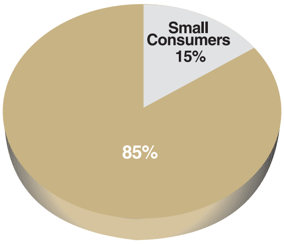
During the year to June 2006, consumer loans grew by 18% with a 14% increase in the number of small borrowers. To capture the true impact of the "consumer boom" in recent times, it is noteworthy that between January 2002 and June 2006 consumer loans witnessed a sharp increase of 140% to Rs. 368 billion with more than 100% increase in the number of small borrowers.

Borrowers by proportion



95% of total borrowers are small consumers

Loans by proportion



and the utilize 15% of total loans

The illustration shows that 95% of scheduled bank borrowers are small borrowers with loans below Rs. 500,000/-. These borrowers consume 15% of scheduled bank total advances.

The relatively recent focus towards consumer products and growth within the industry has necessitated large scale automation within banks in order to meet growing business needs, facilitate volume processing and handle competing challenges.

The increasing volume of associated complaints received at SBP, together with the Government's strong desire to provide customers with an independent, free, impartial and expeditious complaints resolution mechanism, resulted in the appointment of the Banking Mohtasib in August 2004.

The Banking Mohtasib function opened its doors to the public on May 2, 2005. The Secretariat is located at Shaheen Complex, M. R. Kiyani Road Karachi. Regional offices in Lahore, Peshawar and Quetta are situated within SBP premises. An office has also been established in Rawalpindi within SBP premises.

Total staff strength currently is 29. Page 23 shows the team of advisors with their brief resumé.

Case study

During 1997, a customer placed Rs. 100,000/-, free of any return, in the Prime Minister's National Debt Retirement Fund with the Rawalpindi branch of a major local bank.

In March 1999, the Government decided to refund the money to all depositors and appropriate instructions were issued to all the banks by the State Bank of Pakistan.

The customer approached the bank for refund, but could not produce the deposit receipt as it had been misplaced. The saga thereafter continued for the next 7 years, during which period the customer was made to execute indemnities twice but to no avail.

The matter was reported to us in June 2006.

Our investigations revealed that the said branch was unaware of the refund process and as such had taken little action in resolving the issue. We then provided the bank with the relevant SBP circulars and asked it to attend to the matter expeditiously.

The bank acted swiftly and the customer received the refund thus bringing to a satisfactory conclusion a matter which had lingered on for more than 7 years.

Jurisdiction and exclusions

In relation to all scheduled banks operating in Pakistan, Banking Mohtasib has been empowered to entertain all complaints relating to banking services and products.

Banking Mohtasib has been given adequate powers to call for such information as would be relevant for the disposal of complaints provided legal banking confidentiality is maintained.

However, Banking Mohtasib does not have the power to direct banks to grant loans and advances.

Banking Mohtasib has no jurisdiction to consider complaints against a bank's loan mark-up policies, risk policies or product and service pricing if included in schedule of charges and any other policy matter.

Any matter which is sub-judice or has been decided upon by a court of law or other legal forum is outside the purview of Banking Mohtasib.

Grievances of bank employees or ex employees pertaining to their terms and conditions of service fall out with the jurisdiction of the Banking Mohtasib.

Amendments required to the law

The law enacting the Banking Mohtasib requires changes to accurately record jurisdiction and responsibilities of the Banking Mohtasib. A set of proposed amendments to remove deficiencies has been forwarded to the Banking Laws Review Commission.

Advertising and Publicity

Complaint Forms, FAQ Leaflets and posters titled "Banking Mohtasib and You" both in English and Urdu, were sent to branches of all scheduled banks during 2005 for display within banking halls. A fresh stock of Complaint Forms and FAQ leaflets is now being sent to all banks for the convenience of customers. However, it has been reported that not all branches display the posters prominently as required and Complaint Forms are not readily made available to customers upon demand

Banks have been reminded that in the complaints resolution process, customer facilitation must receive high priority at all times.

In order to create awareness, a publicity campaign was undertaken late in the year which drew positive public response. As a follow up, we shall publicize through the print media, the complaints filing process for the benefit of the public.

Several electronic media channels have run special interviews with the Banking Mohtasib.

Significant judgments passed by the Banking Mohtasib which may be of benefit to the public, are published in the print media regularly.

At the request of some banks, presentations were made to senior executives across Pakistan. Presentations were also made to a few trade associations upon request.

Banking Mohtasib website (www.bankingmohtasib.gov.pk) was upgraded during the year, is now more user friendly and incorporates annual reports and case studies of significant decisions.

Administrative Expenses

Administrative expenses incurred during the year were Rs. 32,065,262/- which compare with Rs.29,413,910/- expended for the 8 months to December 2005. All expenses are charged proportionately to banks. Apart from depreciation, rent and salaries, major items of expenditure were:

Rs. 1,585,125/- - advertising and publicity
Rs. 1,444,632/- - travel, car rental, hotel
Rs. 1,370,757/- - utilities
Rs. 723,593/- - telephone and internet
Rs. 669,248/- - security and janitorial services

Complaints brought forward from the previous year

As at December 31, 2005, unresolved complaints totaled 215. During the year under review, these 215 complaints were disposed of as under:

Outstanding 31-12-2005	Rejected	Declined	Granted	Outstanding 31-12-2006
215	18	71	90	36

Most of the outstanding complaints relate to an internal banking fraud scam involving a number of customers at the branch. These are still being investigated by us but resolution has been delayed because the cases are also being probed by other criminal investigation agencies.

Complaint related activities during the year

There are 39 scheduled banks in Pakistan with 7297 branches throughout the country. We receive two types of complaints:

a) Informal i.e. walk in, email, copies of letters or via telephone and
b) Formal written complaints after failure by banks to resolve underlying issues amicably.

Upon receipt of informal complaints, procedural guidance is provided to complainants and where warranted, banks are informally asked to resolve the issue. No correspondence ensues between banks and the Banking Mohtasib in such cases. During the year almost 900 informal complaints were received and suitably addressed.

Formal complaints received during the period were 1005 averaging 84 per month reflecting a 12% increase over the monthly average of 75 during 2005, the first year of operation.

As mentioned in the Annual Report 2005, formal complaints traffic was considered well below initial estimates. The estimate was based on complaints received at SBP and Wafaqi and Provincial Mohtasib offices. Subsequent analysis revealed that the earlier estimate included not only complaints addressed to the State Bank of Pakistan and other Mohtasibs, it also included complaints addressed to banks and copies endorsed to SBP.

The law allows us to entertain only those complaints which are addressed to us directly and made under oath. Therefore all complaints addressed to banks with copies endorsed to us, are disregarded and such complainants advised to put banks on notice to the effect that the matter will be formally taken up with the Banking Mohtasib if not resolved within the legally stipulated three month period.

It has also been noticed that the mandatory three months notice to banks by complainants has often resulted in the resolution of many disputes within the stipulated time frame.

On reflection therefore, the existing level of complaints being received is considered a fair reflection of those unresolved complaints which have been contested by banks.

The following chart tabulates bank-wise complaints received in descending order:

	Bank	Total	Rejected	Declined	Granted	Amount claimed	Amount granted	Compensation granted	Pending 31-12-2006
1	NBP	156	50	27	61	2,112,189	1,050,750	66,833	18
2	United Bank	143	27	16	34	1,769,728	1,097,356	28,892	66
3	Habib Bank	131	42	34	40	1,287,770	1,112,280	137,913	15
4	ZTBL	91	19	45	13	647,883	699,081	16,500	14
5	MCB Bank	67	18	15	18	7,722,824	7,138,853	236,794	16
6	Union Bank	62	11	9	15	625,047	447,686	120,218	27
7	Citibank	56	5	11	17	5,168,424	812,964	4,254,108	23
8	Allied Bank	50	8	9	21	1,016,894	646,894	18,428	12
9	SCB	49	6	16	9	459, 765	580,594	30,000	18
10	PPCB	48	6	5	33	2,759,350	2,655,791	165,683	4
11	Bank Alfalah	30	4	9	5	43,674	88,124	0	12
12	ABN AMRO	16	2	2	5	204,010	51,600	28,781	7
13	Askari	16	4	3	6	36,369	17,500	20,569	3
14	BOP	14	6	2	5	4,087,051	4,072,051	297,567	1
15	SME Bank	9	5	1	0	0	0	0	3
16	Mybank	8	4	1	3	5,403,715	5,694,047	206,384	0
17	Faysal Bank	5	2	2	0	0	0	0	1
18	Soneri Bank	5	3	0	0	0	0	0	2
19	Bank Al Habib	4	1	1	2	608,000	608,000	36,000	0
20	First Women	4	2	1	1	0	0	0	0
21	Prime Comm	4	1	1	0	0	0	0	2
22	IDBP	3	2	1	0	0	0	0	0
23	JS Bank	3	0	0	2	2,160,000	2,160,000	0	1
24	KASB Bank	3	2	0	0	0	0	0	1
25	PICIC Comm	3	2	1	0	0	0	0	0
26	Crescent	2	1	0	0	0	0	0	1
27	Atlas Bank	1	0	0	0	0	0	0	1
28	Habib Metro	1	1	0	0	0	0	0	0
29	Meezan Bank	1	0	1	0	0	0	0	0
30	NIB Bank	1	0	1	0	0	0	0	0
31	Saudi Pak	1	1	0	0	0	0	0	0
	Others	18	18	0	0	0	0	0	0
	Total	1005	253	214	290	35,652,928	29,033,571	5,664,670	248

No formal complaints were received against the following banks:

1	Al-Baraka Islamic Bank	6	Oman International Bank
2	Arif Habib Rupali Bank	7	Bank of Khyber
3	BankIslami Pakistan	8	Bank of Tokyo-Mitsubishi
4	Deutsche Bank	9	Hongkong and Shanghai
5	Dubai Islamic Bank		

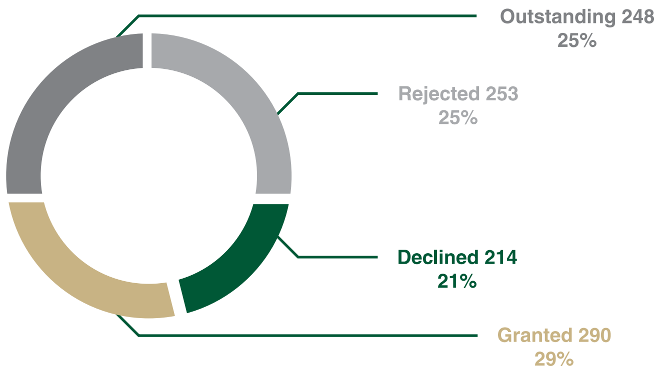
The earlier chart showing the number of complaints received against each bank could project an incorrect picture of bank efficiency; hence the following table which reflects the number of complaints received against each bank according to bank size in terms of its branches:

	Name of Bank	Complaints received	Branches	Complaints per branch
1	Citibank	56	14	4.00
2	ABN AMRO Bank	16	8	2.00
3	SME Bank Ltd.	9	7	1.29
4	Union Bank Ltd	62	53	1.17
5	Standard Chartered Bank	49	46	1.07
6	JS Bank (formerly American Express Bank)	3	4	0.75
7	Bank Alfalah Ltd.	30	97	0.31
8	The Punjab Provincial Co-operative Bank	48	158	0.30
9	Zarai Taraqiati Bank Ltd.	91	342	0.27
10	Atlas Bank Ltd.	1	4	0.25
11	Askari Commercial Bank Ltd.	16	75	0.21
12	Industrial Development Bank of Pakistan	3	19	0.16
13	Mybank	8	51	0.16
14	United Bank Ltd.	143	1056	0.14
15	KASB Bank	3	25	0.12
16	National Bank of Pakistan	156	1316	0.12
17	Crescent Commercial Bank	2	17	0.12
18	First Women Bank Ltd.	4	42	0.10
19	Faysal Bank	5	53	0.09
20	Soneri Bank	5	53	0.09
21	Habib Bank Ltd.	131	1457	0.09
22	NIB Bank	12	0.08	
23	Prime Commercial Bank	4	50	0.08
24	MCB Bank Ltd.	67	969	0.07
25	Allied Bank Ltd.	50	749	0.07
26	The Bank of Punjab	14	254	0.06
27	Bank Al-Habib Ltd.	4	75	0.05
28	Meezan Bank	1	23	0.04
29	PICIC Commercial Bank	3	101	0.03
30	Saudi Pak Commercial Bank	1	39	0.03
31	Habib Metropolitan Bank	1	68	0.01

Similar data was presented in our previous report, when some banks had suggested that this to may not project a fair reflection of their service quality because of the large number of consumer products e.g. credit cards, auto loans etc on their books. In the case of one bank, credit cards alone had an active portfolio of almost 270,000 cards. In the case of another bank, active auto loans exceeded 52,800. The banks contended that a better measure of efficiency would be for complaints received to be measured against the number of customers at each bank.

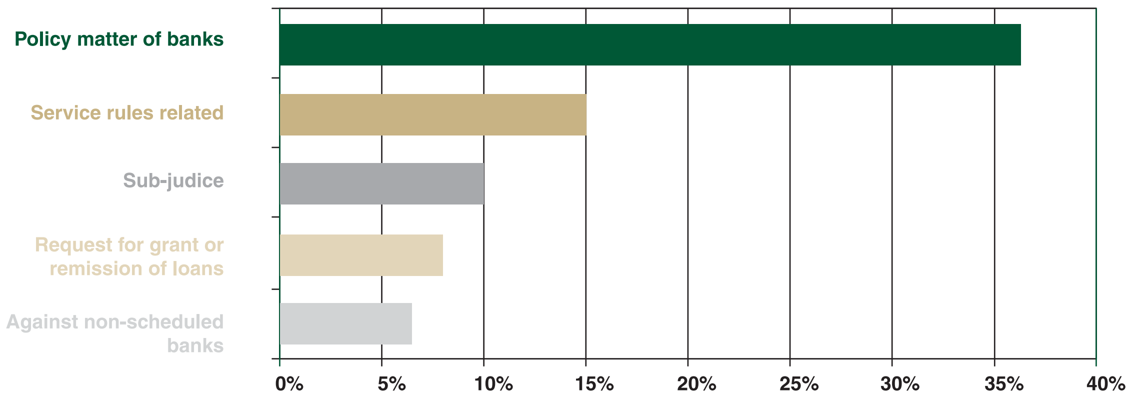
Whilst this argument holds some weight, it does not take into account the sizeable number of utility bills accepted by some banks which puts pressure on those banks and also generates complaints against them. Thus, how best to present complaints data is an endless debate. We expect readers to keep the foregoing in mind when making comparisons.

The diagram below shows the disposal status of the 1005 complaints during the period:



It will be noted that a quarter of the complaints were rejected outright which is consistent with initial estimates. Rejected complaints largely related to policy matters such as schedule of charges, loan markup rates and staff employment disputes, which we are not empowered by law to entertain.

The following chart illustrates the rejection pattern of complaints by major categories:



During the period, 290 or 29% of formal complaints received were decided in favour of the complainants, i.e. "granted". In handling complaints, our main objective is to facilitate resolution through an amicable process of reconciliation. It is noteworthy that during the enquiry phase, many a time banks make direct contact with complainants, resolve their grievances and obtain letters of satisfaction. This action serves the very purpose for which the Banking Mohtasib was established.

Where resolution is not forthcoming, the issue is analyzed and concerned bank presented with our findings and recommendations on how best to settle a dispute. In most cases banks accept our recommendations and the dispute is resolved. However, should banks disagree with our recommendations, they are provided an opportunity of a hearing in terms of Section 82D (3) of the BCO where after an appropriate formal order is passed.

The table below shows "granted" complaints in descending percentage order for banks against which 5 or more complaints were received during the year.

	Bank	Complaints received	Granted	% granted
1	Punjab Provincial Cooperative Bank	48	33	69%
2	Allied Bank of Pakistan	50	21	42%
3	National Bank of Pakistan	156	61	39%
4	Askari Commercial Bank	16	6	38%
5	Mybank	8	3	38%
6	The Bank of Punjab	14	5	36%
7	ABN AMRO Bank	16	5	31%
8	Habib Bank	131	40	31%
9	Citibank	56	17	30%
10	MCB Bank	67	18	27%
11	Union Bank	62	15	24%
12	United Bank	143	34	24%
13	Standard Chartered Bank	49	9	18%
14	Bank Alfalah	30	5	17%
15	Zarai Taraqiati Bank	91	13	14%

Case study

Mid 2005, a dissatisfied credit card holder personally handed over his credit card to an officer of the bank for cancellation. A receipt was obtained.

In September 2005, the customer received card invoice reflecting expenditure exceeding Rs. 200,000/- which was not incurred by him. The bank was approached but declined to refund the fraudulent transactions stating that the officer had since left its service and the card, although delivered by the customer to the officer, had not been cut in two pieces when it was handed over to the officer.

A complaint was lodged with us May 2006.

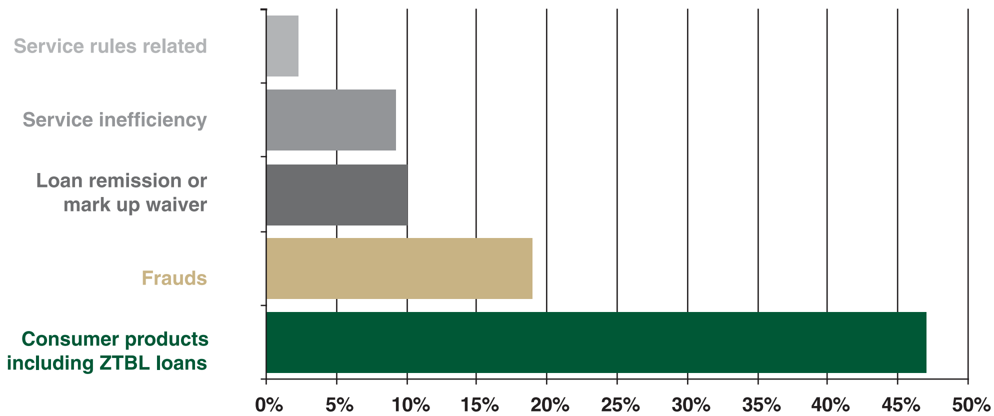
Whilst examining the case we noted that the ex-officer, when confronted by the bank's fraud unit, had actually admitted his guilt. The bank was told by us that it could not be absolved of its liability because in handing over the credit card to an authorized officer of the bank, the customer had acted in good faith and expected the bank to follow the correct procedure for card cancellation and destruction.

The bank was clearly responsible for the fraudulent transactions conducted by its staff member and was therefore asked to bear the entire billing made to the customer.

In June 2006 i.e. within a month from the date the case was reported to us, the issue was resolved and the bank absorbed the entire accumulated liability of Rs. 295,753/-.

Types of complaints received

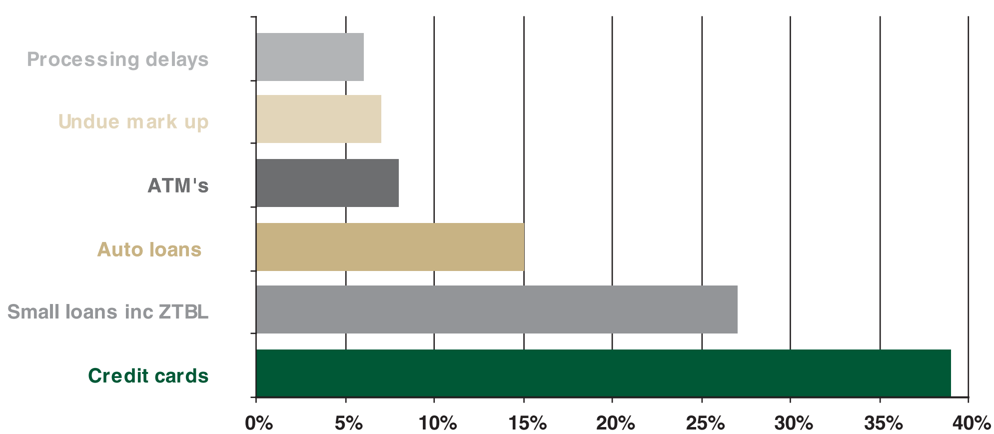
Complaints received during the period fall in the following broad categories;



As expected, nearly half of the complaints received related to consumer products. The next largest complaints category was "frauds" which included complaints relating to parallel banking frauds perpetrated by bank staff.

Complaints were also received relating to increased mark-up rates. Although serious in nature, these were rejected by us because complaints relating to increases in mark-up rates do not fall within our jurisdiction.

Consumer products complaints can be further broken down in the following major categories:



Credit card related complaints represented nearly 40% of complaints falling in the consumer products category.

Observations on service culture

In the previous report we had mentioned that many banks adopt an indifferent approach to the complaints resolution process. The stand usually taken is defensive in nature with little effort made to investigate the core issue.

During the year, we have observed some improvement with some banks more conscious of their obligations towards customer care. The fact that competitive edge in a service industry lies directly in customer satisfaction, one expects banks to be sharply focused on service quality initiatives, be more proactive in resolving client grievances and provide high standards of after sales service. Sadly, this does not appear to be the case across the board.

The following example underlines lack of responsiveness by a bank in dealing with customer problems:

In April 2004, a customer deposited a cheque for Australian Dollars 2215/- (equivalent to Rs. 105,000/-) in his account. The cheque was drawn on a bank in Australia.

However, proceeds of the cheque were not credited to the account and upon enquiry, the bank said that the cheque had been lost in transit and efforts to locate it were unsuccessful.

After complaint lodged with Banking Mohtasib in May 2006, the latest address of the issuer of the cheque was located and provided to the bank for further follow up but its efforts elicited no response from the issuer or the Australian bank.

With no result forthcoming locally, Banking Mohtasib sought assistance from Banking Ombudsman in Australia with the view of obtaining a duplicate cheque, at which point it transpired that the cheque had in fact been paid in June 2004.

Banking Mohtasib thereafter inspected the bank's Australian Dollar nostro account and found that the proceeds of the cheque, which the bank insisted had been lost, were actually received in June 2004 and were shown as an outstanding item. Despite many complaints, including enquiries from the Banking Mohtasib, the bank had made no efforts whatsoever to trace the item in its records.

It was only when the Banking Mohtasib examined Bank's records that the amount was located.

Rs. 105,000/- was finally paid to the harassed customer on January 23, 2007 after nearly 3 years. A further amount of Rs. 25,000/- was also paid as compensation for needless distress suffered by the customer purely due to the bank's negligence.

Service quality can only be institutionalized through a major culture change within an organization; pockets of service excellence will not answer this call. However, increased competitiveness within the industry and higher customer awareness now appears to be forcing banks to prioritize action in this respect.

Analysis of systemic issues and recommendations

During investigation of complaints we occasionally come across systemic deficiencies and control weaknesses within banks. Such weaknesses are brought to the attention of senior bank management. For issues of a serious nature, a report is submitted to SBP for such action as it may consider appropriate.

Based on an analysis of the types of complaints received, both formal and informal, the following section of the Report records some systemic weaknesses and poor banking practices which have given rise to disputes between banks and their customers and if not addressed, could result in serious issues in the future.

Regulatory intervention, as SBP may consider appropriate, is recommended.

Recommendation

Debt collection and vehicle repossession

It is common practice for banks to outsource debt collection of their delinquent consumer loans and vehicle repossession post auto loan default. Recovery is commission based and debt collection agencies often use crude and ruthless recovery tactics.

Instances of forced entry in to houses and work places, use of foul and threatening language etc. have been reported in the media. Cases have also come to light where innocent people have been accosted and maltreated as well as cases where borrowers with up-to-date payment record have been needlessly harassed.

With a rapidly growing consumer asset base and associated delinquencies, such unrestrained action by debt collectors are on the rise.

In most countries, debt collection and recovery is controlled and regulated by law. In the US, the "Fair Debt Collection Practices Act" was incorporated in the "Consumer Credit Protection Act" in 1977 to prohibit abusive practices by debt collectors, such as invasion of individual privacy and lays down detailed procedures on how debt collectors can go about the recovery process.

Some banks in Pakistan have developed guidelines applicable to debt collection but these are not strictly followed by external recovery agencies engaged for the purpose.

To protect consumers from abuse by debt collectors, we strongly feel that debt collection needs to be regulated and suggest that Pakistan Banks Association be asked by SBP to draft a suitable set of instructions for compliance by external debt collection agencies. SBP can then make the instructions mandatory for all banks to follow.

It should be the responsibility of independent Compliance Units within each bank to ensure enforcement by collection agencies of instructions so issued.

Recommendation
Account closure without notice

Complaints have been received by us where banks have unilaterally closed accounts with NIL or nominal balances without any prior notice to account holders.

It is acknowledged that banks may terminate a relationship should they so desire, but account closure without adequate notice is considered decidedly unlawful and it can cause undue inconvenience or hardship to customers.

It is recommended that suitable instructions be issued requiring banks to give reasonable notice to customers whose accounts they wish to close.

Recommendation
Drop boxes

To facilitate round the clock credit card and loan repayment facility, most banks have introduced "Drop Boxes" located at branches and other convenient locations e.g. restaurants, petrol stations, courier companies etc.

Whilst this initiative offers substantial convenience to customers, numerous complaints concerning non-receipt or delayed realization by banks of cheques deposited in drop boxes have been received. Affected customers are charged mark-up due to non-payment and subsequent invoices include late payment charges. Banks, however, invariably deny negligence claiming instead that robust procedures are in place to retrieve cheques deposited in drop boxes.

Ironically, in order to promote the "Drop Box" facility, banks usually discourage cash payments through the levy of a cash payment charge. Because of the many complaints received relating to cheques deposited in "Drop Boxes" having gone astray, it is recommended that banks be asked to abolish cash payment charges for payment of credit card bills or loan repayment, thus allowing consumers the option to pay cash without incurring additional expense.

Case study

In 1983, a customer booked a locker at a Lahore branch of a major local bank. In August 2005, a few lockers at the branch, including the customer's locker, were broken in to by a guard of the security company engaged by the bank and the contents were stolen.

Customer claimed that the value of the contents of his locker was Rs. 2,182,072/- and asked the bank to make good the loss.

The bank refused to entertain the claim on the grounds that it had contracted out lockers security to a security company and it was up to the security company to make good the losses suffered by locker holders. The Customer thereafter lodged a complaint with the Banking Mohtasib in October 2005.

Until 2004, banks offering locker services did not assume any responsibility for losses suffered by locker holders; the reason was that banks were unaware of locker contents.

Case study ... Continued

However given the growing incidence of locker pilferage and refusal by banks to compensate affected locker holders, SBP in 2004 directed all banks providing locker services to arrange insurance coverage, based on locker size, in the future. SBP also directed banks to ensure that all new and existing locker holders are advised the amounts up to which their lockers were insured.

The bank acted swiftly on SBP's instructions and widely publicized its locker service through brochures and colorful leaflets announcing the security its lockers provided to customers and clearly indicated the insured value applicable to various sizes of lockers available with it.

Upon being questioned, the bank took the plea that lockers were guarded by an external security company and that the security company was responsible for the loss. The bank also pleaded that it could not obtain insurance over its lockers and had therefore withdrawn its brochures at a subsequent date. Asked if locker holders were advised of this development, the bank said that they were not.

The Banking Mohtasib felt that the loss suffered by the customer was the direct result of negligence of the bank for inadequate security arrangements of its lockers which led to the posting of a guard whose antecedents were either fake or unknown.

The argument that the bank can not be asked to compensate the customer because the security company had not paid the bank's claim, was also not tenable. The Banking Mohtasib felt that a customer has no concern whatsoever with the arrangements made by banks for the security of their lockers; the customer only has a right to expect that such arrangements will be prudent and adequate. The bank in question chose to contract out its locker security to a third party and could not be allowed to walk away from its responsibility, leaving the customer to pursue the security agency.

Importantly, the customer was made aware through the bank's promotional material, that all its lockers were insured against loss.

The Banking Mohtasib also noted that under SBP directives, any loss sustained by a locker holder shall be made good by banks immediately, and banks would pursue their claims with the insurers thereafter. The bank's refusal to meet the customer's claim was therefore in clear violation of SBP's directives.

The locker holder had claimed that the value of articles stolen from the locker amounted to Rs. 2,182,072/-. Given the nature of the business of safe deposit lockers, it is not possible for any one to prove or disprove the figure. For this reason SBP had left it to the banks to determine the amount of insurance each of them may choose to offer their customers based on locker size. The bank had chosen to offer Rs. 1 million for a small locker, Rs. 1.5 million for a medium sized locker, Rs. 2 million for a large sized locker and Rs. 3 million for an "extra large" size locker.

The customer's locker was medium sized; hence he was entitled to a maximum of Rs. 1.5 million for his loss.

The Banking Mohtasib therefore ordered the bank to pay Rs. 1.5 million to the customer and in addition to pay him Rs. 50,000/- as compensation for the delay in the settlement of the claim and for undergoing the stress of prosecuting the claim.

The money was paid in mid 2006.

Recommendation

Parallel banking fraud

This subject was covered in detail in the 2005 Annual Report and recommendations aimed at curtailing such activities at banks, were made for implementation if found appropriate by SBP.

During the year, more such incidents have come to light. That this activity continues is disturbing enough but what is more disturbing is that affected customers are invariably made to wait, for what could be extended periods of time, for refund of misappropriated funds pending investigation against accused bank officers by criminal investigating agencies.

It has been generally observed that banks, in the first place, decline liability on the pretext that funds misappropriated by their accused officers, related to personal transactions between the accused officers and customers. Banks also take the plea that official cash deposit receipts are issued by the accused officers simply as a guarantee for monies received by the accused officers in their personal capacity.

We consider such defence to be alarming because it tends to shatter public confidence in the banking system. Banks are vicariously liable for actions of its staff and if receipts have been issued on bank stationery, stamped and signed by an authorized officer, then banks are bound to honour such deposit receipts.

However, parallel banking by definition, also includes encashment of cheques outside the books of the bank by accused bank staff. Therefore claims made by customers need careful scrutiny in order to arrive at the exact loss to the claimants.

In order to safeguard the interests of the affected customers and to resolve their grievances, the following is recommended:

a) Immediately upon discovery of parallel banking activity at a branch, the bank should issue press advertisements on 7 consecutive days in 3 leading dailies in the area, alerting the public to the scam and inviting claims from affected customers within the next 30 days. However, customers failing to meet the deadline will not be debarred from filing claims at a later date, provided adequate reasons are given for late filing.

b) Within 3 days of discovery of the fraud, the branch should send account statements covering the 12 month period preceding the fraud, to all customers of the branch.

c) The bank must constitute a high level Committee to investigate the scam and to assess and verify each claim. The Committee must invite the claimant when examining a claim.

d) The Committee should finalize its report within a given time frame; say 3 months from the date the scam is discovered.

e) The bank concerned should pay all claims "approved" by the Committee within 3 days of the date of the Report.

f) Claims not approved by the Committee, will be advised to the claimants in writing within 3 days from the date of the Report. The letter will provide detailed reasons for the rejection of claims.

It is also noted that banks do not make any provisions in their books for claims made by their customers. It is recommended that banks be instructed to make immediate provisions against all claims received by them where branch officer/officers have been implicated in parallel banking frauds.

Case study

During 2004, a large foreign bank aggressively marketed for Term Deposits. It also waived penalties if premature encashment was desired. As a result of the campaign, many customers placed sizeable funds on 5 year Term Deposits with the bank. However, during 2005 when some of the depositors wanted to prematurely encash their deposits, they were threatened with substantial early encashment penalties.

The bank defended the penalty by saying that it was empowered through its "Account Terms and Conditions" to alter any condition unilaterally at any time it chose. The bank claimed that even though the new penalty was included in its Schedule of Charges dated January 1, 2005, penalties were not invoked until July 1, 2005.

Banking Mohtasib accepted the rights of a bank to change its terms and conditions but noted that such change can only have prospective effect. For such change to have retrospective effect, implied consent of the customer was essential.

Banking Mohtasib felt that insertion of a new penalty clause in the Schedule of Charges was an unsatisfactory medium of publicizing a major contractual deviation because customers can not be reasonably expected to minutely study the detailed contents of the Schedule of Charges booklet to uncover unilateral change to an earlier contract.

Banking Mohtasib felt that the bank should have written to all term deposit customers offering them a reasonable period within which to exercise the option to early encash their term deposits as per the original contractual terms i.e. without the new penalty.

Banking Mohtasib felt that by not offering an exit option, the bank had clearly violated the sanctity of the contract which was based on soft conditions offered to lure depositors.

Six such complaints have been decided by the Banking Mohtasib. The bank was ordered to waive the penalties as well as to pay the six customers profit @ 3% p.a. over and above the originally contracted rate from the time premature encashment was demanded by the customers until the time payment was made to the six customers under the orders of the Banking Mohtasib.

The bank waived penalties totaling Rs. 7,153,096/- and paid additional profit of Rs. 596,135/- to the customers.

Recommendation
Credit card fraud

Of considerable concern, is the increasing element of credit card fraud relating to lost or stolen cards. As per established market practice, card issuers do not admit any liability for transactions undertaken on lost or stolen credit cards prior to loss report by card holders. As soon as card loss is reported the card is "blocked" for further use in the credit card automated approval system.

However, the modus operandi adopted by fraudsters is to transact on the credit card immediately after it is stolen and before the card holder discovers the loss and reports to the issuing bank.

Our investigations invariably reveal that merchants, where fraudulent activity is conducted, never verify signatures on sales slips with those on the back of credit cards nor ask for any identity from purchasers. Indeed, video footage has revealed credit card misuse at point of sale by a male, whereas the credit card was issued to a woman. In the main, stolen cards are used at petrol stations and mobile phone shops.

Sadly, the finely printed credit card terms and conditions protect card issuers from such misuse with card holders having little or no recourse to loss recovery.

In our 2005 report, it was suggested that card issuers be asked to shift to Pin based credit cards which would greatly curtail card misuse. In subsequent meetings with Visa International we have been informed that issuance of Pin based credit cards is now mandatory in many countries and that compliance by card issuers in Pakistan is likely to become mandatory by end 2008.

In the interim, in order to provide some protection to credit card holders, we recommend that banks in the card acquiring business should make it incumbent upon merchants to:

a) compare purchaser's signatures on the sales slip with those on the credit card and

b) obtain positive identification each time a credit card is used at their outlet.

Recommendation
Unsolicited credit cards

Complaints received often relate to unsolicited pre-approved credit cards received by individuals. Such marketing tactics more often than not, are a source of inconvenience to unsuspecting individuals because, even when such unsolicited credit cards are not activated, banks invariably claim card issuance fee etc in the ensuing month unless the credit card is returned to the issuer. A few incidents have also come to light where issuing banks have failed to close the accounts so created, and bills continue to be received by the individual.

Credit cards are issued on the basis of a formal agreement, therefore by definition, the issuance of unsolicited credit cards lacking an underlying contract is violative of a basic relationship requirement. Moreover, the unwinding process causes needless inconvenience to individuals.

It is therefore recommended that banks be asked to desist from such practices and those wishing to promote the product, may only be permitted to send written offers to individuals and credit cards issued only after receipt of confirmation and execution of a formal agreement.

Case study

In August 1999, a customer obtained 3 year USD Bonds for USD 168,500/- from a bank in Lahore.

Soon after maturity, on September 20, 2002, the bank was asked to reinvest the matured Bonds for another three year period. The Bonds were reinvested on October 16, 2002, back dated to August 2002.

In February 2003, the bank paid profit of Rs. 162,667/- for the first six month period on the reinvested Bonds. The profit so paid was received from State Bank of Pakistan.

However, profit for the second six month period falling due on August 22, 2003 was not paid by the bank because the Bonds scheme had been abolished effective October 7, 2002 as clarified in SBP's circular dated November 8, 2003.

The matter was reported to us in October 2005. Our investigations revealed that whilst the Bonds had been discontinued, SBP's circular clearly allowed reinvestment of matured Bonds, if applications had been received by banks by October 7, 2002.

In this case the request for reinvestment of the matured Bonds was delivered to the bank on September 20, 2002 i.e. well before the cut off date of October 7, 2002 and the delay in reinvestment occurred because the bank's stock of fresh Bonds had exhausted at the time the reinvestment request was received by it.

The procedure for Bonds issuance issued by SBP clearly stated that authorized banks must maintain sufficient stocks of the Bonds so as not to inconvenience the public. The procedure also clearly stated that delivery by SBP against indents for fresh Bonds shall ordinarily be made on the same working day.

It was therefore quite clear the matured Bonds could not be reinvested within the cut off date because the bank had not replenished its exhausted stock of the Bonds. As a result the customer suffered financial loss. It was felt that had the bank acted diligently and professionally in following up its indent with SBP, reinvestment would have been possible well before the cut off date of October 7, 2002.

In the circumstances, the bank was found guilty of negligence and ordered to pay Rs.11,111,725/- to the customer being Rupee value of principal and interest payable on due dates calculated at exchange rates prevailing on the relevant due dates.

Thus, this acrimonious issue which had arisen 3 years earlier was resolved to the satisfaction of the customer within 3 months of being reported to our office.

Conclusion

During the last few years the banking sector has witnessed phenomenal growth propelled primarily by a multi-pronged reforms process, deregulation and privatization. Indeed, following privatization, the new managers have been responsible for transforming a sector known for its lethargy to one which is now highly competitive and agile.

The sector has achieved unprecedented profitability which coupled with the large untapped market, is being seen as an attractive investment option by both local and overseas investors.

Increased competitiveness has resulted in aggressive marketing of new and innovative consumer centric products which has created a "buyer's market" with a plethora of seemingly attractive options available to the public. However, lack of consumer education and inadequate product knowledge has been the cause of subsequent distress for some consumers.

In order to educate the market, State Bank of Pakistan has regularly issued guidelines to banks aimed towards raising consumer awareness and as a result, banks are now seen to be taking steps to explain product intricacies to potential customers.

An issue which has frequently been raised before us is the hardship faced by borrowers due to a rising rate environment. Based on the recent trend, rates have almost doubled in the last couple of years. Consumer loans be they auto, mortgage, personal etc. are predominantly variable rate loans and are thus subject to frequent rate revision.

There is thus a compelling case for banks to design fixed rate consumer asset products so that borrowers are aware of their future financial obligations and can plan accordingly. However for banks to be able to do so, they would need medium to long term funding access, currently almost non-existent.

In order to protect the rapidly growing consumer base from financial hardship, the government should address establishment of a long term debt market aimed at deepening the financial market's capacity so that fixed rate medium to long tenor assets can be introduced in the market.

The model that comes to mind is the Malaysian Cagamas model. Though primarily created to make mortgages more accessible and affordable, it has since added bank credit card liabilities to its product suite.