



# HEEDING NEW LEGAL SCENARIOS WHEN BOUNCING BACK

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## **Introduction**

When Mr. Buwanekabahu Perera, the immediate past president of the Association of Professional Bankers of Sri Lanka (APB) invited me to contribute an article to their publication to commemorate APB's Twenty First Convention to be held on 25<sup>th</sup> and 26<sup>th</sup> September 2009, I readily agreed for several reasons. From APB's inception, I have been a strong supporter of it. I have publicly and in many writings including my textbooks on Banking Law, applauded the Association's contributions to our country's financial and banking sector for the past over 20 years. Even while I was at Monash University Australia, I have travelled to Sri Lanka to speak and participate at its annual conventions. I wish the APB greater strength and success in future years. Indeed, sustainability is the name of the game and that is where this band of dedicated senior banking professionals who constitute the APB have done so well. The APB has also from time to time held excellent seminars and symposiums and also published some authoritative articles and statements on banking and credit. My most recent direct involvement with the APB's was the preparation and publication of a booklet on Customary Banking Practices.

Coming to APB's 21<sup>st</sup> Anniversary Convention, the theme of their last year's 20<sup>th</sup> Anniversary Convention was "*Managing Financial Institutions in Turbulent Times*". This year, the APB suggests that those Turbulent Times - which were global are now over or that those clouds are disappearing slowly but steadily. I sincerely hope this is so. Apart from the global economic recession that brought about Turbulent Times, a very dark and sad cloud that hung over Sri Lanka for the past over 25 years was the War of Terrorism waged unrelentingly by the LTTE which was successfully and finally uprooted by our government in July this year. The country can once again breathe freely. One can argue that there was an end of Turbulent Times for Sri Lanka by this single act alone. The resilience that our people acquired during the past 25 years of brutal terrorism is not only a fitting tribute to them but equipped them to face Turbulent Times.

This year the APB's Convention theme is "Bouncing back – Opportunities Unleashed". It is as if the APB planned both themes at the same time. Being financial experts, it appears they can read crystal balls better than others and make prophesies. In 2008, they experienced Turbulent Times, but as history records such times must end. So at one planning session in 2008 for its Convention that year, the APB must have said "let us have the theme "Turbulent Times in 2008" and let us call it "Bouncing Back" in 2009. The victory over the LTTE and the end of the war, was a huge added bonanza to that planning decision.



The theme “ Bouncing Back” – Opportunities Unleased” is excellent. As anyone will appreciate, it signifies many things—especially to the professionals in financial institutions. The only items that really bounce back in real life are yo-yos which are toys. Every yo-yo has a spool attached to a string, the end of which is held while the rest of the string is repeatedly spun out and then it automatically reels in.

The words “Opportunities Unleased “ is also apt. To the far-sighted professional or businessman, every problem, every obstacle, every mishap or every issue is but an opportunity. However, let those in the APB remember the well-known Proverb that “Opportunity Seldom Knocks Twice”. So seize it and make the best of it.

Now, I turn to the basic theme of my contribution. It is this. In the euphoria, eagerness and exhilaration of rolling up your sleeves and bouncing back, banking and financial professionals should take heed of the long arm of the law that has also developed during the past few years in Sri Lanka. The Law is not a respecter of persons or time. You cannot argue that because you are bankers working for the betterment or our economy, you should be treated differently. The law does not also go to sleep during turbulent times. The only exception is that in time of war, it is said the laws are silent. That only means that in time of war, the state or the government is not bound to act strictly according to law but can meet any emergency as it deems necessary. We Sri Lankans know this well because our parliament has been regularly extending what was popularly called “Emergency Regulations” for the past 25 years because of the terrorism referred to earlier.

Now I outline and discuss the recent legislative and judicial decisions and some worrying trends such as the increase in “white collar” criminal activity and credit card scams and even “bouncing” cheques that the management of banking and financial institutions should take note of as they Bounce Back.

#### **Recent Legislation of Importance to Financial Institutions.**

1. The Monetary Law (Amendment) Act No 32 Of 2002	7. Payment and Settlement Systems Act No 28 of 2005
2. Information and Communication Technology Act No 27 of 2003	8. Electronic Transactions Act No 19 of 2006
3. The Banking (Amendment) Act No 2 of 2005	9. Computer Crimes Act No 24 of 2007
4. Financial Transactions Reporting Act No. 6Of 2006	10. Companies Act No 7 of 2007
5. Prevention of Money Laundering Act No. 5 of 2006	11. Intellectual Property Act No 36 of 2003
6. Convention on the Suppression of TerroristFinancing Act No 25 of 2005	12. Consumer Affairs Authority Act No. 9 of 2003
	13. Payment Devices Frauds Act No. 30 of 2006



## **Monetary law and Banking Act Amendments**

Banks and financial institutions are well aware of the amendments introduced by the above Monetary Law Act of 2002 and the Banking Act of 2005. By the former the Central bank's focus was changed to "economic and price stability" and its "expertise and efficiency" was strengthened and a larger Monetary Board created. The legislation also saw to improving the Central Banks flexibility and effectiveness of monetary and exchange rate policy and improved its capability to manage the payments and settlements system.

The Banking Act amendments of 2005 were significant. The Central Bank got new powers to investigate banks, cancel banking licences, wider control of off-shore banking, mandatory publications of financial statements by the banking industry in newspapers, directors of banks', including the CEO's to be fit and proper persons, ensuring soundness of banking etc. Also significant was the new definition of "deposit" and the prohibition of pyramid schemes which were beginning to entrench themselves in the country. It was at that time alleged that some officers in banks were promoting such schemes .

## **A New Banking Act ?**

About the year 2005, a new comprehensive Banking Act was proposed to replace the existing Act enacted in 1988. The provisions of the new Act were also published in the Central Banks website and a few seminars held to discuss it at one or two of which the writer also participated. Its objective was to be an Act to replace the Banking Act, No 30 of 1988, consolidating and strengthening the provisions governing the licensing, regulation and supervision of commercial banks and specialized banks in line with best standards and practices recognized as such by the international community of banking supervisors, in order to support the economic development of Sri Lanka through a safe and sound banking system so as to promote public confidence in the banking system, to protect bank customers including depositors and to reduce financial crime, as well as to provide for connected matters. This statement is taken from its preamble. However, for some reasons, this objective has not been pursued and no meaningful steps have been taken to pass a new Banking Act. Perhaps other issues got higher priority.

## **Legislation relating to Money laundering, Terrorist financing and Financial Transactions Reporting**

The above three statutes should be read together. Some local bankers think that these statutory provisions were required to meet the LTTE terrorism and now that that menace has been defeated that this legislation is no longer of importance. This is not so because this legislation was not prompted because of the LTTE. It was a global response to curb money laundering from international drug trafficking and international terrorism which was activated by the 9/11 terrorist attacks on New York. The IMF, the World Bank and ADB etc also would not fund countries that did not have this legislation in their statute book.



Of the above three statutes, the most invasive to banks and financial institutions is the Financial Transactions Reporting Act of 2006 which also set up the Financial Intelligence Unit (FIU) at the Central bank. The Central Bank's Know Your Customer (KYC) rules are now embodied in this statute of which are bankers are fully aware. Compliance with this statute is imperative.

### **Legislation on Payments and Settlements, Information & Communication Technology, Electronic Transactions and Computer Crimes.**

In this writer's view the above statutes dealing with these subjects – which were long overdue in Sri Lanka - will have the most radical impact on our banking and financial institutions. In a well-known anecdote, at an international seminar in the mid 1980's, the CEO of a leading American bank had asked at a large gathering of the bank's staff, "what in your view, has been the most significant change that has occurred in your workplace". After some silence, one member of the staff had loudly said "it was the Air-conditioning of the building!". That is how some people perceive change

The computer, the internet, electronic transactions, will change the face of banking as never before and staff who cannot cope with this technology better find employment elsewhere. The Payments and Settlement legislation also enables Lanka Clear – our Cheque Clearing House – to clear images of cheques. This may necessitate even changes to the Summary Procedure Sections of our Civil Procedure Code where currently the actual cheque has to be annexed to the plaint.

Electronic Transaction legislation must be studied, section by section of the statute and to what extent contract law has been developed by it by the recognition of e-mails and digital signatures etc. The Computer Crimes Act will be a boon to financial institutions in preventing and prosecuting "hackers" and those who attempt to abuse the system. As a small example (which I relate to my banking law students at the PIM) in January 2008, a 28 year old joss stick manufacturer who was a customer of a suburban branch of State Bank had abused the Cheque Imaging and Transaction System (CITS) and misappropriated about Rs. 14 million. No doubt the fraud was discovered but all the money could not be recovered (see Island of 30<sup>th</sup> January 2008). What is important to remember is that technology and electronic aids have plusses and minusses. The minusses are risk factors.

### **“Bouncing” Cheques , Credit Cards Scams and “White Collar” Crime**

All the above three areas are connected because they are all based on criminal intention and activity. All three are also on the increase and hurting the banking and financial sector. If financial institutions want to now "bounce back", they themselves must do more to prevent and /or control such illegal activity. In late 2007 our Central Bank said that "more than Rs. 550 million worth of cheques are returned daily. (see Financial Times Sunday 21<sup>st</sup> October 2007) "One out of Ten cheques in Lanka Bounce" (Sunday Island 27<sup>th</sup> January 2008). Any prosecution need not be



under the Penal Code provisions for “cheating”; Surely, the Police are aware that Section 25 of the Debt Recovery (Special Provisions) Act No 2 of 1990 contains provisions to punish such offenders. But, why cannot the banks themselves put a stop to those who issue “bouncing” cheques. All they have to do is to cancel the bank account of such customers; This is what happens in many foreign countries. Nip it in the bud.

### **Credit Card Scams**

Similarly as regards “credit card scams”, today not a week passes without a news item about such scams. “Credit Card Scam Busted” said The Nation of 25<sup>th</sup> May 2009; Senior Police Officers on the Pay List of Credit Cards fraud Mastermind” said the Daily Mirror of 20<sup>th</sup> June 2008. “Lankan Forgers Linked to Card Scam in UK” said the Daily News of 11<sup>th</sup> January 2008. These are but examples. What this writer wishes to emphasise is that here also our law enforcement officers need not resort to Penal Code provisions to tackle this problem. Many of them may not be aware of the new Payment Devices Fraud Act No. 30 of 2006 which our Parliament brought into operation on 18<sup>th</sup> July 2006. This all-embracing legislation was mooted by our banks and in fact drafted “in -house” by our banking industry. It covers not only fraudulent credit cards, but all payment devices and includes new concepts like “traffic data”, “skimming” “fraudulent applications” and “fraudulent merchant applications”. In bouncing back, banks should create greater awareness of this legislation and its coverage.

### **“White Collar Crime”**

At a special Press Conference as reported in the Sunday Island of 9<sup>th</sup> August 2009, the Senior DIG (Crimes) stated that there is “ a phenomenal increase in white collar crimes in Sri Lanka” Many of the participants at this APB’s 21<sup>st</sup> Convention must be aware of how a senior executive of a leading foreign bank in Sri Lanka misappropriated over Rs. 100 million on the basis that he was, on behalf of the bank, buying and selling American dollars (Daily News 17<sup>th</sup> January 2008). Then, there was the case of the Senior Branch Manager of a private bank who had together with others misappropriated Rs. 77 million from the bank. (Island 29<sup>th</sup> January 2008).

More recently, the female Accountant of a leading private IT educational Institution forged the signature of the authorized signatories to over forty cheques over a period of sixteen months and misappropriated over Rs. 40 million. It was later found that she had also fabricated her Sri Jayawardenapura University degree certificate to get her employment. (Daily Mirror 6<sup>th</sup> August 2008). Another not so-well known case is where a female employee of a leading private bank who was in charge of safe deposit lockers had got duplicate keys of customers cut and pilfered cash and certificates of deposit from the safety boxes.

This white collar crime is not only continuing but increasing and the real number and the stolen amounts are not known because many institutions hide the incidents to avoid publicity. CEO’s of financial institutions should take heed of this trend while their institutions bounce back to more profits !.



## **‘Pramuka’, ‘Sakvithi’, ‘Danduwan’, ‘Golden Key’ Debacles**

Although today everyone talks about it and the newspapers continue to give front page or leading coverage to the “Golden Key” collapse which commenced in October 2008, one cannot forget the repercussions of the “Pramuka” failure in 2002 - where 14,000 small time depositors have not yet been settled. It is also regretted that the Central Bank has not yet – published a report as to why and how Pramuka failed. In this writer’s view this is a must. In any foreign country such a report would have been issued within an year or two of the collapse. The public are entitled to even a post-mortem report !.

After Pramuka came Sakvithi, where an unregulated finance company failed and the Sakvithi owner/CEO has fled abroad like the Pramuka boss. Then came Danduwan, also an unregulated finance company mainly operating in the south. The Danduwan saga has died down in the media at least – because the owner/CEO, Danduwan Mudalali was murdered a few months back !. While the court case relating to his murder is featured in the media, there is nothing very much about the loss of deposits.

Then came “Golden Key” – perhaps, the greatest crash (upto date) in Sri Lanka’s financial history for this first decade of the 22<sup>nd</sup> century. ‘Golden Key’ with a debt of about Rs. 26 billion has not more than eight thousand depositors – some well known names with large deposits. Though its “depositor base” is not large and non-rural based (and therefore not felt throughout the country) the cascading or “ripple effect” of its crash has reverberated through the entire “non – bank” financial sector of the island. People began to lose faith in finance companies and high interest paying deposit taking institutions. Even the regulated/supervised institutions were affected and for the first time senior management of Golden Key and some Ceylinco Companies including directors- found themselves in remand and at Welikada jail. Breaking all norms of company law, even a Board meeting was held in jail – no doubt authorized by a court. The “Golden Key” fallout which has not yet ended – was a “wake-up” call to the country’s financial institutions and should be carefully studied – not for what happened but why – by the country’s financial professionals in their eagerness “ to bounce back”.

## **Fundamental Rights Issues**

In the last one and half years there have been some momentous decisions handed down by our Supreme Court on breach of Fundamental Rights applications by individuals of which banks are fully aware of. These decisions would have been discussed more than once in the Board Rooms of our banks and financial institutions. Here reference is made to the John Keells / Lanka Marine Services case, the Waters Edge judgment. The Petroleum Corporation’s Hedging contract with several banks and most recently the de-privatization and the “judicial re-nationalization” of Sri Lanka Insurance Corporation. What is significant is that four to five years ago no one –not even lawyers would have dreamt that such judicial determinations were possible in the way they happened.



With the retirement of the former Chief Justice one may argue that this trend will not continue but one cannot be sure. Lawyers have now got the “feel” for this type of F.R. applications and one never knows for what cause they will be resorted to.

Though not in the same league as Fundamental Rights relief in the Supreme Court, the Financial Ombudsman scheme – now in its fifth year has become a great success. Such success can only continue if the banking industry and the finance and leasing companies support it further. It is regrettable that some finance and leasing companies are not members of the scheme. The Central Bank should issue a directive on this.

### **Risk Management and Banks**

Let me conclude this brief article by saying that every bank takes stringent and strategic steps to manage risk. Every bank’s annual report recognizes that “banking involves exposure to a multitude of risks and to avoid or reduce their impact, the risks must be identified at the earliest possible stage and effectively managed”. The “talked about” risks and how banks look upon them are broadly depicted below

<b>Risk</b>	<b>How Looked upon by Bank as to their Impact</b>
1. Credit Risk	High
2. Operational Risk	Moderate
3. Market Risk	Moderate
4. Liquidity Risk	Moderate
5. Legal Risk	Minimal
6. Reputation Risk	Minimal
7. Compliance Risk	Minimal

From a brief account of what this writer has set out in this article of the need to heed new legal scenarios and trends in our financial services landscape, it is pertinent to ask whether the “impact” attributed by banks to some the above risks should not be re-examined and a higher risk factor given to some risks currently marked as “minimal”.

