



# SUSTAINABILITY IN VOLATILITY: HOW BANKS SHOULD RESPOND WITH EMPHASIS ON LEGAL ISSUES

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## **1.0 Sustainability Statements in Banks' Annual Reports**

Firstly, the term “Sustainability” used in this theme is the dictionary term “to sustain”, to hold up under difficult circumstances (for example, volatile conditions) and “to withstand”. The term “volatility” here means “a sudden or rapid change”, an “unpredictable change, especially for the worse”. “Sustainability” as used here must also be differentiated from the “Sustainability Statements or Supplements” that all banks are now obliged to include in their Annual Reports. These Sustainability reports are based on the Global Reporting Initiative (GRI) by adhering to the United Nations Global Compact framework governing proper sustainable practices. In that context, Banks have to ensure that their enterprises are conducted in compliance with sustainable best practice.

Secondly, this contribution is on the local Sri Lankan scenario. I concede that today to achieve economic goals one must be realistic of the rapidly changing global issues and challenges (which some economists say is in unprecedented turmoil). However, I prefer to leave the global issues to other contributors to this issue.

## **2.0 Sri Lanka as the Wonder of Asia**

Thirdly, there is considerable talk especially by government politicians and state sector bureaucrats about our country's economic recovery and stability after a long ethnic conflict, and to make it the Wonder of Asia. The Government has ambitious plans of developing Sri Lanka as a naval, aviation, commercial, energy and knowledge hub. There is talk of achieving double-digit economic growth and inclusive development of halving poverty, containing inflation and unemployment, achieving a positive current account in the balance of payments and a realistic exchange rate, of reducing the budget deficit and the national debt and mobilizing foreign direct investment to meet the shortfall in domestic savings and to attract modern technology.

To achieve all this we need to create an investment friendly climate. An optimistic view is that, Sri Lanka is fortunate in being well endowed with natural and human resources, which if properly used by a joint effort of the private and public sector in partnership, the country can progress on a path of sustainable development.



### 3.0 Opening up of the North and East

In this writer's view a very significant factor for banking development in Sri Lanka are the opportunities afforded to the entire financial sector by post-conflict reconciliation and reconstruction in the North and East. After May 2009, the country witnessed the re-integration of the Northern and Eastern Provinces with the rest of the economy. "This has opened approximately *two-thirds of the nation's maritime and coastal resources* and *one third of the untapped fertile land* for productive use, and enabled an additional *fifteen percent* of the country's population to now fully participate in rejuvenated economic activity – earlier disrupted by the war". (Here I have quoted from a Message of a CEO of a leading bank to its Annual Report for 2010).

There are many key areas of the law that bankers should be on top of thus ensuring sustainability in their day to day operations. The Annual Report of each Bank highlights the several Risks that banks run as financial intermediaries – namely, Credit Risk, Market Risk, Foreign Exchange Risk, Liquidity Risk, Operational Risk, Regulatory Risk and Legal Risk.

### 4.0 Highlighting Legal Issues

The legal issues mainly fall under Operational Risk, Regulatory Risk and Legal Risk. Recently, I appeared in a case where a leading Commercial Bank had been lax in its practice in accepting Third Party cheques for deposit and collection. The Bank in question was successfully sued for negligence as a Collecting Bank by the cheque's true owner. The sum involved was over Rs. 12 million on one cheque !

The Operational Manuals also called Manuals of Procedure of some Sri Lankan (Domestic) banks are in need of updating and refinement.

There are some bankers who think that Banking Practice is the last word in banking and the Practices and Procedures adopted by the Bank supersede everything else. They argue if the bank employee has acted in conformity with what is stated in the Manual, then that is the end of the matter and a Court of Law should accept it. But that is not so. A banking practice must have judicial recognition. Without such recognition the practice will not prevail and settle a dispute.

Therefore, senior management or the Bank's Board of Directors should obtain a Compliance statement that the Bank's Manual of Operations has been updated in keeping with developments of the law – both Statute law and Case - law.

### 5.0 Need to Reform Banks' Security Documents

Another key area for Sustainability, is for Banks to seriously consider a reform of their lending/ security documents. These documents have never been scrutinised or modified from the time they were inherited by the British banks. In England, the crusade for Plain English in Legal Documentation won the day and now most financial institutions –including Banks have revamped



their lending and security documents using terms and words that borrowers/customers can understand. But, not so in Sri Lanka. Our Banks talk of Corporate Social Responsibility (CSR) and all that but why not start a project to redo their lending documents. Charity begins at home!

I have heard lawyers working in Bank's legal departments arguing that "we should not meddle or interfere with existing lending documents. The words and terms used in them are tried and tested terminology well interpreted by judicial decisions and if one is to amend or modify them, the Bank can get into trouble". If that argument is to be sustained there can be no reform in any area of life! There is nothing sacrosanct in Banks' lending documents. Judges have said that the terms used cannot be understood even by the Bank's own lawyers and some of these terms are legal gobbledegook. To add a sense of humour, let me remind readers of the well-known Australian case, where the Judge noted that the guarantee bond of the bank had a single sentence of 57 lines in length and was in incomprehensible legal "gobble-degook". It was so complex that the judge thought that neither the customers, nor the two bank officials who had been present when the customers signed it, had any real understanding of the nature and effect of the clause. Nor, it seems, did the bank's counsel who argued the case in court. The customers had also not read the document before signing it: see *Houlahan v ANZ Bank* (1992) 100 FLR 259. The term "gobble-degook" which the judge called the language used, means "English that cannot be understood".

Into the same basket of banking practice reform and a possible reform of lending documentation, we should include the need to have banking documents available in the vernacular - Sinhalese and Tamil - and not only in English. This may be costly but it is a Must. English documentation is hardly read and even when read is not understood. So customers/borrowers sign without appreciating the contents of the document and are caught up with the legal rule that "if you have signed, you are liable".

## **6.0 Banks' should Recognise Privileges of Guarantors**

Banker may be critical of this writer if he questions the uniform practice of all Sri Lankan banks to prepare their Bank Guarantee Documentation with express printed clauses which Renounce All the Common Law Benefits and Privileges given to Guarantors. In other words, every Lending Document signed by a Guarantor guaranteeing the Repayment of a debt by a Borrower contains a clause (normally at the tail end of the document) whereby the Guarantor expressly renounces the Rights conferred on him by Common law. After all, the Guarantor rarely benefits from the loan taken by the Borrower/Debtor. The common law recognized this fact and bestowed Privileges and Rights to guarantors but Sri Lankan banks, in their wisdom, get every guarantor to renounce these Rights. Is this fair? Is this Corporate Social Responsibility ! There has never been a debate on this point.



## 7.0 Unused Deposits and Dormant Accounts

Very recently on 21<sup>st</sup> July 2012 all the newspapers carried an interesting account where one of our leading commercial banks have informed court that monies deposited by one of its customers in October 1995 cannot be accounted for because all details relating to such monies and the account had been destroyed after the normal six year period. The customer/depositor had gone abroad and the claim for repayment had been made in February 2006. The Bank had also stated that the relevant branch manager and the other staff of that bank who could have known about this deposit in 1995 were no longer with the bank and their whereabouts unknown. The Judge, not satisfied with this explanation, had ordered the Chairman of the Bank and a responsible officer of its Legal Department to appear before Court (Daily Mirror newspaper of 21<sup>st</sup> July 2012)

The above incident where a Bank disclaims responsibility for monies deposited in it because of passage of time is also connected to the issue of *Dormant Account* also referred to as *Abandoned Property* of Customers. In 1988, the Banking Act required all Banks to declare the balances in their Dormant Accounts (that is, accounts not operated for over ten years). However, Banks did not conform, and the Central Bank had to take steps in mid-2000 to strictly enforce this requirement which should have occurred in 1998. Now, every year, the Dormant Account provision apply and we see newspaper notices of Banks giving information of their Dormant Accounts. This is more than Corporate Social Responsibility. It is a legal requirement.

## 8.0 Banks' Role in Preventing "Bouncing" Cheques by Customers

Mention of "Bouncing Cheques" and the role that Banks can play to minimize this trend is worth mentioning. In Dubai, for example, this writer is aware that if a person issues a cheque without funds in his account, he is picked up by the Police and kept in custody until the cheque is paid. Consequently, the habit is receding. In Sri Lanka, the Central Bank has reported that over Rs. 550 million worth of cheques were being returned daily. (Financial Times 21 October 2007).

To issue a cheque without funds is a criminal offence. However, the best cure or prevention is for Banks to insist that if its customers are in the habit of issuing such cheques, they should give him notice and close the account and place him on a "black list" apart from informing the Credit Information Bureau (CRIB). The banks, more than the Police or the Courts can take steps to stop this bad practice as a result of which cheques of individuals are today not normally accepted in payment.

## 9.0 New Legislation on Banks and Banking

Speaking of legislation, the first main statute on banking in the modern period was the Banking Act of 1988. Since then there was a lull in legislation on the subject. In early and mid-2000, there was a spate of legislation affecting banks as follows:

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

Out of all the above, the one most pervasive was the Financial Transaction Reporting Act of 2006 (FTRA).

## 9.1 Financial Transactions Reporting Act, No 6 of 2006 (FTRA)

- FTRA provides for the setting up of a Financial Intelligence Unit (FIU) as a national central agency to receive analyse and disseminate information in relation to Money Laundering and the Financing of Terrorism. The FIU is set up in the Central Bank of Sri Lanka.
- The FTRA obliges institutions to report to the FIU cash transactions above a value prescribed (Rs. One Million) by an Order published in the Gazette. The term “institutions” covers a wide array of persons and entities.
- The Act also obliges institutions to report to the FIU all electronic fund transfers above such sum as prescribed by the regulations.
- All suspicious transactions also have to be reported to the FIU irrespective of their magnitude.
- FTRA also requires an institution covered by the Act to appoint a Compliance Officer who would be responsible for the institution’s compliance with the Act.



- The opening and operating of accounts under a fictitious name is made an offence under the FTRA: see [27.25 of FTRA].
- FTRA makes “tipping-off” an offence (e.g. pre warning a suspect of an impending investigation).
- In terms of the FTRA, persons making reports under the Act are protected from civil or criminal liability and the banker’s duty of confidentiality will not apply in such cases.

## 10.0 Absence of Judicial Decision on Banking

Unlike in other countries, in Sri Lanka, apart from Debt Recovery litigation, there has been a marked or even a total absence of reported case-law affecting banks or involving banking disputes, The reason is not far to seek. Except for corporate customers, few individuals can sue or defend cases involving banks. In this context, the mediation by the Financial Ombudsman has been a success but not enough use is made of this scheme.

## 11.0 Guarding against White Collar Crime

Banks must take adequate precautions to protect themselves from being robbed by their own staff. This is now called “white collar crime”. 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 of a female employee of a leading private bank who was in charge of safe deposit lockers. She had got duplicate keys of customers cut and pilfered cash and certificates of deposit from the safety boxes amounting to a very large amount..

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.

## 12.0 Re-Assessing Risk

It was mentioned earlier 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

It is pertinent to ask whether the “impact” attributed by banks to some of the above risks should not be re-examined and a higher risk factor given to some risks currently marked as “minimal”.

### **13.0 Education and Training in the Financial Sector.**

In conclusion let me emphasise the need for continued education and training of bankers and lawyers involved in banking issues. Here I make special mention of the excellent work done by the Institute of Bankers of Sri Lanka and the Institute of Advanced Legal Studies of the Council of Legal Education (Law College).

### **14.0 Banks’ Dominant Role in Economy**

To conclude bankers reading this contribution must not misunderstand any criticisms made. This writer has always supported the banking industry’s pivotal role in our economy. The banking sector is the dominant player in our financial sector. It accounts for nearly 55 percent of the total assets of the sector. Banking activity which now strengthened by an excellent branch network extending even to rural areas – has also educated our general populace on financial matters. Having a bank account is now a status symbol.

No doubt we have seen financial fiascos and failures like Sakvithi, Danduwan and more recently Golden Key. The last affected our entire financial landscape like a tsunami. It had a ripple effect even on our banking sector. However, we must not forget that these were unsupervised, unregulated financial institutions. Pramuka Development Bank which failed in 2002 has been the only Bank failure in our country in modern times. This speaks well for the Sector and the Regulators.

This 24<sup>th</sup> Conference of the APB will no doubt hear many top speakers and see excellent discussions on the theme. I wish the Conference all success.



## **A Bouquet to APB**

Indeed, from its inception I have been closely associated with the Association. I have been invited to speak at several of their annual conferences and equally important I have regularly contributed articles to the journal they put together and publish to commemorate each of their Annual Conferences. The very fact that since their inception 24 years ago, the Professional Bankers have sustained their Association, their Annual Conference, the Conference Journal and their other publications is significant evidence of their strength and recognition in Sri Lanka's banking and financial world. With my years of experience and close involvement with banking and financial matters, I have seen Associations being formed and then flounder and cease to exist in a few years. Some others that were formed exist only in name. The Association of Professional Bankers have been different. They have had a strong membership with most of the country's senior bankers as their members, good Office Bearers and Executive Committees and excellent Presidents and Vice Presidents.

As an impartial outsider –observer interested in the development of our banking industry for over the past 50 years, I must also commend the several volumes published by the Association at each of their Anniversary Conventions. The articles contained in each of those publications, many of which I have read, have been of considerable value to practicing bankers and other professionals in the Banking and Finance areas. On many occasions as a person teaching Banking and Finance Law to postgraduate students, I have used many of these articles as Reading and Background Text material at my lectures and coursework. Truly, this annual publication of the Association is perhaps the only one of its kind containing valuable research, thoughts and ideas of senior bankers and other professionals on the selected subjects.

## **APB's Booklet on Customary Banking Practices**

For purpose of record, I must also briefly mention here a meaningful joint study and publication between myself and the Association. For quite some time, a need had been felt to identify the "Customary Practices on Banking in Sri Lanka". Our country follows English law on "banks and banking". The terms "banking" or "banking business" are not comprehensively defined in our Banking Act of 1988. The definition of the term, "banking business" in section 86 of the Banking Act includes "customary banking practices".

In the above context, in June 2008, at the request of the Association of Professional Bankers, this writer compiled a twenty page Booklet on "**Customary Banking Practices on Customer Account Operations Based on Selected Case-Law**".

This publication was then launched by the respected Supreme Court Judge and President's Counsel, Justice Saleem Marsoof. It has been a boon to bankers, lawyers and members of the Judiciary. Also this compilation by the APB of "customary banking practices" in 2008 was a landmark event because no other common law country has done so.