CHAPTER 11: BANK COMPLIANCE

11.1 Introduction of the Unit of Learning/Unit of Competency

Bank compliance is a unit of competency covered in TVET level 6 banking and finance course qualification. This unit specifies the competencies required to do profiling bank customers, verifying bank compliance status, preparing regulators report, reporting bank performance to board, seeking approval of bank products and services and handling interbank relationships. The significance of managing bank compliance according to TVET level 6 banking and finance curriculum is to equip the learner with the knowledge and skills to communication, negotiation, conflict resolution, listening, budgeting, conflict resolution and negotiation techniques, credit and debit recovery principles and techniques, financial delegations and limits applied within organization and specific to role etc. so as to fit in the workplace.

The critical aspect of competency to be covered include: understanding of risk levels, understanding of compliance standards, understanding of regulatory requirement, understanding of prudential guidelines, understanding of International Trade Basis Resources required include: resource implications, methods of assessment, context of assessment and guidance information for assessment.

The unit of competency covers 6 learning outcomes. Each of the learning outcome presents; learning activities that covers performance criteria statements, thus creating trainee's an opportunity to demonstrate competencies stipulated in the occupational standards and content in curriculum. Information sheet provides; definition of key terms, content and illustration to guide in training. The competency may be assessed through written test, demonstration, practical assignment, interview/oral questioning and case study. Self-assessment is provided at the end of each learning outcome. Holistic assessment with other units relevant to the industry sector workplace and job role is recommended.

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11.2 Performance Standard

Profile bank customers, check bank compliance status, prepare regulators report, report bank performance to board, seek approval of bank products and services and handle interbank relationships as per the risk profile, bank regulations and bank policy.

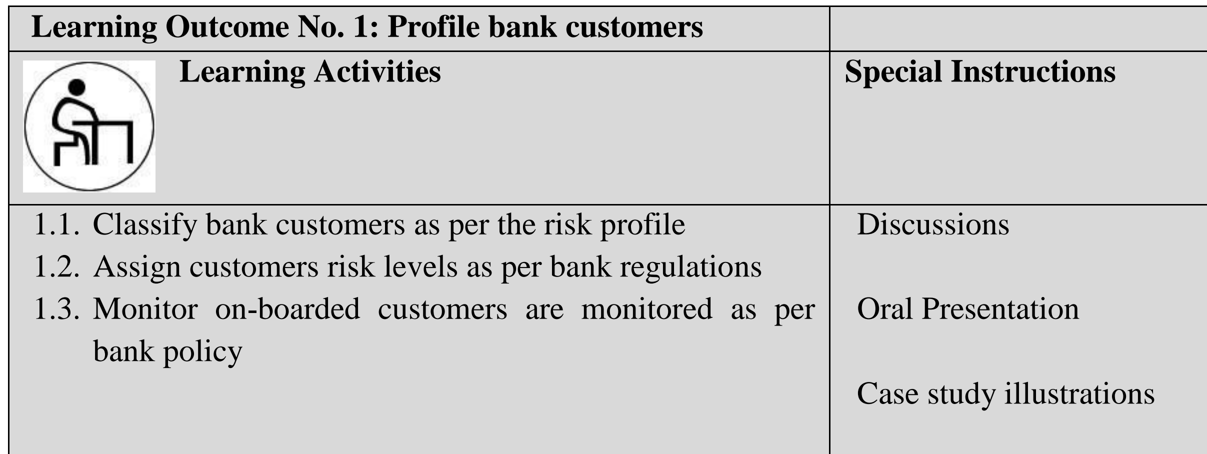
11.3 Learning Outcomes

11.3.1 List of Learning Outcomes

a) Profile bank customers
b) Check bank compliance status
c) Prepare regulators report
d) Seek approval of bank products and services
e) Handle interbank relationships

11.3.2 Learning Outcome No. 1: Profile bank customers

11.3.2.1 Learning Activities



Learning Outcome No. 1: Profile bank customers	
Learning Activities	**Special Instructions**
1.1. Classify bank customers as per the risk profile 1.2. Assign customers risk levels as per bank regulations 1.3. Monitor on-boarded customers are monitored as per bank policy	Discussions Oral Presentation Case study illustrations

11.3.2.2 Information Sheet No. 11/LO1: Profile bank customers

Introduction

This learning outcome covers; the classification of bank customer as per the risk profile, types of customer for banks, types of risks that organisations and banks face, different levels of risks that exist, risk mitigation strategies and also countries that have been sanctioned. The outline has also looked at the process of monitoring on-boarded customers as per the policy of the bank.

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Definition of key terms

Risks: Are situations that can expose a business or an individual to danger. It can also be defined as the chance that the returns of a business will differ from the actual returns.

Mitigate: This refers to as the activity that is undertaken to reduce or lessen the severity that occurs when a risk occurs.

Content/Procedures/Methods/Illustrations

1.1 Bank customers are classified as per the risk profile

A risk profile is an evaluation carried out to access the willingness and ability of an individual to take risks. Risk profile is very important in determining the appropriate investment strategy or credit allocation. Banks have policies regarding the assessment of a risk profile of a customer. According to the policy, a bank should access the capital adequacy of a customer before profiling the customers. One of the main objectives of banking is making profits. To achieve this objective, the banks around the world are attempting to make their services to be customer centred. By understanding the specific needs of their customers, banks are customizing their services to meet the needs of their customers. Banks have also customized not only their services but also other products that banks are offering.

Customer profiling definition
Customer profiling refers to the process of classifying customers based on the existing facts on their transactional activities. One of the major challenges that banks and other financial institutions face is maintaining customers with high profiles. When banks understand the specific needs of customers, product preferences, purchasing patterns and customer history, it is possible for banks to improve and offer customized products and services.

When customers get customized products and services, they get satisfaction which makes them become loyal customers to the bank. In turn the profits of the bank increase and banks have a high customer retention capacity. All customers have some attributes that can be used to create customer profiles some of the attributes which comprise demographic information such as gender, occupation, age, level of income and education level. Other parameters that can be used to profile customers include financial parameters, purchasing preferences and buying history.

Uses of customer attributes
- They help facilitate customer assessment
- They enable banks create and market suitable products
- Enables banks create a better customer experience
- It helps to customize bank products
- It facilitates in the process of categorizing risks
- Helps in predicting the default rate
- Helps banks to assess the eligibility of a customer for various bank products

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Based on the attributes of customers, the bank can classify them into various categories. Some may have more risks and others may be customers with fewer risks. Therefore, they are classified into four different categories as explained below;

a) High value customers
These are customers the bank considers to have low risk due to their net worth. They make large deposits, take huge loans and contribute significantly to the profits of the bank. Such customers receive high quality customer service and banks give them priority and offer timely responses to their grievances. Banks offer incentives to such customers so that they can retain them.

b) Medium value customers
These are customers the bank considers to have medium risks and most of them do businesses with the bank. They are in the process of upgrading to high level customers and contribute significantly to the profitability of the bank. These customers fall into those income earning group of customers and to retain them the banks can provide feasible and attractive products and services specifically for those groups as well as communicate efficiently using the right channel to those customers while addressing their issues.

c) **Low value customers**

Low value customers possess the following features;

- They have a low income.
- They fall into the high risk group of customers.
- Their profit level contribution to the bank is minimal.
- They have a little scope of moving from their level to a higher level.

How banks reduce risk with low value customers

- They can allocate limited resources to such customers
- They communicate to them using the minimum costs

d) **Negative value customers**

These customers have high risks since they incur additional costs to the bank as compared to the profit they generate to the bank. These customers may either be having loans or accounts that are not in operation. Customer profile can be presented on a graph as shown below. It is a graph plotted on profitability against value of customers.

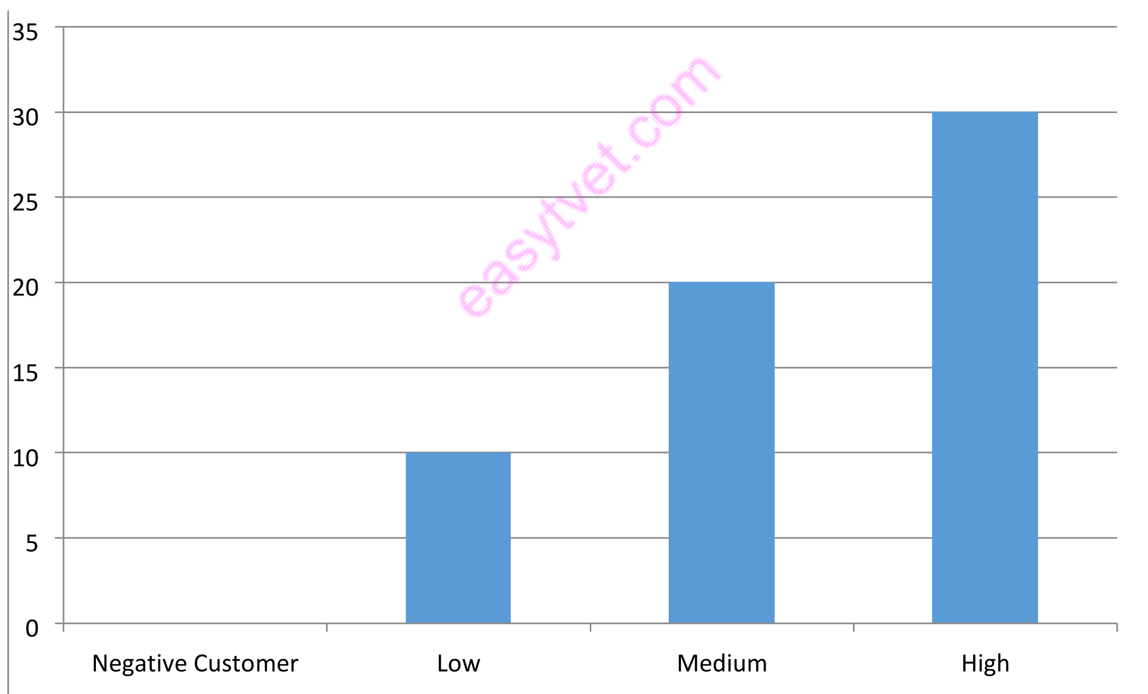

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Figure 35: Graph plotted on profitability against value of customers

From the bar graph above, it is evident that high value customers are the greatest profit contributors to the banks and therefore have the least risk. On the other hand, negative customers have zero contribution to the profits that the banks make. Actually they make the bank to incur costs in maintaining their accounts and servicing their needs.

Types of risks

Investors have information that for them to benefit from their investments, they must be exposed to various types of risks in the market. There are two broad categories of risks which are **systematic** and **unsystematic risks**.

a) **Systematic risks:** These are risks that affect the entire system and the entire market. The risk affects all the investments in the market and includes risks like political turmoil, inflation and changes in interest rates. It is difficult or impossible for an individual or businessman to protect their business against these risks.
b) **Unsystematic risks:** It is also known as diversifiable risk and affects only a specific company or organization thus an individual or company has the possibility of protecting themselves against the risks through diversification. Examples of unsystematic risks include strikes; poor management and lawsuits.

There are specific risks that are categorized under these broad categories and include;

- **Credit risk:** This is the risk that occurs when you predict that the person whom the bank has given credit will be unable to repay the principle amount and the interest.
- **Country risk:** This risk occurs when it becomes difficult for that country to honor its debt obligation such as stocks and bonds. A country with a huge fiscal deficit is considered to be more risky.
- **Political risk:** This is a risk that occurs if a government of a country decides to change policies that govern its operations.
- **Interest rate risk:** It is a risk that's likely to occur due to changes and fluctuations in the level of interest rates of a country.
- **Inflation risks:** This is a risk that occurs when the returns of an investment reduce due to general changes in prices of commodities in the market.

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Risk mitigation factors

Although risks exist in businesses, there are ways in which the risks can be mitigated or managed so that their impact is not adverse. Risk mitigation is the process of establishing steps which will help to reduce the adverse effects of a risk in case it occurs. When developing a risk mitigation strategy, it is necessary to have clear information and profile of the company.

There are four risk mitigation strategies which include;

a) **Risk acceptance:** This is one of the strategies used although it does not reduce or mitigate the impact of a risk occurring. The strategy becomes an option when it is not possible to apply or use other risk mitigation strategies. Risk acceptance occurs mostly to those risks that have a low possibility of occurring.

b) **Risk avoidance:** This refers to a strategy where a bank undertakes an action that prevents it from exposing itself to a risk. However, this is one of the most expensive strategies as it may limit a bank from carrying out most actions.

c) **Risk limitation:** It is one of the most common risk mitigation strategies and provides some limits to a bank that may expose it to the risk. It can be considered as a strategy that combines risk acceptance and risk avoidance. For instance, when a company or bank feels that a hard disk of their computer may fail, they develop backups.

d) **Risk transfer:** This refers to the process of handing off or transferring the risk to another third party. Some companies transfer risks by outsourcing their services to other companies. Risk transfer helps a company or banks to focus on its core competencies.

1.2 Customers are assigned risk levels as per bank regulations

Bank regulation refers to the requirement and policies that a bank has set to guide it in handling its activities. It also helps to enhance transparency between banks and customers. Banks therefore use the bank regulation to assign risk levels of its customers. Assessing risk levels begins by profiling its customers. There are various risk levels that a bank considers or uses to classify and profile its customers and include the following categories;

a) **Low risk levels:** This is the level at which a bank has a low probability of losing its money or properties in case it lends out to a customer. High level customers fall into the category of customers with low risks since they make huge deposits and engage in numerous transactions with the bank.

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b) **Medium risk levels:** This is the level at which the probability of a default occurring is moderate. However, the level may change from point to another. In customer profiling, banks consider income earning individuals to be in medium levels of risk as they also engage the bank with a substantial number of transactions that help the banks in generating some profits. Customers at medium risk level have a reduced credit default rate.

c) **High risk levels:** These are levels of risk that a bank or any financial institution considers to be adverse. While profiling customers, banks profile those customers with few and less value transactions as high risk customers. Due to the classification, the banks do not offer such customers nor do they customize products for such customers. According to the bank regulations, it may be difficult to for such customers to access credit/loan facilities as their repayment model or ability is not guaranteed.

Sanctioned countries

Sanctioning is a process by which one country exerts disapproval with the dealings of another country. When it happens, the relationship between such countries become adverse and no trade/business occurs between such countries. The U.S is one of the countries that sanction other countries. Some of the countries that the U.S has sanctioned include; Burma, Ivory Coast, Cuba, Iran, North Korea and Syria. The U.S has a list of organizations or individuals in such countries that it does not engage with or do business with.

1.3 On-boarded customers are monitored as per bank policy

On-boarded customers: These are customers that have recently opened an account with the bank. The banks take an initiative to monitor their transactions for a period of time to facilitate ease in profiling.

How to monitor on boarded customers

i. Checking their deposit amounts
ii. Assessing the amount of cash they withdraw
iii. Assessing the number of transactions they engage in a day
iv. Checking the mode of deposits either cash or cheque deposits

Importance of monitoring on boarded customers

- Helps the bank to profile the client accordingly
- Helps the bank to check any fraudulent activities
- Gives the bank an opportunity to assess the risk level of the customer in case the customer wants to request for credit

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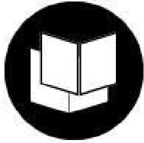
Reasons for monitoring on boarded customers.

- To meet the requirements of Central Bank of Kenya
- To assess and curb any issue of money laundering
- To check if the account has been opened to facilitate terrorism practices through paying terrorist using the account
- To help the account have accountability to the account holder and enable it to profile the customer appropriately

Conclusion

This learning outcome covered; risks, types of risks, risk mitigation factors, sanctioned countries and individuals. It also looked into what customer profiling is and the factors considered in customer profiling.

Further Reading



Read on:

1. Reasons that make countries or individuals to be sanctioned.
2. Negative effects of poor customer profiling by banks.

11.3.2.3Self-Assessment

Written Assessment

1. Which of the following does not form part of the demographic factors used in profiling customers?
   a) Age
   b) Height
   c) Occupation
   d) Gender
2. The following are reasons for profiling an on-board customer. Which is the odd one out?
   a) To meet the CBK requirements
   b) To check the client source of income
   c) To curb money laundering
   d) To prevent terrorism
3. How many broad classifications of risks exist?
   a) One
   b) Two
   c) Three
   d) None of the above
4. Which of the following is not a risk mitigation strategy?
   a) Risk avoidance
   b) Risk transfer
   c) Risk acceptance
   d) Risk mitigation
5. Which of the following countries has been sanctioned by the U.S?
   a) Cuba
   b) Kenya
   c) Uganda
   d) South Africa

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6. Which of the following is not a characteristic of low value customers?
   a) They make large bank deposits
   b) They have a low income
   c) They have high risk
   d) They have minimal profit contribution to the bank
7. Which of the following is not a use of customer attributes in profiling?
   a) Assess customer eligibility to products
   b) Predicting default rate
   c) Customizing bank products
   d) Identifying the faith of an individual
8. Summarize the role of monitoring on-boarded customers.
9. Discuss briefly on the differences that exist between low value & high value customers.
10. Give a brief elaboration on the factors that banks use to profile their customers.
11. Analyse how the characteristics of customers help a bank in carrying out profiling process.
12. Provide a brief description of what customer profiling entails.

Oral Assessment

1. Mention the types of risks that exist.
2. State the levels of risks that exist for banks.

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Practical Assessment

A multi-credit union wanted to grow its membership through services that it provided. However, there was a very high competition in the industry. The union had to target young and highly valued customers to create a strong foundation to enable it have long-term profitable relationships. To establish its objectives, the union created profiles for its customers and customized the products for their customers.

11.3.2.4 Tools, Equipment, Supplies and Materials

- Writing materials
- Projector
- Computer
- Flip chart/white board

11.3.2.5 References

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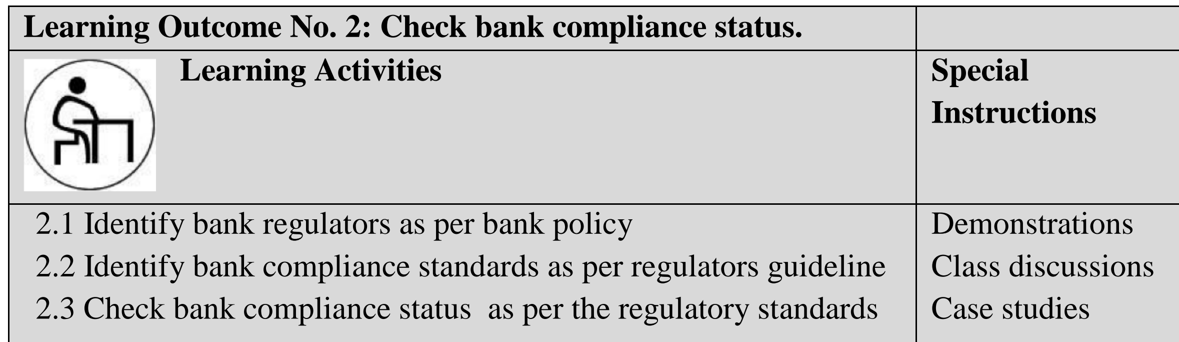
11.3.3 Learning Outcome No. 2: Check bank compliance status.
113.3.1 Learning Activities



Learning Outcome No. 2: Check bank compliance status.	
Learning Activities	Special Instructions
2.1 Identify bank regulators as per bank policy 2.2 Identify bank compliance standards as per regulators guideline 2.3 Check bank compliance status as per the regulatory standards	Demonstrations Class discussions Case studies

11.3.3.2 Information Sheet No. 11/LO2: Check bank compliance status.

Introduction

This learning outcome covers; what regulatory bodies are objectives of regulatory bodies, the benefits of regulatory bodies and consequences of noncompliance to the guidelines established by regulatory bodies. It also covers the principles and standards of regulatory bodies for banks and the prudential guidelines on banking and compliance status.

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Definition of key terms

Regulatory body: This refers to any functional agency which is either a public or government agency that is established to carry out regulatory roles. The body provides requirements, conditions, standards and rules that are used to govern companies in a specific sector.

Compliance: It is the act of upholding and following the specific set of rules and conditions that have been put in place by a regulatory body.

Standard: This is a term used to describe an agreed way or style of doing something. It is a guideline followed in either making a product or providing a service.

Content/Procedures/Methods/Illustrations

2.1 Bank regulators are identified as per bank policy

According to the banking policies of Kenya, the Central Bank of Kenya (CBK) is the regulatory body for banks. It sets regulations, conditions and guidelines that banks should follow while they operate in Kenya.

Bank regulation: This is a form of government oversight that exposes and subjects banks to some requirements or guidelines and restrictions that help in creating transparency in the financial sector between financial institutions and individuals or companies.

With the current network of banking and financial institutions it is necessary that there are regulatory agencies which can help to maintain or control the activities and practices of such institutions. Financial institutions are highly interconnected with the capital markets, insurance sector and banking. With the interconnection of such activities, it is necessary to have a regulatory body for guiding their operations.

Objectives of bank regulations

- Regulations help in mitigating against the risk-level that banks are exposed to.
- Regulations aim at reducing the level of systematic risk which may occur due to the disruption of the state as a result of adverse trading conditions.
- They aim at reducing the misuse of banks which may be used in criminal activities or money laundering activities.
- Regulations aim at protecting the confidentiality of the banking sector.
- To provide a guideline on the sectors that needs credit.
- They help provide rules and regulations of treating customers and how the banks should address the issue of corporate social responsibility.

Principles of regulations

a) Licensing

All banks should be licensed. The regulatory body sets the minimum requirements that a bank is required to have before it is registered and licensed. Before a bank is licensed, various factors are taken into consideration where the intent of the bank is evaluated and the ability of the bank to meet the specified set regulations of the regulating body.

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b) Minimum requirements

A banks regulatory body imposes minimum requirements that banks should meet so as to ensure that it works towards meeting its objectives. In most circumstances, the minimum requirements that a regulatory body imposes are closely linked to the risks that a bank may be exposed to. One of the essential minimum requirements that the regulatory body has put for banks is to maintain a minimum capital requirement rate. However, in other nations such as the U.S the banks may have an opportunity to determine the supervisory or regulatory body.

c) Market discipline

One of the requirements of regulatory bodies for banks is that they publicize or disclose their financial information. Disclosing financial information will help creditors and other people depositing to make an assessment of the level of risk they are exposed to and thus make prudent investment decisions. When a bank complies to the financial discipline principle the regulatory body can assess the financial health of the bank.

Regulatory body requirement

a) Capital requirement

Regulatory bodies for banks set and establish a framework and guidelines that guide banks on how they should handle the amount of capital they have in relation to their assets. The minimum capital requirement for banks is influenced globally by the Basel

capital accords. This committee sets frameworks that are sensitive to the risks that banks are likely to be exposed to.

b) Reserve need

The regulatory body for banks sets out the minimum reserve that a bank should have to enable it demand bank notes and deposits. The regulatory bodies also use reserve requirements to control the amount of stock of bank notes that banks hold.

c) Corporate governance requirements

The main intention of regulatory bodies establishing this requirement is to ensure that there are good management practices in the banks. Some banks are large and have many branches making it important to check and ensure that all these branches are prudently managed. Some of the corporate requirements include;

- The banks should be locally incorporated
- A bank should be a corporate and therefore it should not be an individual or a partnership
- Should have a specific number of directors
- To have a clear and well established organizational structure
- To have a constitution that guides its activities or an article of association

2.2 Bank compliance standards are identified as per regulators guideline

The regulatory body stipulates the compliance standards of banks. Based on the guidelines that the regulation has provided, all banks need to comply and conform to the standards that have been set by a regulatory body. Some of the standards include, Capital requirement standard, Reserve need standard & good management.

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Importance of compliance to standards

- It facilitates easy information processing.
- It helps to facilitate and enhance the level of security.
- Compliance to standards helps in managing risks that a bank may be exposed to.
- It helps to ensure that a bank follows the ethical conduct and other necessary control procedures.
- It enhances the relationship with a regulatory body.

Compliance department

The bank has a compliance department that has various roles which include ensuring that the bank complies with the established laws and regulations. The primary intentions of establishing this department is to enable the bank avoid fines that the government may impose and also protect the banks data and files from loss.

Additionally, the compliance department of a bank works to ensure;

- There is no money laundering
- There is no tax evasion or avoidance
- There are no illegal dealings
- There is no debt flight

Implementation of compliance standards

In order to implement banking compliance standard, an institution should create a culture that aims at complying with the set standards. The management of a bank has a role of ensuring that the culture of compliance has spread among the staff. The management should also provide the right and necessary tools that will facilitate compliance. The compliance department has the following responsibilities;

- To approve compliance policies.
- To inform the management of all the compliance measures.
- To communicate to the bank staff and other service providers about the policy of compliance.
- To disclose any ethical practice as per the banks guidelines.

Consequences of non-compliance

There are grave and adverse impacts for non-compliance which include but not limited to the following:

- Non-compliance will prevent banks and financial institutions from carrying out regulated activities.
- It leads to suspension of firms and individuals from various banking industries.
- Non-compliance will lead to the removal of a banks authorization.
- Banks that fail to comply will be fined for breaching the regulations and laws established.
- Their misconduct will be published which will call for a disciplinary action that impact their reputation negatively.
- Non-compliance can lead to prosecution since it will be considered a criminal offence.

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Bank compliance status is checked as per the regulatory standards

For a bank to have an appropriate standing, the bank should have a formal status with the regulatory authority. To ensure that a bank has a formal status, it develops a monitoring tool that reminds them on every time they need to maintain and update information with the regulatory body.

In Kenya, the Central bank of Kenya (CBK) is the regulatory authority of banks and has established guidelines and regulatory standards for banks and other financial institutions. The CBK has established prudential guidelines for banks which all banks must adhere to in their operational practice.

Some of the regulatory standards to ensure the right compliance include:

a) **Financial disclosure and reporting:** Banks should disclose their finances by preparing and publishing their financial statements. Banks should disclose financial statements subject to the guidelines provided by the CBK which is the regulating body. Once the financial statements have been prepared the directors must attest and declare that such financial statements are accurate and indicate the true financial status of the banks.

b) **Credit requirement rating:** Regulatory bodies require banks to have a specific credit rating obtained from a specific credit rating agency and the rating should be disclosed to the creditors and investors. The credit ratings show investors the level of risks that a bank is taking.

c) **Exposure restrictions:** Regulatory bodies may restrict banks from exposing themselves to other counterparties without prudence. Such restrictions prevent banks from exposing equity holders to unnecessary risks.

Conclusion

This learning outcome covered; what regulatory bodies are, bank compliance standards, consequences of non-compliance and prudential guidelines.

Further Reading

1. Read on how regulating bodies deal with banks and financial institutions that comply from the beginning and fail to maintain compliance standards.

11.3.3.3 Self-Assessment

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1. The following are objectives of regulatory bodies, which one is not?
   a) To operate minimum operating standards
   b) To mitigate risk levels
   c) To reduce misuse of banks
   d) To protect confidentiality of banks
2. The following are true about a regulatory body, which one is not?
   a) It sets guidelines for operations
   b) It establishes conditions for operations
   c) It creates restrictions for operations
   d) It helps in investments
3. The following are principles of regulations except one. Which is it?
   a) Licensing
   b) Minimum requirements
   c) Market discipline
   d) Non-compliance
4. Which of the following is incorrect about standards of compliance?
   a) Facilitates communication
   b) Enhances security
   c) Managing risks
   d) Engaging in unethical behaviour

5. The following are some requirements of corporate governance except one. Which one is it?
    a) Banks should be locally incorporated
    b) Minimum number of directors be present
    c) Have a constitution
    d) None of the above
6. The compliance department has the following except one. Which one is it?
    a) Ensure money laundering
    b) Ensure no tax evasion
    c) Ensure no illegal dealings
    d) Ensure no debt flight
7. Which of the following is not a consequence of non-compliance?
    a) Denies authorization
    b) Enhances company's reputation
    c) Leads to fines by government
    d) Leads to prosecution
8. Analyse the roles played by regulatory bodies.
9. Summarize compliance standards that regulatory bodies have created for banks.
10. Elaborate on the principle of compliance.
11. Discuss some of the practices used in ensuring compliance.
12. Explain the consequences of non - compliance to regulatory bodies.

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Oral Assessment

1. Mention three benefits of compliance.
2. State one consequence of non-compliance.

Practical Assessment

Equity Bank, a Kenyan incorporated bank has been complying with the standards as established by the Central Bank of Kenya regarding the minimum balance. Assuming that the bank has surpassed and is operating below the minimum requirements as stipulated by the CBK, explain some of the consequences the bank is likely to be exposed to.

11.3.3.4 Tools, Equipment, Supplies and Materials

- Writing materials
- Projector
- Computer
- Flip chart/white board

11.3.3.5 References

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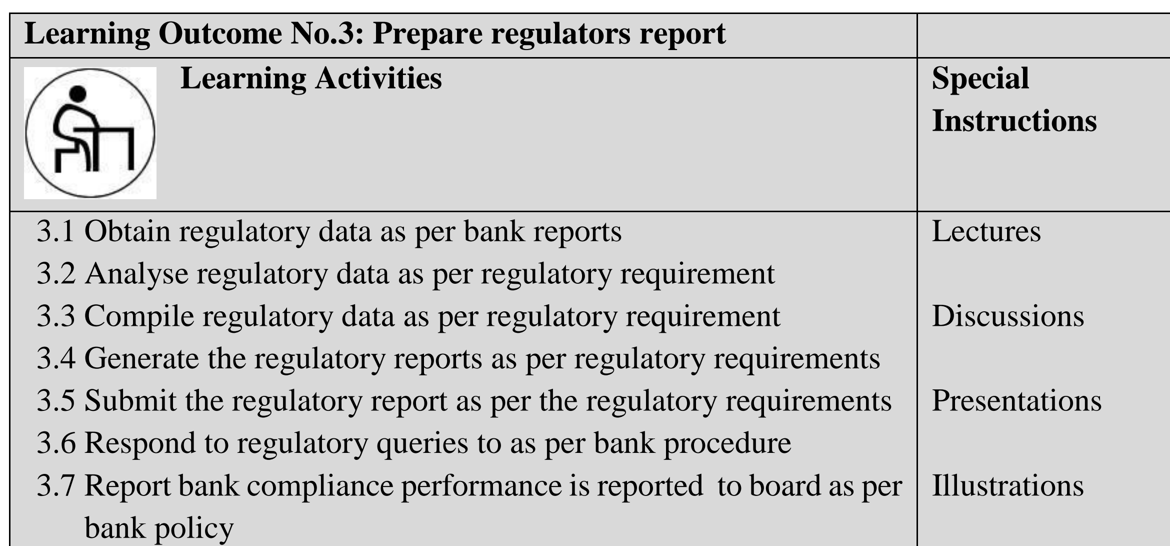
11.3.4 Learning Outcome No.3: Prepare regulators report
11.3.4.1 Learning Activities



Learning Outcome No.3: Prepare regulators report	
Learning Activities	Special Instructions
3.1 Obtain regulatory data as per bank reports 3.2 Analyse regulatory data as per regulatory requirement 3.3 Compile regulatory data as per regulatory requirement 3.4 Generate the regulatory reports as per regulatory requirements 3.5 Submit the regulatory report as per the regulatory requirements 3.6 Respond to regulatory queries to as per bank procedure 3.7 Report bank compliance performance is reported to board as per bank policy	Lectures Discussions Presentations Illustrations

11.3.4.2 Information Sheet No.11/LO3: Prepare regulators report

Introduction

This learning outcome covers; the different types of regulatory reports, their importance and users of regulatory reports.

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Definition of key terms

Regulatory: This is the act of regulating something. Regulation is management of set system according to the rules and regulations that are set.

Report: A report is a document which presents information in an organized format for s specific audience and purpose. Summaries can be presented orally but they must be presented in writing for filing.

Bank reports: It is a report issued by a bank to its depositors document the account balance and activity during the period.

Content/Procedures/Methods/Illustrations

3.1 Regulatory data is obtained as per bank reports

Financial regulation is a form of regulation that subjects financial institutions to certain requirement, restrictions and guidelines, aiming to maintain the integrity of the financial institutions. Aims of regulation include;

- Maintain confidence in the financial system.
- Contribution to maintaining stability in the financial institutions
- Protects the interests and well-being of consumers.

Regulation also ensures fairness in the market preventing other companies from edging out competition by using unfair methods. All money markets and equity markets are regulated by the government.

Importance of obtaining regulatory data

- Prevents market failures
- Ensures government policies and standards in a specific field of activity are met as set

The significance of reports

- They present information for various aspects of the business
- Skills and knowledge of the professionals is sown in the reports
- They help during decision making
- They can also help in problem-solving
- It communicates the planning, policies and other matters regarding organization

Report writing format

- **Title section:** Includes authors name and date of repairing
- **Summary:** This is a summary of the major points, conclusion and recommendations. This is a general overview of the report. It should have all the relevant information
- **Introduction:** This shows the problem and the reason why the report is necessary. Definition of terms is in this section. The arrangement of the report is also included here.
- **Body:** This contains several section that has a subtitle. It is arranged in order of importance with the most important being first
- **Conclusion:** This talks about the components of the whole report
- **Recommendations**: This is what needs to be done to improve the problem or reason for the report writing.
- **Appendices**: This is information for the people of the held. They are technical details to support the conclusions of the report.

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Data needs to be collected for analysis then regulatory report writing. The information can be obtained from both the primary and secondary sources. Primary sources include;

- **Interviews and questionnaire for the customers and employees.** This can help to find improvements that can be made in services or products from people that are close to it.
- **Surveys for potential customer.** This is to know why they do not use the products of the said company.
- **Experiments.** This is by trying out new product will be received well in the market.

Secondary data for regulatory report writing will include;

- Reports from other organizations. This will help know the trends of other competitor and the gaps in the market that need to be explored.
- Government regulatory reports for bank. This provides the guidelines to use when coming up with the regulatory.

Advantages of primary data

- Resolves specific research issue
- Likely to be accurate
- Up-to date information
- Researcher has control

Disadvantages of primary data

- It is expensive
- It is time consuming
- Sometimes too large to be carried out

Advantages of secondary data

- Easy access
- Low cost of obtaining it
- Larger sample size

Disadvantages of secondary data

- Not specific to the needs of the researcher
- Lack of control on the data

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3.2 Regulatory data is analysed as per regulatory requirement

Regulatory requirement: All applicable approvals, licenses, registrations and authorizations and all other requirements of each applicable regulatory authority. Data analysis being the collection and organizing of data to help the researcher come into the conclusion. The analysis method to be used in a data depends on the nature of the research. There are two types of data;

- Qualitative research. Does not use numbers in the research. It is descriptive in nature.
- Quantitative research. This data is mostly presented in terms of numbers.

In quantitative research there are both descriptive analysis and inferential analysis.
Under descriptive analysis there is:

- **Mean:** Finding the numerical average of the data
- **Median:** Finding the mid-point.
- **Mode:** This is the most common value.
- **Percentage:** The ratio as a fraction.

- **Frequency:** The number of occurrences.
- **Range:** The lowest and highest value of the data.

Inferential analysis includes:

- **Correlation:** This is the description of the relation between two variables.
- **Regression:** The prediction of the relationship between variables.
- **Analysis of variance:** Test how groups of data differ.

Qualitative data is analysed using the following methods:

- **Narrative analysis.** This is reformulation of stories told by the respondent to get the context of the experiences.
- **Content analysis.** This is categorizing data using verbal and behavioural natures.
- **Developing and applying codes.** These are short words that represent data, sometimes the data is number for example married, divorced and single.

There are three types of coding:

- Open coding
- Axial coding
- Selective coding

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Importance of data analysis

- Helps in highlighting the findings from different sources of data.
- Helps in separating important information from the rest of the data.
- Helps in breaking of human bias.

3.3 Regulatory data is compiled as per regulatory requirement

Data is compiled using various methods so that it is ready for presentation in the regulatory report. Findings of the analysed data can be compiled in;

- **Bar charts and graph.** This is mostly effective if data compiled is from different years. It is easier to see the rise and fluctuation of the data being presented.
- **Line charts.** They are used best to show population.
- **Pie charts.** They work best if they are used to show different components from a total of 100%.
- **Combo charts.** This is a combination of more than one chart. This is important when using different types of data e.g. population and data from different years.
- **Textual.** Data is compiled in paragraphs and texts.
- **Tabular.** Data is compiled in a table that is sometimes attached wit explanation.

Importance of data compilation

- It makes it easier for listeners to follow
- Easier to present
- Easy to use in decision making

3.4 Generate the regulatory reports as per regulatory requirements

Regulatory reporting is the submission of primary or secondary data as required by regulators to evaluate and track the financial and operation status of the financial institution and the compliance of the regulatory Act.

Importance of regulatory report

- Legal protection. Regulatory reporting demonstrates the willingness to follow rules and protects the business from legal threats.
- Improved customer trust. It assures the consumers/customers that they are safe. For example, Bank Regulation Act assures customers that their banks of choices will not have liquidity issues overnight.

Components of a regulatory report

- The title. It should have the author and date of presentation of the report.
- Summary of the findings. Should be summarized and cover every important aspect of the data in the report.
- Data that has been analysed should be available in the report.
- Recommendation for the regulation.
- Raw data for technical teams.

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3.5 Submit the regulatory report as per the regulatory requirements

In the Kenya Bank regulatory act of 2015, there are requirements in the commission of the regulatory report. The report should be submitted to the minister for finance and the central bank of Kenya. The information received will be published as a whole or as the minister sees fit. Submitted information will not be published if it discloses the financial affairs of an individual unless there is a written consent, except as provided for the act no person was performing their duties.

Reasons for disclosing information

If it is to a monetary authority or fraud allegations and investigates within or outside Kenya.

3.6 Regulatory queries are responded to as per bank procedure

Bank procedures are policies/standards designed to protect consumer assets while establishing methods for efficient and positive customer service. Regulatory queries are communicated to the Central Bank of Kenya through writing. The Central Bank of Kenya then gives directions on how the matter should be handled. In addition to this it appoints a qualified person to help the institution adjust and incorporate the regulatory

report. In some cases, the person is not able to respond to regulatory queries because of the banking act that gives occasion one is allowed to disclose information.

How to respond to regulatory queries

- Make sure you are financially insured by an insurance provider
- Taking the queries with seriousness. Since regulators are already operating with the latest information since they'll take the organizational responses and compare them with the already known information. iii. Keeping things honest and thorough. This will help to alleviate major damage to the organization's own pocket book.

Types of regulatory

There are many classification of regulation in the finance sector especially financial institutions. They include:

- Safety and soundness regulation: This covers issues such as capital adequacy, the quality of an asset and the management.
- Monetary policy regulation: This requiring minimum levels of cash reserves to be a certain amount.
- Credit allocation regulation: This support lending social important factors.
- Consumer protection regulation. It prevents financial institution from discriminating against lenders.
- Investor protection regulation
- Entry and chartering regulation
- Price regulation

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Use of regulatory reports

- Financial institutions
- Policy makers
- Lenders and borrowers
- Central Bank of Kenya
- Researchers and academics

3.7 Bank compliance performance is reported to board as per bank policy

According to the Bank Act of 2015 if at any time, the central bank has a reason to believe:

- That the business is not being concluded according to the act.
- The institution or any of its officers are engaging in business that are likely to contravene the act. The Central Bank of Kenya can do the following;
    a) Give advice and make recommendation for the institution
    b) Issue directions in measures to be taken to improve the business
    c) Appoint a qualified person to assist the business in implementation any directions given by item if the central bank determines that:
- A member of the institution has committed a violation of this act. The activities of the said member may have a negative effect to the depositors.

The central bank will direct the member to eliminate the said irregularities. It shall further appoint a complement authority to enforce the directions used. In addition, the CBK can give further directions including:

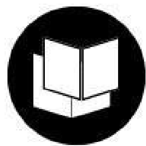
- Suspend further investment by the institution
- Suspend exercise of a non-holding company control of the institution Suspend participation of the person.

A company that resources the regulatory report shall comply within the specified amount of time and provide evidence that it has done so.

Conclusion

This learning outcome covered; the different types of regulatory reports, their importance and users of regulatory reports.

Further Reading



1. Read more about the Kenyan Bank regulatory act of 2015

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11.3.4.3 Self-Assessment

Written Assessment

1. Which of the following is not a component of report writing?
   a) Conclusion
   b) Literature review
2. Which is a source of primary data?
   a) Interviews
   b) journals
3. Qualitative research is presented in number?
   a) Yes
   b) No
4. Median is finding the average of the data?
   a) Yes
   b) No
5. Which of the following is not a user of regulatory reports?
   a) Students
   b) Banks
   c) Government
   d) None of the above

6. Legal protection is an importance of a regulatory report?
   a) True
   b) False
7. Regression is the relation between two variances. True or False?
   a) True
   b) False
8. Analyse the importance of primary data.
9. Discuss types of regulatory reports.
10. Suggest measures taken by the central bank on institutions that do not incorporate regulatory reports.
11. Elaborate ways of presenting data.
12. Evaluate the components of regulatory reports.

Oral Assessment
1. State the uses of regulatory reports
2. What is inferential data?

Practical Assessment
Study the case of imperial bank Kenya. Then discuss how regulations by the central bank would have prevented its collapse.

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11.3.4.4 Tools, Equipment, Supplies and Materials
- Writing materials
- Projector
- Computer
- Flip chart/white board

11.3.4.5 References

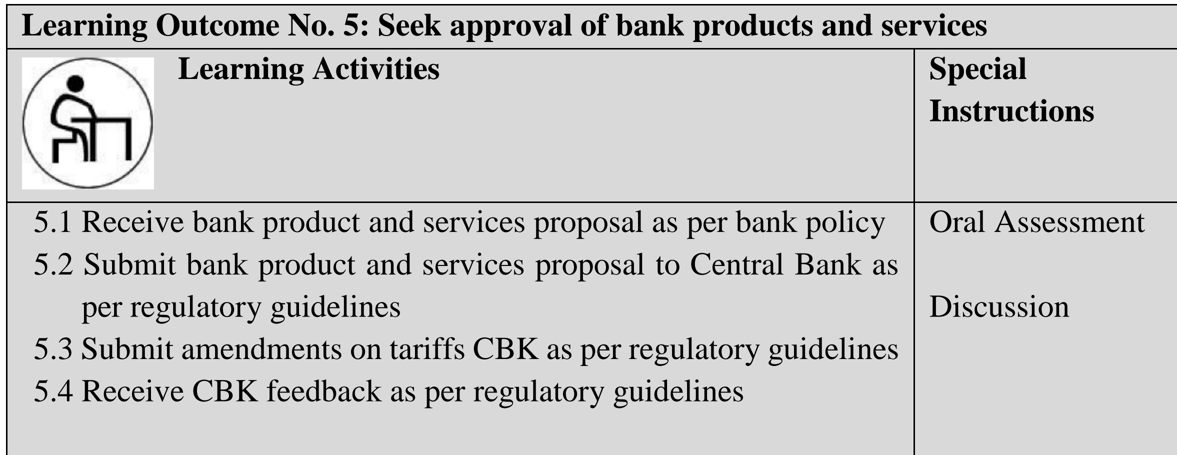
Dow, S. (2019) Monetary reform banks and digital currencies internal journal of political economy; 48(2) 153 – 173

Mugenda, O & Mugenda A.G 2003 research methods: Quantitative and qualitative methods revised in Nairobi (2003)

Silverman, M. (2008). Compliances management for public private or non-profit organization. New York. McGraw-Hill

11.3.5 Learning Outcome No. 4: Seek approval of bank products and services

11.3.6.1 Learning Activities



Learning Outcome No. 5: Seek approval of bank products and services	
Learning Activities	**Special Instructions**
5.1 Receive bank product and services proposal as per bank policy 5.2 Submit bank product and services proposal to Central Bank as per regulatory guidelines 5.3 Submit amendments on tariffs CBK as per regulatory guidelines 5.4 Receive CBK feedback as per regulatory guidelines	Oral Assessment Discussion

11.3.5.2 Information Sheet No.11/LO4: Seek approval for bank products and services

Introduction

This learning outcome covers; the different E-banking products and services and their importance offered by banks.

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Definition of key terms

E-banking: Is a product designed for the purposes of online banking that enables you to have easy and safe access to your bank account.

Bank: An establishment that is authorize by the government to accept deposits, pay interest, clear checks and make loans.

Content/Procedures/Methods/Illustrations

4.1 Bank product and services proposal are received as per bank policy

How they are received

Bank products and services proposals are received in the following ways:

a) **One step receiving process:** This is where bank products are received directly into the inventory/ customers a/c without going through further quantity or quality control process
b) **Two step verification process:** This step is used to record bank products that have been received by entering the information from the vendors' document
c) **Quantity Control:** This process tells how much of bank products have been received by entering the information from the vendor's documents Bank products:
    - Current accounts
    - Saving accounts
    - Credit accounts

- Debit cards
- Credit cards
- Cheque
- Overdraft
- Personal and business loans

Content of bank products

- Set a goal. Have a goal in mind. What do you hope to gain from content marketing?
- Research your audience and learn more about your target audience.
- Find a partner. The person you want to hire to create the content.
- Best location to place your business.
- Start production.

Procedure of bank product

i. Production process is series of steps that creates a product or service.
ii. Job production: The process of creating a single item. iii. Batch production: The number of items together as batch.
iii. Mass customization: Line that produces unique items to customer specifications this requires advanced technology.
iv. Craft production: Is a product that does not use automation?
v. Service production: Delivery of service is often referred to as production.

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4.2 Bank product and services proposal are submitted to Central Bank as per regulatory guidelines

Regulatory guidelines

This means all applicable laws, rules, regulations, orders, requirements & requests in regard to bank policy. Bank products and services are plans or suggestions, especially a formal or written one, put forward for considerations by central bank. The central bank will approve the proposals based on their laws and policies.

How they can be submitted

- They can be submitted inform of written documents to be studied and signed according to their policies.
- They can also be submitted through mails or any other form of electronic measures.
- Proposals of bank products & services can be submitted orally. Where representatives of both parties sit together and discusses it and later comes into a conclusion.

Content of central bank

- What are prudential guidelines?
- How banks are regulated in Kenya.
- How does the central bank regulate commercial bank?
- What is the role of central bank?

Central bank: It is an independent national authority that conducts monetary policy, regulates banks and provide financial services.

Roles of central bank

- Influencing money market and capital market. Controlling the financial markets.
- Collecting statistical data analyses data related to banking currency and foreign exchange.
- Controller of credit has power to regulate the credit creation by commercial banks.
- Lender of last resort; lends money to commercial banks. The central bank provides loans against treasury bills.
- Custodian of cash reserves of commercial banks.
- Bank of issue: To issue note (currency) in every country in the world.

Prudential regulation: It is a type of financial regulation that requires financial forms to control risks and holds adequate capital.

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Table 24. Prudential guidelines for institution/Licensed under the banking Act

Table of content	Title	Page
CBK/ PG/01	Licensing of new institutions	2
CBK/ PG/02	Corporate governance	34
CBK/ PG/03	Capital adequacy	82
CBK/ PG/04	Risk classification of Assets and provisioning	125
CBK/ PG/05	Liquidity management	156
CBK/ PG/06	Foreign exchange	178
CBK/ PG/07	Prohibited business	191
CBK/ PG/08	Proceeds of crime and money laundering preventions and combating the financing of terrorism	203
CBK/ PG/09	Appointment, duties and responsibilities of external auditors	242
CBK/ PG/010	Publication of financial statements and other disclosure	253

CBK/ PG/011	Open of new place of business, closing existing place of business or changing location of business	288
CBK/ PG/012	Mergers, amalgamations, transfer of assets and liabilities	310
CBK/ PG/013	Enforcement of banking	322
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CBK/ PG/015	Agent banking	347
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CBK/ PG/017	Representative officers	410
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CBK/ PG/019	Consolidated supervision	447
CBK/ PG/020	Stress testing	457
CBK/ PG/021	Prompt corrective action	467
CBK/ PG/022	Consumer protection	485

Procedure of central bank as per regulatory guideline

The central of bank of Kenya is guided by the following pieces of legislation.

- Constitutional of Kenya 2010
- Central Bank of Kenya Act (2015)
- Banking Act (2015)
- Microfinance Act (2006)
- The national payment system Act (2011)
- Kenya deposit insurance Act (2012)

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The objectives of these regulations are:

- Prudential to reduce the level of risk to which bank creditors are exposed.
- Systemic risk reduction to reduce the risk of disruption resulting from adverse trading
- To avoid misuse of bank to reduce risk of banks being use for criminal purposes.
- To protect banking confidentiality credit.

Methods of credit control

- Bank rate
- Open market operations
- Variable cash reserve ratio
- Credit rationing
- Regulating the marginal requirements of security loans

4.3 Amendments on tariffs are submitted to CBK as per regulatory guidelines
Amendments: Is a formal or official charge made to a law, contract, constitutional or other legal documents.

Content of amendment

- Bill of rights
- Freedom of speech of the press of assembly and to petition
- Government action are subject to the first amendment

Tariffs
Types of tariffs

- Export duties
- Import duties
- Transit duties
- Specific duties
- Licenses
- Import quotas
- Voluntary export restrains
- Local content requirement

Importance of amendment

- It exists as law.
- Constitutional can be changed according to the needs and aspirations of the people.

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Guidelines of amendment

i. Right to amend
ii. Admissibility of amendment e.g. procedure
iii. Admissibility of amendments other procedural matters procedure for amendments to document
iv. Allow-ability of amendment
v. Allow-ability of amendment in the description

Amendment procedure
A treaty may be amended by the agreement of the parties every party to be a treaty is entitled to participate in the amendment negotiation and become a party to the new amendment. Parties are not required to adopt amendments. In fact, in accordance with the laws of treaties part, the pre-amendment terms remain binding for any party that does not adopt the amendment even in dealing with party that bound by the amendment. Article 14 covers amendment to the convection and to annexes who can propose them the process of submission how they are to be adopted and how they enter into force (para 4, 5, 6).

4.4 CBK feedback is received as per regulatory guideline
How to do tariffs submission

i. By enabling the application of preferential tariffs rates under the agreement and amending the rules
ii. Submission of amendment tariffs are publicly released and published to the parliament websites
iii. Only the company/Firm's names are required on a submission.
iv. Contact details are kept separate
v. Discussion of personal nature of any private information should be done with the clerk of the committee before submitting

CBK feedback: This is the information that is given by the CBK about their decisions either based on credit policies or other general information.

Types of CBK feedback

- Evaluation feedback
- Appreciation feedback
- Coaching feedback

Monetary policy reports
The reports are prepared by the members of the monetary policy committee every six months and submitted to the minister for finance who presents it to the National Assembly the reports outline the activities of the committee in the preceding six months.

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Monetary policy statement
The committee prepares the monetary policy statement for the next twelve months. After the statement is submitted from the parliament, every monetary policy statement of the bank is also published in the official government paper, Kenya gazette.

Market perception survey
The monetary policy committee conducts market perceptions survey every two months to obtain feedback on:

- Is the performance of the economy?
- Perceptions by the private sector on access to credit from commercial banks.
- Response by the private sector to monetary policy committee decisions.

Guidelines of central bank

- Ensuring that the institution desists from unethical, inequitable and unfair business practices that negatively affect consumers.
- Overseeing the consumers' protection framework and ensuring that consumer complaints are attended to and addressed expeditiously.
- Ensuring that institutions comply with this guideline.

- Developing appropriate policies and procedures for the agents of the institutional to comply with this guideline.

CBK feedback per guideline procedure

i. Be ready to listen
ii. Use what is appropriate
iii. Restate the feedback to ensure clear communication
iv. React non-defensively
v. Thank the individual providing the feedback

Importance of feedback

- Improves performance.
- Creates a pipeline. Regular feedback on job performance and new skills promotes professional and personal growth.
- Improve retention effective. Feedback contributes to their development and potential advancement.
- Promotes employee loyalty. Providing feedback in a timely and respectful manner with intent of helping others improve and succeed.
- Increases sales. Their ongoing relationships with guests and clients contribute and increased sales for your organizations.

Conclusion

This learning outcome covered; the different E-banking products and services and their importance offered by banks and other banking institutions licensed to receive deposit and make loans. Regulations and guidelines issued by central bank to certain requirements, restrictions.

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Further Reading

1. Read on features of a bank

11.3.6.3 Self-Assessment

Written Assessment

1. Which of the following is the most important relationship between banker and customer?
   a) Balee and bailor
   b) World Bank
   c) Agency and principle

2. Which one of the following is not a bank product?
   a) Debit cards
   b) Creditor
   c) Customer
   d) Banker
3. Which one of the following is not a bank role?
   a) Ready to listen
   b) React to loans
   c) Lends money to commercial banks
   d) It does not give out loans
4. Which one of the following is a method of credit control?
   a) Bank rate
   b) License
   c) Import duties
   d) Providing feedback
5. Assets convert into cash is called?
   a) Change
   b) Security loan
6. What is the present liquidity rate of commercial banks?
   a) 16%
   b) 16.5%
   c) 19%
7. Which one is not the characteristics of commercial banks?
   a) Providing loans
   b) Receiving deposits
   c) Issuing of notes and coins
8. Categorize the types of commercial banks.
9. Outline types of accounts in the bank.
10. Suggest different ways you can operate accounts.
11. What do you understand by the term overdraft?
12. Evaluate annual percentage rate.

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Oral Assessment

1. What are the different ways you can operate accounts?
2. What is the difference between cheques and demand drafts?

Practical Assessment

On a weekend, the students should visit banks and find out the process of using banking cards e.g. ATM and how to apply loans in the bank.

11.3.5.4 Tools, Equipment, Supplies and Materials

- Writing materials
- Projector
- Computer
- Flip chart/white board

11.3.5.5 References

JE, Johnson, JF Christie, F Wardle (2005). Development and early education.

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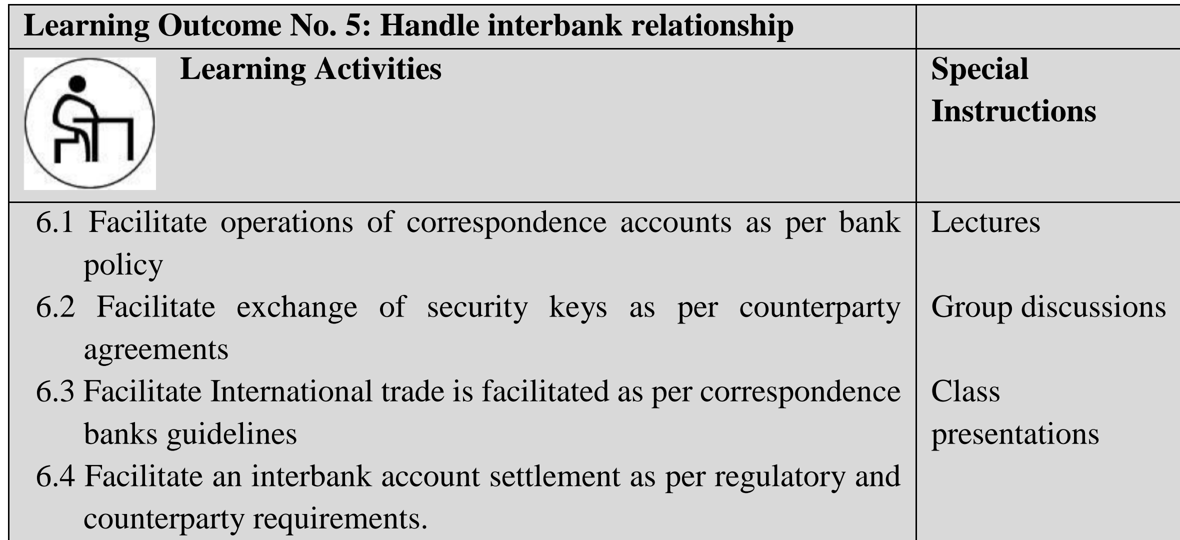
11.3.6 Learning Outcome No.5: Handle interbank relationship

11.3.6.1 Learning Activities



Learning Outcome No. 5: Handle interbank relationship	
Learning Activities	**Special Instructions**
6.1 Facilitate operations of correspondence accounts as per bank policy 6.2 Facilitate exchange of security keys as per counterparty agreements 6.3 Facilitate International trade is facilitated as per correspondence banks guidelines 6.4 Facilitate an interbank account settlement as per regulatory and counterparty requirements.	Lectures Group discussions Class presentations

11.3.6.2 Information Sheet No.11/LO5: Handle interbank relationship

Introduction

This learning outcome covers; the meaning of correspondence banking and its significance in relation to interbank relationships, an outline of their guidelines and services and how to facilitate interbank settlements as per regulatory requirements as well.

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Definition of key terms

International trade: This refers to the exchange of capital, goods and services between countries.

Correspondence accounts: These are accounts established by a banking institution (correspondent account/institution bank) to handle financial transactions like accepting deposits, making payments on behalf of and preparation and offering credit letters for another financial institution (respondent account/institution/bank).

Counterparty: Counterparty refers to a party to a contract or party to a financial transaction**.**

Content/Procedures/Methods/Illustrations

6.1 An operation of correspondence accounts is facilitated as per bank policy

Correspondence banking is an essential component of the global payment system for the cross-border transaction. It involves one financial institution/ bank handling financial transactions for another bank/ financial institution. The banking system has facilitated the interbank relations a great deal. The Wolfsberg Group defines

correspondence banking as the provision of a current or other liability account and related services to another financial institution including affiliates used for the execution of third party payments and trade finance as well as its own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency. The following services are carried out in correspondence banking;

- International funds transfer.
- Foreign exchange services.
- Cheque clearing.
- Deposit taking and cash management.
- Preparation of letters of credit.

Correspondence operations must be done as per the bank policies. Bank policies refer to the plans rather recommendations outlined by the reserve bank in the interest of the banking system so as to stabilize the financial sector and enhance economic growth keeping in mind the interest of bank customers and their deposits amongst other bank assets. For operations of correspondence accounts to be facilitated, the following bank policies must be adhered to;

i. The respondent bank must open an account in the books of a correspondent bank.
ii. The two banks must exchange the messages to verify and settle transactions by debiting and crediting the accounts.
iii. Conduct a due diligent for the clients of each bank through the Know Your Customer (KYC) and anti-money laundering (AML) process so as to determine the risk level associated with each account.

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Correspondent banking is of different types as described below

Traditional correspondent banking

Here, the respondent bank enters an agreement with the correspondent bank so as to execute payments on behalf of the respondent bank and its customers. The customers of the respondent bank have no direct access to the correspondent bank but they transact daily.

Nested correspondent banking

This is where the banks correspondent relationship is used by a number of respondent banks that is, the respondent bank has no direct account relationship with the correspondent bank but conducts business through their relationships with the banks direct respondent bank.

Payable through accounts

In this type of correspondent banking, the respondent bank allows their customers to access the correspondent account directly and carry out transactions on their own.

The following are benefits derived from operating correspondence accounts;

- It eases accessibility of financial services by banks in different jurisdictions
- Growth in international trade due to increased revenues
- Enhances financial inclusion
- Customers are provided with faster and better services
- Enhanced market diversification.

6.2 Exchange of security keys is facilitated as per counterparty agreements A counter party agreement is a loyalty binding contract documenting acceptance of the counter parties to carry out the financial transactions or be party to the contract. One of the major causes of uncertainty in the financial institutions and banks is entering a commercial engagement with counter parties that don't fulfil their side of the agreement. Counterparty refers to a party to a contract or financial transaction. The respondent and correspondent banks are both counterparties that agree to make cross border transactions for each other. The two must therefore undertake the following as per their agreements before starting operations.

- Conduct customer due diligent
- Establish a screening criterion to identify potential risky transactions so as to come up with a way to mitigate the risks
- Ensure adequate documentation on specific customers and transactions with emphasis on details of each bank and its customers

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6.3 International trade is facilitated as per correspondence banks guidelines
Correspondent banking plays a critical role in international trade trough provision of trade finance products with subsequent reduction of the export risks. Those banks however are subject to the stipulated guidelines that outline their operations and service offered. This is important for customer protection and satisfaction. Correspondent bank guidelines are a set of legal framework and guidelines, for operation of both the correspondent and respondent banks in relation to cross border financial transactions. International banking is key to interbank relationships as it entails exchange of capital, goods and services between countries.

In the wake of correspondent banking and the countries response to it, international trade has really advanced as the cross border transfer of funds have been an enhanced enabling financial institutions to access financial services in different currencies and foreign jurisdictions thereby facilitating flow of trade and remittances, credit access etc. and subsequently promoting financial inclusion.

Benefits of international trade

- International trade has led to increased revenues due to the wide range of products being traded different countries.
- It has also fostered peace and goodwill/good working relations with mutual understanding among countries.

- It has reduced trade fluctuations leading to price stability due to the large market size with large supplies and demand.
- It has enhanced efficient production as countries tend to adopt better production methods to cut on costs.
- Resources are efficiently allocated and well utilized as countries opt to produce goods that they have comparative advantage. Promoted financial inclusion.

International trade can be a risky business even in the most established markets. It is faced with different risk challenges as outlined below;

a) **Credit risks:** This is risk that arises due to the lengthy nature of export transactions and is the possibility of debt default by the customer.
b) **Currency risk:** This is a major problem facing international trade and arises due to the use of foreign currency. It is the possibility of financial loss arising from changes in the exchange rates for transactions that have already been entered into and payment is scheduled for the future in foreign currency.
c) **Political risk:** This risk affects commercial transactions in other countries and mostly is as a result of the general political instability and changes in commercial law.

6.4 An interbank account settlement is facilitated as per regulatory and counterparty requirements

Interbank account settlements are accounts arrangements through which funds are transferred between banks for their own account or on behalf of their customers. The settlement must be done in accordance to the regulatory and counter party requirements. The central banks have come to acknowledge inter bank account settlement as an area of strategic interest by becoming increasingly involved in the oversight of operations of settlement systems. Fund transfer process involves two core which are transfer of information between the respondent and correspondent banks and settlement where a fund transfer is reached at after transmitting a payment order requesting transfer of funds to the payee. Settlement is the actual transfer of cash between the payers' bank and payees' bank and is deemed final if it is irrevocable and unconditional. Interbank account settlement is based on transfer of balances of books of the central bank given its status in the monetary systems.

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Systems of interbank fund transfer are categorized as;

a) **Net settlement systems:** This entails settlement of fund transfers on a net basis as per the rules and procedures of the system in which case net position is calculated as bilaterally or multilaterally.
b) **Gross settlement system:** It entails transaction by transaction of account settlement systems.

The following are reason why central banks facilitate inter bank account settlement;

i. Central banks help provide accounts to qualified banks in which balances of the central bank money may be held.
ii. The central bank is mandated to maintain financial stability and implement monetary policy.
iii. So as to provide a monetary asset free of default risk used to make interbank transfers and settle obligations in a bid to manage systemic risks.

The following are risks associated with the interbank account settlement process;

- **Liquidity risk:** It is the risk that a counterparty will not settle an obligation for full value when due at an unspecified time in future.
- **Credit risk:** This is risk associated with default of counterparty and is as a result of the lengthy nature of the transactions. Credit risks leads to loss of unrealized gains on unsettled contracts with the defaulter.

Conclusion

This learning outcome covered; the meaning of correspondence banking and its significance in relation to interbank relationships, an outline of their guidelines and services and how to facilitate interbank settlements as per regulatory requirements as well.

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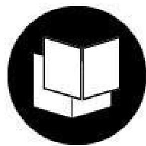
Further Reading



1. Read on the market mechanisms and infrastructures that can be used to help mitigate against account settlement risks.
2. Peter Olfich (2012). Business and Economics

11.3.6.3 Self-Assessment

1. Underlying the application of monopolistic completion model is the idea that trade __________.
   a) Increases market size
   b) Increases consumer choices
   c) Decreases the number of firms in an industry
   d) Allows companies to charge higher prices

2. Identify the trade policy that limits specified quantity of goods to be imported at one tariff rate.
    a) Quota
    b) Specific tariff
    c) Import tariff
    d) All of the above
3. From the following services, which one is not offered by a correspondent bank?
    a) Preparation and offering of credit letters
    b) Accepting deposits of the respondent bank clients
    c) Lender of last resort
    d) Money remittance services
4. International is most likely to generate short term unemployment in?
    a) Import competing industries
    b) Industries that sell only to foreign buyers
    c) Industries in which there are neither imports nor exports
    d) Industries that sell to domestic and foreign buyers
5. Which of the following is not a benefit of correspondence banking?
    a) Promote financial inclusion
    b) Promote availability of financial services by banks in different jurisdictions
    c) Enhanced liquidity risks
    d) Customers enjoy faster and cheaper services
6. The following are roles of central bank in facilitating the interbank account settlement except one. Which one is it?
    a) Maintain financial stability and monetary policy implementation
    b) Lender of last resort
    c) Books of accounts of the counterparty banks must be held with the central bank
    d) Central banks accept deposits of the counterparty banks
7. Which is not a risk associated with international trade?
    a) Credit risk
    b) Translation risk
    c) Political risk
    d) Currency risk
8. Analyse the benefits of international trade
9. Discuss the three types of correspondent banking
10. What do you understand by the term credit risk and elaborate ways of reducing it
11. Suggest reasons why banks carry out due diligence on their customers
12. Elaborate reasons for your recommendations of cross boarder banking

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Oral Assessment

1. Who is counterparty?
2. Who is a respondent bank?

Practical Assessment

Maleek is a Malaysian client with a Malaysian bank account. Maleek needs to pay a British supplier with a British bank account quite a large amount of money for the goods provided at his baby on board holdings in Uganda. Elaborate how the transfer of funds will be made through a correspondent account.

11.3.6.4 Tools, Equipment, Supplies and Materials

- Writing materials
- Projector
- Computer
- Flip chart/white board

11.3.7.5 References

Freixas X., Parigi B. & Rochet J.C (2000) Systemic Risk, Interbank Relations and Liquidity Provision by The Central Bank, Journal of Money, Credit and Banking.

Norman, B. Rachel S. & George S. (2011) History of Interbank Settlement Arrangements, Bank of England, London.

Tedeshi G., Mazloumian. A., Gallegati M. Helbing. D. (2012) Bankruptcy Cascades in Interbank Markets, USA.

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