

ALLAMA IQBAL OPEN UNIVERSITY
Department of Commerce / Business Administration

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Assignments Last Date: 20-02-2027

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Question No. 1

What is a bank? Explain the various kinds of banks working in Pakistan.

(20 Marks)

Answer

1. Definition and Meaning of a Bank

According to the **Banking Companies Ordinance, 1962** of Pakistan, a **banking company** is defined as *"any company which transacts the business of banking, which means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise."*

Fundamentally, a bank functions as a financial intermediary that mobilizes surplus funds from savers and channels them as loans to deficit economic units (investors, businesses, and consumers), facilitating capital formation and macroeconomic stability.

2. Kinds of Banks Operating in Pakistan

The banking sector in Pakistan is regulated by the State Bank of Pakistan (SBP) and comprises several distinct institutional categories:

A. Central Bank (State Bank of Pakistan - SBP)

The apex monetary and banking authority established under the SBP Act, 1956. It manages money supply, issues currency, regulates commercial banks, and acts as the banker to the government.

B. Commercial Banks

Commercial banks form the core of the financial sector, providing short and medium-term financing, deposit accounts, and trade services:

1. **Public Sector Commercial Banks:** State-owned institutions (e.g., National Bank of Pakistan - NBP, First Women Bank).
2. **Private Commercial Banks:** Domestically owned financial institutions (e.g., HBL, UBL, MCB, Allied Bank, Bank Alfalah).
3. **Foreign Banks:** Branches of international banking corporations operating under SBP license (e.g., CitiBank, Deutsche Bank, Standard Chartered).

C. Islamic Banks

Institutions operating strictly under Shariah principles, excluding interest (*Riba*) and prohibited activities.

- **Full-Fledged Islamic Banks:** Meezan Bank, BankIslami, Faysal Bank (converted).
- **Islamic Banking Windows:** Dedicated Shariah-compliant branches of conventional commercial banks.

D. Specialized Banks

Established by government statutes to cater to specific economic sectors:

- **Zarai Taraqiat Bank Limited (ZTBL):** Agricultural sector credit and development.
- **Industrial Development Bank of Pakistan (IDBP):** Industrial project financing.
- **SME Bank Limited:** Financial assistance to Small and Medium Enterprises.

E. Microfinance Banks (MFBs)

Regulated under the Microfinance Institutions Ordinance, 2001, providing collateral-free small loans and micro-deposits to low-income populations (e.g., Khushhali Bank, Mobilink Microfinance Bank, Telenor Bank).

F. Development Finance Institutions (DFIs)

Joint-venture financial institutions providing long-term equity and industrial finance (e.g., Pak-Oman Investment Co., PAIR Investment).

Question No. 2

What are the different types of advances offered by commercial banks to their clients? **(20 Marks)**

Answer**1. Concept of Bank Advances**

Commercial banks deploy mobilized deposits primarily into **advances and loans** to generate profit (net interest margin or spread). An advance is a credit facility extended by a bank to meet the working capital, investment, or personal financial requirements of its borrowers.

2. Classification and Types of Bank Advances

Commercial bank advances in Pakistan are broadly classified into **Funded Facilities** (direct cash disbursement) and **Non-Funded Facilities** (off-balance sheet contingent commitments).

Table 1: Taxonomy of Commercial Bank Advances

Category	Specific Facility Type	Operational Feature
Funded Advances	• Cash Credit (CC) • Overdraft (OD) • Running Finance (RF) • Term Loans • Bill Discounting	Direct outflow of bank funds; interest charged on utilized limit or principal balance.
Non-Funded Advances	• Letter of Credit (LC) • Bank Guarantees (Performance/Bid Bonds) • Standby Letters	Contingent obligation; bank incurs financial liability only upon client default.

A. Cash Credit (CC)

A continuous credit facility granted against the pledge or hypothecation of primary security (goods, raw materials, or stock-in-trade). The borrower can draw cash up to the sanctioned limit, and interest is charged only on the actual daily utilized balance, not the total limit.

B. Overdraft (OD)

An arrangement permitting a current account holder to overdraw their account up to a pre-approved limit. It is ideal for short-term working capital shortfalls and can be secured (against T-bills, fixed deposits) or clean (unsecured based on goodwill).

C. Running Finance (RF)

Widely utilized in Pakistan, RF is a flexible short-term revolving facility for business working capital requirements. Repayment is made through regular business cash inflows, with quarterly interest mark-up servicing.

D. Term Loans

Fixed-amount credit facilities disbursed for a specified duration, repaid in structured periodic installments (EMIs):

- **Short-Term Loans (< 1 Year):** For seasonal business needs or inventory acquisition.
- **Medium and Long-Term Loans (1 – 10 Years):** For capital expenditure, machinery procurement, commercial real estate, or project expansion.

E. Discounting and Purchasing of Commercial Bills

The bank advances cash against trade bills of exchange or export/import documents prior to their maturity date, deducting a discounting fee or mark-up.

F. Consumer Credit Facilities

Personal loans extended to retail customers, including Auto Loans, Home Mortgages, Personal Finance, and Credit Cards.

Question No. 3

Explain in detail the concept of the five Cs of credit and the process to obtain a bank loan. (20 Marks)

Answer

1. The Concept of the Five Cs of Credit

The **Five Cs of Credit** is a globally recognized risk assessment framework utilized by commercial bank credit committees to evaluate a loan applicant's creditworthiness and probability of default.

The 5 Cs Credit Assessment Framework

1. **Character:** The applicant's moral standing, integrity, management quality, and willingness to repay obligations. Verified via past repayment records, market reputation, and SBP **eCIB (Electronic Credit Information Bureau)** reports.
2. **Capacity:** The primary source of repayment—evaluating the borrower's financial ability to service debt from operational cash flows. Measured using metrics like Debt-Service Coverage Ratio (DSCR) and Debt-to-Equity ratio.
3. **Capital:** The borrower's own financial stake or equity contribution in the business (*"skin in the game"*). Higher capital contribution indicates commitment and lowers bank risk.
4. **Collateral:** Secondary protection or security pledged to the bank (land, buildings, plant, deposits) that can be liquidated if the borrower defaults.
5. **Conditions:** External macroeconomic conditions, industry growth prospects, interest rate trends, and specific loan purpose affecting borrower performance.

2. Systematic Process to Obtain a Bank Loan

The loan acquisition journey in Pakistani commercial banks follows a structured regulatory and operational workflow:

Table 2: End-to-End Bank Loan Processing Stages

Stage	Process Step	Key Operational Deliverables
1	Loan Application & Prospecting	Submission of formal application form, business profile, and borrowing request.
2	Document Submission & KYC	Providing CNIC, financial statements (3 years), tax returns, bank statements, legal titles.
3	Credit Appraisal & eCIB Check	Relationship Manager drafts Credit Proposal (CP); SBP eCIB check for default history.
4	Collateral Valuation & Legal Search	Independent valuation of pledged assets by SBP-approved valuers; legal title clearance.
5	Credit Committee Approval	Review by Risk Management; issuance of formal Sanction Advice / Offer Letter .
6	Legal Execution & Security Creation	Signing of Loan Agreements, Promissory Notes, and Legal Charge creation (e.g., SECP registration).
7	Disbursement & Monitoring	Disbursal of funds to account; ongoing monitoring of stock inspections and turnover.

Question No. 4

Briefly discuss the role and functions of the State Bank of Pakistan.

(20 Marks)**Answer****1. Establishment and Status of the State Bank of Pakistan**

The **State Bank of Pakistan (SBP)** was inaugurated by Quaid-e-Azam Muhammad Ali Jinnah on July 1, 1948. Established under the State Bank of Pakistan Act, 1956 (amended in 2022 to grant operational autonomy), the SBP serves as the nation's central bank, responsible for monetary stability, financial sector soundness, and economic growth.

2. Core Functions of the State Bank of Pakistan**A. Monopoly of Currency Note Issue**

The SBP holds exclusive sovereign rights to issue banknotes and regulate coinage in Pakistan. It manages currency distribution through its subsidiary, SBP Banking Services Corporation (BSC), ensuring supply integrity and security.

B. Formulator and Executor of Monetary Policy

Through its independent **Monetary Policy Committee (MPC)**, the SBP formulates and implements monetary policy to achieve price stability and sustainable growth:

- **Policy Rate Adjustments:** Setting the benchmark interest rate (repo/discount rate).
- **Open Market Operations (OMOs):** Injecting or mopping up liquidity via T-bill/PIB transactions.
- **Reserve Requirements:** Adjusting the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR).

C. Banker and Advisor to the Government

- Maintains federal and provincial government treasury accounts.
- Manages public debt issuance (floating Treasury Bills and PIBs).
- Provides financial and economic policy advice to the Ministry of Finance.

D. Banker to Commercial Banks (Lender of Last Resort)

- Maintains statutory cash reserves of all scheduled commercial banks.
- Provides emergency liquidity assistance as the *Lender of Last Resort* during banking distress.
- Operates the national clearing house system (**NIFT**) and real-time gross settlement system (**PRISM**).

E. Regulator and Supervisor of the Financial System

Under the Banking Companies Ordinance 1962, the SBP issues Prudential Regulations, licenses new banks, conducts on-site inspections, and enforces AML/CFT compliance.

F. Custodian of Foreign Exchange Reserves

Manages national foreign currency reserves, enforces the Foreign Exchange Regulation Act 1947, and oversees exchange rate stability.

Question No. 5

Write a note on the following:

(20 Marks)

- i. Islamic banking**
- ii. Digital banking**
- iii. Microfinance banks**
- iv. ATM**

Answer

i. Islamic Banking

Islamic Banking refers to a financial system guided by Islamic Law (*Shariah*). Its foundational principles prohibit **Riba** (usury/interest), **Gharar** (excessive ambiguity/speculation), and **Maysir** (gambling), while requiring transactions to be asset-backed.

Core Islamic financial contracts include:

- **Murabaha:** Cost-plus profit sale agreement.
- **Ijarah:** Shariah-compliant leasing model.
- **Musharakah & Mudarabah:** Equity partnership and profit-and-loss sharing models.

In Pakistan, Islamic banking operates under strict SBP Shariah Board supervision, with full-fledged banks like Meezan Bank leading market share.

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ii. Digital Banking

Digital Banking encompasses the complete digitization of traditional banking operations, eliminating paper transactions and physical branch visits. Services are delivered via mobile applications, internet banking portals, and open banking APIs.

Key milestones in Pakistan include the State Bank of Pakistan's launch of **Raast** (instant peer-to-pay payment platform) and the issuance of licenses for standalone **Digital Banks** under the SBP Digital Bank Regulatory Framework.

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iii. Microfinance Banks

Microfinance Banks (MFBs) are specialized financial institutions established under the Microfinance Institutions Ordinance, 2001. They cater to low-income individuals, micro-entrepreneurs, and unbanked segments by providing micro-loans, micro-savings, and insurance without traditional asset collateral requirements.

Prominent MFBs in Pakistan include Khushhali Microfinance Bank, Mobilink Microfinance Bank, and Telenor Microfinance Bank, playing a crucial role in financial inclusion and poverty alleviation.

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iv. Automated Teller Machine (ATM)

An **Automated Teller Machine (ATM)** is a computerized telecommunications device that provides retail banking clients with 24/7 self-service financial transactions without a human teller.

Key functions and features of ATMs include:

- **Financial Services:** Instant cash withdrawal, fund transfers, utility bill payments, and balance inquiries.

- **Interoperability Network:** In Pakistan, all ATMs are integrated through the **1LINK** and **MNET** switch networks, allowing cross-bank card usage.
- **Security Mechanisms:** EMV chip technology, Personal Identification Number (PIN) encryption, and biometric thumbprint verification.