

**CA FINAL**  
**ELECTIVE PAPER 6A: RISK MANAGEMENT**  
**Case Study**

ZEO Payment Technology is one of promising Financial Technology Start Up Company in India. ZEO is founded in 2015 and has emerged as one of the largest player in India's Domestic Money Transfer (DMT) (Cash to Bank) segment. It is an award winning Online Transaction platform for DMT, Payments and Travel. ZEO has won several accolades and awards such as the prestigious National Payments Excellence Award 2016 organized by the National Payment Council of India for the largest number of transactions on the IMPS (non-Bank category). ZEO has one of the largest cash collection network agents in the country to work on cash collection and banking activities.

RA has founded ZEO and is now aspiring to apply for the Small Payment Bank License. The application has to be made to a Statutory Authority. As per the Statutory Authority's guidelines the payment bank applicant have to submit the top 10 risk scenarios that they would face while operating a Small Payment Bank in India.

The Board of ZEO would then evaluate the risk scenarios and prepare a formal report to adopt the risk scenarios with specific risk management actions. Post discussions at the Board and adoption of the risk scenarios, RA would make the application to the Statutory Authority for transforming ZEO into a Small Payment Bank.

Required:

1. Design any 5 risk scenarios in the following format out of risk scenarios given in Exhibits.

Risk Scenario Title	
Scenario description	
Impact of scenario	
Current measures to manage risks	

(4 marks for each scenarios)

2. Prepare a report to the Board of ZEO including:
- (i) Bucketing of above identified risks
  - (ii) Likelihood Scale (10 marks)
3. Multi Choice Questions (MCQs)
- (i) Which among the following is the most potent measure to prevent a cyber-attack on a Small Payment Bank?
    - (a) Control of physical access to the system
    - (b) Strong Password
    - (c) Multi-layer authentication
    - (d) All of the above
  - (ii) What is the most important advice that the RBI gave to banks to prevent bank frauds?
    - (a) Thorough performance evaluation of bank employees.
    - (b) Conducting investor awareness programs regularly to inform and train customers to apprehend fraud.
    - (c) Proactive fraud control initiatives.
    - (d) All of the above
  - (iii) How RBI ensures to prevent money laundering activities?
    - (a) All cash transactions of more than ₹10,00,000 requires an Aadhar number.
    - (b) Any financial transaction above ₹500000 required an Aadhar Number.
    - (c) Both (a) and (b)
    - (d) None of the above
  - (iv) Every unlisted company having a paid up share capital of ₹10 crore or more is not required to constitute a/an
    - (a) Audit committee
    - (b) Nomination and Remuneration Committee
    - (c) Risk Management Committee
    - (d) Suitable policy for training and performance evaluation of directors.
  - (v) What is the main source of worry to banks regarding their customers?
    - (a) Cashback facilities offered by e-wallet companies.

- (b) Non-banks are getting access to their customer information through third party applications.
  - (c) Deficiencies in sale of third party investment products by lenders.
  - (d) Non-adherence to the RBI instructions with regard to mobile or electronic banking services.
- (vi) In a Risk Enabled and Risk Managed Organisations \_\_\_\_\_ is a Monitoring tool to track progress of risk management.
- (a) Flow Charts with Risk Flags
  - (b) Risk Event Maps
  - (c) Risk Scorecards
  - (d) Value at Risk
- (vii) On likelihood scale an event that happens every 10 years or more in the industry shall be placed at level\_\_\_\_\_.
- (a) 1
  - (b) 2
  - (c) 3
  - (d) 4
- (viii) The two oil shocks in 1970s triggered unusually severe economic consequences. These episodes for many institutions represent stress scenarios.
- (a) Normal
  - (b) Severe
  - (c) Near Default
  - (d) Stress to Default
- (ix) ABN-Amro Bank, Amsterdam, wants to purchase ₹15 million against US\$ for funding their Vostro account with Canara Bank, New Delhi. Assuming the inter-bank, rates of US\$ is ₹51.3625/3700, what would be the rate Canara Bank would quote to ABN-Amro Bank? Further, if the deal is struck, the equivalent US\$ amount would be.
- (a) US\$ 2,92,041.86
  - (b) US\$ 2,94,041.86
  - (c) US\$ 2,91,999.22
  - (d) US\$ 2,93,999.22

- (x) Which of the following technique to hedge interest rate risk the premium is least or nil.
- (a) Cap
  - (b) Floor
  - (c) Collar
  - (d) None of these
- (10 x 2 = 20 marks)

## Exhibit 1

### Cyber-attack on the website and systems

Recently, the systems of a PSU Bank have been hacked to create fake documents that may have been used to raise money outside India or help in dealing of prohibited items. The fake document may be letter of credit (LC) or guarantees. The bank later realised that their SWIFT (Society for World Wide Interbank Financial Telecommunication) system have been used to create fake documents. SWIFT is a financial messaging service which is used by banks to move millions of dollars and documents in various countries.

Therefore, the person who hacked into the system to create a fake LC may put it before a foreign bank for finance. However, the Indian Bank, whose system has been used to create a fake L.C., may face a claim for money when a foreign bank tries to recover its money released against an LC.

Some measures have been taken to prevent such reoccurrences in future. Firstly, physical access to the system must be controlled. Secondly, strong password and multi-layer authentication policy should be there. And, lastly, identity and token management policies are needed to control who has access to data.

SWIFT customers should have in place a system of detecting any unusual activity and how the staff shall respond when such an untoward event happens.

*(Extract from an article)*

## Exhibit 2

### Bank Fraud

In a leading multinational bank, a banking fraud of ₹400 has been taken place. The fraud has happened because of the mastermind of an employee named Lalit. The modus operandi of Lalit was to sell investment products to high net worth individuals (HNIs). He falsely projected to the HNIs that these financial products are authorised by the bank's investment product committee.

So, he lured them by convincing them that their investments would be invested in lucrative schemes giving good returns. Then, he transferred the funds accumulated from HNIs to some fictitious accounts. Funds amounting to Rs 400 crore belonging to about 20 customers were transferred to such accounts. He, then, used the money to invest it into the stock market.

Modus operandi was simple. He lured customers with a fake circular by SEBI promising 2-3% returns per month. The fake circular also mentioned a custodian that route investor funds. Lalit also use some blank cheques and he used this to transfer money out of their accounts directly to the brokerages to be invested in the stock market.

The RBI has issued master circular advising banks to set up internal control system to combat frauds and to take pro-active fraud control and enforcement measures.

*(Source : Extract from a leading financial daily)*

## Exhibit 3

### **Use of company channels for illegal business or money laundering activities**

In ABC Bank, allegations of money laundering surfaces. Allegation was that foreign exchange to the value of 557 crore has been sent out of India through 11 fictitious firms under the shadow of imports.

Further, investigations disclosed that a person alongwith his partner operated 66 accounts at ABC. Further, bank records showed that ₹505 was deposited by the accused and remitted abroad through this bank during 2012 to 2016.

He was making illegal fund transfers to Hong Kong on the basis of forged import documents. He had two companies in Hong Kong PQ and ZY. Funds were actually remitted to these two firms. The accounts in Hong Kong were in the CEO Bank from where the funds were transferred to China.

The Government of India has taken some initiatives to curb the practice of money laundering as illustrated above on the following lines:

The Government has made it mandatory for banks and financial institutions to check the original identification documents of individuals dealing in cash above the prescribed threshold, to weed out the use of forged or fake copies.

As per Rule 9 of RBI, every reporting entity shall at the time of commencement of an account-based relationship, identify its clients, verify their identity and obtain information on the purpose and intended nature of the business relationship. Intermediaries like stockbroker, Chit Fund Company, cooperative bank, housing finance institution and non-banking finance companies are also classified as reporting entities.

Biometric identification number Aadhaar and other official documents are required to be obtained by the reporting entities from anyone opening a bank account as well as for any financial transaction of Rs 50,000 and above.

The same is also required for all cash dealing of more than Rs 10 lakh or its equivalent in foreign currency, cash transactions where forged or counterfeit currency notes have been used and all suspicious transactions.

All cross-border wire transfers of more than Rs 5 lakh in foreign currency and purchase and sale of immovable property valued at Rs 50 lakh or more also fall under this category, according to the reporting rules.

The Gazette notification said in case the officially valid document furnished does not contain updated address, a utility bill like electricity, telephone, post-paid mobile phone, piped gas or water bill which is not more than two months old can be considered as a proof of address.

Also, property or municipal tax receipt, pension or family pension payment orders issued to retired employees by Government departments, or letter of allotment of accommodation from employer can be considered for the same purpose.

*(Source : Extract from a leading financial daily)*

## Exhibit 4

### **Natural Calamity impacting continuity of business operations**

Small businesses are personally affected by a storm, earthquake or extreme weather. Since ZEO payment technology is a small financial technology company, it can feel the pinch of a natural disaster, in case it happens.

When a natural calamity took place, it affects the supply chain of an organisation severely. When the devastating flood took place in Thailand in 2011, the impact was felt the world over, affecting almost every industry from electronics to automobile. It leads to break down of supply of many crucial components. This prompted many companies to outsource their supply chain to a few low cost countries. However, the business of a fintech company may also be impacted if the physical office from which it conducts its business is also being affected by the natural disaster.

*(Source : Extract from a leading Financial Daily)*

## Exhibit 5

### **Non-compliance with legal requirements leading to penalties**

ZEO is a fintech company. Peer to Peer (P 2 P) lending is currently in vogue in ZEO as is the case in other companies. P 2 P lending creates a market for lenders and borrowers to connect immediately.

Further, with the use of P 2 P remittance platforms such as Transferwise creates a market place where outgoing remittances are matched with incoming remittances. For example, if a person in London wants to remit some money to India would deposit the amount in platforms' London office. The platforms' algorithm would detect another person in India who would want to transfer some money to London. Then, the platform matches and "nets" the transaction. So, the money never actually leaves the jurisdiction of a country.

However, the difficulty is that Indian rupee is not freely convertible and Foreign Exchange Management Act, 1999 i.e. FEMA has provided certain regulations which curbs the free flow of money. Compliance function has to ensure strict compliance of Banking Regulation Act, RBI Act, FEMA, Prevention of Money Laundering Act etc.

All peer-to-peer lending (P2P) platforms will be regulated by the Reserve Bank of India (RBI), according to a government of India notification. The Reserve Bank of India (RBI) said, through an 18 September, 2017 gazette notification, those peer-to-peer lenders (P2P)—companies that provide loan facilitation services from their platform—will be treated as non-banking financial companies (NBFCs).

The Reserve Bank of India's move to allow up to 100% foreign direct investment (FDI) in regulated financial services companies other than banks or insurance companies through the automatic route is likely to benefit several fintech startups

as it is expected to ease equity funding norms, increase investor interest, and also help them expand into more financial services.

*(Source : Extract from a leading Financial Daily)*

## **Exhibit 6**

### **Corporate Governance Issues**

ZEO Payment Technology is a small unlisted company willing to venture into the field of Small Payment Bank. ZEO has 6 directors out of which one is independent director. The paid up share capital of the company is ₹12 crore. However, the company is yet to draft a suitable policy for training and performance evaluation of directors.

Some of the provisions of the Companies Act, 2013 relating to Corporate Governance have been given in the following sentences. Every company having a paid up share capital of ₹10 crore or more has to constitute an audit committee and shall have atleast two independent directors. Further, it is required to appoint a Nomination and Remuneration Committee and draft a suitable policy for training and performance evaluation of directors. Also, a company having a paid share capital of ₹50 crore or more OR a turnover of ₹200 crore or more has to appoint an internal auditor to conduct internal audit of the functions and activities of the company.

The new Companies Act has given powers to Serious Fraud Investigation Office (SFIO) to carry out arrests, raids and seizure in respect of certain offences of the act which attract the punishment for fraud. Further, as per the section 212, on the intimation of special resolution passed by the company, SFIO can investigate into the affairs of the company or on the receipt of a report of the Registrar or inspector or in the public interest or on request from any Department of the Central Government or a State Government.

Moreover, the Companies Act, 2013 do not contain any compulsory provision for constitution of a Risk Management Committee. However, it requires its Board to develop and implement a risk management policy and identify risks which may threaten the existence of the company.

## Exhibit 7

### **3.2 million debit cards compromised; IBS, CFDH Bank, CCC Bank, No Bank and ITU Bank worst hit**

Banks in India will either replace or ask users to change the security codes of as many as 3.2 million debit cards in what's emerging as one of the biggest ever breaches of financial data in India, people aware of the matter said. Several victims have reported unauthorised usage from locations in China.

Of the cards, 2.6 million are said to be on the Visa and Master-Card platform and 600,000 on the RuPay platform. The worst-hit of the card-issuing banks are IBS, Bank, CFDH Banks, CCC Bank and No Bank.

The breach is said to have originated in malware introduced in systems of Sakura Payment Services, enabling fraudsters to steal information allowing them to steal funds.

CFDH Bank said it had already taken action in the matter a few weeks back. "Besides advising those customers who we know have used a non- CFDH Bank ATM in the recent past to change (their) ATM PIN, we are advising our customers to use only CFDH Bank ATMs as we believe security controls at some of the other bank ATMs may not be at par with HDFC Bank ATMs".

The newspaper had reported on Wednesday that IBS Bank would reissue 600,000 debit cards following a malware-related security breach and has asked customers to change their PIN numbers as well.

*(Source : Extract from a leading Financial Daily)*

## Exhibit 8

### **Legal suits, claims by third parties**

PhoneSe is a third party app owned by Blipmart. And, it becomes a part of UPI through a partnership with No Bank. Blipmart recently integrated UPI payments on its website and is offering customers cashback on their e-wallet on PhoneSe UPI payment.

However, banks have expressed worry that non-banks are getting access to their customer information through third party applications developed for the Unified Payment Interface (UPI).

Therefore, PQRST Bank has blocked customers from accessing their accounts using the PhoneSe UPI applications.

The RBI on June, 2017 has widened the scope of its Banking Ombudsman Scheme 2006 to include deficiencies arising out of sale of third-party investment products by lenders. Under the amended scheme, a customer would also be able to lodge a

complaint against banks for non-adherence to the RBI instructions with regard to mobile or electronic banking services.

Following the amendment, the pecuniary jurisdiction of the ombudsman to pass an award has been doubled from ₹10 lakh to ₹ 20 lakh. The ombudsman has been empowered to award compensation not exceeding ₹ 1 lakh for loss of time, expenses incurred and also harassment and mental anguish suffered by the complainant. There is also an option for customers to go in for appeal in respects to closed complaints which was not available earlier.

*(Source : Extract from a leading Financial Daily)*

## **Exhibit 9**

### **Rumors Spark Run On Indian Bank**

Wall Street's worries made their way to India Tuesday as CCC Bank , the country's largest private-sector bank, saw hundreds of clients withdrawing cash at branches and ATMs in some parts of the country on rumors that the bank could fail.

Chief Executive K.V. Kumar said the rumors were "baseless and malicious." Central Bank, in an unprecedented move, issued a statement saying there was enough liquidity at CCC Bank and the Central Bank had arranged to provide adequate cash to the bank to meet the demands of customers.

So far, CCC is the only Indian bank that has been directly hit by the recent disasters on Wall Street. Its U.K. subsidiary has \$80 million in exposure to Lehman Brothers , a substantial portion of which may have to be written down, said Ajit Saxena, an analyst with Benaam Securities, a Mumbai-based financial services firm, in a report. The subsidiary has a provision of about \$12 million against investment in these bonds.

"The key worry, of course, remains that if any other global bank or financial institution files for bankruptcy, CCC may have to take further losses, the extent of which is not known," the Benaam report says. Total capital base of overseas subsidiaries stood at \$800 million in the first quarter of fiscal year 2009.

CCC Bank, through its U.K. and Canadian subsidiaries, has around \$5 billion of investment book (largely bonds, certificates of deposit and other treasury assets). Of this, roughly 60% is invested in various U.S. and European banks. "The recent crisis could lead to high MTM [mark-to-market] losses in the overseas investment book," Saxena added.

According to Indian media reports, anxious CCC customers rushed to withdraw their money from ATMs and branches after rumors the bank was in trouble due to exposure to Wall Street's mess.

CCC, which has consolidated assets of \$105 billion, saw net profits of \$900 million in fiscal year 2008 on revenue of \$10 billion and \$155 million in the first quarter of

this year on revenue of \$2.2 billion. But it has seen its stock price hammered from a 52-week high of \$37 (Jan. 14) to \$9.60 Tuesday.

As of June 30, it had a capital adequacy ratio of 13.4%, well above the regulatory requirement of 9%. Kumar added that the U.K. subsidiary had zero exposure to U.S. subprime credit and zero non-performing loans. If only Wall Street was so lucky.

*(Source: Extract from a leading Financial Magazine)*

## Exhibit 10

### EMAIL

From: Lee Port

To: Mr. Z (CEO of ZBO Payment Bank)

Dated:.....

**Subject: Pitch Presentation for financing of proposed small payment bank under the FDI Scheme of Govt. of India**

Hi Z,

This has reference to your last week's Pitch Presentation at Singapore for making investment in your proposed Small Payment bank in India. While the idea of this type of banking is naïve in India but the most catchy feature of the same is to reach consumers through mobile phones rather than traditional system of bank branches as it is quite uneconomical affair for the banks to open branch in each and every village of India. This is a good initiate by Govt. of India as a major step towards financial inclusion in India where a major part of population is living in villages.

Before we forward your proposal of investing the funds in your start-up to the Board please confirm the following unique features of the proposed Small Payment Banks:

- Payment bank will reduce the dependency on Cash and will increase m-commerce as mobile wallet will be used as payment option.
- Payment Bank will invest 75% of its demand deposits in Government Securities and Treasury Bills and balance 25% can be held as fixed deposits with other Scheduled Commercial Banks.
- Payment bank can also provide Forex Cards to the travellers.
- Payment Bank will get a big chunk of deposit comparing to commercial banks due to reason of providing higher interest rates.

In case there is any deviation in above points please let us know immediately.

Thanks,

Lee Port