Bank Fraud in Crescent Investment Bank

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Submitted on:

January 15, 2008.

Class:

BBA-2K8-C

Abstract:

The paper tells about Crescent Investment Bank's fraud case, with the involvement of the bank's CEO who was stopped from officiating as the chief executive until the court decision came out. The paper examines other fraud cases around the world on which research papers have been written and the consequences of fraud. Fraud by top management is a topic that has stirred public interest, concern, and controversy. In this paper, we analyze fraud by senior executives in terms of its nature, scope, antecedents, and consequences.

Introduction:

In October 2006, the CEO of Crescent Investment Bank, Anjum Saleem and his brother, Altaf Saleem, Chairman of Earthquake Rehabilitation and Reconstruction Authority (ERRA), were found to be illegally benefiting from the bank's assets.

This was investigated by two Security and Exchange Commission of Pakistan (SECP) officials Jaweria Athar and Shoaib Adnan , who later resigned, stating they had differences with the SECP chairman, but inside information told it was due to strong government pressure. The SECP stopped Anjum Saleem from officiating as the bank's chief executive along with suspending the board of directors.

The SECP has already appointed Badruddin Khan Administrator of the bank and has also stopped Anjum Saleem from officiating as the bank's chief executive. This scam could deprive individual depositors of Rs 1.6 billion. The resignations came at a time when the SECP was considering various options to protect depositors from severe losses. The bank's assets are valued at around Rs 8 billion, while its liabilities amount to around Rs 9.5 billion. The SECP has been pressing sponsors to inject equity of at least Rs 2 billion to allow the bank to resume normal functions.

Methodology:

To write this research article, we surfed various websites online, like Google and Wikipedia and newspaper articles. We could not find any research paper on this as the decision of the bank fraud is still in court and therefore undecided. However we have done our best to dig as deep as our resources allowed into this issue. Our introduction basically tells about the issue at hand and the literature review tells about bank fraud in other cases and its consequences. We took help of our professors, Sir Shariq and Sir Fazli Azim, who guided us very well.

Literature review:

- **O'Hara and R. Macey (April 2003) found out that, "bank directors take solvency risk explicitly and systematically into account when making decisions or else face personal liability for failure to do so."**

- **Drummond (2002) explains, "Why Barings' management failed to respond effectively to those danger signs and considers the lessons to be learned."**

- **Eaton (1987) found out, "Because of the supernormal profits that banks must earn, an equilibrium that is sustained by bank reputation will not replicate an equilibrium in which loan repayment is automatically guaranteed."**

- **Jackson & Perraudin (Jan 2002) found out how regulators limit the incidence of securities fraud by encouraging firms to provide managers and dealers with suitable incentives and by imposing ex post penalties once a scam has been exposed.**

- **S. Kroszner (1998) writes, "Indeed, one of the most important findings issuing from this research is that the regulatory safety net has often had the unfortunate impact of undermining rather than promoting financial stability."**

- **Gerety and Lehn (1997) wrote that costs and benefits of bank fraud can be varied by external forces, through institutions such as equity markets and independent auditors, or internally through the design of observing and reward systems. They**

wrote, “We will divide our attention between the external and internal forces that change the costs and benefits of accounting fraud.”

- **Priem, Rasheed and Zahra (2005) had reviewed the consequences of management fraud on various stakeholder groups such as shareholders, debt holders, managers, local communities, and society.**

- **Uzan and Song (2004) found that there was little evidence that the market disciplines entrant commercial banks as underwriters who also diversify across traditional banking business.**

- **Tschoegl and Kofford (1997) concluded that fraud against banks is common, but typically goes unpunished; prosecutors are apparently not interested in such cases. Bankers and prosecutors must make the prosecution of bank fraud a priority.**

- **Lugo 2004 writes, corruption impedes organizational development through quadri-damages (evolutionary hazard, strategic impediment, competitive disadvantage and organizational deficiency; and (5) illuminates a corruption-resisting architecture comprising corporate culture, organizational structure and compliance system.**

Discussion and Conclusion:

The collapse of a bank shows what may lie behind an appearing to be successful organization. A bank may be destroyed by the illegal activities of an borrower, by appearing to be earning phenomenal profits, while in reality he may be going through huge and eventually disastrous losses. A banks collapse can be immediate and would entirely wipe out the bank, and no one may have the slightest clue of the upcoming doom even when indicative signs of malfeasance may be present.

For their reputations as enforcers of contracts to be respected and constant, it is a requirement that banks earn strictly positive profits. Maintaining the value of bank equity also provides an incentive for bank owners to invest deposits rather than using them up illegally. Because of the extraordinary profits which banks must earn, an equilibrium

that is sustained by the banks good image will not replicate an in which loan repayment is confirmed.

Frauds in investment banks, in recent years, have proven how delicate and

vulnerable modern financial institutions are to illegal activities practiced by their employees. A solution to this problem can be in the form of regulators, which limit the occurence of frauds by encouraging firms to provide managers and dealers with appropriate incentives and by imposing ex post penalties once a frauds been discovered.

One of the fundamental purposes of corporate accounting is to facilitate the monitoring of managers. Since managers are essential in the production of accounting numbers, and since it is risky and uneasy to observe their behavior in this regard, firms at times report false accounting numbers. Directors of companies that commit frauds are obviously not disciplined in the managerial\par labour market, and their decision to commit a fraud is based on comparing the\par relative advantages and disadvantages of the commitment of the fraud.

Reputation can be effective in ensuring that borrowers fulfill their contracts. However, there is a general lack of credit reporting institutions to share information about credit-worthiness; this need to be remedied. The heavy reliance on collateral imposes high costs on borrowers and lenders. For collateral to work properly, banks must be able to perfect the collateral and to dispose of it quickly. Finally, fraud against banks is common, but typically goes unpunished; prosecutors are apparently not interested in such cases. Bankers and prosecutors must make the prosecution of bank fraud a priority.

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