Chapter-5

Banking Sector Performance, Regulation and Bank Supervision

5.1 Industry Statistics of the banking sector and the performances trends have been discussed in this chapter. The banking sector of Bangladesh comprises of four categories of scheduled banks. These are nationalized commercial banks (NCBs), government owned development finance institutions (DFIs), private commercial banks (PCBs) and foreign commercial banks (FCBs). The number of banks came down from 49 in 2004 to 48 in 2005 due to acquisition of American Express Bank by the Standard Chartered Bank. These banks have a total number of 6412 branches (including 10 overseas branches) as of December 2005. The number of bank branches increased from 6303 to 6412 due to opening of new branches by the PCBs mainly during the year. Structure of the banking sector with breakdown by type of banks is shown in Table 5.1 below:

Table 5.1 Banking system structure

(billion Taka)

Bank types	2004						2005					
	Number of banks	Number of branches	Total assets	% of industry assets	deposits	% of deposits	Number of banks	Number of branches	Total assets	% of industry assets	deposits	% of deposits
NCBs	4	3388	683.7	39.6	567.5	42.8	4	3393	763.1	37.4	621.3	40.0
DFIs	5	1328	167.9	9.7	75.1	5.7	5	1340	197.2	9.7	89.5	5.8
PCBs	30	1550	749.3	43.5	588.0	44.3	30	1638	934.3	45.6	731.3	47.0
FCBs	10	37	124.6	7.2	95.5	7.2	09	41	148.2	7.3	112.6	7.2
Total	**49**	**6303**	**1725.5**	**100.0**	**1326.1**	**100.0**	**48**	**6412**	**2042.8**	**100.0**	**1554.7**	**100.0**

5.2 In 2005 the nationalized commercial banks (NCBs) held 37.4 percent of the total industry assets as against 39.6 percent in 2004. Evidently, NCBs' domination in this area is showing a declining trend, while PCBs share rose to 45.6 percent in 2005 as against 43.5 percent in 2004. The foreign commercial banks held 7.3 percent of the industry assets in 2005, showing a satisfactory increase by 0.1 percentage point over the previous year. The DFIs' shares of assets remained unchanged at 9.7 percent in 2005.

5.3 Total deposits of the banks in 2005 rose to Taka 1554.7 billion from Taka 1326.1 billion in 2004 showing an overall increase by 17.24 percent. The NCBs' (comprising of 4 largest banks) share in deposits decreased from 42.8 percent in 2004 to 40.0 percent in 2005. On the other hand, PCBs' deposits in 2005 amounted to Taka 731.3 billion or 47.0 percent of the total industry deposit against Taka 588.0 billion or 44.3 percent in 2004. FCBs' deposits in 2005 rose by Taka 17.1 billion or 17.9 percent over the previous year. The DFIs' deposits in 2005 were Taka 89.5 billion against Taka 75.1 billion in 2004 showing an increase of 19.2 percent over the year.

Aggregated Balance Sheet

5.4 **Assets:** Aggregate industry assets in 2005 registered an overall increase by 18.4 percent over 2004. During this period, NCBs' assets

Chart 5.1

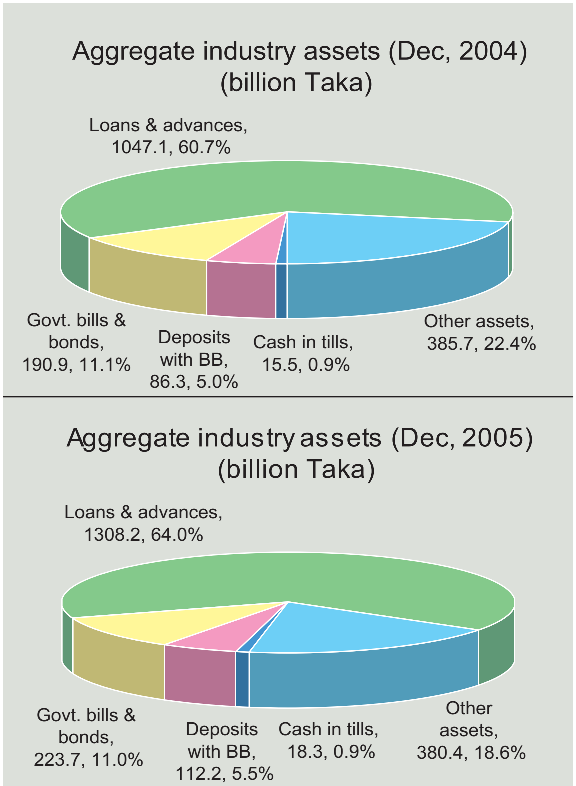
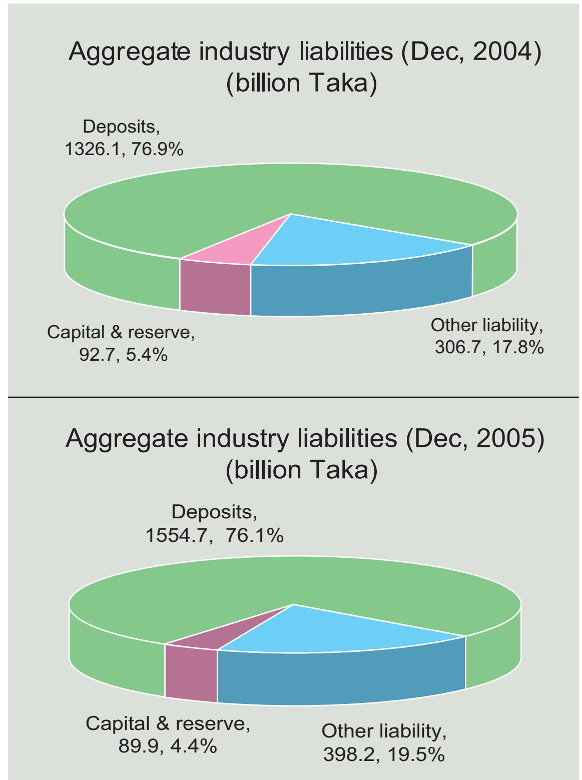


Chart 5.2



increased by 11.6 percent and those of the PCBs rose by 24.7 percent. Loans and advances played a major role on the uses of fund. Loans and advances amounting to Taka 1308.2 billion out of aggregate assets of Taka 2042.8 billion constituted a significant portion (64 percent). Cash in tills were Taka 18.3 billion (below 1.0 percent); Deposits with Bangladesh Bank were Taka 112.2 billion or 5.5 percent. Other Assets were Taka 380.4 billion or 18.6 percent and investment in government bills and bonds accounted for 11.0 percent (Taka 223.7 billion) of the assets.

5.5 **Liabilities:** The aggregated liability portfolio of the banking industry in 2005 was Taka 2042.8 billion of which deposits constituted Taka 1554.7 billion or 76.1 percent and continued to be the main sources of fund of banking industry. Capital and reserves of the banks were Taka 89.9 billion or 4.4 percent of aggregate liabilities in 2005, as against Taka 92.7 billion or 5.4 percent in 2004.

Performance and Rating of Banks

5.6 Performance of the banking sector under CAMEL framework, which involves analysis, and evaluation of the five crucial dimensions of banking operations, has been discussed in this chapter. The five indicators used in the rating system are (i) Capital adequacy (ii) Asset quality (iii) Management soundness (iv) Earnings and (v) Liquidity.

Capital Adequacy

5.7 Capital adequacy focuses on the total position of bank capital and protects the depositors from the potential shocks of losses that a bank might incur. It helps absorbing major financial risks (like credit risk, market risk, foreign exchange risk, interest rate risk and risk involved in off-balance sheet operations). Banks in Bangladesh have to maintain a minimum Capital Adequacy Ratio (CAR) of not less than 9.0 percent of their risk weighted assets (with at least 4.5 percent in core capital) or Taka 1.0 billion whichever is higher.

5.8 Table 5.2 shows that as on 31 December 2005 the DFIs, PCBs and FCBs maintained CAR of 9.2, 9.1 and 26.0 percent respectively. The 4 NCBs could not attain the required level. In 2005, Agrani Bank has adjusted its provision shortfall by creating retained loss for Taka 20.0 billion. For this reason, the CAR of NCBs and all banks have declined from 4.1 and 8.7 percent in 2004 to -0.4 and 7.3 percent respectively in 2005 (Chart 5.3). One of the DFIs and 9 PCBs could not maintain required CAR. FCBs maintained 26 percent CAR in 2005, which was the highest during the last 8 years.

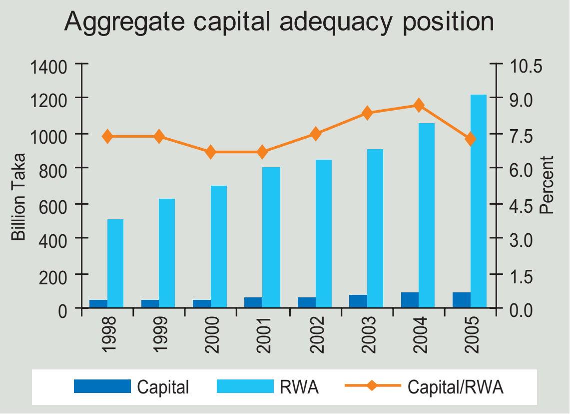
5.9 At present, capital adequacy requirement of the banking sector in Bangladesh is based on Basel-I accord. Bangladesh has decided in principle to adopt the new capital adequacy framework finalized by the Basel Committee on Banking Supervision (BCBS) known as Basel-II. A plan for the implement of Basel-II in Bangladesh has also been chalked out (in Box 5.1).

Table 5.2 Capital to risk weighted assets ratio by type of banks

(Percent)

Bank types	1998	1999	2000	2001	2002	2003	2004	2005
NCBs	5.2	5.3	4.4	4.24	4.1	4.3	4.1	-0.4
DFIs	6.9	5.8	3.2	3.93	6.9	7.7	9.1	9.2
PCBs	9.2	11.0	10.9	9.85	9.7	10.5	10.3	9.1
FCBs	17.1	15.8	18.4	16.84	21.4	22.9	24.2	26.0
Total	**7.3**	**7.4**	**6.7**	**6.7**	**7.5**	**8.4**	**8.7**	**7.3**

Chart 5.3



Box 5.1

Basel II and Plan for its Implementation in Bangladesh

Capital adequacy is the key measure of the soundness and stability of banks. It is defined as the minimum level of capital required to protect a bank from portfolio losses. In 1988, the Basel Committee on Banking Supervision (BCBS) released a capital adequacy measurement system commonly known as the Basel Accord I or Basel I, which is the current international standard framework for assessing capital adequacy of banks. Basel I was initially introduced to assess capital in relation to credit risk and was revised in 1999 taking into account market risk. In June 2004, the Basel Committee published a more comprehensive new package on capital adequacy framework known as Basel II. The new Accord is based on the following three mutually reinforcing pillars:

Pillar 1- Minimum Capital Requirements: This part of the Accord outlines the level of capital by the bank against credit, market and operational risks based on the risk profile of the organization. Under pillar-1, the framework offers three distinct options for assessment of capital for credit risk, which are: Standardized Approach, Foundation Internal Rating Based (IRB) Approach and Advanced Internal Rating Based Approach. The approaches available for computing capital charge for operational risk are: Basic Indicator Approach, Standardized Approach and Advanced Measurement Approach. Whereas the capital requirement as to the market risk remains unchanged, banks will continue to assess the capital charge against the market risk based on the existing instructions under the Basel I.

Pillar 2- Supervisory Review of Capital Adequacy: Pillar-2 addresses supervisory oversight. The supervisory review process requires supervisors to ensure that each bank has sound internal processes in place to assess the adequacy of its capital based on a thorough evaluation of its risks. The new framework stresses the importance of bank management developing an internal capital assessment process and setting targets for capital that are commensurate with the bank's particular risk profile and control environment.

Box 5.1

Basel II and Plan for its Implementation in Bangladesh

Contd.

The four basic and complementary principles on which the Pillar 2 rests are: (i) a bank should have a process for assessing its overall capital adequacy in relation to its risk profile as well as a strategy for maintaining its capital levels; (ii) supervisors should review and evaluate a bank's internal capital adequacy assessment and strategy as well as its compliance with regulatory capital ratios; (iii) supervisors expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum; and (iv) supervisors should seek to intervene at an early stage to prevent capital from dipping below prudential levels.

Pillar 3- Market Discipline: The third pillar of the new framework aims to bolster market discipline through enhanced disclosure by banks. Effective disclosure is essential to ensure that market participants can better understand banks' risk profiles and the adequacy of their capital positions.

Current Status of Implementation Process of Basel I (Bangladesh Scenario)

The Basel I adopted by the BCBS in 1988 was introduced in Bangladesh in 1996. According to Basel I banks are required to maintain a minimum capital ratio that must be equal to at least 8 (eight) percent of total risk weighted assets while at present the ratio of capital to risk weighted asset is 9 percent (with at least 4.5 percent in core capital).

Preparation for Basel II in Bangladesh

The G-10 countries have agreed to implement the new Accord by year-end 2006 while non G-10 countries will take three more years starting from 2007. On the basis of foregoing and keeping in view the global response towards Basel II, the Bangladesh Bank has decided in principle to adopt the Accord in Bangladesh. With a view to ensuring migration to Basel II in a non-disruptive manner, Bangladesh Bank has adopted a consultative approach. It is also agreed in principle that a mix of Standardized and Foundation IRB approach may be adopted for the purpose of Minimum Capital Requirements under Basel II. A high level National Steering Committee comprising of senior officials from banking industry, Bangladesh Bank, and Chartered Accountancy has been constituted. Furthermore, a mid level Coordination Committee for risk based grouping and a Basel II implementation cell have been established. Bangladesh Bank intends to implement the new Accord in early 2009. The Steering Committee is now working on preparation of a roadmap for implementation of the same. The Coordination Committee is assisting the Steering Committee for preparing such roadmap; consideration is being given on the existing capacity of banks and their financial position to meet the additional capital requirement.

Efforts are underway to draw a realistic timeframe so as to give banks sufficient time to prepare themselves for meeting requirements of Basel II. Bangladesh Bank will shortly undertake a quantitative impact study (QIS) to assess the variation in capital requirement of banks.

Basel II is more risk sensitive and comprehensive and its implementation will require improved risk management in banks. As a measure of improving risk management in banks in Bangladesh, Bangladesh Bank has already introduced guidelines on managing core risks in banks. It will create an environment conducive to the development of risk management policies and practices of banks in Bangladesh. As the Accord is new and very complicated document than the 1988 Accord, Bangladesh Bank is considering institutional capacity building to implement Basel II.

Asset Quality

5.10 The asset composition of all commercial banks shows the concentration of loans and advances (64 percent) in total assets. The high concentration of loans and advances indicates vulnerability of assets to credit risk, especially since the portion of non-performing assets is significant. A huge infected loan portfolio has been the major predicament of banks particularly of the state owned banks. In the total assets the share of loans and advances is followed by the investment in government bills and bonds covering 11.0 percent.

5.11 The most important indicator intended to identify problems with asset quality in the loan portfolio is the percentage of gross and net non-performing loans (NPLs) to total advances. FCBs have the lowest and DFIs have the highest ratio of NPLs. NCBs have gross NPLs to total Loans of 21.4 percent whereas in case of PCBs, FCBs and DFIs, the ratios are 5.6 percent, 1.3 percent and 34.9 percent respectively. Similarly NPLs net of provisions and interest suspense to the total Loans is 13.2 percent, 1.8 percent and 22.6 percent for NCBs, PCBs and DFIs. FCBs are having excess provision for loan losses.

5.12 The ratio of NPL to total loans of all the banks shows an encouraging trend since its decline from the peak (41.1 percent) in 1999, although the aggregate ratio is still as high as 13.6 percent in December 2005. The reason is being very high NPL of the NCBs and the DFIs.

5.13 The NCBs and DFIs continue to have very high NPLs mainly due to substantial loans provided by them on considerations other than commercial and under directed credit programmes during the 70s and 80s. Poor appraisal and inadequate follow-up and supervision of the loans disbursed by the NCBs and DFIs in the past eventually resulted in massive booking of poor quality assets which still continue to remain significant in the portfolio of these banks. Furthermore, the banks were reluctant to write-off the historically bad loans because of poor quality of underlying collaterals and to avoid any possible legal complication due to lacunas in the judicial framework. Recovery of NPLs however witnessed some signs of improvement mainly because of the steps taken with regard to internal restructuring of these banks to strengthen their loan recovery mechanism and recovery drive and write-off measures initiated in recent years.

5.14 It appears from the Table 5.3(a) and chart 5.4 (a) that the net non-performing loans to total loans after adjustment of actual provision and interest suspense stands at 13.2 percent (NCBs), 22.6 percent (DFIs), 1.8 percent (PCBs) and 7.2 percent (Banking Sector) in 2005. NCBs' and DFIs' non-performing portfolio is still high after adjustment of actual provision and interest suspense, whereas FCBs has zero net classified loans.

5.15 Chart 5.5 displays the amounts of NPLs of the 4 types of banks since 1998 through 2005. Amount of NPLs of the NCBs increased from Taka 99.6 billion in 2004 to Taka 100.2 billion in 2005 although the ratio had declined. The PCBs recorded a total decrease of Taka 11.0 billion in their NPL accounts, which stood at Taka 35.4 billion in 2005 as against Taka 46.4 billion in 1998. The amount of NPLs of the DFIs decreased to Taka 38.4 billion in 2005 from

Table 5.3 NPL ratios by type of banks

(Percent)

Bank types	1998	1999	2000	2001	2002	2003	2004	2005
NCBs	40.4	45.6	38.6	37.0	33.7	29.0	25.3	21.4
DFIs	66.7	65.0	62.6	61.8	56.1	47.4	42.9	34.9
PCBs	32.7	27.1	22.0	17.0	16.4	12.4	8.5	5.6
FCBs	4.1	3.8	3.4	3.3	2.6	2.7	1.5	1.3
Total	40.7	41.1	34.9	31.5	28.0	22.1	17.6	13.6

Chart 5.4

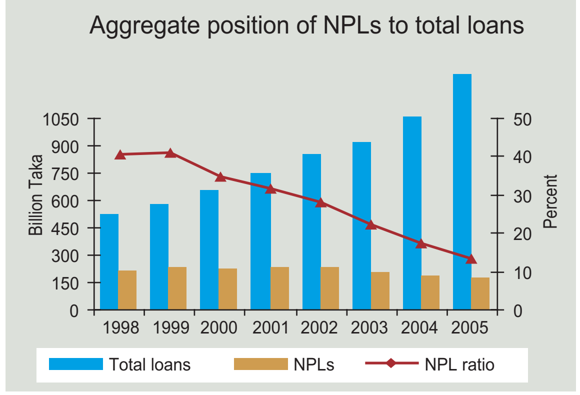


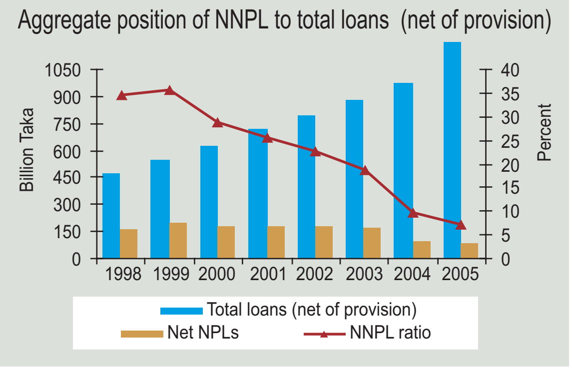
Table 5.3(a) Ratio of net NPL to total loans by type of banks

(Percent)

Bank types	1998	1999	2000	2001	2002	2003	2004	2005
NCBs	35.6	41.3	34.1	32.8	30.1	28.3	17.6	13.2
DFIs	59.1	58.5	54.6	54.5	48.0	38.3	23.0	22.6
PCBs	26.3	21.2	15.5	10.5	10.5	8.3	3.4	1.8
FCBs	0.1	0.9	-0.1	-0.3	-0.4	0.1	-1.5	-2.2
Total	34.4	35.6	28.8	25.6	22.6	18.8	9.8	7.2

* Net of actual provision and interest suspense.

Chart 5.4 (a)



Taka 59.1 billion in 1998. The decline in NPL ratios in the recent years can be attributed partly to some progress in recovery of long outstanding loans and partly to write-offs of loans classified as 'bad' or 'loss'.

Loan Loss Provisioning of the Banks

5.16 Table 5.4 shows the aggregate amounts of NPLs of all banks, amounts of provision required to be maintained and the amounts actually provided by the banks from 1998 to 2005.

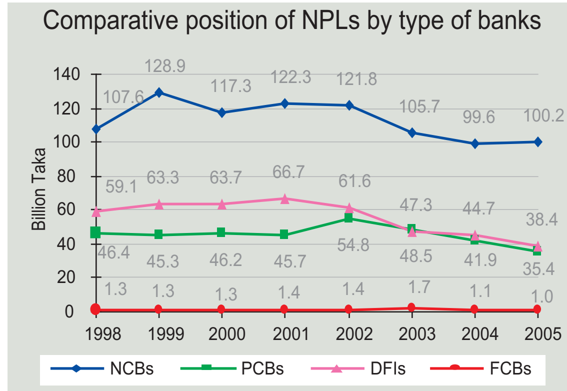
5.17 Table 5.4 and Chart 5.6 depict that in aggregate, banks have been continuously failing to maintain the required level of provisions against their NPLs. During the years from 1998 through 2005, banks could maintain 55.8 percent of the required provision in 2002, which declined thereafter to 48.2 percent in 2005. The main reasons for the continuous shortfall in provision adequacy are the inability of the NCBs and some of the PCBs including those in problem bank category to make sufficient provisions due to inadequate profits and also transferred provision for write-offs. Notably the FCBs are much better in that they have been able to make adequate provisions in the recent years. A comparative position as of end 2004 and 2005 is shown in Table 5.5.

5.18 Out of 30 PCBs, 25 PCBs could make adequate provisions, other 5 failed to maintain adequate provision due to their poor assets portfolio and earning level.

Weighted Average Deposit and Lending Rates

5.19 The weighted average deposit rate, decreased from 5.64 percent to 5.56 percent during the first half of FY06. But the weighted average lending rate of banks increased from 10.92 percent to 11.24 percent during the same period. The spread between lending and deposit rate is the measure of intermediation cost of banks, which has increased over time. It was 5.28 percentage points at the end of FY05, which increased to 5.68 percentage points in the first half of FY06.

Chart 5.5



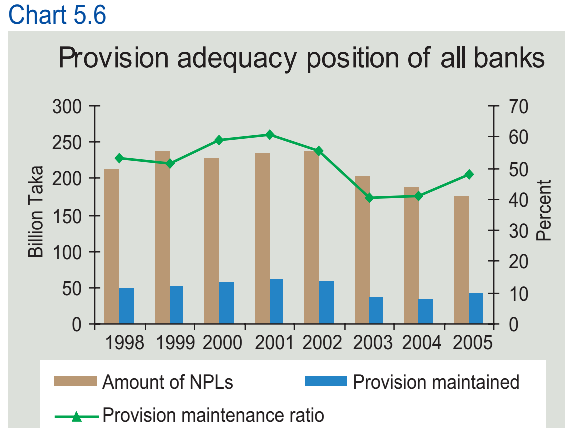
Comparative position of NPLs by type of banks

Table 5.4 Required provision and provision maintained - all banks

(billion Taka)

All banks	1998	1999	2000	2001	2002	2003	2004	2005
Amount of NPLs	214.3	238.8	228.5	236.0	238.6	203.2	187.3	175.1
Required provision	93.5	100.2	98.4	101.6	106.8	92.5	87.8	88.3
Provision maintained	50.1	51.5	58.1	61.4	59.6	37.3	35.9	42.6
Excess(+)/ shortfall(-)	-43.4	-48.7	-40.3	-40.2	-47.2	-55.2	-51.9	-45.7
Provision maintenance ratio	53.5%	51.4%	59.1%	60.5%	55.8%	40.3%	40.9%	48.2%

Chart 5.6



Provision adequacy position of all banks

Table 5.5 Comparative position of provision adequacy

(billion Taka)

Year	Items	NCBs	DFIs	PCBs	FCBs
2004	Required provision	50.7	13.5	22.3	1.3
	Provision maintained	3.4	12.4	18.5	1.6
	Provision maintenance ratio	6.7%	91.9%	83.0%	123.1%
2005	Required provision	52.8	13.4	20.5	1.6
	Provision maintained	13.2	9.3	17.8	2.2
	Provision maintenance ratio	25.0%	69.4%	86.8%	137.5%

Weighted average deposit and lending rate along with the spread during 31/12/2000 to 31/12/2005 have been depicted in Table 5.6 and Chart 5.7.

Writing-off Bad Debts

5.20 To impede unnecessarily and artificially inflated size of balance sheet, uniform guidelines of write-off has been introduced in 2003. The total amount of bad debts written-off from June 2003 to 2006 by the different banks complying policy guidelines is shown in Table 5.7.

It is revealed from the above Table that banks have been able to write-off an amount of Taka 15.2 billion bad loans during 1 July 2005 to June 2006.

Management Soundness

5.21 Sound management is the most important pre-requisite for the strength and growth of any financial institution. Since indicators of management quality are primarily specific to individual institution, these cannot be easily aggregated across the sector. In addition, it is difficult to draw any conclusion regarding management soundness on the basis of monetary indicators, as characteristics of a good management are rather qualitative in nature. Nevertheless, the total expenditure to total income, operating expenses to total expenses, earnings and operating expenses per employee, and interest rate spread are generally used to gauge management soundness. In particular, a high and increasing expenditure to income ratio indicates the operating inefficiency that could be due to flaws in management.

5.22 It transpires from Table 5.8 and Chart 5.8 that expenditure-income (EI) ratio of the DFIs was very high with 180.4 percent in 1998 and 175.3 percent in the year 2000. This was mainly because the DFIs made loan loss provisions by debiting 'loss' in their books. The position however improved after 2000 and the ratio came down to 89.1 percent and 95.9 percent in 2001 and 2002 respectively but again rose to 101.1 percent in 2003 and 103.9 percent in

Table 5.6 Weighted average deposit and lending rates (31/12/2000 - 31/12/2005)

(Percent)

Date	Weighted average		Spread
	Deposit rate	Lending rate	
31/12/00	7.08	13.75	6.67
30/06/01	7.03	13.75	6.72
31/12/01	6.75	13.42	6.67
30/06/02	6.74	13.16	6.42
31/12/02	6.49	13.09	6.60
30/06/03	6.30	12.78	6.48
31/12/03	6.25	12.36	6.11
30/06/04	5.65	11.01	5.36
31/12/04	5.56	10.83	5.27
30/06/05	5.64	10.92	5.28
31/12/05	5.56	11.24	5.68

Chart 5.7

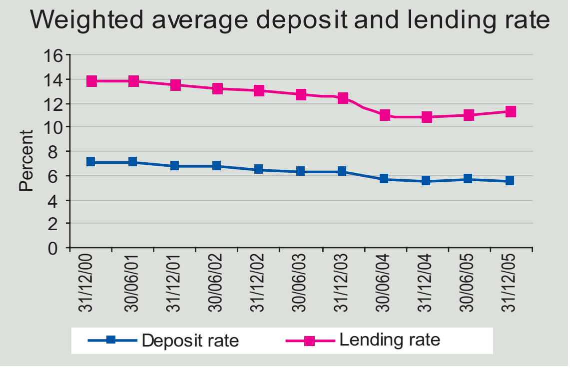


Table 5.7 Writing off bad debts in different bank categories (30/06/2003 - 30/06/2006)

(billion Taka)

Bank types	30/06/2003	30/06/2004	30/06/2005	30/06/2006
NCBs	11.4	26.3	29.7	35.7
DFIs	12.8	17.4	27.6	28.6
PCBs	12.6	21.2	32.9	40.7
FCBs	0.5	0.9	1.1	1.5
Total	37.3	65.8	91.3	106.5

Table 5.8 Expenditure-income ratio by type of banks

(Percent)

Bank types	1998	1999	2000	2001	2002	2003	2004	2005
NCBs	99.8	100.5	99.4	99.0	98.5	98.8	102.3	101.9
DFIs	180.4	145.2	175.3	89.1	95.9	101.1	104.0	103.9
PCBs	85.3	90.4	90.8	88.1	91.9	93.1	87.1	89.3
FCBs	60.1	67.4	77.7	75.7	78.3	80.3	76.3	70.8
Total	**95.4**	**96.6**	**99.9**	**91.2**	**93.3**	**93.9**	**90.9**	**92.1**

2005 due to operating loss incurred by BKB & RAKUB. The EI ratio of the NCBs exceeded 100 percent in 1999 before falling to over 99 percent by end 2003 but again rose to 101.9 percent in 2005 due to loss incurred by Agrani Bank. Very high EI ratio of NCBs was mainly attributable to high administrative and overhead expenses, and suspension of income against NPLs. EI ratio of PCBs is substantially high due to deduction of provision for loans, other assets and corporate tax from current income.

Chart 5.8

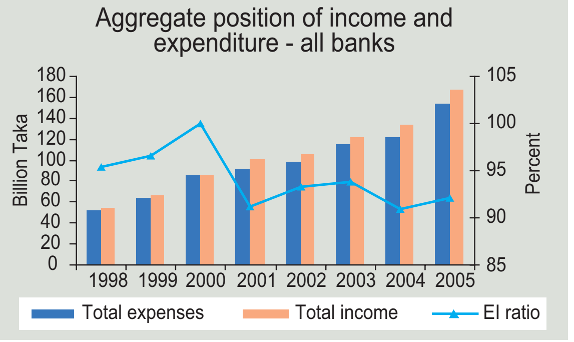


Table 5.9 Profitability ratios by type of banks

(Percent)

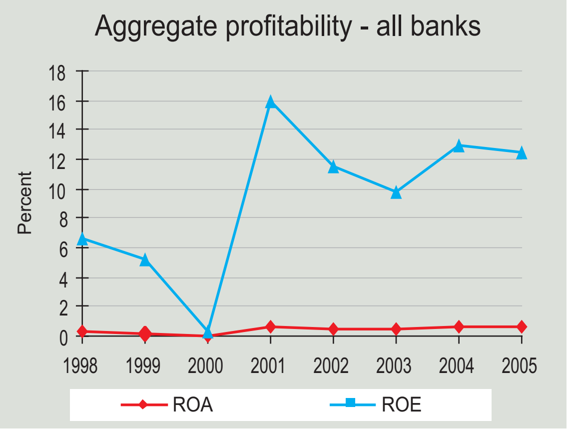
Bank types	Return on assets (ROA)								Return on equity (ROE)							
	1998	1999	2000	2001	2002	2003	2004	2005	1998	1999	2000	2001	2002	2003	2004	2005
NCBs	0.0	0.0	0.1	0.1	0.1	0.1	-0.1	-0.1	0.3	-1.1	1.7	2.4	4.2	3.0	-5.3	-6.9
DFIs	-2.8	-1.6	-3.7	0.7	0.3	0.0	-0.2	-0.1	-36.3	-29.4	-68.0	12.3	5.8	-0.6	-2.1	-2.0
PCBs	1.2	0.8	0.8	1.1	0.8	0.7	1.2	1.1	26.8	15.3	17.0	20.9	13.6	11.4	19.5	18.1
FCBs	4.7	3.5	2.7	2.8	2.4	2.6	3.2	3.1	40.7	41.8	27.3	32.4	21.5	20.4	22.5	18.4
Total	**0.3**	**0.2**	**0.0**	**0.7**	**0.5**	**0.5**	**0.7**	**0.6**	**6.6**	**5.2**	**0.3**	**15.9**	**11.6**	**9.8**	**13.0**	**12.4**

Earnings and Profitability

5.23 Strong earnings and profitability profile of a bank reflect its ability to support present and future operations. More specifically, this determines the capacity to absorb losses by building an adequate capital base, finance its expansion and pay adequate dividends to its shareholders. Although there are various measures of earning and profitability, the best and widely used indicator is return on assets (ROA), which is supplemented by return on equity (ROE) and net interest margin (NIM).

5.24 Earnings as measured by return on assets (ROA) and return on equity (ROE) vary largely within the industry. Table 5.9 shows ROA and ROE by types of banks and Chart 5.9 shows the aggregate position of these two indicators for all banks. Analysis of these indicators reveals that the ROA of the NCBs have been negative and that of the DFIs even worse. PCBs had an inconsistent trend but satisfactory and FCBs' return on assets ratio consistently declined from 4.7 percent in 1998 to 3.1 percent in 2005.

Chart 5.9



5.25 NCBs return on equity ratio rose from -1.1 percent in 1999 to 3.0 percent in 2003 but again declined to -6.9 percent in 2005. In case of DFIs, the ROE sharply rose from -68.0 percent in 2000 to 12.3 percent in 2001 and again declined to -0.6 percent in 2003 and -2.0 percent in 2005. The sharp rise in 2001 was due to booking of net profit amounting to Taka 1.0 billion in 2001 against net loss of Taka 5.2 billion in 2000 by the DFIs. The huge loss of the

DFIs in 2000 was mainly due to making of provisions by debiting 'loss' in their books of accounts. In 2005, Agrani Bank, BKB and RAKUB incurred loss due to their huge operating expenses.

Net Interest Income

5.26 Aggregate net interest income (NII) of the industry has been positive and consistently increased from Taka 7.1 billion in 1998 to Taka 35.3 billion in 2005. However, the NII of the NCBs sharply declined from Taka 3.1 billion in 1999 to a negative amount of Taka 1.2 billion in 2000. The trend continued and the NCBs' interest income in 2001 was less by Taka 1.8 billion than interest expenses, and in 2002 by Taka 1.5 billion, in 2003 by Taka 0.3 billion and in 2004 by Taka 1.1 billion but in 2005 their positive NII was Taka 7.7 billion. The DFIs had a negative NII in 1999, which was reversed in 2000 to Taka 1.0 billion and thereafter was positive in 2001 (Taka 2.7 billion), 2002 (Taka 1.4 billion), 2003 (Taka 1.3 billion), 2004 (Taka 1.8 billion) and 2005 (Taka 1.0 billion).

5.27 In 2005, NCBs were able to increase their net interest income (NII) by reducing their classified loans and cost of fund. The NII of the PCBs and FCBs has been very high over the period from 1998 through 2005. Overall industry NII shows a consistently upward trend. The trend of NII indicates that the PCBs and the FCBs are charging interests at very high rates on their lending as compared to the interest they are paying to the depositors.

Table 5.10 Net interest income by type of banks

(billion Taka)

Bank types	1998	1999	2000	2001	2002	2003	2004	2005
NCBs	2.2	3.1	-1.2	-1.8	-1.5	-0.3	-1.1	7.7
DFIs	0.5	-0.1	1.0	2.7	1.4	1.3	1.8	1.0
PCBs	2.3	3.0	6.1	9.2	10.2	12.0	13.7	21.0
FCBs	2.2	1.8	2.5	3.3	3.4	3.6	4.2	5.6
Total	**7.1**	**7.8**	**8.4**	**13.4**	**13.5**	**16.6**	**18.3**	**35.3**

Chart 5.10

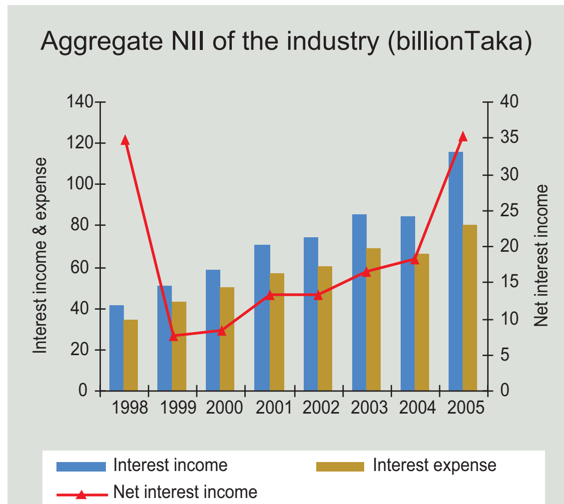


Table 5.11 Liquidity ratio by type of banks

(Percent)

Bank types	Liquid assets 1998	1999	2000	2001	2002	2003	2004	2005	Excess liquidity 1998	1999	2000	2001	2002	2003	2004	2005
NCBs	24.4	25.2	26.5	25.7	27.3	24.4	22.8	20.0	4.4	5.2	6.5	5.7	7.3	8.4	6.8	2.0
DFIs	16.6	15.7	16.2	15.3	13.7	12.0	11.2	11.2	9.2	8.7	9.9	8.9	6.9	5.8	4.7	6.2
PCBs	24.8	25.9	24.8	24.2	26.3	24.4	23.1	21.0	6.7	8.0	6.8	6.2	8.5	9.8	8.8	5.1
FCBs	39.8	51.3	34.7	34.1	41.6	37.8	37.8	41.5	19.9	31.4	14.8	14.3	21.8	21.9	21.9	23.6
Total	**25.2**	**27.0**	**26.1**	**25.3**	**27.2**	**24.7**	**23.4**	**21.7**	**6.4**	**8.3**	**7.5**	**6.7**	**8.7**	**9.9**	**8.7**	**5.3**

Liquidity

5.28 Commercial banks deposits are at present subject to a statutory liquidity ratio (SLR) of 18 percent inclusive of average 5 percent (at least 4 percent) cash reserve requirement (CRR) on bi-weekly basis. The CRR is to be kept with the Bangladesh Bank and the remainder as qualifying secure assets under the SLR, either in cash or in government securities. SLR for the banks operating under the Islamic Shariah is 10 percent and the specialized banks are exempt from maintaining the SLR. Liquidity indicators measured as percentage of demand and time liabilities (excluding inter-bank items) of the banks indicate that all the banks had excess liquidity.

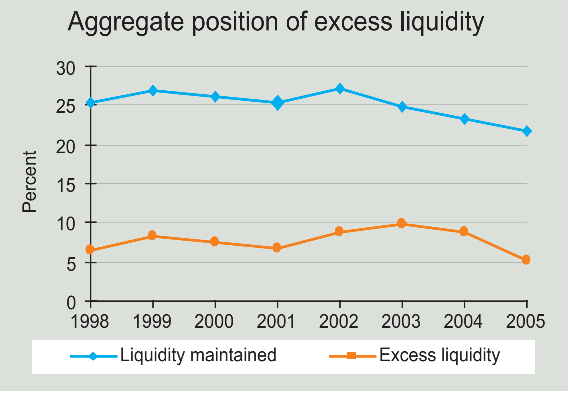
5.29 Table 5.11 and Chart 5.11 show that the FCBs are having the highest liquidity ratios followed by the PCBs. This situation of constant surplus of liquidity warrants creation of effective demand for credit at lower costs.

CAMEL Rating

5.30 Performance indicators of the banking industry depict a trend similar to that of the state owned banks, which is understandable due to their predominant market share. Ratings done on the basis of the various indicators discussed hereinbefore indicate that financial performance of the PCBs and FCBs in general has been better than that of the industry average. However, 1 of the PCBs rated CAMEL 5 are still in the problems bank list out of 7 put in this category in the mid-nineties. Activities of the problem banks are closely monitored by the central bank with special guidance and care. Up to 2005, 6 such banks were taken off the problem bank list because of improved performance. Newly 3 banks were included in the problem bank list for their distressed financial position. At present 4 banks are in the problem bank list.

5.31 To assess the degree to which a bank might be exposed to adverse financial market conditions, the Bangladesh Bank added a new characteristic named as "Sensitivity to market risk" to what was previously referred to as the CAMEL ratings. In particular, Bangladesh Bank started placing much emphasis on banks sensitivity to interest rate movement through the introduction of revised CAMELS rating system since July 1, 2006.

Chart 5.11



5.32 Presently Bangladesh Bank is employing Early Warning System (EWS) of supervision to address the difficulties faced by the banks in any of the areas of CAMEL. Any bank found to have faced difficulty in any areas of operation, is brought under Early Warning category and monitored very closely to help improve its performance. Presently 9 banks are in the EW system.

5.33 Bangladesh Bank is also monitoring the NCBs through its off-site supervision tools. Government of Bangladesh (GOB), the owner of those banks also adequately monitors them. At present, the NCBs are experiencing huge capital and provision shortfall, having large amount of classified loans, low earnings and ineffective management. Various restrictions have been imposed by the Bangladesh Bank on the activities of the NCBs to put them on right track of business operation and growth. All the 4 NCBs have been made to sign Memorandum of Understandings (MOUs) with the Bangladesh Bank to improve their performance. Approvals of large loans by the banks are also monitored by the Bangladesh Bank on monthly basis to detect the irregularities.

5.34 As of end 2005, CAMEL rating of 13 banks was 1 or Strong; 16 banks were rated 2 or Satisfactory; rating of 8 banks was 3 or Fair; 6 were rated 4 or Marginal and 5 got 5 or Unsatisfactory rating. 1 NCB had Unsatisfactory rating and other 3 NCBs had Marginal rating.

Islamic Banking

5.35 Alongside the conventional interest bearing banking system, Bangladesh entered into an Islamic banking system (profit-loss sharing) in 1983. At present, out of 48 banks in Bangladesh, 6 private commercial banks are operating as full-fledged Islamic banks and 10 conventional banks are partially involved in Islamic banking in a total of 20 branches. Box 5.2 provides a brief review on operations of Islamic banks in Bangladesh.

Deposit Insurance Scheme

5.36 A deposit insurance system has been introduced in Bangladesh in August 1984 to act as a safety net. It aims at minimizing or eliminating the risk of loss of depositors' fund with banks. Deposit insurance in Bangladesh is now being governed by the Bank Deposit Insurance Act 2000. A Deposit Insurance Trust Fund (DITF) has also been created for providing limited protection (not exceeding Tk. 1.00 lac) to a small depositor in case of winding up of any bank. The Board of Directors of the Bangladesh Bank is the Trustee Board for DITF. The DITF is now being administered and managed under the guidance of the Trustee Board. Bangladesh Bank is now a member of International Association of Deposit Insurers (IADI). As at end December 2005, the total assets of the DITF stood at Taka 4.25 billion, which were invested in the Government Securities.

Box 5.2

Islamic Banking in Bangladesh

Bangladesh is the third largest Muslim country in the world with around 139 million populations of which 90 percent are Muslim. Islamic banking system started operation in Bangladesh in 1983 with the establishment of first Islamic bank "Islami Bank Bangladesh Limited". After that, five more full-fledged Islamic banks and 20 Islamic banking branches of 10 conventional banks have started their operations in the private sector on the basis of Islamic Shariah. They have passed about two decades of successful Islamic banking operations in Bangladesh in spite of some problems in their operations.

The growth of Islamic banking in Bangladesh is progressing day by day. The remarkable shifting or conversion of the conventional banks and their branches into the Islamic lines, signals high acceptance of the interest-free

Table-1: Comparative position of the Islamic banking sector (as at end June 2006)

(in million Taka)

	Group of Banks				
Particulars	Islamic banks	Islamic banking branches	Islamic banking sector	Private commercial banks[1]	All banks[2]
1	2	3	4	5	6
1. Number of banks	6	10	16	30	48
2. Number of branches	308	20	328	1648 (19.90)	6425 (5.11)
3. Number of employees	10288	368	10656	38426 (27.73)	99287 (10.73)
4. Deposits	214950.00	18031.00	232981.00	818530.00 (28.46)	2405330.00 (9.67)
5. Investments (credits)	198270.00	12223.80	210493.80	717160.00 (29.35)	1414370.00 (14.88)
6. Investment deposit ratio	0.92	0.68	0.90	0.88	0.59
7. Liquidity: excess + shortfall -	7913.60	1043.20	8956.80	46943.10 (19.08)	109416.10 (8.19)

Notes: 1/ Figures in the parentheses indicate percentage share of the Islamic banking sector to the all private banks.
2/ Figures in the parentheses indicate percentage share of the Islamic banking sector to all banks.
Sources: Research Department, Statistics Department and Department of Offsite Supervision, Bangladesh Bank and Central Accounts Departments of all Islamic banks and conventional banks having the Islamic banking branches.

Box 5.2

Islamic Banking in Bangladesh

Contd.

banking by the public in general. The Islamic banking industry continued to show strong growth since its inception in 1983 to June 2006 in tandem with the growth in the economy, as reflected by the increased market share of the Islamic banking industry in terms of assets, financing and deposits of the total banking system. The entire picture is given at Table-1. The products being offered by these banks range from consumer credit to long term finance for big investment projects using Islamic modes of financing such as Marahaba, Bia-Muazzal and Ijarah.

The Islamic banks in Bangladesh started from a very limited resource base right from the beginning. But with the passage of time, they have excelled strong performance in respect of mobilization of deposits as well as in investments. Total deposits of the Islamic banks and Islamic banking branches of the conventional banks stood at Taka 232981.00 million at end June 2006. This was 28.46 percent of the deposits of all private commercial banks and 9.67 percent of the deposits of the total banking system at the end of June, 2006. Total investment of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 210493.80 million at end June 2006. This was 29.35 percent of all private banks and 14.88 percent of the total banking system of the country. The Statutory Liquidity Requirement (SLR) for the Islamic banks is fixed at 10 percent since inception of first Islamic Bank in 1983. This has remained unchanged till date while SLR for the traditional commercial banks has been changed several times which presently is fixed at 18 percent. The low requirement of SLR for Islamic banks is due to the non-holding of interest bearing types of eligible securities. In order to overcome the situation, the Bangladesh Bank has issued an Islamic Bond on behalf of the government namely "Government Islamic Investment Bond (GIIB)" in October 2004, which is governed by the Islamic Shariah. It is evident from the Table that Islamic banks have been facing excess liquidity problems. Excess liquidity of the Islamic banks and Islamic banking branches as well stood at Taka 8956.80 million as at end June 2006 (19.08 percent of private banks and 8.19 percent of all banks) which originated due mainly to the non-responsiveness of the good borrowers for investment demand and absence of adequate interest free financial instruments and an organized Islamic money market in the country as well. However, efforts are underway to develop Islamic inter-bank market instruments to help banks in managing their liquidities.

The role of Bangladesh Bank in regulating, guiding and supervising the Islamic Banks in Bangladesh in accordance with Islamic Shariah is at the preparatory stage. The inspectors and supervisors of Bangladesh Bank have been undergoing massive training programme on Islamic banking both at home and abroad to be equally familiar with the technicalities of the different operational methodologies of the Islamic banking system.

Legal Reforms and Prudential Regulations

Policy on Loan Classification and Provisioning

5.37 With a view to moving towards international best practices and to ensure early recognition of NPLs, appropriate provisioning against unclassified loans like 'Special Mention Account' has been enforced and the banks are required to make General Provision @ 5% on the outstanding amount of loans kept in the 'Special Mention Account' after netting off the amount of Interest Suspense effective from 31 December 2005.

There has been more concentration on Short-term Microcredit by enhancing its limit from Taka 10,000/- (ten thousand) to Taka 25,000/-(twenty five thousand).

Banks having Offshore Banking Unit (OBU) have been brought under the purview of loan classification and provisioning with a view to transparency of OBU transactions of EPZ (Export Processing Zone) enterprises and thereby reporting to BRPD and CIB of Bangladesh Bank for cross information purposes.

Implementation of Credit Risk Grading Manual

5.38 Effective risk management has become focal point of good governance for the development of banking activities. Bangladesh Bank has prepared a guideline for Managing Core Risk in banking which was forwarded to the banks for implementation. In continuation, with a view to making banks more cautious in case of sanctioning/ Renewal/Rescheduling of loans, Credit Risk Grading System (CRGS) has been introduced for all loans (other than short term Agricultural Credit and Micro Credit) where loans have been graded into 8(eight) categories as Superior (SUP), Good (GD), Acceptable (ACCPT), Marginal/Watch list (MG/WL), Special Mention Account (SMA), Substandard (SS), Doubtful (DF) and Loss (BL).

Prudential Guidelines for Consumer Financing and Small Enterprise Financing

5.39 With a view to facilitating more credit towards consumers and better customer service a guideline named ***Prudential Guidelines for Consumer Financing*** had been issued in FY06. Since, small and medium industries can make important contributions to growth, employment and poverty alleviation, required instructions for establishing of such type of industries, a guideline named ***Prudential Guidelines for Small Enterprise Financing*** had also been issued by Bangladesh Bank in the reporting year.

To encourage (i) Housing Finance and (ii) Loans for Professionals to set up business, provisioning for these two sub-sectors under Consumer Financing has been lowered from 5 percent to 2 percent in FY06. And in case of Small Enterprise Financing also banks have been advised to maintain 2 percent general provision instead of 5 percent against unclassified loan amount.

Guideline on Information & Communication Technology for Scheduled Banks

5.40 In recent years the banking industry has undergone massive changes in providing service to their customers by using information technology. So it is important to ensure security in IT setup as well as in IT operations and banks must take adequate measures to prevent the information from unauthorized access, modification, disclosure and destruction so that customers' interest is fully protected. To address this sensitive issue, during the year, Bangladesh Bank issued guidelines for banks for establishing an effective IT security framework. Banks are advised to follow the Guideline in their IT area and implement all the security standards by 15 May 2006.

Marking to Market based Revaluation of Treasury Bills & Bonds held by the Banks

5.41 With a view to widening application of fair value accounting of Government Securities and encourage secondary trading of these securities after issuance, some changes have been made in the note no. 4(kha) of the first schedule of section 38 of the Bank Companies Act, 1991. As per the instructions stipulated, the securities held for the fulfillment of Statutory Liquidity Requirement (SLR) by a banking company, will be treated as Held to Maturity (HTM). The gain/loss due to the revaluation will be taken to Capital Account and disclosed in the 'Statement of Changes in Capital'. And Government treasury bills and bonds held in excess of SLR will be treated as Held For Trading (HFT). The portion of securities Held for Trading should be revaluated at least on weekly basis based on marking to market or at current market prices. The banking company will show the gain/loss due to this revaluation in the Profit and Loss Account of the concerned period. The weekly revaluation based on marking to market for the portion of securities held for trading by the banks has been made compulsory since 1 February 2006.

Cash Reserve Requirements (CRR) of Scheduled Banks with Bangladesh Bank

5.42 In pursuance of the objectives of monetary policy, the amount of CRR has been increased to 5 percent from 4.5 percent of total demand and time liabilities of banks effective from 1 October 2005. However, banks are allowed to maintain CRR at the rate of 5 percent daily on bi-weekly average basis subject to the condition that the amount of CRR so maintained should not be less than 4 percent in any day.

Statutory Liquidity Requirement (SLR) of Scheduled Banks

5.43 The Statutory Liquidity Requirement (SLR) for the scheduled banks, excepting banks operating under the Islamic shariah and the specialized banks, was re-fixed at 18 percent from 16 percent on 1 October 2005 and remained unchanged thereafter. The SLR for the Islamic banks remained unchanged at 10.0 percent. The specialized banks continued to remain exempted from the SLR.

Interest Rate Policy

5.44 Under the Financial Sector Reform Programme, the banks are free to charge/fix their deposit and lending rate other than export credit. Loans at reduced rates (7 percent) are provided for all sorts of export credit since January 2004. At present, banks can differentiate interest rate up to 3 percent considering comparative risk elements involved among borrowers in the same lending category. With progressive deregulation of interest rates, banks have been advised to announce the mid-rate of the limit (if any) for different sectors and the banks may change interest 1.5 percent more or less than the announced mid-rate on the basis of the comparative credit risk.

Revised Policy of Rescheduling

5.45 Policy for rescheduling of loans has been reviewed and it has been decided that the borrowers whose credit facility has been rescheduled will get new loan facility subject to the fulfillment of the following conditions : i) the defaulting borrower who has availed interest waiver must settle at least 15 percent of the compromise amount (excluding the down payment on rescheduling as per present guidelines) to avail any further credit facility from any bank. In case of borrowing from other banks, the same rule will be applicable and NOC in support of settlement of 15 percent of compromise amount will have to be submitted; ii) export borrowers may be granted further credit facility (after being identified as not a willful defaulter), if required, subject to settlement of at least 7.5 percent of the compromise amount (excluding the down payment on rescheduling as per present guidelines).

Guidelines Regarding Appointment of Chief Executive Officer of Banks

5.46 It is essential to ensure corporate governance in banks, particularly in private commercial banks. Bangladesh Bank has taken several measures in recent times to put in place good corporate governance in banks, protecting depositors' interest and managing the banks in a professional and transparent manner. In continuation of the on going reforms, banks /financial Institutions have been advised to follow the guidelines while submitting proposals to Bangladesh Bank regarding the salary-allowances and other facilities of the chief executives. Financial condition, area of operations, business volume and earning capacity, qualification, age and experience of the person concerned and salary-allowances paid to the persons holding the same position in peer banks/financial institutions shall have to be taken into consideration for determination of salary and allowances of the chief executives of banks/financial institutions.

Bank Rate

5.47 The bank rate has been revised downward from 6 percent to 5 percent on 6 November 2003 and remained unchanged thereafter.

NCB Reforms Programme

5.48 To minimize the losses and improve the financial stability and efficiency of the NCBs, the GOB has adopted a strategy to implement a broader banking sector reform, which includes; (i) the privatisation of Rupali Bank Ltd; (ii) hiring an external Management Team for Agrani Bank and (iii) hiring of management experts for Sonali and Janata Bank. The progresses in the efforts, so far achieved, are summarized below:

(a) Rupali Bank: The Government of Bangladesh, owning 93.11 percent of RBL, wished to bring about as expeditiously as possible the transfer of 67.26 percent of total share of ownership and management control of the Rupali Bank Limited (RBL) to a qualified strategic investor/partner. In order to expeditiously carryout the process, GOB appointed a Financial Advisor (FA) on May 24, 2004 to assist privatization process of the bank. As per law, Privatization Commission (PC) was entrusted with the task, with assistance from the FA. An expression of Interest was invited on July 20, 2005 and the final deadline for submission was at 2 p.m. on April 10, 2006. At the closing 10 (ten) Expressions of Interest (EOIs) were received of which seven entities were short-listed that include an individual, and consortiums of banks and firms. Four Tenders were received by the deadline, which was August 21, 2006. After evaluation of the Technical Proposals, two Tenders were found to be technically qualified and their Financial Bids were opened on August 27, 2006. The Tenderers were: 1) The Domestic Investors Consortium, Bangladesh and 2) Prince Bandar Bin Moh'd Abdulrahman Al-Saud, KSA.

Tender Participant HRH Prince Bandar Bin Mohammed Bin Abdulrahman Al-Saud offered a total purchase price of US$ 330.00 million. His Tender was accepted by the Government and currently a Sale and Purchase Agreement is being negotiated.

(b) Agrani Bank: In October 2004, a consulting firm was appointed to take over the management of Agrani Bank. The firm provided a Bangladeshi to take over the position of CEO and MD of the bank. The firm also provided management advisors for eight core banking areas. After a year of functioning, there was marked improvement in the operations of the bank. The GOB at this stage decided to convert the existing contract of the management advisors as that of Financial Advisor to facilitate divestment process within the contractual time frame. The GOB has already conducted first round negotiations with the firm and the contract will be modified to reflect the changed role of the consultants.

(c) Janata Bank: The management team for Janata Bank started functioning from 17 May 2005. The GOB, in this case has proposed to make the consulting contract as a Management Contract with provision for providing a suitable Bangladeshi person as its CEO and MD. The modifications were discussed and accepted, which was also cleared by the World Bank.

(d) Sonali Bank: The Management Team started functioning at Sonali Bank from 8 July 2005. The effort of the GOB, in this case, is aimed at increasing efficiency of the bank by reducing the losses. Policies are being reviewed together with the organisational structure, branches locations, human resources development etc.

Activities of Credit Information Bureau

5.49 In the backdrop of huge non-performing loan of the banking sector of the country during the decade of the 1980s, a full-fledged Credit Information Bureau (CIB) was set up in 18 August 1992 in Bangladesh Bank under Financial Sector Reform Project (FSRP) of the World Bank. The main objective behind setting up of the Bureau was to minimize the extent of default loan by facilitating the banks and financial institutions with credit reports of the loan applicants so that the lending institutions do not encounter any credit risk while extending any lending or rescheduling facility.

5.50 The workload of the Bureau kept on increasing unabated in terms of number of requests, number of borrowers and owners, number of reporting banks/financial institutions as well as number of branches. CIB database consists of detailed information in respect of individual borrowers, owners and guarantors; the total number of which was 1,146,437 (end June, 2006) recording an increase of 42.20 percent over the previous period (806,165 as of end June, 2005). The number of CIB reports supplied during FY06 stood at 445,756 as compared to 377,350 in the FY05 showing an annual increase by 18.12 percent. As per existing service standard the credit reports are supplied within 5 working days of receiving the request, the volume of which was around 1850 per day during FY06.

5.51 The achievement of Credit Information Bureau in fulfilling its objectives of bringing down the extent of default loan has been found quite remarkable. As per reporting of scheduled banks, the classified loan slightly increased during FY06 (end June, 2006). The classified loan increased to 15.70 percent in June 2006 compared to 14.71 percent in the preceding year (end June, 2005). A few years back, the percentage of such classified loan was 34.9 percent (in December 2000). It may be mentioned that with effect from June 2004 quarter the amount of "Write-off" loan was excluded from both classified and outstanding loans while evaluating the percentage of classified loans.

5.52 In order to ensure prompt collection of credit data from the sources as well as instantaneous delivery of credit report to the users by applying latest computer technology, the CIB would soon undertake a project aimed at implementing on-line services between the Bureau and the lending institutions by using Internet. The project of implementing on-line connectivity between CIB and the Head Offices of the banks and financial institutions is expected to be completed by the year 2007.

Inspection of Banks

5.53 Bangladesh Bank, being the Central Bank of the country, is entrusted with the responsibility to regulate and supervise the banks and financial institutions of the country. Inspection of banking companies is assigned to Bangladesh Bank under section 44 of Bank Company Act 1991. Two departments of the Bank namely Department of Banking Inspection-1 and Department of Banking Inspection-2 are conducting the inspection activities. These two departments conduct on-site inspection on Nationalised Commercial Banks (NCBs), Specialised Banks, Private Commercial Banks (including banks under Islamic Shariah), Foreign Banks and other institutions including Investment Corporation of Bangladesh (ICB) and Money Changers. Basically, two types of inspections are conducted namely (i) comprehensive inspection and (ii) special inspection. In comprehensive inspection, overall performance/conditions of the banks such as capital adequacy, asset quality, liquidity, earnings, management soundness etc. are evaluated. Based on their performance banks are rated between 1-5 grades in ascending order. Inspection is done according to the Annual Inspection Programme (AIP) chalked out by the departments well ahead of the beginning of each calendar year. These departments also monitor implementation of the suggestions /recommendations made in the inspection reports. Special inspections are conducted on the banks on specific/particular issue(s) as well as to investigate complaints received from the depositors, general public or institutions. Moreover to oversee risk management practice of the banks/ implementation of core risk management guidelines by the banks, systems inspection were also conducted.

5.54 Commercial Banks having CAMEL rating between 3-5 are inspected every year. Banks rated 1 or 2 are inspected once in two years. But Foreign Commercial Banks rated 1 or 2 are inspected every year. Branches of scheduled banks covering around 60-70 percent of total loans and advances are normally brought under the comprehensive inspection programme. Inspections of the banks have been conducted based on four reference dates: 31 December, 31 March, 30 June and 30 September instead of only one reference date i.e. 31 December of the previous year. This system has been adopted to enhance the effectiveness of on-site inspection and to reduce the time-gap between on-site and off-site supervision.

5.55 These departments inspected a total number of 1851 branches of bank companies under comprehensive inspection programme during FY06 including 43 head offices, 561 big branches and 1247 small branches. Under the special inspection programme, a total number of 2054 inspections were carried out during FY06 including 789 inspections on moneychangers and 649 risk-based audits.

Non-bank Financial Institutions (NBFIs)

5.56 NBFIs represent one of the most important segments of financial system and play very important role in mobilising and channeling resources in Bangladesh. The Non-bank Financial Institutions comprise investment and finance companies, leasing companies etc. The Non-bank Financial Institutions (NBFIs) numbering 29 as of September 2006 (starting from IPDC in 1981) are regulated by the Financial Institutions Act, 1993 and the regulations made thereunder. In view of their increased role in financing industry, trade and commerce, transport, information technology, housing etc. the minimum capital requirement of the NBFIs was raised to Taka 0.25 billion vide FID circular 2, dated 29 June 2003. Most of the NBFIs have raised their required capital. All NBFIs have been asked to raise their capital through IPO (Initial Public Offering) within December 2005 and then the time limit for IPO issue has been extended up to September 2006. The amount of paid up capital and reserve of NBFIs thus increased to Taka 15.04 billion as of June 2006. NBFIs are allowed to collect fund from the call money market up to 15 percent of their total net assets for their investment purpose. The financing modes of NBFIs are long term in nature. Total investment by the NBFIs up to June 2006 was Taka 73.14 billion, which is 20.08 percent higher than that of the previous year (Taka 60.91 billion as of June 2005). The rate of default in the non-bank financial sector is quite low. As of June 2006, classified loans and leases of the NBFIs in aggregate were 7.18 percent (1.61 percent after deduction of provision and interest suspense).

Financial Institutions Development Project (FIDP)

5.57 Financial Institutions Development Project (FIDP), administered by the Bangladesh Bank, was formally launched in February 2000 as per the 'Development Credit Agreement' (DCA) signed between the Government of the People's Republic of Bangladesh and the International Development Association (IDA) on 29-09-99. The duration of the project was 5 (five) years. However, the project period was extended up to June 2006. The major objective of the FIDP was to promote the development of Financial Institutions (FIs) and improvements in investment financing on a sustainable basis through strengthening the quality of intermediation with a view to accelerating industrial growth in Bangladesh. Total project cost was USD 57.69 million (IDA-USD 46.90 million, GOB - USD 5.41 million and others - USD 5.38 million). The project consisted of two components: (a) resource mobilisation for FIs and (b) strengthening of FIs through developing and managing a credit bridge and standby Facility (CBSF). Besides, establishing a strong capital market, the FIDP aimed to reform the National Savings Schemes (NSS), activate a secondary market for treasury securities and devise procedures for the issuance and marketing of debt instruments.

Credit Bridge and Standby Facility (CBSF) was established. Up to June 30, 2006 a total of Taka 264.61 crore (USD 45.58 million) has been disbursed against 147 sub-projects to the 6 (six) Participating Financial Institutions (PFIs). The PFIs in turn has made a repayment of Taka 212.53 crore. Financial and technical assistance was provided to those PFIs who mobilized mid term and long-term resources through issuing bonds and debentures. The PFIs mobilized resources through issuing debentures/bonds to the tune of Taka 140.83 crore. All the debentures/bonds under the FIDP had to be issued under private placement basis due to regulatory and other impediments. Besides, steps were taken to create and enabling environment for the issuance of securitized debt instruments. So far 3 (three) PFIs and 1 (one) non-PFI have been given NOC from Special Purpose Vehicle (SPV) for the purpose of issuing Zero-coupon Bonds. 3 PFIs have mobilised Taka 94.86 crore through issuing Zero Coupon Bonds under securitization.

The prospect of securitizing the receivables of Jamuna Multipurpose Bridge in accordance with the process practiced in case of FIDP is currently under consideration.

Investment Promotion and Financing Facility (IPFF)

5.58 A contract between the government and the International Development Association (IDA) over assisting in a project named "Investment Promotion and Financing Facility (IPFF)" for financing government approved private sector infrastructure project has been signed recently (1 June 2006). The estimated cost of the project is USD 105.2 million. IDA will provide soft loan of USD 50.00 million for the proposed IPFF. Besides, as co-finance government will provide USD 10.00 million, the Participating Financial Institutions (PFIs) and concerned entrepreneurs will provide USD 14.40 million and USD 30.80 million respectively. Bangladesh Bank will be implementing the project on behalf of the government. Under the proposed project different infrastructure sectors i.e. power generation, transmission and distribution and services, port development (sea, river and land), environmental, industrial and solid waste management, highways and expressways including flyovers, water supply and distribution sewerage and drainage, industrial estates and park development etc. will be financed. However, highest priority will be given to the power sectors. One of the main features of the project is that the 30 percent cost of any approved project should be borne by the entrepreneurs' own source. 20 percent cost of the remaining 70 percent will be provided by the participating financial institutions (PFIs) whereas the rest 56 percent will be financed form IPFF. The bank/financial institution will bear the credit risk associated with the concerned project.