Banking Sector Performance, Regulation and Bank Supervision

5.1 The banking sector of Bangladesh showed remarkable resilience in FY12. With a view to fostering a sound, efficient and stable financial system, Bangladesh Bank began implementing a number of important policy measures. These included forceful emphasis on undertaking timely and effective risk management practices by banks through the issuance of revised Risk Management Guidelines. Supervisory oversight over banks has been strengthened through instituting routine and periodic review of the stability of the individual banks as well as the whole banking system, reinforced through the introduction of stress testing for bank resilience. Great efforts have been made to broaden the inclusion of underserved or unserved productive economic sectors and population segments into the financial system with easier access to banking services. At the same time, banks have been encouraged and reminded to expand CSR initiatives. Furthermore, an inaugural BB report has placed specific focus on adopting enlarged Green Banking operations. The following paragraphs highlight and provide further details on the recent regulatory and supervisory measures initiated by BB for banks and other financial institutions and performance of the banking sector.

Table 5.1 Banking system structure

(billion Taka)

Bank types	2010						2011					
	Number of banks	Number of branches R	Total assets	Percent of industry assets	Deposits	Percent of deposits	Number of banks	Number of branches	Total assets	Percent of industry assets	Deposits	Percent of deposits
SCBs	4	3404	1384.3	28.5	1044.9	28.1	4	3437	1629.2	27.8	1235.6	27.4
DFIs	4	1382	295.4	6.1	183.4	4.9	4	1406	328.8	5.6	214.4	4.8
PCBs	30	2810	2854.6	58.8	2266.5	60.9	30	3055	3524.2	60.0	2787.5	61.8
FCBs	9	62	320.8	6.6	227.1	6.1	9	63	385.4	6.6	272.2	6.0
Total	**47**	**7658**	**4855.1**	**100**	**3721.9**	**100**	**47**	**7961**	**5867.6**	**100**	**4509.7**	**100**

Note : Banks prepare their balance sheet on calendar year basis. And there is an obligation that banks have to submit their audited balance sheet at the end of every calendar year. That is why banks performance related figures are stated in calendar year basis.
R= Revised.

A. Banking Sector Performance

5.2 The banking sector of Bangladesh comprises four categories of scheduled banks. These are the state owned commercial banks (SCBs), the state owned development financial institutions (DFIs), the private commercial banks (PCBs), and the foreign commercial banks (FCBs). While the number of banks remained unchanged at 47 in 2011, the number of bank branches increased from 7658 in 2010 to 7961 in 2011 reflecting the opening of new branches by the PCBs. At the end of June 2012, the total number of bank branches increased further to 8059, with total number of banks remaining unchanged at 47 (Appendix-3, Table-I). The structure of the banking sector with breakdown by type of banks is shown in Table 5.1.

Chart 5.1

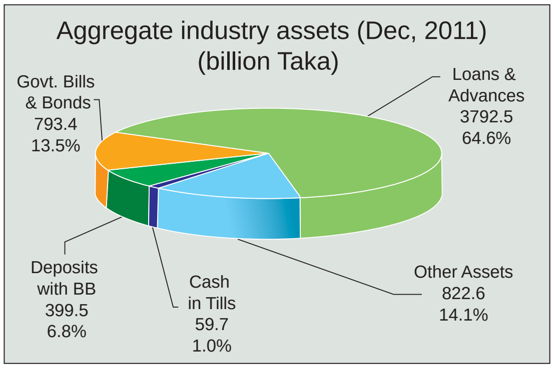
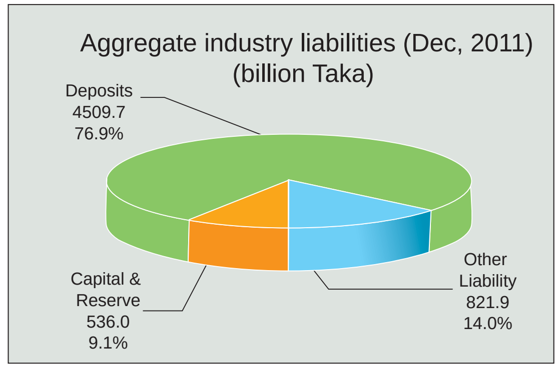
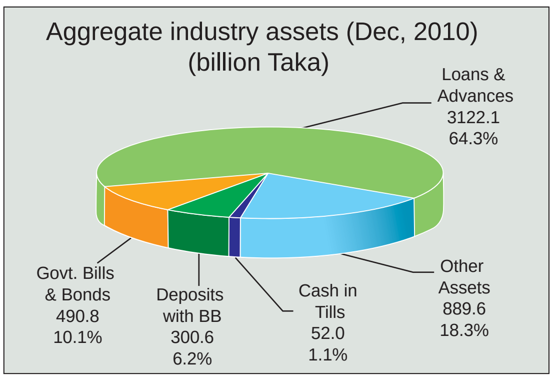
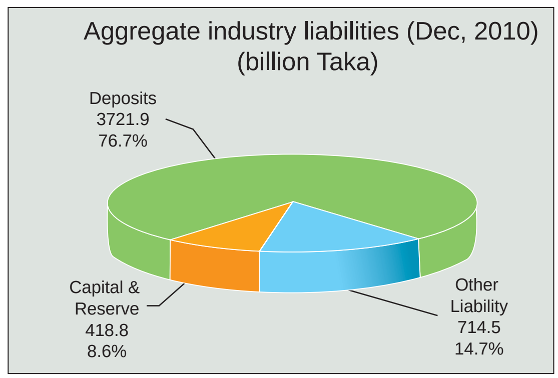


Chart 5.2







5.3 In 2011, the SCBs held 27.8 percent of the total industry assets as against 28.5 percent in 2010. PCBs' share rose to 60.0 percent in 2011 from 58.8 percent in 2010. The FCBs' share in total industry assets remained unchanged at 6.6 percent in 2011. The DFIs' share of assets was 5.6 percent in 2011 against 6.1 percent in 2010.

5.4 Total deposits of the banks in 2011 rose to Taka 4509.7 billion from Taka 3721.9 billion in 2010 showing an overall increase of 21.2 percent. The SCBs' (comprising the largest 4 banks) share in deposits decreased from 28.1 percent in 2010 to 27.4 percent in 2011. The PCBs' deposits in 2011 amounted to Taka 2787.5 billion or 61.8 percent of the total industry deposits against Taka 2266.5 billion or 60.9 percent in 2010. The FCBs' deposits in 2011 rose by Taka 45.1 billion over the year. The DFIs' deposits in 2011 were Taka 214.4 billion against Taka 183.4 billion in 2010 showing an increase of 16.9 percent over the year.

Aggregate Balance Sheet

5.5 **Assets:** Aggregate industry assets in 2011 were Taka 5867.6 billion, showing an overall increase of 20.9 percent over 2010. During this period, the SCBs' assets increased by 17.7 percent and those of the PCBs' increased by 23.5 percent. Loans and advances constituted the most significant part (64.6 percent) of these assets. Cash in tills including foreign currencies was Taka 59.7 billion; deposits with BB were Taka 399.5 billion; other assets were Taka 822.6 billion and investment in Government securities was Taka 793.4 billion (Chart 5.1).

5.6 **Liabilities:** The aggregate liability portfolio (including equities) of the banking industry in 2011 was Taka 5867.6 billion of which deposits constituted 76.9 percent (Taka 4509.7 billion) and was the main sources of funds of the banking industry. Capital and reserves of the banks were Taka 536.0 billion (9.1 percent) in 2011, as against Taka 418.8 billion (8.6 percent) in 2010 (Chart 5.2). It is worth mentioning here that capital and reserves of the banks stood at Taka 562.0 billion at end June 2012.

Performance and Rating of Banks

5.7 The performance and financial conditions of the scheduled banks are evaluated through the CAMELS rating system. It involves analysis and evaluation of the six crucial indicators of banks' financial health. They are (i) capital adequacy, (ii) asset quality, (iii) management efficiency (including implementation status of core risk management guidelines), (iv) earnings, (v) liquidity, and (vi) sensitivity to market risk.

Capital Adequacy

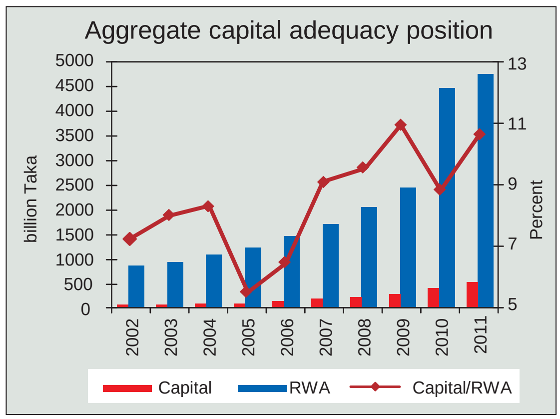
5.8 Capital adequacy focuses on the total position of banks' capital and the protection of depositors and other creditors from the potential shocks of losses that a bank might incur. It helps absorbing all possible financial risks like credit risk, market risk, operational risk, residual risk, core risks, credit concentration risk, interest rate risk, liquidity risk, reputation risk, settlement risk, strategic risk, environmental & climate change risk etc. Under Basel-II, banks in Bangladesh were instructed to maintain the Minimum Capital Requirement (MCR) at 10.0 percent of the Risk Weighted Assets (RWA) or Taka 4.0 billion as capital, whichever is higher, with effect from July-September quarter in 2011. MCR was revised to increase the shock resilient capacity of the bank. However, for the fourth quarter of 2011 MCR was lowered to 9.0 percent of RWA or Taka 2.0 billion, whichever is higher.

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

(Percent)

Bank types	2004	2005	2006	2007	2008	2009	2010	2011	End June 2012
SCBs	4.1	-0.4	1.1	7.9	6.9	9.0	8.9	11.7	11.2
DFIs	9.1	-7.5	-6.7	-5.5	-5.3	0.4	-7.3	-4.5	-4.3
PCBs	10.3	9.1	9.8	10.6	11.4	12.1	10.1	11.5	11.4
FCBs	24.2	26.0	22.7	22.7	24.0	28.1	15.6	21.0	21.5
Total	**8.7**	**5.6**	**6.7**	**9.6**	**10.1**	**11.6**	**9.3**	**11.4**	**11.3**

Chart 5.3



Under the Supervisory Review Process (SRP), banks are directed to maintain a level of "adequate" capital which is higher than the minimum required capital and sufficient to cover for all possible risks in their business. This higher level of capital for the banks is usually determined and finalised through SRP-SREP dialogue (Box 5.1).

5.9 Table 5.2 shows that on 31 December 2011 in aggregate the SCBs, DFIs, PCBs and FCBs maintained CAR of 11.7, -4.5, 11.5 and 21.0 percent respectively. But individually, 3 PCBs and 2 DFIs did not maintain the minimum required CAR. Whereas, all PCBs and FCBs complied with the minimum required capital. The CAR for the banking industry as a whole was 11.4 percent at end of 2011 as against 9.3 percent at end of 2010.

Box 5.1

Required Bank Capital: Minimum or Adequate?

The Basel Committee on Banking Supervision [BCBS] has set a framework on how the banks calculate their capital as a buffer against comprehensive risks. The committee suggested maintaining Capital Adequacy Ratio [CAR] ≥ 8% of the Risk Weighted Assets [RWA] to protect the interest of the depositors as well as to act as a summary indicator of bank soundness. Accordingly, Bangladesh Bank has implemented the "Risk Based Capital Adequacy" in 2010 with few customisations in view of the local economic situation. BB has suggested that the CAR should be ≥ 10% of the RWA. Now the question is regarding the symbol of '≥'. The symbol is a combination of '=' and '>'. If the symbol '>' is ignored then minimum CAR will be 10% of the RWA, which is the minimum capital requirement for a bank or NBFI. On the other hand, adequate CAR should be >10% of the RWA. Therefore, adequate capital will be Minimum Capital Requirement [MCR] + some additional capital. According to Pillar-2 of the Basel II statement this additional capital buffer will be calculated against those risks which are not captured under the 1st Pillar of Basel II.

The minimum capital of a bank is the stipulated funds, the banks must hold to ensure shock absorbance in the event of disruption from credit, market and operational risks. In Bangladesh, banks are required to maintain the MCR as 10% of the RWA or BDT 4000 million whichever is higher. In line with Basel-II framework credit, market and operational risks are considered for calculation of the RWA. Here capital should stand for eligible regulatory capital only, which consists of core capital (Tier-1), supplementary capital (Tier-2) and additional supplementary capital (Tier-3). Hence, adequate capital can be defined as

$$\text{Adequate Capital} = \text{MCR} + \text{Additional Capital}$$
$$\text{If, Additional Capital} = \delta$$
$$\text{Them, Adequate Capital} = \text{MCR} + \delta \quad \Big| \quad \delta > 0$$

According to the 2nd pillar of Basel II the additional capital [δ] will be determined through bank's own SRP (Supervisory Review Process, the bank's assessment). Extending the additional measure through ICAAP [Internal Capital Adequacy Assessment Process], a bank company can determine its optimal position of capital requirement. Optimality depends on few more capital in addition to the MCR. BB has identified several risks which are not captured under the 1st pillar. Those risk areas are: residual risk [error in documentation, error in valuation of callateral and loss of time value of money], adaption level of core risks management models, credit concentration risk, interest rate risk, liquidity risk, reputational risk, settlement risk, strategic risk, environmental & climate change risk and other material risk. Discrepancy (if any) as well as debate on additional capital should be settled through dialogue between the SRP and the SREP (Supervisory Review Evaluation Process, the central bank's assessment) teams. During dialogue, findings on additional capital could be compared with the results of stress testing which has been introduced for banks in Bangladesh in 2011.

In 2009, BCBS published Basel III documents. The documents have defined leverage, liquidity coverage along with net stable funding ratio and countercyclical position of banks and NBFIs. Considering these risk factors, Basel III suggested that banks should have additional capital conservation buffer at least 2.5% of the RWA.

Therefore, there is an indication to maintain not only a minimum capital but also an adequate capital for a banking company operating in Bangladesh. Maintaining adequate capital helps improving capital base as well as the risk management practice within the organisations. Adequate level of capital can ensure a bank having sufficient capital for meeting their risks or in other words ensure the solvency and continuous survival of the bank.

Asset Quality

5.10 The asset composition of all commercial banks shows that loans and advances represent the major component (64.6 percent). Loans and advances are vulnerable to credit risk, which are reflected as non-performing assets. A large non-performing loan portfolio has been the major predicament of banks particularly of the SCBs and the DFIs. Other bank assets include investment of banks in bills, bonds, shares etc. which constituted 14.1 percent of total assets in 2011.

5.11 The most important indicator of bank asset quality in the loan portfolio is the ratio of gross non-performing loans (NPLs) to total loans and the ratio of net NPLs to net total loans. In 2011, the FCBs and the PCBs had the lowest and the DFIs had the highest ratio of gross NPLs to total loans. The SCBs had a gross NPLs ratio of 11.3 percent whereas in case of the PCBs, the FCBs and the DFIs, the ratios were 2.9, 2.9 and 24.6 percent respectively, at the end of December 2011. At the end of FY12 the gross NPL ratios for the SCBs, the PCBs and the FCBs increased to 13.5, 3.8 and 3.2 percent respectively and that of the DFIs declined to 23.8 percent (Appendix-3, Table-III).

5.12 The ratio of NPL to total loans of all the banks has shown an encouraging trend declining from the peak (34.9 percent) in 2000. Nevertheless, the aggregate ratio was still as high as 6.1 percent in December 2011, resulting from the high NPL of the SCBs and the DFIs and it further increased to 7.2 percent at the end of FY12 (Appendix-3, Table-III).

5.13 The SCBs and the DFIs continue to have high levels of NPLs mainly due to substantial loans provided by them on considerations other than commercial criteria and under directed credit programmes during the 70s and 80s. Poor appraisal and

Chart 5.4

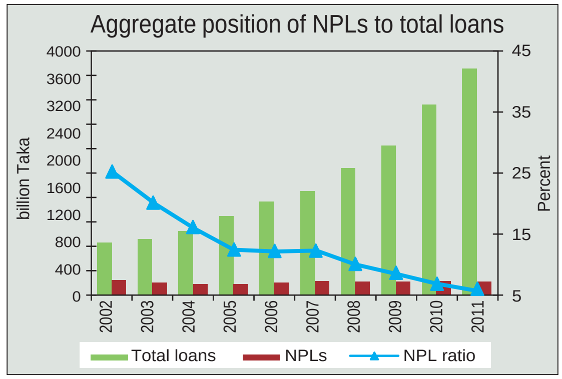


Table 5.3 NPLs to total loans ratios by type of banks

(Percent)

Bank types	2004	2005	2006	2007	2008	2009	2010	2011	End June 2012
SCBs	25.3	21.4	22.9	29.9	25.4	21.4	15.7	11.3	13.5
DFIs	42.9	34.9	33.7	28.6	25.5	25.9	24.2	24.6	23.8
PCBs	8.5	5.6	5.5	5.0	4.4	3.9	3.2	2.9	3.8
FCBs	1.5	1.3	0.8	1.4	1.9	2.3	3.0	2.9	3.2
Total	**17.6**	**13.6**	**13.2**	**13.2**	**10.8**	**9.2**	**7.3**	**6.1**	**7.2**

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

(Percent)

Bank	2004	2005	2006	2007	2008	2009	2010	2011	30 June 2012
SCBs	17.6	13.2	14.5	12.9	5.9	1.9	1.9	-0.34	2.4
DFIs	23.0	22.6	23.6	19.0	17.0	18.3	16.0	16.9	16.4
PCBs	3.4	1.8	1.8	1.4	0.9	0.5	0.0	-0.20	0.4
FCBs	-1.5	-2.2	-2.6	-1.9	-2.0	-2.3	-1.7	-1.81	-1.3
Total	**9.8**	**7.2**	**7.1**	**5.1**	**2.8**	**1.7**	**1.3**	**0.70**	**1.7**

Table 5.4 Required provision and provision maintained - all banks

(billion Taka)

All banks	2004	2005	2006	2007	2008	2009	2010	2011	2012 (30 June)
Amount of NPLs	187.3	175.1	200.1	226.2	224.8	224.8	227.1	226.4	290.0
Required Provision	87.8	88.3	106.1	127.2	136.1	134.8	149.2	148.2	178.4
Provision maintained	35.9	42.6	52.9	97.1	126.2	137.9	142.3	152.7	167.5
Excess(+)/ shortfall(-)	-51.9	-45.7	-53.2	-30.1	-9.9	3.1	-6.9	4.6	-10.9
Provision maintenance ratio (%)	40.9	48.2	49.9	76.3	92.7	102.3	95.4	103.0	93.9

inadequate follow-up and supervision of the loans disbursed by the SCBs and the 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, these banks were reluctant to write-off the historically accumulated bad loans because of the poor quality of underlying collaterals. The recovery of NPLs, however, witnessed some improvement in recent years. The steps taken with regard to internal restructuring of these banks to strengthen their loan recovery mechanism and recovery drive and write-off measures helped to achieve this improvement.

5.14 Table 5.3(a) and Chart 5.4(a) present the ratio of the net NPLs (net of provisions and interest suspense) to net total loans (net of provisions and interest suspense). It reveals from the table that the DFIs' non-performing portfolios were still high after adjustment of actual provision and interest suspense, whereas the SCBs, the FCBs and the PCBs had excess provision against their NPLs in December 2011. The net NPLs to net total loan ratios were 2.4, 16.4, 0.4, -1.3 and 1.7 percent for the SCBs, the DFIs, the PCBs, the FCBs and all banks respectively at the end of FY12 (Appendix-3, Table-IV).

5.15 Chart 5.5 displays the amount of NPLs of the 4 types of banks since 2000 through 2011. Amount of NPLs of the SCBs decreased from Taka 117.3 billion in 2000 to Taka 91.7 billion in 2011. The PCBs recorded a total increase of Taka 25.8 billion in their NPL accounts, which stood at Taka 72.0 billion in 2011 against Taka 46.2 billion in 2000. The amount of NPLs of the DFIs decreased to Taka 56.5 billion in 2011 from Taka 63.7 billion in 2000. The decline in NPLs to total loans ratio in the recent years [Chart 5.4(a)] can be

Chart 5.4 (a)

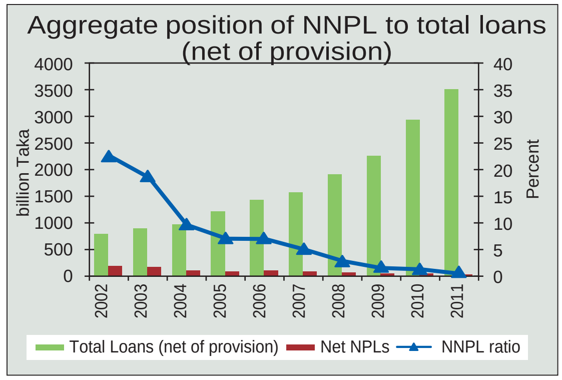


Chart 5.5

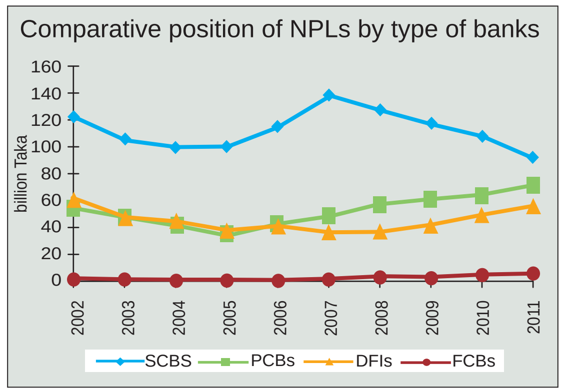


Chart 5.6

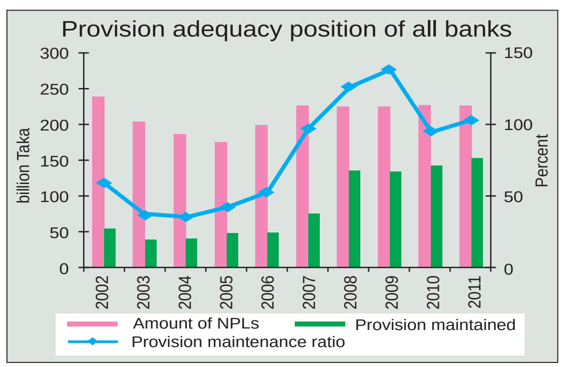


Table 5.5 Comparative position of provision adequacy

(billon Taka)

Year	Items	SCBs	SBs	PCBs	FCBs
2010	Required provision	70.6	19.1	53.3	6.2
	Provision maintained	69.9	13.3	51.8	7.4
	Provision maintenance ratio (%)	99.0	69.6	97.1	119.4
2011	Required provision	60.8	21.7	58.3	7.4
	Provision maintained	69.0	13.9	61.2	8.5
	Provision maintenance ratio (%)	113.5	64.1	105.0	114.9
30/06/12	Required provision	73.3	24.9	71.8	8.4
	Provision maintained	70.8	15.1	72.5	9.0
	Provision maintenance ratio (%)	96.6	60.6	101.0	107.1

attributed partly to some progress in recovery of long outstanding loans and partly to write-off of loans classified as bad or loss.

Loan Loss Provisioning of the Banks

5.16 Table 5.4 shows the aggregate amount of NPLs, required loan loss provision and actual provision maintained by the banks from 2004 to June 2012. In aggregate, the banks have been continuously failing to maintain the required level of provisions against their NPLs from 2004 through 2011 except in the year 2009 and 2011. In 2009 and in 2011, the banking sector was able to maintain 100 percent or more provision. Banks maintained 40.9 percent of the required provision in 2004; which increased thereafter to 103.0 percent in 2011. The main reason for the shortfall in provision adequacy from 2000 through 2011 (except 2009 & 2011) was the inability of some of the SCBs, the DFIs and the PCBs including those in problem bank category to make sufficient provisions due to inadequate profits and transferred provision for write-offs. Notably, the FCBs were in a much better position. They have been able to make adequate provisions in the recent years. A comparative position of loan loss provision as of end 2010, 2011 and FY12 is shown in Table 5.5.

5.17 Twenty eight out of the thirty PCBs could maintain the required provision, the remaining 2 failed due to their poor asset portfolios and earning levels at the end of December 2011.

Weighted Average Deposit and Lending Rates

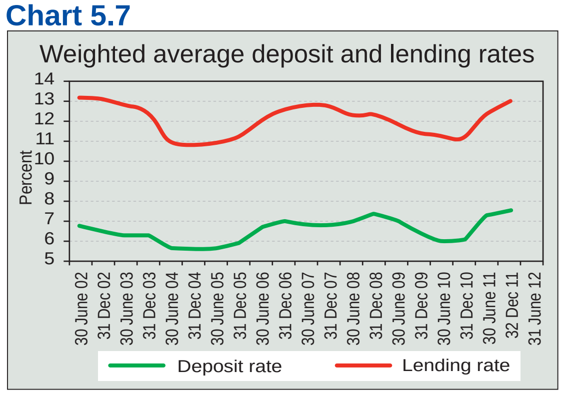
5.18 Banks weighted average deposit rate increased from 7.52 percent to 8.15 percent and weighted average lending rate increased from 12.99 percent to 13.75 percent during the second half of FY12 (1/1/2012 to 30/6/2012). The spread between lending and deposit rates increased from 5.47 to 5.60 percent during the same period. The weighted average deposit and lending rates along with the spread during 30/6/2003 to 30/6/2012 are shown in Table 5.6 and Chart 5.7.

Table 5.6 Weighted average deposit and lending rates

(Percent)

Date	Weighted average		Spread
	Deposit rate	Lending rate	
30 June 03	6.30	12.78	6.48
31 Dec 03	6.25	12.36	6.11
30 June 04	5.65	11.01	5.36
31 Dec 04	5.56	10.83	5.27
30 June 05	5.62	10.91	5.31
31 Dec 05	5.90	11.25	5.35
30 June 06	6.68	12.06	5.38
31 Dec 06	6.99	12.60	5.61
30 June 07	6.90	12.80	5.90
31 Dec 07	6.77	12.75	5.98
30 June 08	7.00	12.30	5.30
31 Dec 08	7.31	12.31	5.00
30 June 09	7.00	11.90	4.90
31 Dec 09	6.33	11.44	5.11
30 June 10	6.01	11.31	5.30
31 Dec 10	6.07	11.19	5.12
30 June 11	7.27	12.42	5.15
31 Dec 11	7.52	12.99	5.47
30 June 12	8.15	13.75	5.60

Chart 5.7



Writing-off Bad Debts

5.19 To wipe out unnecessarily and artificially inflated size of balance sheet, uniform guidelines of write-off have been introduced in 2003. According to the policy, banks may, at any time, classify write-off loans as bad/loss. Those loans, which have been classified as bad/loss for the last 5 years and above and loans for which 100 percent provisions have been kept, should be written-off immediately. The total amount of written-off bad debts from June 2006 to June 2012 in different categories of bank are presented in Table 5.7.

Management Soundness

5.20 Sound management is the most important and inevitable pre-requisite for the strength and concrete 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 based on quantitative 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 portray management soundness. Technical competence & leadership of mid and senior level management, compliance with banking laws and regulations, adequacy, compliance of sound internal policies, ability to plan and respond to changing circumstances etc. are also taken into consideration to illustrate the quality of management.

5.21 As evident from Table 5.8 and Chart 5.8, in 2011, the expenditure-income (EI) ratio of the DFIs was the highest among the shown bank clusters due to poor non-interest income and higher operating expenses particularly

Table 5.7 Writing-off bad debts in different bank categories

(billion Taka)

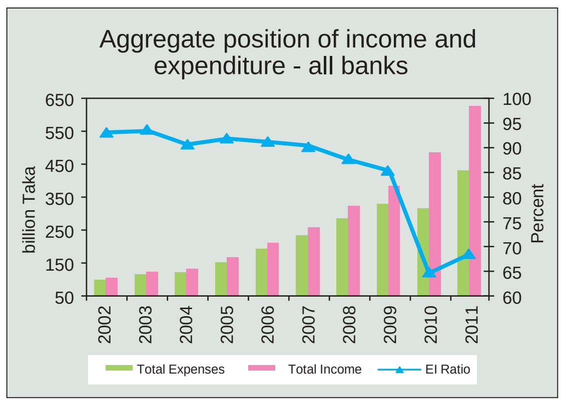
Bank types	30 June 06	30 June 07	30 June 08	30 June 09	30 June 10	30 June 11	30 June 12
SCBs	35.7	42.8	48.4	64.5	70.5	82.4	92.3
DFIs	28.6	30.4	31.0	31.8	31.8	32.0	32.3
PCBs	40.7	45.5	49.4	54.7	69.6	77.1	85.5
FCBs	1.5	1.6	1.7	2.0	2.1	2.4	2.9
Total	**106.5**	**120.3**	**130.5**	**153.0**	**174.0**	**193.9**	**213.0**

Table 5.8 Expenditure-income ratio by type of banks

(Percent)

Bank types	2003	2004	2005	2006	2007	2008	2009	2010	2011
SCBs	-0.3	102.3	101.9	100	100	89.6	75.6	80.7	62.7
DFIs	1.3	104	103.9	103.5	107.7	103.7	112.1	87.8	88.6
PCBs	12.0	87.1	89.3	90.2	88.8	88.4	72.6	67.6	71.7
FCBs	3.6	76.3	70.8	71.1	72.9	75.8	59.0	64.7	47.3
Total	**16.6**	**90.9**	**92.1**	**91.4**	**90.4**	**87.9**	**72.6**	**70.8**	**68.6**

Chart 5.8



incurred by BKB and RAKUB. The EI ratio of the PCBs was 71.7, the second highest, which could mainly be attributable to high administrative and operating expenses. The EI ratio of the SCBs fell from 80.7 in 2010 to 62.7 in 2011 mainly due to significant increase (Taka 60.5 billion to Taka 91.7 billion) in interest income.

Earnings and Profitability

5.22 Strong earnings and profitability profile of a bank reflect its ability to support present and future sound operation, absorb future contingent shocks and strengthen resilience

Table 5.9 Profitability ratios by type of banks

(Percent)

Bank types	Return on assets (ROA)									Return on equity (ROE)								
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2003	2004	2005	2006	2007	2008	2009	2010	2011
SCBs	0.1	-0.1	-0.1	0.0	0.0	0.7	1.0	1.1	1.3	3.0	-5.3	-6.9	0.0	0.0	22.5	26.2	18.4	19.7
DFIs	0.0	-0.2	-0.1	-0.2	-0.3	-0.6	0.4	0.2	0.1	-0.6	-2.1	-2.0	-2.0	-3.4	-6.9	-171.7	-3.2	-0.9
PCBs	0.7	1.2	1.1	1.1	1.3	1.4	1.6	2.1	1.6	11.4	19.5	18.1	15.2	16.7	16.4	21.0	20.9	15.7
FCBs	2.6	3.2	3.1	2.2	3.1	2.9	3.2	2.9	3.2	20.4	22.5	18.4	21.5	20.4	17.8	22.4	17.0	16.6
Total	0.5	0.7	0.6	0.8	0.9	1.2	1.4	1.8	1.5	9.8	13.0	12.4	14.1	13.8	15.6	21.7	21.0	17.0

capacity. 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 indicators of earning and profitability, the most representative and widely used indicator is Return on Assets (ROA), which is supplemented by Return on Equity (ROE) and Net Interest Margin (NIM).

5.23 Earnings as measured by the Return on Assets (ROA) and the Return on Equity (ROE) differ largely within the industry. Table 5.9 shows the ROA and the 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 SCBs was less than the industry average, but it is gradually increasing over time. The DFIs' situation was not better due to the operating loss incurred by BKB and RAKUB. For the PCBs and the FCBs, the ROA shows diverse trend but strong position during the last five years. The aggregate ROA has been consistently strong during the last couple of years.

5.24 The SCBs' ROE was 26.2 percent in 2009, but dropped down to 18.4 percent in 2010 as owners' equity had increased comparatively at a higher rate than after tax profit. However, it increased to 19.7 percent in 2011. In case of the DFIs, the ROE was still negative in 2011. The ROE of the PCBs was diverse but satisfactory (except the year 2011) during the last five years. The ROE of the FCBs has been showing gradual decline from 2009 due to increase in equity. The ROE of the FCBs in 2009 stood at 22.4 percent, which declined to 16.6 percent in 2011.

Chart 5.9

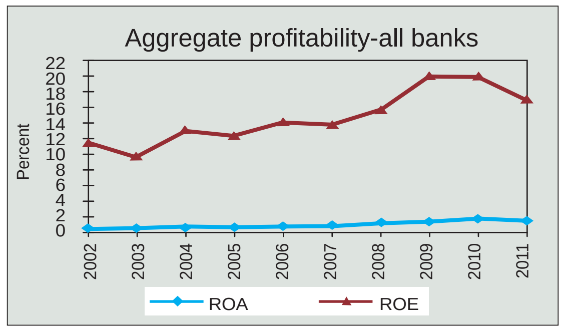


Table 5.10 Net interest income by type of banks

(billion Taka)

Bank types	2004	2005	2006	2007	2008	2009	2010	2011
SCBs	-1.1	7.7	9.0	7.4	7.9	12.1	19.8	34.3
DFIs	1.8	1.0	1.7	1.4	1.9	1.9	6.2	4.9
PCBs	13.7	21.0	25.4	36.1	48.5	56.7	82.8	91.4
FCBs	4.2	5.6	8.2	9.9	12.6	10.7	13.0	16.1
Total	**18.3**	**35.3**	**44.3**	**54.8**	**70.9**	**81.5**	**121.9**	**146.7**

Net Interest Income

5.25 The aggregate net interest income (NII) of the industry has consistently increased from Taka 18.3 billion in 2004 to

Table 5.11: Liquidity ratio by type of banks

(Percent)

Bank types	Liquid assets									Excess liquidity								
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2003	2004	2005	2006	2007	2008	2009	2010	2011
SCBs	24.4	22.8	20.0	20.1	24.9	32.9	25.1	27.2	34.7	8.4	6.8	2.0	2.1	6.9	14.9	17.6	8.2	15.7
DFIs	12.0	11.2	11.2	11.9	14.2	13.7	9.6	21.3	12.3	5.8	4.7	6.2	3.8	5.6	4.9	7.1	2.3	2.5
PCBs	24.4	23.1	21.0	21.4	22.2	20.7	18.2	21.5	23.9	9.8	8.8	5.1	5.6	6.4	4.7	5.3	4.6	7.0
FCBs	37.8	37.8	41.5	34.4	29.2	31.3	31.8	32.1	30.5	21.9	21.9	23.6	16.4	11.2	13.3	21.8	13.2	11.8
Total	**24.7**	**23.4**	**21.7**	**21.5**	**23.2**	**24.8**	**20.6**	**23.0**	**26.5**	**9.9**	**8.7**	**5.3**	**5.1**	**6.9**	**8.4**	**9.0**	**6.0**	**9.3**

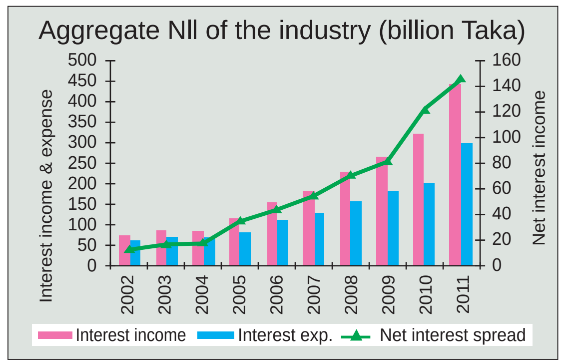
Taka 146.7 billion in 2011. However, the NII of the SCBs was a negative amount of Taka 1.1 billion in 2004 and had started to become positive (Taka 7.7 billion) from 2005. In 2011, the NII of the SCBs was Taka 34.3 billion. The DFIs had a positive trend in NII since 2002 and it was Taka 4.9 billion in 2011.

5.26 Since 2005, the SCBs have been able to increase NII by reducing their cost of fund. The NII of the PCBs has been incredibly high over the period from 2004 through 2011. The overall industry NII shows a consistently upward trend. The trend of NII indicates that the PCBs and the FCBs' interest spreads are higher than those of the SCBs and the DFIs.

Liquidity

5.27 Commercial conventional banks' Statutory Liquidity Requirement (SLR) is at present 19.0 percent of their total demand and time liabilities on daily basis, inclusive of average 6.0 percent (at least 5.5 percent in any day) Cash Reserve Ratio (CRR) on bi-weekly basis. The CRR is to be kept with the BB and the remainder as qualifying unencumbered assets, either in cash or in Government securities. The SLR for the banks operating under the Islamic Shariah is 11.5 percent (inclusive of average 6.0 percent CRR on bi-weekly basis and at least 5.5 percent in any day). The specialised banks

Chart 5.10



(except Basic Bank Ltd.) are exempted from maintaining the SLR. Liquidity indicators measured as percentage of demand and time liabilities (excluding inter-bank items) of the banks indicated that there was an increase in excess liquidity from 2010, but the amount (Taka 402.98 billion) was lower than that in 2009.

5.28 Table 5.11 and Chart 5.11 show that the FCBs had the highest liquidity ratios (except 2008 & 2011) followed by the SCBs. This situation of lower surplus of liquidity created occasional pressure in the money market.

CAMELS Rating

5.29 CAMELS rating is a supervisory tool to identify those banking companies which have problems and require increased supervision. Under this rating system, banking companies are assigned two sets of ratings-(i) performance ratings, based on six individual ratings that address six components of CAMELS (Capital, Assets, Management, Earnings, Liquidity and Sensitivity to market risk); and (ii) an overall composite ratings, based on a comprehensive assessment of the overall condition of the banking company. Both the ratings are expressed on a scale of 1 to 5 in ascending order of supervisory concern, 1 representing the best rating, while 5 indicating the worst. Any bank rated 4 or 5 i.e. Marginal or Unsatisfactory under composite CAMELS rating is generally identified as a problem bank. Activities of these banks are closely monitored by the BB.

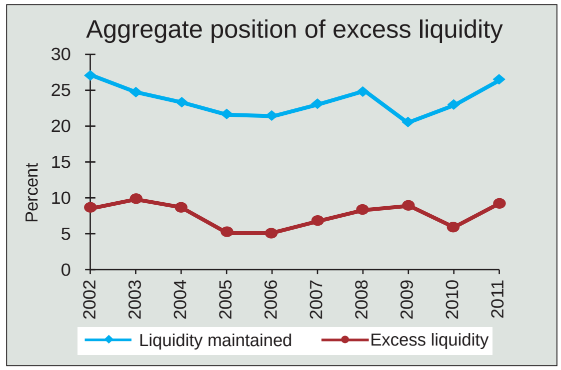
5.30 The BB had introduced Early Warning System (EWS) of supervision from March 2005 to address the difficulties faced by the banks in any of the areas of CAMELS. Any bank found to have faced difficulty in any areas of operation, is brought under Early Warning category and monitored very closely to help improve it's performance. Presently 2 banks are monitored under EWS.

5.31 As of end 2011, CAMELS rating of 2 banks was 1 or Strong; 33 banks were rated 2 or Satisfactory; 9 banks were rated 3 or Fair; 2 were rated 4 or Marginal and 1 bank got 5 or Unsatisfactory rating.

Financial Projection Model

5.32 Bangladesh Bank has taken all out efforts to implement the Financial Projection Model as a supervisory tool with the help of World Bank experts. The main objectives of the model is to (1) assess the strengths and weaknesses of individual banks in the system based on hypothetical scenarios (2) perform comprehensive scenario analyses to identify risks and take policy measures accordingly and (3) improve BB's risk assessment capacity for individual banks by incorporating the FPM into the supervisory risk assessment processes. This task will be completed over three phases. The task of 1st phase has already been completed.

Chart 5.11



Quick Review Report

5.33 With the existing supervisory tools like CAMELS rating, stress testing, financial projection model etc. Bangladesh Bank started determining the banks' financial position quarterly through quick review report. This report focuses on major risks existing in the bank and provides the possible way out in brief.

Islamic Banking

5.34 Alongside the conventional interest based banking system, Bangladesh entered into an Islamic banking system in 1983. In FY12 out of the 47 banks in Bangladesh, 7 PCBs operated as full-fledged Islamic banks and 16 conventional banks (including 3 FCBs) were involved in Islamic banking through Islamic banking branches. The Islamic banking industry continued to show strong growth since its inception in 1983 until December 2011 in tandem with the growth in

Table 5.12 Comparative position of the Islamic banking sector (as of end December 2011)

(billion Taka)

Particulars	Islamic banks		Dual banking (Conventional+ Islamic)		Islamic banking sector		All banking sector	
	2011	2010	2011	2010	2011	2010	2011	2010
1	2		3		4=2+3		5	
Number of banks	7	7	16	16	23	23	47	47
Deposits	751.2	627.6	56.2	48.0	818.9	675.6	4484.4	3858.9
Investments (credits)	693.0	587.2	45.8	41.6	738.8	628.7	3642.6	3297.5
Investment deposit ratio	90.9	93.6	81.4	86.7	90.2	93.1	79.7	85.5
Liquidity: Excess(+)/Shortfall(-)@	31.0	25.5	0.5	0.5	31.5	26.0	358.5	211.8

@ conventional banks which have Islamic banking branches do not maintain SLR individually.
The head offices of the respective bank maintain combinedly SLR and liquidity position.

the economy. This is reflected in the increased market share of the Islamic banking industry in terms of assets, financing and deposits of the total banking system. A brief picture is given in Table 5.12. Total deposits of the Islamic banks and Islamic banking branches of the conventional banks stood at Taka 818.9 billion at the end of December 2011. This was 18.3 percent of deposits of the total banking system. Total credit of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 738.8 billion at the end of December 2011. This was 20.3 percent of the credit of the total banking system of the country.

Introduction of Islami Inter-bank Fund Market (IIFM)

5.35 Recently Bangladesh Bank has established Islami Interbank Fund Market (IIFM) in order to remove temporary and short term liquidity problem of Islami shariah based scheduled banks & financial institutions and Islami banking branches of conventional banks.

Deposit Insurance Scheme

5.36 Deposit Insurance Scheme (DIS) was introduced in Bangladesh in August 1984 to act as a safety net. It aims at minimising or eliminating the risk of loss of depositors' fund with banks. DIS in Bangladesh is now being governed by the Bank Deposit Insurance Act 2000. A Deposit Insurance Trust Fund (DIFT) has also been created for providing limited protection (not exceeding Taka 0.10 million) to a small depositor in case of winding up of any bank. It covers 84 percent of total depositors in the country. The Board of Directors of the Bangladesh Bank is the Trustee Board for the DITF. The DITF is now being administered and managed under the guidance of the Trustee Board. The BB is a member of the International Association of Deposit Insurers (IADI) since 2006. The fund is being mobilised through collection of premium from the bank deposit as per the present Act. The rate of premium is not same for all banks. It depends on the category of the status of the bank. Revised risk based premium rate was introduced from January 2007. As per new schedule, the banks under problem bank category will have to pay 0.09 percent and other scheduled banks including state owned banks will pay 0.07 percent as premium on their deposits. At the end of December 2011, the total fund of the DITF stood at Taka 19.8 billion (unaudited) of which

Taka 19.5 billion was invested in Government securities. To inform the public and for stabilising the payment system in the banking sector, the information regarding deposit insurance scheme, it's nature, operating procedures, level of coverage, premium rates etc. and last audited balance sheet (as on 30-06-2012) has been disclosed in BB website (www.bb.org.bd).

The Board of Directors of BB as the Trustee of the DITF has approved a new risk based premium rate and amount of coverage which will come into force after government approval. BB has also taken initiative to include the Non-Bank Financial Institutions (NBFIs) as scheduled banks in DIS which is now under consideration of the government. The current deposit insurance framework in Bangladesh complies with most of the major principles of the IADI core principles for effective Deposit Insurance Systems. The effectiveness of DITF in reducing systemic risk would increase if the public was well aware of it's existence and scope. In addition to disclosing various relevant information in its website, the BB endeavours to reduce banking risks through on-site inspection and off-site monitoring. The presence of DIS complements the existing supervisory framework in promoting stability and soundness of the financial system.

B. Legal Reforms and Prudential Regulations

5.37 As part of the ongoing efforts to strengthen the banking system through the adoption of policies aimed at both improving the financial strength of banks as well as bringing about greater transparency in their operations, several policy measures were initiated during FY12.

Risk Based Capital Adequacy (RBCA) for Banks

5.38 BB introduced the Risk Based Capital Adequacy (RBCA) framework for banks from January 2010 as a regulatory compliance. Under the new capital adequacy framework, BB is entrusted with ensuring that banks are accurately assessing all the risk they are exposed to and maintaining the required capital commensurate with their risk profile. Pertinently, banks have been instructed to raise their capital to Taka 4.0 billion of which paid up capital shall be minimum Taka 2.0 billion with effect from 11 August 2011. Moreover, BB has reviewed the minimum regulatory Capital Adequacy Ratio (CAR) and the Minimum Capital Requirement (MCR) of the banks in the year 2010 through revising the existing RBCA policy and banks' past capital adequacy reporting. Banks are required to maintain the CAR at greater than or equal to 10 percent of Risk Weighted Assets (RWA) from July 2011. According to Pillar-1 of Basel-II, RWA of banks is calculated against Credit Risk, Market Risk, and Operational Risk. Banks are instructed to submit their Capital Adequacy Statement at the end of each quarter to BB.

BB is now on its way to implement the Pillar-2 of RBCA framework. The key principle of the Supervisory Review Process (SRP) is that "banks have a process for assessing overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital at an adequate level". Banks are now instructed to form a SRP team, where risk management unit is an integral part, and to develop a process document called Internal Capital Adequacy Assessment Process (ICAAP) for assessing their overall risk profile. Adequate capital means enough capital to compensate all the risks in their business. Basel II has linked capital to the level of risk management. Therefore, banks should have best practiced risk management techniques in monitoring and mitigating their risks. Supervisory Review Evaluation Process (SREP) of BB includes dialogue between BB and the bank's SRP team followed by findings/evaluation of the bank's ICAAP. During SRP-SREP dialogue, BB will review and determine additional capital to MCR of banks. To facilitate the dialogue, a process document has been developed by BB, [can be accessed at: http://www.bb.org.bd/mediaroom/baselii/guidelinefeb2011.pdf.] Under the process document, BB provides guidance to banks to calculate adequate capital to supplement the MCR against residual risk, evaluation of core risk management, credit concentration risk, interest rate risk, liquidity risk, reputation risk, settlement risk, strategic risk, environmental & climate change risk and other material risks in specified format and submit the return to BB. In this process, information of banks' ICAAP would be counterchecked with the information available to the On-site inspection departments of BB. During the SRP-SREP dialogue, if banks are not able to produce information backed by proper evidence and real review regarding risk management, the available information of the BB inspection department would be used for determining the adequate capital.

Rationalisation of Schedule of Charges

5.39 Bangladesh Bank has rationalised the charges of some services to protect the interest of depositors/investors/customers and advised all scheduled banks to display the complete schedule of charges in suitable visible places in their branches and head offices and upload the same in their respective websites for the convenience of the customers.

In the interest of small depositors it has been decided that no charge can be imposed as account maintenance fee for average deposit balance up to Taka 5000. It has also been decided that a maximum of Taka 100 may be imposed as account maintenance fee for average deposit balance up to Taka 25000 on six month basis.

Rationalisation of Rate of Interest

5.40 The cap on rate of interest on lending in all sectors other than pre-shipment export credit (7.0 percent) and agricultural credit (13.0 percent) has been withdrawn. Banks are advised to limit the difference between the lending rate and the weighted average rate of interest on deposit or intermediation spread within lower single digit in different sectors other than the high risk consumer credit (including credit card) and SME loans.

Banks are allowed to differentiate interest rate up to a maximum of 3.0 percent in consideration of the diverse risk elements applicable to borrowers in the same lending category. With progressive deregulation of interest rates, banks have been advised to announce the mid-rate of the interest rate for different sectors and they may change a lower or higher interest rate of up to 1.5 percent around this pre-announced mid-rate based on the comparative credit risk for each customer.

In cases where the maximum interest rate has been fixed by Bangladesh Bank, Banks shall report their own maximum cap. Banks have also been advised to upload their deposit and lending interest rates on their respective websites.

Policy Guidelines for Green Banking

5.41 Bangladesh is one of the many countries vulnerable to adverse impacts from climate change. Financial institutions of Bangladesh can play an important role to prevent and mitigate environmental degradation. Comprehensive policy guidelines for Green Banking have been issued with a view to developing a strong and environment friendly banking system.

The top ten banks have been graded based on their overall Green Banking activities. More emphasis has been given on the bank`s operational policy as reflected in the allocation of its budget for promoting Green finance, environmental risk rating, and expansion in programmes to foster greater access to online banking, ATM, Internet and Mobile/SMS banking. In-house activities covering building an inventory of savings on utilities and energy, encouraging Green marketing, enhancing capacity building and disclosure of the bank's practices are considered part of Green activities. Bank Asia Limited, Dutch Bangla Bank Limited, Eastern Bank Limited, Islami Bank Bangladesh Limited, Mutual Trust Bank Limited, Prime Bank Limited, Pubali Bank Limited, Standard Chartered Bank Limited, Shahjalal Islami Bank Limited, and Trust Bank Limited have been considered as the top ten banks, arranged in alphabetical order.

Guidelines on Environmental Risk Management (ERM)

5.42 A detailed guideline on Environmental Risk Management (ERM) has been introduced to assess the environmental risk along with the credit risk for an overall credit rating prior to the disbursement of loan/credit facility.

SCB Monitoring Cell

5.43 With a view to developing the financial soundness and operational efficiency of the nationalised commercial banks, the Government of the People's Republic of Bangladesh (GoB) corporatised three of the state-owned commercial banks (Sonali, Janata and Agrani Bank Ltd.) in 2007. At the time of corporatisation, the cumulative losses of Sonali, Janata and Agrani Bank were transformed into intangible assets- that should be amortised within 10 years. Rupali Bank was converted into a public limited company on 14 December 1986. After restructuring, a positive impact in the financial indicators of these four banks was observed as the performance of the SCBs improved over the years. Bangladesh Bank is monitoring these banks closely under Memorandum of Understanding (MoU) since 2003. Fixing ceilings on the net loan growth, mandating reductions in classified loans, setting up targets on cash recovery from classified loans, focusing on agricultural and SME loans, ensuring better fund management, developing human resources, implementing core risk management guidelines etc. have been incorporated into the MoUs. As a result of this special monitoring, the SCBs at present hold sufficient capital consistent with BASEL-II requirements. There is no shortfall in provisioning requirements for the SCBs as in December 2011. The average classified loans (in percentage) of the SCBs was 11.3 percent in December 2011, against 15.7 percent in December 2010, while the average classified loan in the banking industry was 6.1 percent in December 2011. In short, the overall position of these SCBs is gradually improving. On the other hand, Bangladesh Krishi Bank

(BKB) and Rajshahi Krishi Unnayan Bank (RAKUB) are also being monitored and reviewed under the MoU of FY12. Preparation of MoU for BKB and RAKUB for FY13 is under process.

Corporate Governance in Banks

5.44 Liquidity and solvency problems caused by poor governance in banks can have harmful systematic consequences in the broader economy. High priority is, therefore, accorded to good corporate governance in banks, putting in place checks and balances comprising a mix of legal, regulatory, and institutional provisions, specifying the roles and accountabilities of the board, the executive management, external and internal audit, disclosure and transparency prescriptions. BB has taken several measures in recent past to put in place good corporate governance in banks. These include fit and proper test for appointment of chief executive officers of PCBs, constitution of audit committee of board and enhanced disclosure requirements etc. In continuation of the above reforms, the roles and functions of the Board and Management were redefined and clarified with a view to specifying the powers of the management and restricting the intervention of directors in day-to-day management of the bank.

Corporate Social Responsibility

5.45 Corporate Social Responsibility (CSR) is mainly about the awareness of and actions in support of environmentally sustainable societal development. CSR actions aim at mitigating the diverse environmental impacts of the activities of the business, and at reducing inequalities and alleviating deprivation and poverty in the communities across the country.

Table 5.13 CSR expenditures of banks during 2008 to 2011

(millon Taka)

Year	2008	2009	2010	2011
CSR Expenditure	410.7	553.8	2329.8	2188.3

All banks had undertaken CSR practices in some form or other in 2011. As shown in Table 5.1 the CSR expenditure in 2011 was lower than that in 2010 mainly due to a decline in the needs of emergency assistance, with fewer natural disasters etc.

CSR expenditures of banks in 2011 comprised both passive one-off donations to voluntary/civil society organisations, and sustainable support to charitable organisations as scholarships for courses of studies, health care treatment etc. In addition, some banks route their CSR expenditures through separately established charitable foundations. They reported increased involvement in CSR practices focusing on social and financial inclusion of excluded and underserved population segments and economic sectors. They lend to the SMEs and small farmers including sharecroppers, help opening bank accounts in state owned banks for rural farmers/hardcore poor/freedom fighters/small life insurance policyholders/others with nominal deposit as low as Taka 10. Awareness has heightened in the banks about environmental impacts of the projects they lend to; they are extending environment friendly financing through Green Financing.

In view of the growth pursuits as well as alleviation of abject poverty from the country BB has taken various initiatives incorporating the rural poor into the formal financial sector. (Box 5.2).

Box 5.2

Financial Inclusion: Bangladesh Bank's Initiatives

Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by the vulnerable groups of the society at an affordable cost in a fair and transparent manner by banks and financial institutions. Poverty, lack of education and lack of awareness are the main obstacles preventing an estimated 60% of the population of Bangladesh from having access to financial services. As a result of this, they often go to the local money lenders and are forced to borrow at unfair prices. They often find it difficult to start their own business as they have no formal bank account.

There are certain challenges in financial inclusion standardisation and they are (a) enrolment of large numbers (b) high maintenance costs for accounts (c) small size of transaction (d) illiteracy and use of vernacular (e) product & service pricing (f) trust and acceptance (g) lack of electricity (h) poor telecommunications etc.

In this backdrop, BB has taken several initiatives to bring the huge number of financially excluded people under financial inclusions to create opportunities for the poor people and to help the economic growth of the country as well.

The measures for improvement in financial inclusion are (a) number of accounts opened (b) value of deposits in these accounts (c) number of transactions in these accounts per period (d) value of transactions in these accounts.

BB has already given necessary instructions to the banks for the following target groups:

Bank Account for Farmers: A farmer with a national ID card/birth registration card and 'agricultural equipment assistance card' issued by the Department of Agricultural Extension, can open an account by depositing Taka 10/- (ten) only at any state owned commercial and specialised bank. The total number of farmer's accounts as of June, 2012 is 95,78,028.

Bank Account for Unemployed Youth: An unemployed youth can open a bank account by depositing Taka. 50/-at any scheduled bank under National Services Programme.

Bank Account for Hardcore Poor: A hardcore poor, with a national ID card and registration card issued by the Ministry of Food & Disaster Management, can open a bank account by depositing Taka 10/- (ten) only at any state owned commercial and specialised bank.

Banking Services for Physically Handicapped People: Banks have been advised to designate an official as 'Focal Point' at each branch of their bank with a view to making the banking services beneficial and easily accessible to the physically handicapped people.

Bank Account for Freedom Fighters: A freedom fighter, who has a national ID card and a payment receipt book for freedom fighter's allowance, can open a bank account by depositing Taka 10/- (ten) only at any state owned commercial and specialised bank. Total number of accounts for freedom fighters as of June 2012 is 1,08,332.

Bank Account for Beneficiaries under Social Security Programme: The beneficiaries under Social Security Programmes, with thier national ID cards and payment receipt books containing Pension Payment Order (PPO) for the beneficiaries, can open a bank account by depositing Taka 10/-(ten) only at any state owned commercial and specialised bank. Transactions may also be carried on through vouchers in case of insufficiency of check books. Total number of accounts for beneficiaries under Social Security Programme as of June 2012 is 25,75,690.

Bank Account for Distressed People having Grant from Hindu Religious Welfare Trust: Beneficiaries under Hindu Religious Welfare Trust can open bank accounts by depositing Taka 10/- (ten) only at any state owned commercial and specialised bank against the national ID card and certificate issued by Hindu Religious Welfare Trust.

Bank Account for Small Life Insurance Policy Holder: Small life insurance policy holders(up to Taka 1,50,000) can open bank accounts by depositing taka 100/-(hundred) only at any state owned commercial and specialised bank against the national ID card/birth certificate and premium deposit book/document for life insurance. Total number of accounts for beneficiaries under Social Security Programme as of June 2012 is 7,468.

Box 5.2

Financial Inclusion: Bangladesh Bank's Initiatives (Contd.)

Mobile Banking: Bangladesh Bank has approved Mobile Financial Services such as inward foreign remittance, cash in/out using M-wallet, P2B, B2P and G2P payments etc., aiming at financial inclusion of the unbanked.

School Banking: BB has advised to the scheduled banks to introduce School Banking activities to encourage saving behaviour of the students, to facilitate their financial inclusion as well as for introducing modern banking service and technology to the student. The total number of accounts under School Banking activities as of June 2012 is 67,220.

There are no bindings for maintaining minimum balance on the accounts in most of the above mentioned cases and banks shall not impose any charges/fees there. It is expected from the banks that they will move with their financial inclusion programme with a view to (i) making mass people learn financial matters (financial education) (ii) making the target groups access to the financial markets (iii) enabling them to play effectively in the credit market. BB is also committed to issue a broad based policy guideline on financial inclusion for the banks soon so that the banks can play a more effective role in serving the prioritised target groups in the best possible manner.

Activities of Credit Information Bureau

5.46 In the backdrop of huge non-performing loan of the banks/financial institutions during the 1980s, a full-fledged Credit Information Bureau (CIB) was set up on 18 August 1992 in Bangladesh Bank under the Financial Sector Reform Project (FRSP) of the World Bank. The main objective was to minimise 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.

5.47 CIB online services were opened up in 19 July 2011.The CIB database consists of detailed information in respect of borrowers, owners, and guarantors. The total number of borrower was 710020 at the end of June 2012 recording an increase of 3.5 percent (685801 as on end June 2011) over the previous period. It has brought huge advantages in CIB related operations over the previous system. With the help of CIB the amount of classified loan in banks and financial institutions decreased during FY12 (end June 2012). The rate of decline of classified loan in 2012 was 10.9 compared to that of 11.0 percent in the preceding year. It may be mentioned that with effect from June 2004 quarter, the amount of 'Written-off' loan was excluded from both classified and outstanding loans, and after exclusion the percentage of classified loan stood at 10.9 of total loans as of end June 2012.

C. Supervision of Banks

5.48 With a view to promoting and maintaining soundness, solvency, and systematic stability of the financial sector as well as to protecting interest of depositors, BB carries out two types of supervision namely (i) off-site supervision and (ii) on-site supervision. The Department of Off-site Supervision (DOS) is vigilant in their operation. The operations of the DOS were discussed in earlier sections of this chapter. The details of on-site supervision are given below:

On-site Inspection of Banks

5.49 As part of Bank's statutory function, currently five departments of BB namely Department of Banking Inspection-1 (DBI-1), Department of Banking Inspection-2 (DBI-2), Department of Banking Inspection-3 (DBI-3), Foreign Exchange Inspection and Vigilance Department (FEIVD) and Bangladesh Financial Intelligence Unit (BFIU) conduct on site inspection of SCBs, DFIs, PCBs (including banks under Islamic Shariah), FCBs, and other institutions including Investment Corporation of Bangladesh (ICB) and Money Changers. Basically, three types of inspections are conducted namely (i) comprehensive inspection, (ii) risk based inspection/system check inspection, and (iii) special inspection. The broad objectives of on-site inspection are as follows:

- To promote soundness, solvency and systemic stability of the financial sector as well as to protect depositors' interests.
- To ensure safety, stability and discipline in the banking sector;
- To ensure compliance of banking laws, rules and regulations;
- To combat money laundering and terrorist financing activities;
- To evaluate quality and performance of bank management and Board of Directors;
- To identify weaknesses which are to be addressed to strengthen the banks; and
- To evaluate financial soundness and operational efficiency of the banks.

In comprehensive inspection, overall performance/conditions of the banks such as capital adequacy, asset quality, liquidity, earnings, management competence etc. are evaluated. Based on their performance banks are rated on a scale of 1-5 in ascending order. Inspection is done according to the Annual Inspection Programme formulated by the respective departments well ahead of the beginning of each calendar year. The on-site inspection departments also monitor implementation of the suggestions or recommendations made in the inspection reports.

Risk based inspection is conducted to examine the compliance of the Core Risk Management Guidelines issued by BB as well as to evaluate and monitor risk management systems and control environment of the banks. The frequency of the inspection is annual and areas covered are risks associated with credit, internal control and compliance, asset liability management and information system.

Special inspections are conducted on the banks on specific/particular issue(s) as well as to investigate complaints received from the depositors, public or institutions.

5.50 Commercial banks having CAMELS rating between 3 and 5 are inspected every year. Banks rated 1 or 2 are inspected once in every two years. The branches of scheduled banks covering around 60-70 percent of total loans and advances are normally brought under the comprehensive inspection programme. Inspections of banks are 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. However, as it is difficult to correct the account of the banks if the inspections are done at different basis dates, steps have been taken to inspect most of the banks on 31 December.

Based on the findings about provisions, income and expenditure entries, banks are asked to correct their final account. This system has been adopted to enhance the effectiveness of on-site inspection and reduce the time gap between on-site and off-site supervision (Box 5.3).

Box 5.3

New Architecture of Bank Supervision

Bangladesh Bank has introduced substantial changes in its onsite and offsite supervision architecture under bank supervision techniques and approaches, aiming towards better safeguarding of institutions and improving systemic soundness of banking sector.

The major tasks are

- An integrated prudential regulatory and supervisory structure in full harmony with evolving international best practice standards;
- Strengthening legal framework and closely coordinating onsite and offsite supervision functions;
- Intensifying supervisory focus on risk appraisal and management practices of banks in their lending and other business functions;
- Effective corporate governance and internal control functions;
- Establishment of risk management unit;
- Loan classification and provisioning system in line with international best practices;
- Introducing more stringent requirements in loan rescheduling;
- Holding a series of town hall meetings with field level BB supervisory staff aimed at eliciting their wholehearted engagement in and commitment to the newer supervision approaches focusing on the risks inherent in lending and other banking businesses; and
- Opening of Customer's Interest Protection Centres (CIPCs) at BB head office and branch offices.

Bangladesh Bank has taken such type of initiatives to make the banking system sound and strong so that it can act as the base of a sustained and stable economic growth and extend a diverse services domestic as well as international, to a broad range of customers including individuals, small, medium and large-scale entrepreneurs and government bodies. BB's supervision of the banking sector aims at preserving confidence of depositors on the banking system with a view to observe that banks operate safely and soundly, extending financial services efficiently at affordable costs in compliance with relevant laws and regulations.

5.51 During the period from 1 July 2011 to 30 June 2012 comprehensive inspections were conducted on 789 branches including head/country offices of 30 private and 6 foreign commercial banks. Out of 789 branches, DBI-1 (head office) conducted inspection in 423 branches including head/country offices and the rest 366 branches were conducted by different offices of Bangladesh Bank. At the same time core risk inspections were conducted on the banks under the jurisdiction of DBI-1 to review the progress of implementation of the core risk guidelines [Asset-Liability Management (ALM), Credit Risk Management (CRM), Information Communication Technology (ICT) and Internal Control & Compliance (ICC)] issued by the BB. The head/country offices of the banks as well as one branch of each of the banks were brought under the purview of the core risk inspection. A summary of inspections conducted is stated below.

DBI-2 conducted a total of 951 comprehensive inspections including 7 head offices, 132 big branches and 812 small branches. At the same time a total number of 97 special inspections were conducted on state-owned commercial banks and specialised banks, 5 risk based inspections on 6 banks and 17 surprised inspections were conducted on 6 banks of the country. The department also conducted 77 comprehensive inspections on financial institutions (FIs) including 26 head offices and 11 special inspections on the 26 non-bank financial institutions of the country.

DBI-3 conducted a total of 643 comprehensive inspections on banks including 5 head offices, 199 big branches, 312 small branches and 127 SME service centres. The department conducted 12 risk based, 5 surprised and 14 special inspections on banks.

5.52 FEIVD conducts inspection on foreign trade financing, treasury functions and foreign exchange risk management of banks, foreign exchange transactions of banks and money changers. In FY12, the department conducted a total of 230 comprehensive inspections on banks including 42 head offices and 188 authorised dealer branches. The department also conducted 361 special inspections on various banking irregularities, 46 special inspections on foreign exchange risk management, 6 inspections on Off-shore banking units and 431 inspections on money changers.

A special centre named Customers' Interests Protection Centre (CIPC) came into operation under this department from 21 March 2011. The CIPC receives complaints from banks, financial institutions and customers through telephone, fax, e-mail, web address, letters etc. and resolves those by taking rapid and appropriate actions. In FY12, the centre received 2936 complaints and settled 2446 complaints.

5.53 In FY12, BFIU conducted system check

Comprehensive inspection

Category of banks	Number of head offices/branches inspected			
	Head office	Big branch	Small branch	Total
Private banks	30	313	414	757
Foreign banks	6	12	14	32
Total	36	325	428	789

Comprehensive inspection

Category of banks	ALM		CRM		ICC		ICT		Total
	HO	Br	HO	Br	HO	Br	HO	Br	
Private banks	30	30	30	30	30	30	30	30	**240**
Foreign banks	09	09	09	09	09	09	09	09	**72**
Total	**39**	**39**	**39**	**39**	**39**	**39**	**39**	**39**	**312**

inspection in 47 head offices and 121 bank branches under core risk programme. The department also conducted special inspection on 25 branches of 20 banks. Besides, some other special inspections were also conducted for further analysis of some STRs. During FY12, 29 branches have been inspected for this purpose. In addition to this, on the basis of allegation/complaints received from different persons, organisations, some special inspections were also conducted to verify the complaints. The BFIU has conducted special inspections in 51 branches during FY12. Under the provision of MPLA, 2009, 22 banks were penalised so far for non-compliance of the Act; among those 1 bank was fined during FY12.

Risk Management Activities of the Banks

5.54 The BB has issued several prudent guidelines on risk management for the banks in order to face the ongoing challenges of increased competition and expansion of diversified financial business of the banking sector under the recent global financial upheavals. This includes risk based capital adequacy, stress testing and six core risk management.

For better management of risks, each scheduled bank was advised to form an independent Risk Management Unit (RMU) in June 2009. Probable terms of reference and organogram were also proposed in September 2009. Banks were also instructed to prepare Risk Management Paper (RMP) and place the same in their regular monthly meeting of the RMU and submit the RMP along with the minutes of the meetings (that is supposed to contain specific decisions based on the analyses/recommendations made in the risk management paper) to the department of Off-site Supervision within 10 days of each quarter end. To ensure the uniformity in risk analysis and presentation in the RMPs, a directive proposing several specific risk areas was also issued in November 2011.

Under constant vigilance and ensuing guidance, the banks started risk management practice through preparing their RMPs and respective minutes of the meetings since the last quarter of 2009. Subsequently, the Department of Off-site Supervision has been focusing on effective analysis and reporting of risk management activities of the banks. Regular constructive feedbacks are provided on each bank's performance in this regard.

Along with regular risk management activities, banks are also advised to perform stress testing. The aim is to determine the stability of the banking entity through measuring its risk resilience under several probable worse scenarios. A detailed guideline on stress testing was issued in April 2010, followed by a revised one in February 2011. Accordingly, the Department of Off-site Supervision has been analysing the results of each bank's stress testing to have a broader picture of risks evolving in the overall banking sector.

Reviewing Minutes

5.55 The minutes of board, executive committee, and audit committee meetings of all scheduled banks except foreign banks along with the appointed observers' reports have been reviewed in order to find out the irregularities and violations of existing laws, regulations, circulars, policies etc. During 2011, on reviewing of 1,645 (730 Board Minutes, 323 Audit Committee Minutes and 592 Executive Committee Minutes) minutes, many gross irregularities and violations of banking laws, circulars etc. have been detected. Accordingly, the banks have been advised to regularise the same so that major financial indicators as well as internal control system of the banks become strong and can achieve shock resilient capacity.

Financial Stability

5.56 In light of the global economic turmoil and the rapidly growing and evolving financial sector in Bangladesh, BB has created a new department titled "Financial Stability Department", (FSD), on 29 May 2012. The purpose of FSD is to strengthen the macro prudential framework of Bangladesh. This department has five units namely, Macro Prudential Policy Unit, Financial Stability Research Unit, Bank/Financial Institution Stress Watch Unit, Financial Market Stress Watch Unit and General Unit.

The FSD is entrusted with:

i) examining the stability of the financial system through macro prudential analysis;

ii) assessing and identifying financial system risks and vulnerabilities, analysing their outlook and making appropriate policy recommendations for safeguarding financial stability;

iii) designing and conducting stress testing exercise in order to assess the resilience of the banking system and the potential repercussions on the real economy;

iv) overseeing the means of payment, clearing and settlement systems operating in Bangladesh aiming at ensuring their reliability and efficiency, and in particular the containment of systemic risk;

v) monitoring developments in insurance sector as well as capital markets' participants such as securities firms and collective investment firms which are not supervised by BB;

vi) publishing a Financial Stability report in co-operation with other departments of BB; and

vii) recommending macro-prudential regulation and engaging in macro-prudential oversight which is focused on analysing, assessing, and mitigating systemic risk.