Banking Sector Performance, Regulation and Bank Supervision

5.1 The world financial system became susceptible to escalate vulnerability and instability in the recent past. Yet the banking sector of Bangladesh underwent a moderate level of resilience in FY15. With a view to maintaining a sound, efficient and stable financial system, Bangladesh Bank (BB) has initiated a number of policy measures giving augmented emphasis on (i) risk management and corporate governance in the banks, (ii) periodic review of stability of the individual bank as well as the whole banking system, (iii) exercise of stress testing, (iv) inclusion of underserved productive economic sectors and population segments in financial system, (v) monitoring of fraud-forgeries and strengthening internal control and (vi) compliance through self assessment of anti-fraud internal controls, etc. Monitoring of investment in stock market by the scheduled banks has been stringent. Risk Management Committee at the board level has been made mandatory to ensure proper risk management practice in the banks. Presently, the banks are being rated for their overall risk management performance. Focus has also been given on Corporate Social Responsibility (CSR) and green banking activities and a distinguished department has been working to monitor the initiatives being undertaken by banks. BB is shifting from a compliance-based approach to a forward-looking risk-based approach in regulation and supervision. Basel-III, the revised regulatory capital framework, has been implemented to improve the resilience of individual banking institutions during the periods of stress, while addressing system-wide risks that arise across the banking sector. Two new tools namely the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) have been introduced for measuring liquidity under Basel-III to ensure stronger and more targeted liquidity management of banks. A Basel-III Compliance Unit has been established by each bank as per instruction of BB, and steps have been

Table 5.1 Banking systems structure

(billion Taka)

Bank types	2013						2014					
	Number of banks	Number of branches	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	3520	2108.5	26.4	1631.2	26.0	5	3553	2517.1	27.5	1952.1	28.0
DFIs	4	1494	454.8	5.7	343.0	5.5	3	1500	333.8	3.7	237.6	3.4
PCBs	39	3602	4948.2	61.8	3939.3	62.8	39	3917	5787.1	63.3	4449.4	63.9
FCBs	9	69	488.7	6.1	359.5	5.7	9	70	505.0	5.5	326.0	4.7
Total	**56**	**8685**	**8000.2**	**100**	**6273.0**	**100**	**56**	**9040**	**9143.0**	**100**	**6965.1**	**100**

Note: Banks prepare their balance sheet on calendar year basis, and are obliged 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.

Chart 5.1 Aggregate industry assets (Dec, 2013)
(billion Taka)

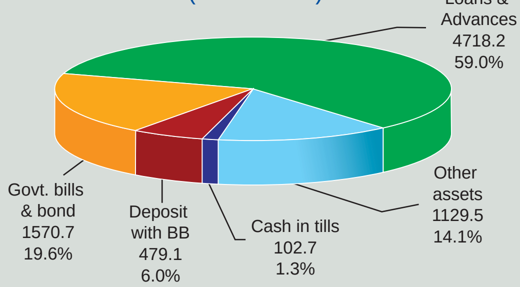
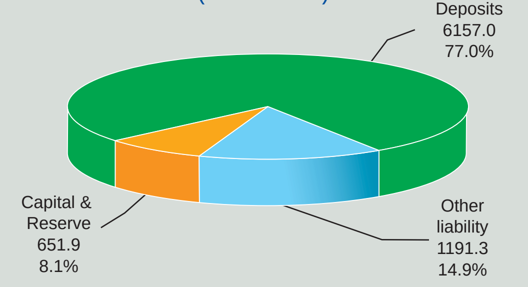
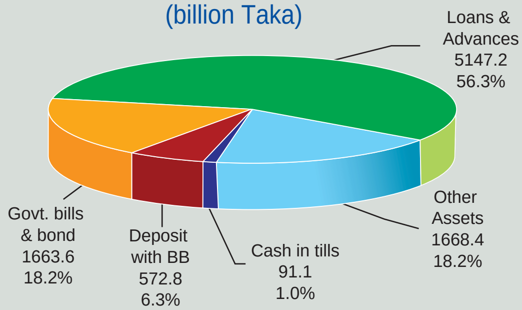


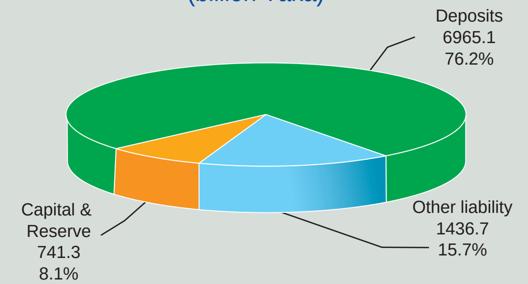
Chart 5.2 Aggregate industry liabilities (Dec, 2013)
(billion Taka)



Aggregate industry assets (Dec, 2014)
(billion Taka)



Aggregate industry liabilities (Dec, 2014)
(billion Taka)



taken to increase board awareness through arranging meetings with the boards of non-compliant banks.

A. Banking Sector Performance

5.2 The banking sector of Bangladesh comprises four categories of scheduled banks- State-owned Commercial Banks (SCBs), State-owned Development Financial Institutions (DFIs), Private Commercial Banks (PCBs) and Foreign Commercial Banks (FCBs). Recently, BASIC bank has become an SCB instead of DFI. The scheduled banks had a total number of 9040 branches as of December 2014 which increased from 8685 of 2013 mainly due to opening of new branches during the year. At the end of June 2015, the total number of bank branches increased further to 9131 with total number of banks remained unchanged at 56 (Appendix 4, Table I). Structure of the banking sector with breakdown by type of banks is shown in Table 5.1.

5.3 In 2014, the SCBs held 27.5 percent of the total industry assets against 26.4 percent in 2013. PCBs' share in total assets was showing persistent trend and it increased slightly from 61.8 percent in 2013 to 63.3 percent in 2014. The FCBs held 5.5 percent of the industry assets in 2014, showing a decrease by 0.6 percentage points over the previous year. The DFIs' share of assets decreased to 3.7 percent in 2014 from 5.7 percent in 2013 as one bank of this group was categorised as SCB.

5.4 Total deposits of the banks in 2014 increased to Taka 6965.1 billion from Taka 6273.0 billion in 2013, showing an overall increase by 11.0 percent. The SCBs' share in deposits increased slightly from 26.0 percent in 2013 to 28.0 percent in 2014. PCBs' deposits in 2014 amounted to Taka 4449.4 billion or 63.9 percent of the total industry deposit against Taka 3939.3 billion or 62.8 percent in 2013. FCBs' deposits in 2014 decreased by 9.3 percent to Taka 326.0 billion from Taka 359.5 billion in 2013. The DFIs' deposits decreased by 30.7 percent to Taka 237.6 billion in 2014 from Taka 343.0 billion in 2013.

A.1. Aggregate Balance Sheet

5.5 Total industry assets in 2014 showed an overall increase of 14.3 percent over 2013. During this period, the SCBs' assets increased by 19.4 percent and those of the PCBs' increased by 17.0 percent. Loans and advances of Taka 5147.2 billion constituted the most significant portion (56.3 percent) of the sector's total assets of Taka 9143.0 billion. Cash in hand including foreign currencies was Taka 91.1 billion; deposits with BB was Taka 572.8 billion; other assets was Taka 1668.4 billion and investment in government bills & bonds was Taka 1663.6 billion (Chart 5.1).

5.6 Deposits continued to be the main sources of funds of the banking industry and constituted 76.2 percent (Taka 6965.1 billion) of total liability in 2014. Capital and reserves of the banks were Taka 741.3 billion (8.1 percent) in 2014 compared to Taka 651.9 billion (8.1 percent) in 2013 (Chart 5.2).

A.2. Capital Adequacy

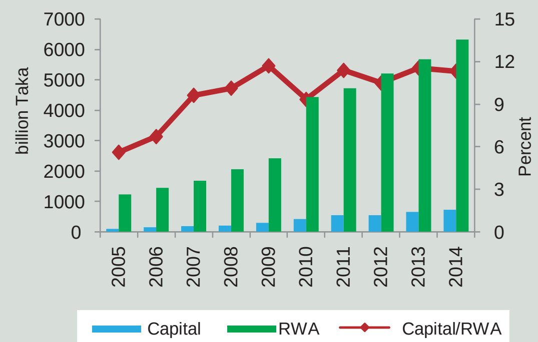
5.7 Capital adequacy ratio (CAR) focuses on the total position of banks' capital and the protection of depositors and other creditors from the potential losses that a bank might incur. It helps absorbing all possible financial risks related to credit, market, operation, interest rate, liquidity, reputation, settlement, strategy, environmental and climate change, etc. Under Basel-II, banks in Bangladesh are instructed to maintain the Minimum Capital Requirement (MCR) at 10.0 percent of the Risk Weighted Assets (RWA) or Taka 4.0 billion, whichever is higher. Under the Supervisory Review Process (SRP), banks are instructed 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 (Supervisory Review Evaluation

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

(percent)

Bank types	2007	2008	2009	2010	2011	2012	2013	2014	End June 2015
SCBs	7.9	6.9	9.0	8.9	11.7	8.1	10.8	8.3	4.9
DFIs	-5.5	-5.3	0.4	-7.3	-4.5	-7.8	-9.7	-17.3	-18.1
PCBs	10.6	11.4	12.1	10.1	11.5	11.4	12.6	12.5	11.8
FCBs	22.7	24.0	28.1	15.6	21.0	20.6	20.2	22.6	24.1
Total	**9.6**	**10.1**	**11.6**	**9.3**	**11.4**	**10.5**	**11.5**	**11.3**	**10.3**

Chart 5.3 Aggregate capital adequacy position



Process, the central bank's assessment) dialogue. The amount of capital was Taka 717.5 billion at the end of December 2014.

5.8 On 31 December 2014, the SCBs, DFIs, PCBs and FCBs maintained CAR of 8.3, -17.3, 12.5 and 22.6 percent respectively as a group. But individually, two SCBs (Sonali, BASIC), two PCBs (BCBL, ICB) and two DFIs (BKB, RAKUB) did not maintain the minimum required CAR due to the increase in classified loans. The CAR of the banking industry as a whole was 11.3 percent at end of December 2014 as against 11.5 percent at the end of 2013. Implementation of revised policy on loans was the main reason of the increase in CAR in 2013 and 2014. The CAR of the industry was 10.3 percent at end of June 2015.

A.3. Asset Quality

5.9 Loans and advances are the major components of the asset composition of all commercial banks. The high concentration of loans and advances increases the vulnerability of assets to credit risk.

5.10 The most important indicator to identify the asset quality in the loan portfolio is the ratio of gross non-performing loans (NPLs) to total loans and net NPLs to net total loans. At the end of December 2014, PCBs had the lowest and DFIs had the highest ratio of gross NPLs to total loans. PCBs' gross NPLs to total loans ratio was 5.0 percent, whereas that of SCBs, FCBs and DFIs were 22.2, 7.3 and 32.8 percent respectively in 2014 (Table 5.3). The gross NPL ratios to total loans for the SCBs, PCBs, FCBs and DFIs were recorded as 21.9, 5.7, 8.2 and 25.5 percent respectively at end of June 2015.

Chart 5.4 Aggregate position of NPLs to total loans

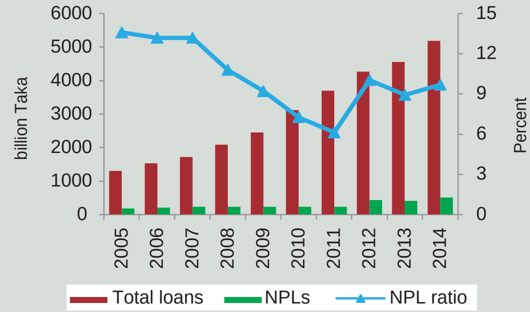


Table 5.3 NPL ratios by type of banks

(percent)

Bank types	2007	2008	2009	2010	2011	2012	2013	2014	End June 2015
SCBs	29.9	25.4	21.4	15.7	11.3	23.9	19.8	22.2	21.9
DFIs	28.6	25.5	25.9	24.2	24.6	26.8	26.8	32.8	25.5
PCBs	5.0	4.4	3.9	3.2	2.9	4.6	4.5	5.0	5.7
FCBs	1.4	1.9	2.3	3.0	3.0	3.5	5.5	7.3	8.2
Total	**13.2**	**10.8**	**9.2**	**7.3**	**6.1**	**10.0**	**8.9**	**10.0**	**9.7**

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

Bank types	2007	2008	2009	2010	2011	2012	2013	2014	End June 2015
SCBs	12.9	5.9	1.9	1.9	-0.3	12.8	1.7	6.1	9.4
DFIs	19.0	17.0	18.3	16.0	17.0	20.4	19.7	25.5	9.2
PCBs	1.4	0.9	0.5	0.0	0.2	0.9	0.6	0.8	1.1
FCBs	-1.9	-2.0	-2.3	-1.7	-1.8	-0.9	-0.4	-0.9	-0.4
Total	**5.1**	**2.8**	**1.7**	**1.3**	**0.7**	**4.4**	**2.0**	**2.7**	**2.8**

5.11 The ratio of NPL to total loans of all the banks showed an overall declining trend from its peak (34.9 percent) in 2000 up to 2011 (6.1 percent). But the ratio increased in 2012 (10.0 percent), decreased again in 2013 (8.9 percent), then increased again (9.7 percent) in 2014. The decline in NPLs to total loans ratio in recent years till 2011 (Table 5.3) can be attributed partly to some progress in recovery of long outstanding loans and partly to write-off of loans classified as 'bad' or 'loss'. But it went up again in 2012 and 2014 due to new loan classification policy and some scams in the banking industry.

5.12 The SCBs and DFIs continued to have high level of NPLs due mainly to poor appraisal, inadequate follow-up and supervision of the loans disbursed. Furthermore, these banks were reluctant to write-off the historically accumulated bad loans because of poor quality of underlying collaterals. Recovery of NPLs, however, witnessed some signs of improvement has mainly because of the steps taken with regard to internal restructuring of these banks to strengthen their loan recovery mechanism, and write-off measures initiated in recent years.

5.13 Table 5.3 (a) and Chart 5.4 show that in 2014, the ratio of net NPLs (net of provisions and interest suspense) to net total loans (net of provisions and interest suspense) was 2.7 percent for the banking sector. But it was 25.5 percent for DFIs. DFIs' nonperforming portfolios were still high after adjustment of actual provision and interest suspense, whereas SCBs, FCBs, and PCBs had excess provision against their NPLs. The net NPLs to net total loan ratios were 6.1, 0.8, and -0.9 percent for the SCBs, PCBs and FCBs respectively at the end of December 2014. The ratios were 9.4, 9.2, 1.1 and -0.4 percent for SCBs, DFIs, PCBs and FCBs respectively at the end of June 2015.

5.14. Table 5.3(b) shows the amount of NPLs of the four types of banks from 2000 to 2015 (end of June). The amount of NPLs of the SCBs increased from Taka 137.9 billion in 2007 to Taka 227.6 billion in 2014. The PCBs recorded a total increase of Taka 135.1 billion in their NPL accounts, which stood at Taka 184.3 billion in 2014 against Taka 49.2 billion in 2007. The amount of NPLs of the DFIs increased to Taka 72.6 billion in 2014 from Taka 37.2 billion in 2007. The amount of NPLs of the FCBs increased from Taka 1.9

Table 5.3 (b) Amount of NPLs

(billion Taka)

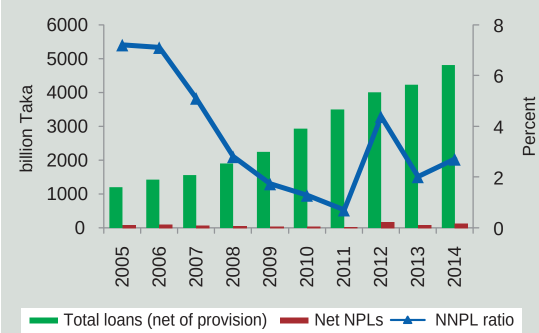
Bank types	2007	2008	2009	2010	2011	2012	2013	2014	End June 2015
SCBs	137.9	127.6	117.5	107.6	91.7	215.2	166.1	227.6	224.0
DFIs	37.2	37.3	42.1	49.7	56.5	73.3	83.6	72.6	58.3
PCBs	49.2	57.0	61.7	64.3	72.0	130.4	143.1	184.3	223.5
FCBs	1.9	2.9	3.5	5.5	6.3	8.5	13.0	17.1	19.4
Total	**226.2**	**224.8**	**224.8**	**227.1**	**226.5**	**427.3**	**405.8**	**501.6**	**525.2**

Table 5.4 Required provision and provision maintained -all banks

(billion Taka)

All banks	2007	2008	2009	2010	2011	2012	2013	2014	End June 2015
Amount of NPLs	226.2	224.8	224.8	227.1	226.4	427.3	405.8	501.6	525.2
Required Provision	127.2	136.1	134.8	149.2	148.2	242.4	252.4	289.6	300.4
Provision maintained	97.1	126.2	137.9	142.3	152.7	189.8	249.8	281.6	275.6
Excess(+)/ shortfall(-)	-30.1	-9.9	3.1	-6.9	4.6	-52.6	-2.6	-7.9	-24.8
Provision maintenance ratio (%)	76.3	92.7	102.3	95.4	103.0	78.3	99.0	97.2	91.7

Chart 5.4 (a) Aggregate position of NNPL to total loans (net of provision)



billion in 2007 to Taka 17.1 billion in 2014. The amount of NPLs of SCBs, DFIs, PCBs and FCBs stood at Taka 224.0, 58.3, 223.5 and 19.4 billion respectively at the end of June 2015.

5.15 Table 5.4 shows the aggregate amount of NPLs, the required loan loss provision and the actual provision maintained by the banks from 2007 to end of June 2015. Table 5.4 and Chart 5.6 show that in aggregate, the banks continuously failed to maintain the required level of provision against their NPLs from 2007 to 2014 except the year 2009 and 2011 when the banking sector was able to maintain more of the required provisions. Banks maintained 76.3 percent of the required provisions in 2007 which increased thereafter to 103.0 percent in 2011, then declined to 99.0 percent in 2013 and 91.7 percent in June 2015.

The main reason for the shortfall in provision was the inability of some SCBs, DFIs and PCBs including those in the problem bank category, due to inadequate profits and provision transfer for write-offs. Notably, the FCBs were in a much better position as they were able to make adequate provisions. A comparative position of loan loss provisions as of end 2013, 2014 and 2015 (end June) is shown in Table 5.5.

5.16 37 out of 39 PCBs were able to maintain the required provision at the end of December 2014, but the remaining two failed due to their poor asset portfolios and earning levels.

5.17 To correct an unnecessarily and artificially inflated size of the balance sheet, uniform guidelines for write-offs were introduced in 2003. According to the policy, banks may, at any time, write off bad/loss loans. The loans classified as bad/loss for the last 5 years or more with 100 percent provisions embarked are written-off. The total amount of written-off bad debts from June 2008 to June 2015 in different bank categories is given in Table 5.6.

Chart 5.5 Comparative position of NPLs by type of banks

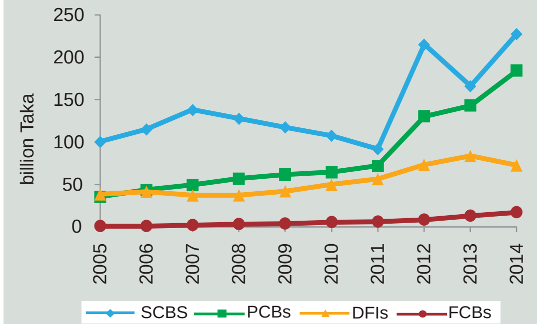


Chart 5.6 Provision adequacy position of all banks

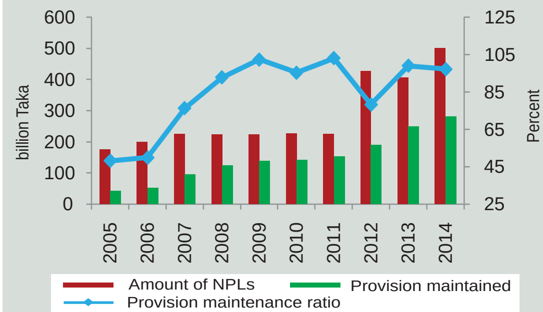


Table 5.5 Comparative position of provision adequacy

(billon Taka)

Year	Items	SCBs	DFIs	PCBs	FCBs
2013	Required provision	107.8	38.3	94.8	11.6
	Provision maintained	122.3	17.4	97.8	12.3
	Provision maintenance ratio (%)	113.5	45.5	103.2	106.0
2014	Required provision	128.6	37.1	108.7	15.3
	Provision maintained	135.3	14.7	115.4	16.2
	Provision maintenance ratio (%)	105.2	39.6	106.2	105.9
2015 June	Required provision	126.2	31.2	126.5	16.2
	Provision maintained	96.7	31.2	130.6	17.2
	Provision maintenance ratio (%)	76.6	100	103.2	106.2

A.4. Management Soundness

5.18 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 and leadership of mid and senior level management, compliance to plan and respond to changing circumstances, etc. are also taken into consideration in evaluating the quality of management.

5.19 As evident from Table 5.7, in 2014, the expenditure-income (EI) ratio of the DFIs was the highest among bank clusters. The EI ratio of the SCBs was 84.1 percent the second highest, which was mainly attributable to high administrative and operating expenses. The EI ratio of DFIs increased from 94.8 percent in 2013 to 99.5 percent in 2014. The EI ratio of PCBs and FCBs declined to 75.8 and 46.8 percent respectively compared to the previous year. At end of June 2015, the EI ratio of SCBs, DFIs, and FCBs increased to 85.9, 120.4, and 49.6 percent respectively and remained almost unchanged for PCBs.

A.5. Earnings and Profitability

5.20 There are various indicators of earnings and profitability, but the most representative and widely used one is Return on Assets (ROA) which is supplemented by Return on Equity (ROE) and Net Interest Margin (NIM).

Table 5.6 Writing-off bad debts in different bank categories

(billion Taka)

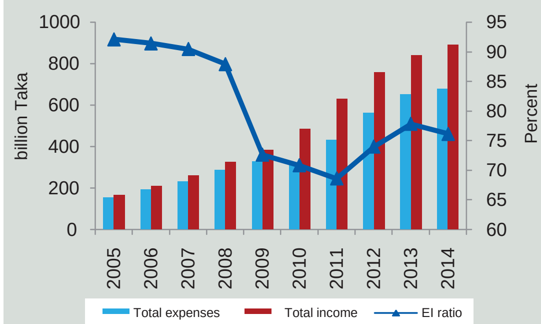
Bank types	30 June 08	30 June 09	30 June 10	30 June 11	30 June 12	30 June 13	30 June 14	30 June 15
SCBs	48.4	64.5	70.5	82.4	72.9	107.2	154.8	210.3
DFIs	31.0	31.8	31.8	32.0	24.5	32.6	34.2	5.6
PCBs	49.4	54.7	69.6	77.1	64.9	109.7	127.7	155.5
FCBs	1.7	2.0	2.1	2.4	2.6	3.7	4.4	5.1
Total	**130.5**	**153.0**	**174.0**	**193.9**	**164.9**	**253.3**	**321.1**	**376.5**

Table 5.7 Expenditure-income ratio by type of banks

(percent)

Bank types	2007	2008	2009	2010	2011	2012	2013	2014	2015 June
SCBs	100.0	89.6	75.6	80.7	62.7	73.2	84.1	84.1	85.9
DFIs	107.7	103.7	112.1	87.8	88.6	91.2	94.8	99.5	120.4
PCBs	88.8	88.4	72.6	67.6	71.7	76.0	77.9	75.8	75.5
FCBs	72.9	75.8	59.0	64.7	47.3	49.6	50.4	46.8	49.6
Total	**90.4**	**87.9**	**72.6**	**70.8**	**68.6**	**74.0**	**77.8**	**76.1**	**78.3**

Chart 5.7 Aggregate position of income and expenditure - all banks



5.21 Earnings as measured by ROA and ROE differ greatly within the industry. Table 5.8 shows ROA and ROE by type of banks. Analysis of these indicators reveals that the ROA of the SCBs was less than the industry average. The ROA of SCBs was gradually increasing up to 2011, but it dropped down to

Table 5.8 Profitability ratios by type of banks

(percent)

Bank types	Return on assets (ROA)									Return on equity (ROE)								
	2007	2008	2009	2010	2011	2012	2013	2014	2015 June	2007	2008	2009	2010	2011	2012	2013	2014	2015 June
SCBs	0.0	0.7	1.0	1.1	1.3	-0.6	0.6	-0.6	-0.6	0.0	22.5	26.2	18.4	19.7	-11.9	10.9	-13.5	-22.5
DFIs	-0.3	-0.6	0.4	0.2	0.1	0.1	-0.4	-0.7	-1.5	-3.4	-6.9	-171.7	-3.2	-0.9	-1.1	-5.8	-6.0	-8.2
PCBs	1.3	1.4	1.6	2.1	1.6	0.9	1.0	1.0	0.9	16.7	16.4	21.0	20.9	15.7	10.2	9.8	10.3	9.7
FCBs	3.1	2.9	3.2	2.9	3.2	3.3	3.0	3.4	3.1	20.4	17.8	22.4	17.0	16.6	17.3	16.9	17.7	15.7
Total	**0.9**	**1.2**	**1.4**	**1.8**	**1.5**	**0.6**	**0.9**	**0.6**	**0.5**	**13.8**	**15.6**	**21.7**	**21.0**	**17.0**	**8.2**	**11.0**	**8.1**	**6.6**

negative (-0.6 percent) in 2012 due to a huge net loss. In 2013, it increased and became positive but eventually turned into negative (-0.6 percent) at the end of 2014. The DFIs' situation is not getting better due to persistent operating losses incurred by BKB and RAKUB. The ROA of DFIs' deteriorated more, scoring negative (-0.7 percent) in 2014. PCBs' ROA showed a consistently strong position up to 2010, but it was in a decreasing trend during 2011 to 2014 due to the decrease of net profit. Though FCBs' ROA was continuously strong, it decreased slightly in 2013, increased in 2014 and dropped again in June 2015.

5.22 ROE of SCBs showed negative in 2014. It dropped from 10.9 percent in 2013 to negative 13.5 percent in 2014 due to huge loss incurred by BASIC Bank and further declined to negative 22.5 percent in June 2015. DFIs' ROE was negative 6.0 percent in 2014 compared to negative 5.8 percent in 2013. ROE of PCBs increased to 10.3 percent in 2014 from 9.8 percent in 2013 and decreased again to 9.7 percent in June 2015. The ROE of FCBs stood at 17.7 percent in 2014 which was 16.9 percent in 2013 and fell to 15.7 percent in June 2015.

5.23 Aggregate net interest income (NII) of the industry in 2014 increased sharply and

Chart 5.8 Aggregate profitability-all banks

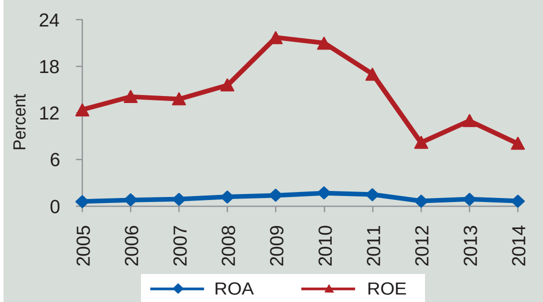


Table 5.9 Net interest income by type of bank

(billion Taka)

Bank types	2007	2008	2009	2010	2011	2012	2013	2014	2015 June
SCBs	7.4	7.9	12.1	19.8	34.3	14.9	-5.4	39.7	19.4
DFIs	1.4	1.9	1.9	6.2	4.9	4.7	3.8	2.1	1.9
PCBs	36.1	48.5	56.7	82.8	91.4	114.7	118.2	205.8	105.0
FCBs	9.9	12.6	10.7	13.0	16.1	19.6	15.8	26.6	14.1
Total	**54.8**	**70.9**	**81.5**	**121.9**	**146.7**	**153.8**	**132.3**	**274.2**	**140.3**

stood at Taka 274.2 billion from Taka 132.3 billion in 2013. After falling down to Taka 5.4 billion (negative) in 2013, SCBs were able to regain positive NII at Taka 39.7 billion in 2014. Major portion of the industry's NII comes from PCBs. Their contribution was 75.1 percent of the banking industry in 2014. PCBs showed an increasing trend from 2007 to 2014 whereas NII of DFIs and FCBs were fluctuating moderately.

Table 5.10 Liquidity ratio by type of banks

(percent)

Bank types	Liquid assets									Excess liquidity								
	2007	2008	2009	2010	2011	2012	2013	2014	2015 June	2007	2008	2009	2010	2011	2012	2013	2014	2015 June
SCBs	24.9	32.9	25.1	27.2	31.3	29.2	44.3	42.0	39.3	6.9	14.9	17.6	8.2	12.3	10.2	25.3	23.9	26.4
DFIs	14.2	13.7	9.6	21.3	6.9	12.0	15.3	6.6	0.0	5.6	4.9	7.1	2.3	1.3	1.0	4.2	6.6	0.0
PCBs	22.2	20.7	18.2	21.5	23.5	26.3	28.0	28.2	20.8	6.4	4.7	5.3	4.6	6.6	9.5	11.3	11.0	11.9
FCBs	29.2	31.3	31.8	32.1	34.1	37.5	46.2	56.9	51.1	11.2	13.3	21.8	13.2	15.3	18.7	27.4	37.6	38.9
Total	**23.2**	**24.8**	**20.6**	**23.0**	**25.4**	**27.1**	**32.5**	**32.7**	**26.8**	**6.9**	**8.4**	**9.0**	**6.0**	**8.4**	**9.9**	**15.4**	**15.7**	**16.9**

5.24 SCBs were able to increase their net interest income (NII) by reducing their cost of funds during 2007 to 2011. In 2012, the NII of SCBs dropped and alarming situation occurred in 2013 due to higher interest expenses which grew faster than interest earnings. Sonali Bank Limited experienced a sharp fall of net interest income (NII) of Taka 10.5 billion. The NII of the PCBs was significantly high during 2007 to 2014. Overall industry NII showed a continuously upward trend from 2007 to 2014 except 2013 due to the lackluster performance of SCBs. The trend of NII indicates that the interest spreads of PCBs and FCBs were higher than that of SCBs and DFIs.

Chart 5.9 Aggregate NII of the industry (billion Taka)

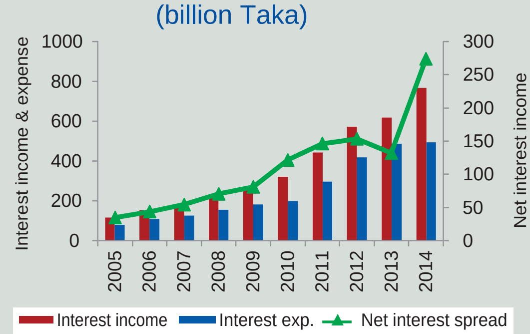
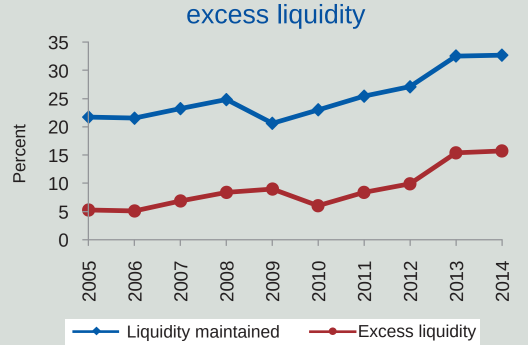


Chart 5.10 Aggregate position of excess liquidity



A.6. Liquidity

5.25 Currently, the scheduled commercial banks have to maintain a CRR averaging 6.5 percent daily on bi-weekly basis against Average Total Demand and Time Liabilities (ATDTL) of the 2nd preceding month, with an obligation to maintain daily minimum 6 percent cash against the same ATDTL held by the bank. The current rate of Statutory Liquidity Reserve (SLR) for conventional banks is 13 percent of time and demand liabilities. In case of Islamic Shariah-based commercial banks, the rate of SLR is 5.5 percent of their total time and demand liabilities. The specialised banks/DFIs are exempted from maintenance of SLR, but they have to maintain the CRR at the stated rate. The banks maintain CRR in cash with BB. However, they are allowed to hold government approved securities (unencumbered portion) for maintenance of the SLR.

5.26 Table 5.10 shows that the FCBs had the highest liquidity ratios followed by the SCBs in 2014. There was an overall steady trend in the percentage of liquid assets in total assets of the banks during the last year although the ratio for FCBs had an increasing trend.

A.7. CAMELS Rating

5.27 CAMELS rating is a supervisory tool to identify banks with problems and require increased supervision. The previous CAMELS rating guideline has been reviewed by the Department of Off-site Supervision with a view to adapting international best practices, upgrading with modern banking activities and assessing the banks' soundness more accurately. The updated CAMELS rating guideline has been followed since December 2013.

The revised CAMELS rating guideline has brought not only major changes in ratios or indicators but also modifications in the qualitative evaluation questionnaire. Basel-III principles related to capital adequacy have been considered, and some related issues have been included while reviewing the guideline. Along with emphasising best quality capital, investments in the capital market, the amount of off-balance sheet items in comparison to the capital of the banks, large loan exposures to capital, etc. are considered to calculate capital adequacy. Herfindahl-Hirschman Index (HHI) has been incorporated in the updated CAMELS rating guideline to analyse loan portfolio concentration, as a complement to percentages of classified loans and provisioning in the evaluation of asset quality. The disbursed loan amount to risk-associated different sectors has been included as well. 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 rating, based on a comprehensive assessment of the overall condition of the banks. Both the ratings are expressed by using a numerical 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 the composite CAMELS rating is generally identified as a problem bank and their activities are closely monitored by the BB.

5.28 BB has introduced the 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 difficulty in any areas of operation, is brought under the early warning category and monitored very closely to help improving its performance. Presently, no banks are monitored under EWS.

5.29 No banks were qualified for CAMELS "1" or "Strong" in 2014; the rating of 39 banks was "2" or "Satisfactory"; rating of 10 banks was "3" or "Fair"; five banks were rated "4" or "Marginal" and two banks received "5" or "Unsatisfactory" rating.

A.8. Operations of Banks in Urban and Rural Areas

5.30 The number of rural branches stood at 5150.0 (57.0 percent of total branches) at

Table 5.11 Comparative position of the Islamic banking sector (as of end December 2014)

(billion Taka)

Particulars	Islamic banks		Dual banking@ (Conventional+ Islamic)		Islamic banking sector		All banking sector	
	2014	2013	2014	2013	2014	2013	2014	2013
1	2		3		4=2+3		5	
Number of banks	8	8	16	16	24	24	56	56
Deposits	1349.7	1117.9	67.6	61.0	1417.3	1178.9	6965.1	6273.0
Credits	1137.6	951.3	57.7	52.5	1195.4	1003.7	5147.2	4638.7
Credit deposit ratio	84.3	85.1	85.4	68.1	84.3	85.2	73.9	73.9
Liquidity: excess(+)/shortfall(-)	127.5	91.2	0.1	3.1	128.2	94.3	1142.2	955.8

@ Conventional banks which have Islamic banking branches do not maintain SLR individually.
The head offices of the respective banks maintain a combined SLR and liquidity position.

the end of December 2014 (Appendix 4, Table XIII). The number of branches in urban areas increased to 3890 (43.0 percent of total branches) during the same period. Total deposits of rural branches increased to Taka 1326.0 billion (19.1 percent of total deposits) at the end of December 2014 and the amount of urban deposits increased to Taka 5605.2 billion (80.9 percent of total deposits) at the end of December 2014. The amount of advances in rural and urban areas increased to Taka 505.1 billion (10.0 percent of total advances) and Taka 4571.2 billion (90.0 percent of total advances) respectively as on 30 December 2014.

A.9. Islamic Banking

5.31 Islamic banking system has been introduced in Bangladesh since 1983. In FY15, out of 56 banks in Bangladesh, eight PCBs operated as full-fledged Islamic banks and 16 conventional banks (including three FCBs) were involved in Islamic banking through Islamic banking branches. The Islamic banks have continued to show strong growth since its inception, as reflected by the increased market share of the Islamic banking in terms of assets, financing and deposits of the total banking system. A brief picture of the performance of Islamic banks is given in Table 5.11. Total deposits of the Islamic banks and Islamic banking branches of the conventional banks stood at Taka 1417.3 billion at the end of December 2014 which accounted for 20.3 percent of total deposits. Total credit of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 1195.4 billion at the end of December 2014 which accounted for 22.2 percent of total credit of the banking system of the country.

B. Legal Framework and Prudential Regulations

B.1. Risk Based Capital Adequacy (RBCA) for Banks

5.32 BB has introduced the Risk Based Capital Adequacy (RBCA) framework for banks from January 2010 as regulatory compliance. Moreover, BB reviewed the minimum regulatory CAR and MCR of the banks in 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 the move to implement the Supervisory Review Process (SRP) of RBCA framework. The key principle of the 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 required to form an SRP team, where the 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.

BB has also declared the roadmap and action plan of the phase-in arrangements for Basel-III implementation. These instructions will be adopted in a phased manner and the initial phase is already being implemented from January 2015. Full implementation is expected to be completed by December 2019.

Under the new capital adequacy framework, all banks will be required to maintain the following ratios on an ongoing basis:

i. Common Equity Tier-1 (CET1) of at least 4.5 percent of the total RWA.

ii. Tier-1 capital will be at least 6.0 percent of the total RWA which means that additional Tier-1 capital can be admitted maximum up to 1.5 percent of the total RWA or 33.3 percent of CET-1, whichever is higher.

iii. Minimum Capital to Risk-weighted Asset Ratio (CRAR) of 10 percent of the total RWA i.e. Tier-2 capital can be admitted maximum up to 4.0 percent of the total RWA or 88.9 percent of CET-1, whichever is higher.

iv. In addition to minimum CRAR, Capital Conservation Buffer (CCB) of 2.5 percent of the total RWA is being introduced which will be maintained in the form of CET-1.

5.33 The 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 the SRP-SREP dialogue, BB reviews and determines any additional capital that would be required for banks on the basis of quantitative as well as qualitative judgment. The first SREP dialogue was initiated in 2011. Afterwards, to facilitate the dialogue, BB prepared a revised evaluation process document in May 2013. Under the process document, BB provided guidance to calculate required capital against residual risk, credit concentration risk, interest rate risk, liquidity risk, reputational risk, settlement risk, strategic risk, appraisal of core risk management practice, environmental & climate change risk and other material risks in a specified format and submit the same by the banks to BB. Information of banks' ICAAP is counter checked with the information available from both on-site inspection and off-site supervisory departments of BB. During the SRP-SREP dialogue, if a bank fails to produce their own ICAAP backed by proper evidence and rigorous review regarding risk management, the SREP team of BB applies their prudence and the available information from the inspection departments in determining the level of adequate capital. The process document further revised in May 2014. On the basis of the revised process document and return format, all (56) banks have submitted their ICAAP report based on 31 December 2013 and one to one meeting with BRPD and SRP team of 40 banks have already been completed by June 2015.

B.2 Loan Classification and Loan-Loss Provisions

5.34 BB changed its policies on loan classification and loan-loss provisions in FY13. BB also introduced and clarified the difference between a "defaulted loan", which is a legal concept granting the bank the right to take certain actions against the borrower, and a "classified loan", which is an accounting concept that implies a certain required level of provisioning for expected losses.

B.3. Corporate Governance in Banks

5.35 BB has taken several measures in the recent past to put in place good corporate governance in banks. These include a "fit and proper" test for appointment of chief executive officers of PCBs, specifying the constitution of audit committee of the board, enhanced disclosure requirements, etc. In continuation of the above reforms, the roles and functions of the board and management have been 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. In this connection, related clauses of Bank Company Act 1991 have already been amended.

C. Supervision of Banks

5.36 With a view to promoting and maintaining soundness, solvency and systematic stability of the financial sector as well as protecting the interest of depositors, BB carries out two types of supervision namely (i) off-site supervision and (ii) on-site supervision. Department of Off-site Supervision (DOS) is vigilant to conduct off-site supervision on banks. Recently DOS has made an innovation regarding banking supervision.

C.1. Off-site Monitoring of Banks

5.37 Off-site monitoring continued as a necessary compliment to on-site inspection in FY15, with its various tools and procedures for intensive and rapid analysis.

Banking Supervision Specialists (BSSs)

5.38 In order to strengthen and intensify current banking supervision, BB has recently formed six Banking Supervision Specialist Sections in the Department of Off-site Supervision. Each section is headed by a Banking Supervision Specialist (BSS), at the Deputy General Manager level. Banking Supervision Specialist emphasises more on analytical works. BSSs work as early signal providers of the banks they are assigned to. They maintain extensive familiarity with condition, performance, risks, corporate governance and corporate structure of portfolio banks. They collect executive summary reports of comprehensive inspections carried out by Departments of Banking Inspection and take actions accordingly. They maintain regular co-ordination with inspection departments to get update on recent supervisory developments. Junior Banking Supervision Specialists monitor treasury functions, capital adequacy, ADR, etc. of portfolio banks. They prepare Diagnostic Review Report (DRR) on audited financial statements and Quick Review Report (QRR) at the required frequency which focus on major risks existing in the banks and provide possible solutions to problems. They also examine the meeting minutes of the Board of Directors and Executive/Audit Committee of the banks to detect the irregularities and violation of banking laws, circulars, etc. and accordingly, advise the banks to regularise the same so that major financial indicators as well as the internal control systems of the banks become regular and can achieve shock-resilient capacity.

BSSs monitor the progress of Memorandum of Understanding (MoU) with the SCBs and specialised banks and report immediately to the concern senior management. BASIC Bank Ltd. and Bangladesh Development Bank Ltd. (BDBL) were categorised as SCBs in December 2014 and May 2015 respectively. Monitoring of SCBs (except BDBL) under MoU is going on. To enhance the standard of credit management and internal control system, a special inspection on internal control & compliance system of four state-owned commercial banks (Sonali Bank Ltd., Janata Bank Ltd., Agrani Bank Ltd. and Rupali Bank Ltd.) is being conducted by Bangladesh Bank. Meanwhile, Government has injected Taka 0.71 billion and Taka 0.79 billion to Sonali Bank Ltd. and BASIC Bank Ltd. respectively in December 2014 as recapitalisation. On the other hand, BKB and RAKUB are also being monitored and reviewed under the MoUs of FY15. Preparation of MoUs for BKB and RAKUB for FY16 is currently under process.

Risk Management Activities of Banks

5.39 BB has issued six core risk management guidelines, risk based capital adequacy guideline and stress testing guideline to ensure robustness, efficiency and effectiveness of risk management systems for the banking sector. On 15 February 2012, BB issued another guideline called Risk Management Guideline for banks. This guideline promotes an integrated, bank-wide approach to risk management which will facilitate banks in adopting contemporary methods to identify, measure, monitor and control risks throughout their institutions.

5.40 Each scheduled bank was instructed to establish an independent Risk Management Unit (RMU) in June 2009 for better risk management practices. Banks were also instructed to prepare a Risk Management Paper (RMP) containing the analysis of all types of existing and probable risks that might occur in future, place the same in their regular monthly meeting of the RMU and submit the RMP along with the decisions of the meetings to the Department of Off-site Supervision. Recently, BB has introduced a new reporting format in the name of Comprehensive Risk Management Report (CRMR) for banks in place of the previous format (RMP). To make the risk management activities more effective, various types of contemporary risk issues and a questionnaire (related to risk management structure, credit policies & procedures, evaluation process of credit proposals, post sanction process, follow up & monitoring of loans, operation level risk verifications, liquidity risk, etc.) are included in the new format.

5.41 Banks have been instructed to establish Risk Management Division (RMD) in place of Risk Management Unit and to appoint a Chief Risk Officer (CRO) from a senior management position (at least from the Deputy Managing Director level) to give more emphasis on risk management practices. BB has instructed the banks to form a risk management committee whose members will be nominated by the board of directors from themselves and the company secretary of the bank will be the secretary of the Risk Management Committee. Based on the RMP, DOS regularly evaluates the risk management activities of each bank and provides constructive recommendations to improve their conditions. Banks have to execute all the recommendations and submit their compliance reports within a specified time frame.

5.42 A risk rating procedure has been developed to quantify all possible risks based on available information in the CRMR, minutes of RMD and board risk management committee meetings, compliance status of previous quarters submitted by banks and other sources. This risk rating is done on half yearly basis and carries 15 percent weight in the management component of CAMELS rating. Therefore, a bank's risk management practices will have a significant effect on its CAMELS rating. According to the rating of December 2014, out of 56 scheduled banks, 23 banks were rated as low risk, 25 as moderate and the rest eight as high risk category bank.

5.43 Banks are now bound to submit a self-assessment report on internal control systems. The objective of this self-assessment process is to keep the operational risk at a minimum level by strengthening the internal control and compliance system of a bank. In this regard, BB has formulated a reporting format with 53 questionnaires on anti-fraud internal controls and a statement of fraud and forgeries that have taken place during a period along with the action taken against those incidences. BB is analysing these reports on quarterly basis and providing proper instructions to the banks. The information provided in that report is sent to the on-site supervision departments for verification through on-site inspection also.

The details of on-site supervision are given below:

C.2. On-site Inspection of Banks

5.44 As part of bank's statutory function, currently seven 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), Department of Banking Inspection-4 (DBI-4), Department of Foreign Exchange Inspection (DFEI), Financial Integrity and Customer Services Department and Bangladesh Financial Intelligence Unit (BFIU) are conducting inspection activities. These seven departments conduct on-site inspection on SCBs, DFIs, PCBs (including banks under Islamic Shariah), FCBs and other institutions including Investment Corporation of Bangladesh (ICB) and money changers. These departments conduct different types of inspection which may be summarised in three major categories like (i) comprehensive/ regular/ traditional inspection; (ii) risk based/ system check inspection, and (iii) special/ surprise inspection.

5.45 The overall performance of the banks (such as capital adequacy, asset quality, liquidity, earnings, management competence, etc.) is evaluated in a comprehensive inspection. Based on their performance, banks are rated from "1" to "5" grades in ascending order. 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. Special inspections are conducted to investigate complaints received from the depositors, public or institutions.

5.46 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. Based on the findings about provisions, income and expenditure entries, banks will be asked to correct their final accounts. 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.

5.47 During FY15, DBI-1 conducted inspection on 1288 branches of 28 banks including head offices. At the same time, core risk inspections were conducted on 28 banks under the jurisdiction of DBI-1 to review the progress of implementation of the core risk guidelines (asset-liability management, credit risk management, information system security and internal control & compliance) issued by Bangladesh Bank. Head/Country offices of the bank as well as one branch of each bank have been taken under the purview of the core risk inspection. In terms of core risk inspection, a total of 191 branches including head office of one bank were inspected. The banks are directed to sit in a tri-partite meeting with their Management Committee (MANCOM), inspectors of Bangladesh Bank and external auditors before finalisation of the annual financial statements of the banks. DBI-1 has arranged 11 in house training sessions in four working days.

5.48 During FY15, DBI-2 conducted comprehensive inspection on 928 bank branches including seven head offices, 293 big branches and 628 small branches. At the same time, a total number of 69 special inspections were conducted on SCBs and DFIs including one head office and 14 risk based inspections including six head offices of the banks. The department also conducted comprehensive inspection on five branches and the Head office of ICB.

5.49 During FY15, DBI-3 conducted a total of 726 comprehensive inspections on banks including four head offices, 92 big branches, 630 small branches and 182 SME service centres, SME/agriculture branches (including inspection on some of the branches of different banks involved in SME activities). At the same time, a total number of 192 special inspections were conducted on two banks (including SME) and 60 risk-based inspections on five banks.

5.50 During FY15, DBI-4 conducted 237 inspections on banks' head offices and

Box 5.1

Liquidity Management by Islamic Banks in Bangladesh

Liquidity management is a fundamental component in the safe and sound management of all financial institutions including islamic banks. Customer's confidence mostly depends on how efficiently a bank handle liquidity crisis. For this, a planned way of safety, liquidity and return framework is necessary to manage the overall liquidity of a bank. Islamic banks are committed to conduct all banking and investment activities on the basis of Islamic Sharia'h. In Bangladesh, Islamic banks are allowed to maintain their Statutory Liquidity Requirement (SLR) at a concessional rate compared with the conventional banks in the absence of enough Sharia'h-compliant SLR eligible instruments in the market place. At present, Islamic banks have to maintain 6.5 percent as CRR with Bangladesh Bank and 5.5 percent as SLR of their total time and demand liabilities prescribed by Bangladesh Bank. The conventional commercial banks having Islamic bank branches/windows shall maintain SLR/CRR for its Islamic branches/windows at the same rate through maintaining a separate Current Account with Bangladesh Bank.

Islamic banks in Bangladesh have been facing excess liquidity problem since long as they do not invest in Government Treasury Bills and Bonds because of interest bearing nature of those monetary instruments. Considering the excess liquidity problem of the Islamic banks, Government of Bangladesh introduced 'Bangladesh Government Islamic Investment Bond (BGIIB)' in 2004 with the objectives to develop a sound foundation for the Islamic bond market and also to provide a space to convert excess liquidity into investment through BGIIB. Islamic banks' investment in BGIIB was showing upward trend during last three years as they had no other alternative to invest their surplus liquidity (Table 1). Recently, the BGIIB has been made more short-term in tenor-three months. On the other hand, in case of liquidity crisis, the Islamic banks/branches may overcome the crisis by availing of investment facilities from Islamic Bond Fund against lien of their over purchased Islamic Bonds, introducing Repo system for the Islamic Bonds, opening reciprocal Mudaraba current accounts maintaining with each other. However, to meet the liquidity crisis, if any, of the Islamic branches of the conventional commercial banks, they may collect fund from sources which will comply with Islamic Sharia'h.

Table 1 : All Islamic Banks' Investment, Borrowing and Profit Rate of BGIIB (Islamic Bond)

	June 2013	June 2014	June 2015
Investment (billion Taka)	9681.4	15051.2	21316.5
Borrowing (billion Taka)	15906.0	6785.0	5110.0
Profit rate			
Investment	4.6	3.4	1.0
Borrowing (weighted average)	5.0	4.6	4.5

Source: Securities Department, Motijheel Office, Bangladesh Bank.

branches. Within this timeline, the department conducted core risk inspections in 20 branches and 20 head offices of banks under the jurisdiction of DBI-4 to review the implementation advancements of core risk management guidelines as well as to evaluate and monitor risk management systems and to control environment of the banks. During the period, DBI-4 also carried out comprehensive inspection in 119 branches and 20 head offices of banks. DBI-4 conducted 58 special inspections on 37 branches and 20 head offices of banks. During the financial year all banks listed in the local stock exchange were inspected. For the first time, DBI-4 conducted SRP inspections on 20 head offices and 20 branches of banks. 20 banks were also inspected before finalisation of their annual financial statements at close of business on 31 December 2014.

5.51 DFEI conducts inspection on foreign trade financing, treasury functions and foreign exchange risk management of banks, foreign exchange transactions of banks and money changers. In FY15, the department conducted a total of 483 comprehensive inspections on banks including 11 head offices and 483 authorised dealer branches. The department also conducted 45 inspections on foreign exchange risk management, 85 special inspections, 115 inspections on money changers and a good number of special inspections on foreign trade and foreign exchange related irregularities.

5.52 Customers' Interests Protection Centre (CIPC) was reconstituted as a department named Financial Integrity and Customer Services Department (FICSD) on 26 July 2012. FICSD is acting as a watchdog for spotting the early warning signs of internal and external fraud at banks and NBFIs, investigating frauds and making criminal referrals when necessary. This department is also continuing its efforts to promote security, efficiency, effectiveness, transparency and risk management of the information and communication technology (ICT) structures of banks and NBFIs.

5.53 During FY15, the department received a total of 14,920 complaints through the dedicated hot line numbers, emails and traditional letters. The department is working to investigate and resolve the complain within the shortest possible time. The rate of compliance resolved has been increased notably.

The department conducted 127 special inspections on banks and financial institutions operating in Bangladesh. Apart from the Customer Service Division of Head Office, the CIPCs were established in 10 offices of Bangladesh Bank to deal with the complaints received from the bank customers of their respective areas.

5.54 A number of activities on AML/CFT for the banking sector were taken during FY15. BFIU has issued circulars for the scheduled banks and financial institutions for proper compliance of the instructions regarding prevention of Money Laundering (ML) & Terrorist Financing (TF); circulated money laundering and terrorist financing risk assessment guidelines for banking sector to assess the associated risk of ML/TF of the respective banks and started to use the national ID card database of Election Commission (EC), database of Credit Information Bureau (CIB), Bangladesh

Automated Clearing House (BACH) and Dash Board of Bangladesh Bank in its analysis process. BFIU has been receiving CTR and STR from all scheduled banks through goAML software since January 2014. In FY15, this department conducted system check inspections under core risk programme in 57 head offices and 44 branches of 56 banks and carried out special inspection in 19 branches of 12 banks to examine whether banks are submitting STR/CTRs properly and regularly. It also carried out some other special inspections in one head office and 24 branches of 17 banks for further analysis of some STRs and in two head offices and 45 branches of 22 banks to look into the allegation/complaints received from different media, individuals and other organisations. In order to create awareness among bank officials, BB has encouraged the banks to conduct a number of training programmes for their officials on AML/CFT in 56 districts and provided its support to make the programme successful. Separate annual conferences for Chief Anti-Money Laundering Compliance Officer (CAMLCO) of banks, financial institutions and capital market intermediaries were held during the year.

C.3 Financial Stability and Macro prudential Supervision

5.55 The Financial Stability Department (FSD) has been working actively to strengthen the macro prudential framework of the country. Since inception, this department has published Financial Stability Report (annual and quarterly) to evaluate overall financial stability which will give comprehensive analysis of the major trends.

5.56 The department primarily has designed macro stress tests to quantify the impact of possible changes in economic environment on the financial system. The Financial Projection Model (FPM) has been implemented with the technical assistance of the World Bank. Inter-bank Transaction Matrix (ITM) tool has been introduced and is used to observe liquidity management of banks and NBFIs. This matrix will help to find out the institutions which may potentially face any crisis and give early warning signals for safeguarding financial institutions.

5.57 The department has developed the framework for identifying and dealing with the Domestic Systemically Important Banks (DSIB) in its jurisdiction due to the underlying assumption that the impact of the failure of DSIBs will be significantly greater than that of a non-systemic institution. The formulation and implementation plan of Counter-cyclical Capital Buffer (CCB) in the time of crisis is under process to resist the pro-cyclicality of financial system. The department has prepared the bank intervention and resolution framework, comprising a Bank Intervention Resolution Plan (BIRP) and a contingency plan to have more effective tools, information in order to enable the orderly resolution of banks without any resort to taxpayers' fund.

5.58 The Department has prepared the Lender of Last Resort (LOLR) framework documents and corporate 'watch list'. Development of a "Coordinated Supervision Framework" is under process.

D. Banking Sector Infrastructure for Financial Stability and Risk Management

D.1. Deposit Insurance Scheme

5.59 The Deposit Insurance Scheme (DIS) is introduced to minimise or eliminate the risk of loss of depositors' funds with banks that subsequently fail. The direct rationale for deposit insurance is customer protection. The indirect rationale for deposit insurance is that it reduces the risk of a systemic crisis involving, for example, panic withdrawals of deposits from sound banks and breakdown of the payments system. From a global point of view, deposit insurance provides many benefits and over the long term, appears to be an essential component of a viable modern banking system.

5.60 In Bangladesh, DIS was first introduced in August 1984, in terms of "The Bank Deposit Insurance Ordinance 1984", which was repealed by "The Bank Deposit Insurance Act 2000" in July 2000. DIS in Bangladesh is now being administered by the said Act. In accordance with the Act, Bangladesh Bank (BB) is authorised to administer a fund called the Deposit Insurance Trust Fund (DITF) for providing limited protection (Taka 0.10 million) to a small depositor in case of winding up of any bank. The Board of Directors of BB acts as the Trustee Board for DITF. The DITF is now being administered and managed under the guidance of the Trustee Board. In addition, Bangladesh Bank is a member of the International Association of Deposit Insurers (IADI).

5.61 In accordance with "The Bank Deposit Insurance Act 2000," the main function of DITF is collecting premium from all scheduled banks on a half yearly basis (end of June and December) and investing the proceeds in Government securities. The income derived from such investments is also credited to the DITF account for further investment.

Table 5.12 The recent position of DITF

Particulars	Unaudited figure (as on 30 June 2013)	Premium rate*
Total fund	4.05 billion Taka	-
Total investment	3.90 billion Taka	-
Covered deposit of total insurable deposit	27.54%	-
Insurable deposit to total D&T liabilities	81.20%	
Fully insured deposit	87.98%	-
Sound bank categories	-	0.08%
Early warning bank categories	-	0.09%
Problem bank categories	-	0.10%

* Effective from 2013

5.62 To enhance the effectiveness of market discipline, BB has adopted a system of risk based deposit insurance premium rates applicable for all the banks effective from the period of January-June 2007. Very recently the premium rate has been increased, with effect from the period of January-June 2013. Along with the scheduled banks, BB has also taken the initiative to bring the NBFIs under the coverage of DIS, an initiative which is now under the consideration of the Ministry of Finance (MoF).

5.63 The effectiveness of DIS in reducing systemic risk will surely increase if the public become well aware of its existence and scope. With this in mind, BB has already issued a circular regarding public awareness about DIS and more information and updates are available in the Bangladesh Bank website so that the general public can be informed about the benefits and capabilities of the DIS.

D.2. Activities of Credit Information Bureau

5.64 The Credit Information Bureau (CIB) was set up in BB on 18 August 1992 with the objective of minimising the extent of potential default loans. The CIB has been providing its online services since 19 July 2011. The online system of CIB developed by an Italian company CRIF is playing an important role to maintain a risk free lending procedure in banking industry. With the adoption of highly sophisticated ICT facilities, the performance of the CIB services has been improved significantly in terms of efficiency and quality. It has also reduced the time and physical movement for the banks/NBFIs to submit credit information and CIB report generation process which ultimately makes the loan processing faster. The system has gone through a major change over the last year aiming at developing a new CIB online solution. The new CIB online solution will eliminate the vendor dependency as well as reduce huge cost which is incurred by maintaining the existing online system.

5.65 The CIB database consists of detailed credit information in respect of borrowers, co-borrowers and guarantors. CIB database includes credit information of borrowers having outstanding amount of Taka 50000 & above and classified credit card information having outstanding amount of Taka 10000 and above. Total number of borrowers increased by 6.0 percent to 905112 at the end of June 2015 as compared to 853851 at the same month of the previous year. The number of classified borrowers in Banks and NBFIs increased by 7.15 percent during June 2015 over June 2014.