Banking Sector Performance, Regulation and Bank Supervision

5.1 Bangladesh Bank continued its efforts to improve the performance of the banking sector and ensure a sound, efficient and resilient financial system. In FY16, Bangladesh Bank (BB) adopted a number of policy measures to emphasise risk management and corporate governance in the banks, periodic review of stability of the individual bank as well as the whole banking system, stress testing, monitoring of large borrowers, fraud-forgeries and strengthening internal control and compliance through self assessment of anti-fraud internal controls etc. Monitoring of investment in shares by the scheduled banks has been stringent in light of the amendment brought in the Bank Company Act, 1991 (amended up to 2013). Risk Management Committee at the board level has been made mandatory, with regular evaluation. A revised risk guideline has already been put into effect for banks to improve resiliency. Besides, all core risks management guidelines including Asset Liability Management Guideline have been revised recently for timely identification, measurement, control, and monitoring of all existing and probable risks of banks.

A. Banking Sector Performance

5.2 The banking sector in 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). As of December 2015 there are 56 banks in Bangladesh and the number of bank branches increased to 9397 from 9040 as of December 2014 due mainly to opening of new branches by the banks during the year. At the end of June 2016, the total number of bank branches increased further to 9453 (Appendix 4, Table 1). Information on the banking structure by types of banks is shown in Table 5.1.

5.3 In 2015, the SCBs held 27.5 percent share of the total assets which was the same as in 2014. PCBs' share of the total assets increased from 63.3 percent in 2014 to 64.5

Table 5.1 Banking systems structure

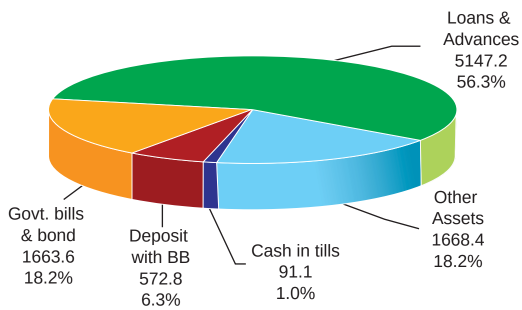
(billion Taka)

Bank types	2014						2015					
	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	5	3553	2517.1	27.5	1952.1	28.0	6	3690	2839.6	27.5	2254.8	28.4
DFIs	3	1500	333.8	3.7	237.6	3.4	2	1406	291.3	2.8	226.6	2.9
PCBs	39	3917	5787.2	63.3	4449.4	63.9	39	4226	6652.9	64.5	5110.4	64.5
FCBs	9	70	505.0	5.5	326.0	4.7	9	75	530.8	5.2	336.8	4.3
Total	**56**	**9040**	**9143.1**	**100**	**6965.1**	**100**	**56**	**9397**	**10314.6**	**100**	**7928.6**	**100**

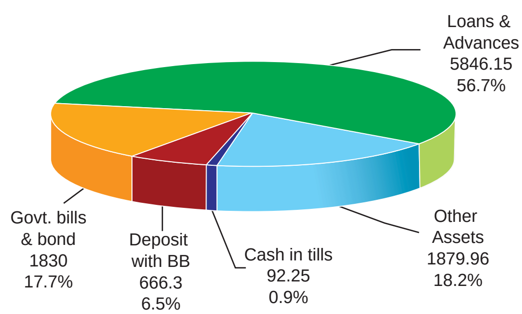
Note: Banks prepare their balance sheet on calendar year basis, and are obliged to submit their audited balance sheet at the end of every calendar year. That is why banks' performance-related figures are stated in calendar year basis.

Chart 5.1 Aggregate industry assets (billion Taka)

December 2014



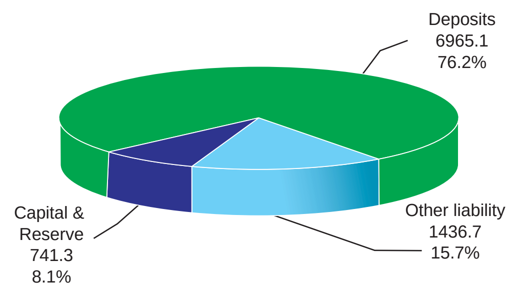
December 2015



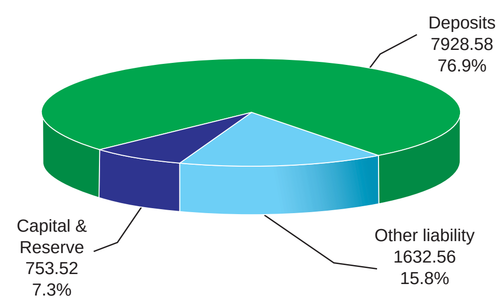
Source: Bangladesh Bank.

Chart 5.2 Aggregate industry liabilities (billion Taka)

Deceember 2014



December 2015



Source: Bangladesh Bank.

percent in 2015. The FCBs held 5.2 percent share of the total assets in 2015, showing a decline of 0.3 percentage points over the previous year. The DFIs' share of the total assets was 2.8 percent in 2015 against 3.7 percent in 2014 as one bank of this group was categorised as SCB.

5.4 Total deposits of the banks in 2015 rose to Taka 7928.6 billion from Taka 6965.1 billion in 2014 showing an overall increase of 13.8 percent. The SCBs' share in deposits slightly increased from 28.0 percent in 2014 to 28.4 percent in 2015. PCBs' deposits in 2015 amounted to Taka 5110.4 billion or 64.5 percent of the total deposit compared to Taka 4449.4 billion or 63.9 percent in 2014. FCBs' deposits in 2015 slightly increased by Taka 10.8 billion over the year 2014 though its contribution to total deposits decreased to 4.3 percent from 4.7 percent. The DFIs' deposits in 2015 was Taka 226.6 billion against Taka 237.6 billion in 2014 showing a decrease of 4.6 percent over the year.

A.1. Aggregate Balance Sheet

5.5 Total assets of the banking industry in 2015 increased by 12.8 percent over 2014. During this period, the assets of the SCBs increased by 12.8 percent and those of the PCBs increased by 15.0 percent. Loans and advances stood at Taka 5846.2 billion which constituted the most significant portion (56.7 percent) of the sector's aggregate assets of Taka 10314.7 billion. Cash in hand including foreign currencies was Taka 92.3 billion; deposits with BB were Taka 666.3 billion; other assets were Taka 1880.0 billion and investment in government bills & bonds were Taka 1830.0 billion (Chart 5.1).

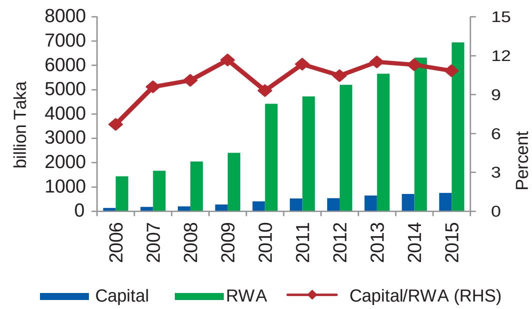
5.6 Deposits served as the main sources of funds for the banking industry and constituted 76.9 percent (Taka 7928.6 billion) of total liability in 2015. Capital and reserves of the banks were Taka 753.5 billion (7.3 percent of the liability) in 2015 compared to Taka 741.3 billion (8.1 percent) in 2014 (Chart 5.2).

A.2. Capital Adequacy

5.7 Capital adequacy measures the loss absorption capacity of the banks, related to credit, market, operation, interest rate, liquidity, reputation, settlement, strategy, environment and climate change, etc. Under Basel-III, 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 as capital, whichever is higher. 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 SP-SREP (Supervisory Review Evaluation Process, the central bank's assessment) dialogue. The amount of capital was Taka 753.5 billion at the end of December 2015.

5.8 On 31 December 2015, in aggregate, the SCBs, DFIs, PCBs and FCBs maintained CAR of 6.4, -32.0, 12.4 and 25.6 percent respectively (Table 5.2). But individually, four SCBs, two PCBs and two DFIs did not maintain the minimum required CAR. The CAR of the banking industry as a whole was 10.8 percent at the end of December 2015 as against 11.3 percent at the end of 2014. The CAR of the industry was 10.3 percent at the end of June 2016.

Chart 5.3 Aggregate capital adequacy position



Source: Bangladesh Bank.

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

(percent)

Bank types	2008	2009	2010	2011	2012	2013	2014	2015	End June 2016
SCBs	6.9	9.0	8.9	11.7	8.1	10.8	8.3	6.4	5.8
DFIs	-5.3	0.4	-7.3	-4.5	-7.8	-9.7	-17.3	-32.0	-34.7
PCBs	11.4	12.1	10.1	11.5	11.4	12.6	12.5	12.4	11.9
FCBs	24.0	28.1	15.6	21.0	20.6	20.2	22.6	25.6	23.8
Total	**10.1**	**11.6**	**9.3**	**11.4**	**10.5**	**11.5**	**11.3**	**10.8**	**10.3**

Source: Bangladesh Bank.

A.3. Asset Quality

5.9 Loans and advances constitute the largest share of assets. The high concentration of loans and advances can increase credit risk.

5.10 The most important measure of asset quality in the non-performing loans (NPLs) ratio. At the end of December 2015, PCBs had the lowest and DFIs had the highest ratio of gross NPLs to total loans. PCBs' gross

Box 5.1 New Regulatory and Supervisory Measures in Bangladesh under Basel III.

To improve financial stability at both the national and the global levels, Basel Committee on Banking Supervision (BCBS) issued Base III: A global regulatory framework for more resilient banks and banking systems in December 2010. In this context, BB has issued the "Guidelines on Risk Based Capital Adequacy - Revised Regulatory Capital Framework for banks in line with Basel III" in December 2014 and declared the road map and action plan of the phase-in arrangements for the implementation of such. According to the roadmap, the implementation of Basel III has commenced since 1 January 2015 and full implementation will be completed by January 2020. Basel III reforms are the response of Basel Committee on Banking Supervision (BCBS) to improve the banking sector's ability to absorb shocks arising from financial and economic stress. Basel III reforms will strengthen the bank-level i.e. micro prudential regulation, with the intention to raise the resilience of individual banking institutions in periods of stress. Besides, the reforms have a macro prudential focus also, addressing system wide risks as well as the pro-cyclical amplification of these risks over time. The macro prudential aspects of Basel III are largely enshrined in the capital buffers. Both the buffers i.e. the capital conservation buffer and the countercyclical buffer are intended to protect the banking sector from periods of excess credit growth.

In addition to increasing the quality of capital, Basel III increases the quantity of capital that banks must hold. Banks are expected to maintain a total capital ratio of 10.50 percent, an increase from the 8 percent requirement under Basel II. As with Basel I and Basel II, banks under Basel III must maintain a minimum total capital ratio of at least 8 percent of risk-weighted assets. However, under Basel III, after a bank has calculated its 8 percent capital requirement, it will have to hold an additional capital conservation buffer equal to at least 2.50 percent of its risk-weighted assets, which brings the total capital requirement to 10.50 percent of risk-weighted assets. Basel III requires a capital conservation buffer (CCB) to further encourage adequate capital maintenance which is designed to ensure that banks have access to supplementary capital during periods of stress. Thus, in addition to the minimum risk-based capital requirements, all banks must hold common equity tier 1 (CET1) capital (the highest-quality and most loss-absorbing form of capital) in an amount greater than 2.5 percent of total capital to risk weighted assets. Maintenance of CCB has been started with 0.625 percent in 2016 and will end up at 2.5 percent in 2019. The capital conservation buffer must be maintained to avoid limitations on both (i) capital distributions (e.g., repurchases of capital instruments or dividend) and (ii) discretionary bonus payments. For example, a bank with a CET-1 capital ratio in the range of 5.125 percent to 5.75 percent is required to conserve 80 percent of its earnings in the subsequent financial year (i.e. payout not more than 20 percent in terms of dividends, share buybacks and discretionary bonus payments is allowed). However, the constraints imposed are related to the distributions of earnings only and are not related to the operations of banks.

Banks were advised to prepare capital adequacy reports/statements following new Basel III accord from the quarter ended in March 2015. It is evident that at the end of March 2016, CRAR of the banking industry stood to 10.62 percent while CET1 was 8.17 percent which accomplished Basel III capital adequacy requirements. However, at individual level, seven banks out of 56 scheduled banks failed to maintain both CET1 and CRAR requirements as per Basel III.

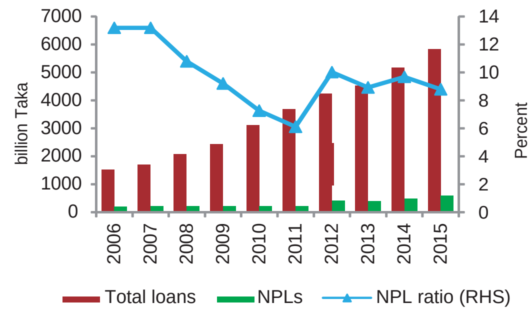
NPLs to total loans ratio was 4.9 percent, whereas that of SCBs, FCBs and DFIs were 21.5, 7.8 and 23.2 percent respectively (Table 5.3). The gross NPL ratios to total loans for the SCBs, PCBs, FCBs and DFIs were recorded as 25.7, 5.4, 8.3 and 26.1 percent respectively at the end of June 2016.

5.11 NPL had shown a 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), then decreased to 8.8 percent in 2015. The decline in NPLs to total loans ratio in recent years till 2011 can be attributed partly to some progress in recovery of long outstanding loans, write-off of loans classified as 'bad' or 'loss' and rescheduling and restructuring of non-performing loans. But it went up again in 2012 and 2014 due to the implementation of new loan classification and a few notable irregularities in the banking industry.

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

5.13 Table 5.3 (a) and Chart 5.4 show that in 2015, the ratio of net NPLs (net of provisions and interest suspense) to net total loans (net of provisions and interest suspense) was 2.3 percent for the banking sector. DFIs' ratio of net NPL to total loans decreased to 6.9 percent in 2015 from 25.5 percent in 2014. This significant decline of DFIs' net NPL ratio to total loans occurred mainly because one of the DFIs has migrated into SCBs. The net NPLs to net total loan ratios were 9.2, 0.6 and -0.2 percent for SCBs, PCBs and FCBs at the end of

Chart 5.4 Aggregate position of NPLs to total loans



Source: Bangladesh Bank.

Table 5.3 NPL ratios by type of banks

(percent)

Bank types	2008	2009	2010	2011	2012	2013	2014	2015	End June 2016
SCBs	25.4	21.4	15.7	11.3	23.9	19.8	22.2	21.5	25.7
DFIs	25.5	25.9	24.2	24.6	26.8	26.8	32.8	23.2	26.1
PCBs	4.4	3.9	3.2	2.9	4.6	4.5	5.0	4.9	5.4
FCBs	1.9	2.3	3.0	3.0	3.5	5.5	7.3	7.8	8.3
Total	**10.8**	**9.2**	**7.3**	**6.1**	**10.0**	**8.9**	**9.7**	**8.8**	**10.1**

Source: Bangladesh Bank.

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

(percent)

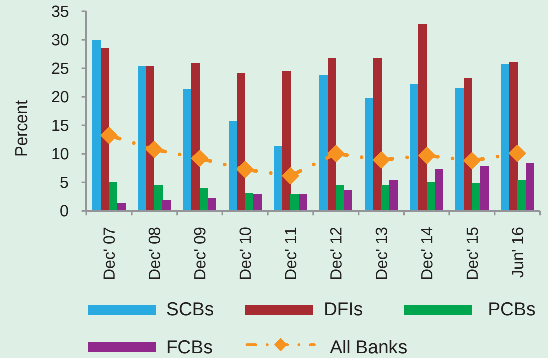
Bank types	2008	2009	2010	2011	2012	2013	2014	2015	End June 2016
SCBs	5.9	1.9	1.9	-0.3	12.8	1.7	6.1	9.2	11.8
DFIs	17.0	18.3	16.0	17.0	20.4	19.7	25.5	6.9	10.8
PCBs	0.9	0.5	0.0	0.2	0.9	0.6	0.8	0.6	0.6
FCBs	-2.0	-2.3	-1.7	-1.8	-0.9	-0.4	-0.9	-0.2	0.9
Total	**2.8**	**1.7**	**1.3**	**0.7**	**4.4**	**2.0**	**2.7**	**2.3**	**2.8**

Source: Bangladesh Bank.

Box 5.2 Factors Affecting the Non-performing Loans (NPLs) in Commercial Banks of Bangladesh

A set of factors have contributed to the current level of NPL. Several remedial measures notably, loan rescheduling, provisioning, write-off, debt restructuring and integrated supervision have been taken. Despite some initial improvements in 2011, the ratio remains elevated (Chart 1).

Chart 1 Ratio of gross NPL to total outstanding loans



The factors behind high NPL identified by financial analysts, researchers, policy makers and different stakeholders may be classified into two groups-economic and non-economic. Economic factors include sluggishness in select business activities, commodities price fluctuations, and global economic shock. Some firms faced production disruptions due to natural disasters, labour unrest, and political instabilities.

Non-economic factors behind the higher NPLs include governance constraints, inefficiency in fund management due to skill gaps in project appraisal, directed lending by the SCBs and DFIs, and lengthy legal procedures. Some loans/risky projects were approved at a lower collateral value and high interest rate by hiding actual market condition. The factors of NPL vary in different bank groups. For example, the main factors in the SCBs and DFIs are weak governance. Private banks suffered from skilled manpower for project appraisal. As a result, adverse selection and moral hazard weakened loan quality.

In order to reduce NPL, Bangladesh Bank (BB) strengthened its monitoring and supervision activities by adopting prudential guidelines, integrated supervision and Basel III framework. BB has advised the state-owned commercial banks (SCBs) to improve collection of their classified loans. Moreover, the scheduled banks have been advised to improve their underwriting and risk management practices and exercise due diligence while sanctioning fresh loans.

December 2015.The ratios were 11.8, 10.8, 0.6 and 0.9 percent for SCBs, DFIs, PCBs and FCBs respectively at the end of June 2016.

5.14 Table 5.3 (b) shows the amount of NPLs of the four types of banks from 2008 to 2015. The amount of NPLs of the SCBs increased from Taka 127.6 billion in 2008 to Taka 272.8 billion in 2015. The amount of NPLs of the PCBs increased by Taka 196.3 billion to Taka 253.3 billion in 2015 from Taka 57.0 billion in 2008 while those of the DFIs increased to Taka 49.7 billion in 2015 from Taka 37.3 billion in 2008. The amount of NPLs of the FCBs increased from Taka 2.9 billion in 2008 to Taka 18.2 billion in 2015.The amount of NPLs of SCBs, DFIs, PCBs and FCBs stood at Taka 300.8, 58.2, 253.2 and 21.6 billion respectively at the end of June 2016.

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 2008 to 2015. Table 5.4 and Chart 5.5 show that there were gaps in the adequate provisioning. Banks maintained 92.7 percent of the required provisions in 2008 which increased thereafter to 103.0 percent in 2011, then declined to 99.0 percent in 2013 and 86.1 percent in 2015. In June 2016, it increased again 87.7 percent.

5.16 The main reason for the shortfall in provision against NPLs 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. On the other hand, the FCBs were in a much better position as they were able to make adequate provisions. A comparative position of loan loss provisions at the end of 2014, 2015 and 2016 (end June) is shown in Table 5.5.

5.17 37 out of 39 PCBs were able to maintain the required provision at the end of December 2015, but the remaining two failed due to their poor asset portfolios and earning levels.

5.18 A uniform guidelines for write-offs was introduced in 2003 to create resilience in the banking system. According to the policy, banks may write off bad/loss loans at any time. 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 by banks is shown in Table 5.6.

A.4. Management Soundness

5.19 It is difficult to conclusively draw any conclusion about the quality of management based solely on the quantitative indicators.

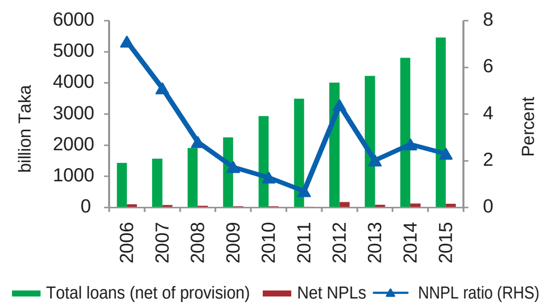
Table 5.3 (b) Amount of NPLs

(percent)

Bank types	2008	2009	2010	2011	2012	2013	2014	2015	End June 2016
SCBs	127.6	117.5	107.6	91.7	215.2	166.1	227.6	272.8	300.8
DFIs	37.3	42.1	49.7	56.5	73.3	83.6	72.6	49.7	58.2
PCBs	57.0	61.7	64.3	72.0	130.4	143.1	184.3	253.3	253.2
FCBs	2.9	3.5	5.5	6.3	8.5	13.0	17.1	18.2	21.6
Total	**224.8**	**224.8**	**227.1**	**226.4**	**427.3**	**405.8**	**501.6**	**594.1**	**633.7**

Source: Bangladesh Bank.

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



Source: Bangladesh Bank.

Table 5.4 Required provision and provision maintained -all banks

(billion Taka)

All banks	2008	2009	2010	2011	2012	2013	2014	2015	End June 2016
Amount of NPLs	224.8	224.8	227.1	226.4	427.3	405.8	501.6	594.1	633.7
Required Provision	136.1	134.8	149.2	148.2	242.4	252.4	289.6	308.9	361.8
Provision maintained	126.2	137.9	142.3	152.7	189.8	249.8	281.6	266.1	317.3
Excess(+)/ shortfall(-)	-9.9	3.1	-6.9	4.6	-52.6	-2.6	-7.9	-42.8	-44.5
Provision maintenance ratio (%)	92.7	102.3	95.4	103.0	78.3	99.0	97.2	86.1	87.7

Source: Bangladesh Bank.

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 determine management soundness. Technical competence and leadership of mid and senior level management, compliance with plan and response to changing circumstances, etc. are also taken into consideration in evaluating the quality of management.

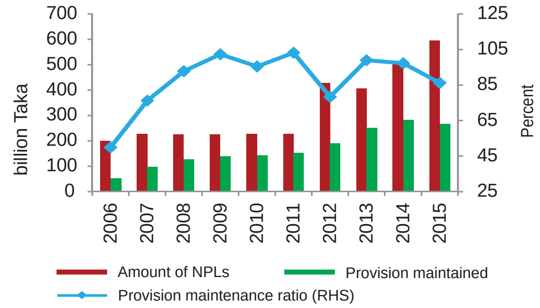
5.20 As evident from Table 5.7 and Chart 5.7, in 2015, the expenditure-income (EI) ratio of the DFIs was the highest among the bank categories which was mainly attributable to high administrative and operating expenses. The EI ratio of the DFIs increased from 99.5 percent in 2014 to 113.9 percent in 2015. In 2015, the EI ratio of SCBs, PCBs and FCBs were 84.5 percent, 75.5 percent and 47.0 percent respectively which remained almost unchanged as compared to the previous year. At the end of June 2016, the EI ratio of SCBs and DFIs increased to 99.2 and 132.2 percent respectively whereas those of PCBs and FCBs decreased slightly to 73.5 and 45.0 percent respectively.

A.5. Earnings and Profitability

5.21 Although there are various indicators of earnings and profitability, 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).

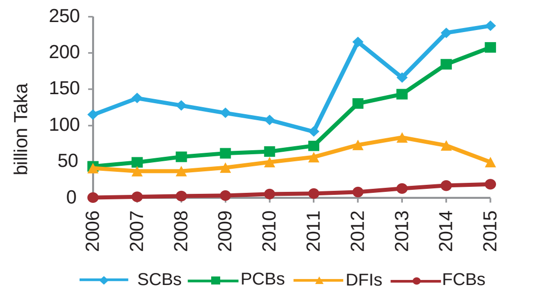
5.22 Earnings as measured by ROA and ROE differ greatly within the banking industry. Table 5.8 shows ROA and ROE by four types of banks over the period 2008-2015. Analysis of these indicators reveals that the ROA of the SCBs and DFIs was less than the industry average. The ROA of SCBs and DFIs have not improved much. PCBs' ROA showed a consistently strong position up to 2010, but it was in a decreasing trend during 2011-2012 due to declining net profit. But after 2012 it is

Chart 5.5 Provision adequacy position of all banks



Source: Bangladesh Bank.

Chart 5.6 Comparative position of NPLs by type of banks



Source: Bangladesh Bank.

Table 5.5 Comparative position of provision adequacy

(billon Taka)

Year	Items	SCBs	DFIs	PCBs	FCBs
2014	Required provision	128.6	37.1	108.7	15.3
	Provision maintained	135.3	14.7	115.3	16.2
	Provision maintenance ratio (%)	105.2	39.6	106.1	105.9
2015	Required provision	140.4	26.4	126.0	16.1
	Provision maintained	94.7	28.4	126.6	16.5
	Provision maintenance ratio (%)	67.5	107.6	100.5	102.5
2016 June	Required provision	169.7	30.4	146.2	15.5
	Provision maintained	114.6	28.5	158.0	16.3
	Provision maintenance ratio (%)	67.5	93.8	108.1	105.2

Source: Bangladesh Bank.

consistently increasing. FCBs' ROA had been consistently strong during the last couple of years.

5.23 ROE of the SCBs was -1.5 percent in 2015, but improved compared to negative 13.6 percent in previous year. ROE of the DFIs was also negative. ROE of the PCBs slightly increased to 10.8 percent in 2015 from 10.3 percent in 2014. ROE of the FCBs declined to 14.6 percent in 2015 from 17.7 percent in 2014.

5.24 Aggregate net interest income (NII) of the banking industry in 2015 stood at Taka 292.9 billion which was Taka 274.2 billion in 2014. NII of the SCBs increased to Taka 40.4 billion in 2015 from Taka 39.7 billion in 2014. NII of the DFIs decreased to Taka 1.7 billion in 2015 from Taka 2.1 billion in the previous year. PCBs held the major portion (76.0 percent) of NII in 2015 like previous years. NII of the PCBs increased to Taka 222.6 billion from Taka 205.8 billion in the last year. NII of FCBs also increased slightly from Taka 26.6 in 2014 to Taka 28.2 billion in 2015.

5.25 SCBs have been able to increase their net interest income (NII) by reducing their cost of funds from 2008 to 2011. In 2012, the NII of SCBs dropped, and deteriorated afterwards. The NII of the PCBs had been significantly high since 2008. Overall NII of the banking industry showed a consistently upward trend from 2008 to 2015 though it went reverse in 2013 due to a lacklustre performance of the SCBs.

A.6. Liquidity

5.26 Currently, the scheduled commercial banks have to maintain a CRR (cash reserve ratio) averaging 6.5 percent daily on a bi-weekly basis against average total demand and time liabilities (ATDTL) of the second preceding month, with an obligation to maintain daily minimum 6.0 percent cash against the same ATDTL held by the bank. The current rate of SLR (statutory liquidity reserve) for conventional banks is 13.0 percent of ATDTL. In case of Islamic Shariah-based commercial banks, the rate of SLR is 5.5 percent of their ATDTL. Three banks (two specialised banks and BDBL) are exempted from maintenance of SLR, but they have to maintain the CRR at the stated rate. The banks maintain CRR in cash with Bangladesh

Table 5.6 Writing-off bad debts in different bank categories

(billion Taka)

Bank types	30 June 09	30 June 10	30 June 11	30 June 12	30 June 13	30 June 14	30 June 15	30 June 16
SCBs	64.5	70.5	82.4	72.9	107.2	154.8	210.3	220.4
DFIs	31.8	31.8	32.0	24.5	32.6	34.2	5.6	5.6
PCBs	54.7	69.6	77.1	64.9	109.7	127.7	155.5	189.4
FCBs	2.0	2.1	2.4	2.6	3.7	4.4	5.1	7.2
Total	**153.0**	**174.0**	**193.9**	**164.9**	**253.3**	**321.2**	**376.5**	**423.2**

Source: Bangladesh Bank.

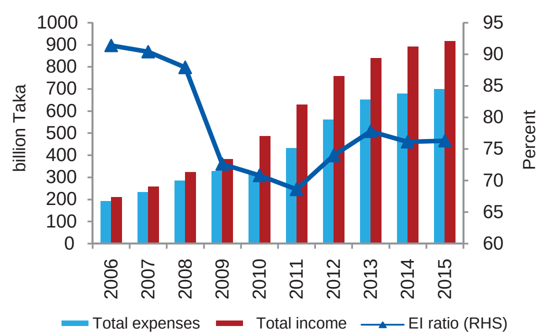
Table 5.7 Expenditure-income ratio by type of banks

(percent)

Bank types	2008	2009	2010	2011	2012	2013	2014	2015	2016 June
SCBs	89.6	75.6	80.7	62.7	73.2	84.1	84.1	84.5	99.2
DFIs	103.7	112.1	87.8	88.6	91.2	94.8	99.5	113.9	132.2
PCBs	88.4	72.6	67.6	71.7	76.0	77.9	75.8	75.5	73.5
FCBs	75.8	59.0	64.7	47.3	49.6	50.4	46.8	47.0	45.0
Total	**87.9**	**72.6**	**70.8**	**68.6**	**74.0**	**77.8**	**76.1**	**76.3**	**79.8**

Source: Bangladesh Bank.

Chart 5.7 Aggregate position of income and expenditure - all banks



Source: Bangladesh Bank.

Table 5.8 Profitability ratios by type of banks

(percent)

Bank types	Return on assets (ROA)									Return on equity (ROE)								
	2008	2009	2010	2011	2012	2013	2014	2015	2016 June	2008	2009	2010	2011	2012	2013	2014	2015	2016 June
SCBs	0.7	1.0	1.1	1.3	-0.6	0.6	-0.6	-0.04	-0.2	22.5	26.2	18.4	19.7	-11.9	10.9	-13.6	-1.5	-9.5
DFIs	-0.6	0.4	0.2	0.1	0.1	-0.4	-0.7	-1.2	-2.0	-6.9	-171.7	-3.2	-0.9	-1.1	-5.8	-6.0	-5.8	-9.5
PCBs	1.4	1.6	2.1	1.6	0.9	1.0	1.0	1.0	0.7	16.4	21.0	20.9	15.7	10.2	9.8	10.3	10.8	9.4
FCBs	2.9	3.2	2.9	3.2	3.3	3.0	3.4	2.9	2.7	17.8	22.4	17.0	16.6	17.3	16.9	17.7	14.6	13.2
Total	**1.2**	**1.4**	**1.8**	**1.5**	**0.6**	**0.9**	**0.6**	**0.8**	**0.4**	**15.6**	**21.7**	**21.0**	**17.0**	**8.2**	**11.0**	**8.1**	**10.5**	**7.1**

Source: Bangladesh Bank.

Bank. However, they are allowed to hold government approved securities (unencumbered portion) for maintenance of the SLR.

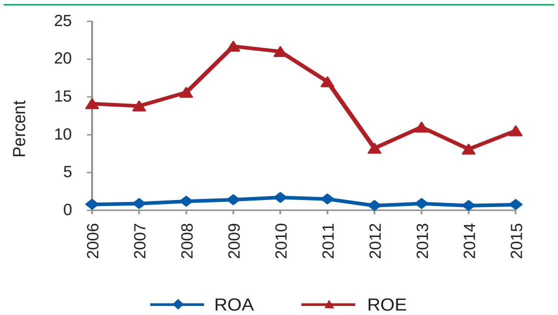
5.27 Table 5.10 shows that the FCBs have the highest liquidity ratios followed by the SCBs. There is an overall steady trend in the percentage of liquid assets in total assets of the banks during the last year although the ratio for DFIs is zero as they do not need to maintain SLR.

A.7. CAMELS Rating

5.28 CAMELS rating is a supervisory tool to identify to improve supervision. The previous CAMELS rating guideline has been reviewed by the Department of Off-site Supervision with a view to adopting 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.

5.29 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 reflected in 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. HHI (Herfindahl-Hirschman Index) has been incorporated in the updated CAMELS rating guideline to analyse loan

Chart 5.8 Aggregate profitability-all banks



Source: Bangladesh Bank.

Table 5.9 Net interest income by type of banks

(billion Taka)

Bank types	2008	2009	2010	2011	2012	2013	2014	2015	2016 June
SCBs	7.9	12.1	19.8	34.3	14.9	-5.4	39.7	40.4	15.6
DFIs	1.9	1.9	6.2	4.9	4.7	3.8	2.1	1.7	1.9
PCBs	48.5	56.7	82.8	91.4	114.7	118.2	205.8	222.6	118.9
FCBs	12.6	10.7	13.0	16.1	19.6	15.8	26.6	28.2	12.4
Total	**70.9**	**81.5**	**121.9**	**146.7**	**153.8**	**132.3**	**274.2**	**292.9**	**148.7**

Source: Bangladesh Bank.

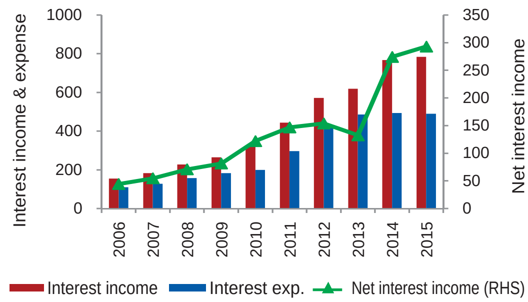
portfolio concentration, as a complement to percentages of classified loans and provisioning in the evaluation of asset quality. The amount of loan disbursed to different risk-associated sectors has been included as well. Under this rating system, banking companies are assigned two sets of ratings- (i) 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 banking company. Both 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 the activities of these banks are closely monitored by BB.

5.30 Bangladesh Bank has introduced the early warning system (EWS) since 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 improve its performance. Presently, no banks are monitored under EWS.

5.31 In December 2015, CAMELS rating, no banks were rated '1' or 'Strong'; the rating of 36 banks was '2' or 'Satisfactory'; rating of 13 banks was '3' or 'Fair'; five banks were rated '4' or 'Marginal' and two banks received the rating of '5' or 'Unsatisfactory'.

Chart 5.9 Aggregate NII of the industry

(billion Taka)



Source: Bangladesh Bank.

Table 5.10 Liquidity ratio by type of banks

(percent)

Bank types	2008	2009	2010	2011	2012	2013	2014	2015	2016 June
SCBs	32.9	25.1	27.2	31.3	29.2	44.3	42	41.4	40.1
DFIs	13.7	9.6	21.3	6.9	12.0	15.3	6.6	0.0	0.0
PCBs	20.7	18.2	21.5	23.5	26.3	28	28.2	19.7	18.5
FCBs	31.3	31.8	32.1	34.1	37.5	46.2	56.9	51.8	46.0
Total	**24.8**	**20.6**	**23**	**25.4**	**27.1**	**32.5**	**32.7**	**26.5**	**25.3**

Source: Bangladesh Bank.

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

5.32 As on 30 June 2016, 56 scheduled banks are operating with their 9453 number of branches throughout Bangladesh. The number of rural branches stood at 5360 (56.7 percent of total branches) at the end of June 2016 (Appendix 4, Table XIII) and the number of branches in urban areas increased to 4093 (43.3 percent of total branches) during the same period. The number of branches of SCBs are 2330 (63.0 percent) in rural areas and 1370 (37.0 percent) in urban areas. Specialised banks have 1297 (92.2 percent) branches in rural areas and 110 (7.8 percent) in urban areas. Private commercial banks have 1733 (40.6 percent) branches in rural areas and 2538 (59.4 percent) in urban areas. Foreign commercial banks are

Table 5.11 Comparative position of the Islamic banking sector (as of end December 2015)

(billion Taka)

Particulars	Islamic banks		Dual banking* (Conventional+ Islamic)		Islamic banking sector		All banking sector	
	2015	2014	2015	2014	2015	2014	2015	2014
1	2		3		4=2+3		5	
Number of banks	8	8	16	16	24	24	56	56
Deposits	1552.2	1349.7	89.4	67.6	1641.6	1417.3	8033.5	6965.1
Credits	1305.5	1137.6	81.7	57.7	1387.2	1195.4	5952.9	5147.2
Credit deposit ratio (%)	83.2	84.3	75.6	85.4	82.7	84.3	70.98	73.9
Liquidity: excess(+)/shortfall(-)**	133.4	127.5	3.1	0.1	136.5	128.2	1234.1	1142.2

*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.
Source: Bangladesh Bank.

operating through 75 urban branches. The share of urban deposits to total deposits was 80.2 percent and the share of rural deposits to total deposits was 19.8 percent during this period. On the other hand, the amount of advances given in urban areas constituted 90.1 percent of total advances of the banking industry and the amount of advances disbursed in rural areas accounted for 9.9 percent of total advances of the banking industry as of December 2015.

A.9. Islamic Banking

5.33 Islamic banking system has been introduced in Bangladesh since 1983. In FY16, 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 increasing market share of the Islamic banking in terms of assets, financing and deposits of 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 1641.6 billion at the end of December 2015 which accounted for 20.7 percent of total deposits. Total credit of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 1387.2 billion at the end of December 2015 representing 23.7 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

5.34 To comply with international best practices and to improve financial stability, Bangladesh Bank has commenced implementation of Basel III capital adequacy framework since January 2015. According to Pillar-1 of Basel-III, RWA of banks is calculated against credit risk, market risk, and operational risk. BB announced the Roadmap for implementing Basel III in Bangladesh and issued Guidelines on Risk Based Capital Adequacy (Revised Regulatory Capital Framework for banks in line with Basel III) in 2014. After successful completion of Basel-II

Box 5.3 Shadow Banking in Bangladesh

According to the Financial Stability Board (FSB), shadow banking is a system of credit intermediation that involves entities and activities outside the regular banking system, and raises (i) systemic risk concerns, in particular by maturity/liquidity transformation, leverage and flawed credit risk transfer, and/or (ii) regulatory arbitrage concerns.

Shadow banking system played a major role in the financial crisis during 2007-2009, but remained largely unregulated. A proximate cause of the crisis was shock to home prices, which had a large detrimental effect on subprime mortgages. In turn, assets backed securities (ABSs) linked to subprime mortgages quickly lost value. The shocks spread quickly to other asset classes as entities based short-term debt were unable to roll over the debt or faced withdrawals. Essentially, there was a run on short run debt. The epicentres were the repo market, the market for asset backed commercial papers (ABCPs) and money market mutual funds (MMMFs), which by definition, comprises of shadow banking activities.

Shadow banking has grown in Bangladesh in recent years. For instance, shadow banking activities were about Taka 39.64 billion in July 2013, which increased to Taka 64.66 billion in December 2015 (63.31 percent rise over the period). Although the amount of shadow banking activities is a very small in terms of the total aggregate banking sector asset (63 basis point in FY15), unregulated shadow banking, involving billions of Taka in short-term debt to fund inherent risky financial activity, would cause a systemic risk for the whole financial system of Bangladesh in future. In this respect, shadow banking activities should be closely regulated and supervised..

To build the shadow banking index, the above definitions are used to identify the activities to be included. The shadow banking components of the index are repo market, ABS/MBS and commitment (including derivatives), of which commitment and interbank repo market contribute lion's share of shadow banking activities in Bangladesh. For example commitment contributed about 56.65 percent, while interbank repo constituted about 41.36 percent of shadow banking activities in 2015. Shadow banking activities reached its peak in March 2015 at Taka 99.33 billion. Interbank repo and commitment (including derivatives) constituted Taka 64.92 billion and Taka 32.71 billion respectively in the same period.

The relative share of interbank repo and commitment (including) covers about 96.7 percent of shadow banking sector for the period from July 2013 to December 2015. The remaining portion is covered by ABS/mortgage backed securities (MBS) and ABCP. The average share of repo market contributed to about 45.2 percent and that of commitment stood at about 51.7 percent of shadow banking activities in Bangladesh. The repo's share reached its peak in February 2015, about 69.7 percent while commitment's share hit its peak in August 2015, 80.3 percent of shadow banking sector.

The shadow banking system is playing an increasingly important role in the provision of household and corporate credit. Along with regular monitoring of shadow banking activities, the following recommendations, especially for repo market, may be taken into consideration:

- Reducing demand and supply of intra-day credit,
- Shortening the window for daily unwind,
- Increasing transparency,
- A minimum haircuts would be required on all collateral used in repo and could be specific to the two parties and the collateral offered,
- Position limits would be set in terms of asset size and collateral used,
- Repo transactions would be restricted to the treasury securities and other assets as Bangladesh, Bank deems appropriate and
- Liquidity coverage ratio (LCR) and net stable funding ratio may be required for NBFI.

in December 2014, BB has started implementation of Basel-III in a phased manner which has already been started since January 2015.

Banks were instructed to submit their Capital Adequacy Statements/Reports to BB following new Basel-III accord from the quarter ended in March 2015. At the end of June 2016, CRAR of the banking industry stood at 10.3 percent while CET1 was 7.5 percent which fulfilled Basel-III capital adequacy requirements. However, at individual level, seven banks out of 56 scheduled banks failed to maintain CET1 and CRAR requirements as per Basel-III.

5.35 In order to avoid building-up excessive on and off-balance sheet leverage in the banking system, a simple, transparent, non-risk based leverage ratio has been introduced. In Bangladesh the minimum requirement of leverage ratio is 3 percent. Instructions mentioned in the Guidelines will be adopted phase by phase, with full implementation of capital ratios by December 2019. Phase-in-arrangement of minimum capital requirements is depicted in Table 5.12. 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 33.33 percent of CET-1, whichever is higher.

Table 5.12 Phase-in-arrangement of minimum capital requirements.

Bank types	2015	2016	2017	2018	2019
Minimum common equity Tier 1 (CET1) capital ratio	4.5	4.5	4.5	4.5	4.5
Capital conservation buffer (CCB)	-	0.625	1.25	1.875	2.5
Minimum CET1 plus CCB	4.5	5.125	5.75	6.375	7.0
Minimum Tier 1 capital ratio	5.5	5.5	6.0	6.0	6.0
Minimum total capital ratio	10.0	10.0	10.0	10.0	10.0
Minimum total capital plus CCB	10.0	10.625	11.25	11.875	12.5
Leverage ratio	3.0	3.0	3.0 readjustment	Migration to pillar-1	

Source: Bangladesh Bank.

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 88.89 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.

5.36 Considering the recent scenario of country's banking industry, section 3.3 of Guidelines on Risk Based Capital Adequacy has been revised as "the entire general provision maintained against unclassified loans and advances as per regulations will be considered as capital under Tier-2".

5.37 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 Internal Capital Adequacy Assessment Process (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 to submit the same 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 the bank fails to produce their own ICAAP report backed by proper evidence and rigorous review regarding risk management, the SREP team of BB applies their prudence and also uses the available information from the inspection departments in determining the adequate capital. The process document was further revised in May 2014. On the basis of the revised process document and return format, all 56 banks submitted their ICAAP report based on 31 December 2014 and one to one meeting with BRPD and SRP team of 56 banks have already been completed.

B.2 Loan Classification and Loan-Loss Provisions

5.38 BB has changed its policies on loan classification and loan-loss provisions near the end of 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 Loan Restructuring

5.39 Loan restructuring policy for large borrowers having multiple bank exposures was revised. Considering the contribution of the large borrowers to the socio-economic development and employment generation of the country, and to support the loan recovery efforts of the banks, the Board of Directors of Bangladesh Bank recommended necessary policy support in line with international best practices for the affected large borrowers. Accordingly, large loan restructuring policy was issued and was valid till 30 June 2015. According to the policy, loans of a particular borrower or group in a bank, singly or in clubbed together form, shall be eligible for restructuring. Borrower having exposure in multiple banks may also be eligible for loan restructuring by forming a consortium. Minimum outstanding loan amount for restructuring shall be Taka 5.0 billion or above in aggregate. Under this policy, banks can provide restructuring facility to a particular loan account only once and the restructured loan shall have a maximum tenure of twelve years for term loan(s); in case of demand and/or continuous loan(s), the tenure shall be maximum six years. However, borrowers indulging in frauds and forgeries will not be eligible for loan restructuring. Under the large loan restructuring policy, Taka 145.7 billion has been restructured with the approval of Bangladesh Bank. Respective banks have recovered Taka 1.9 billion as down payment and Taka 5.0 billion as instalment from various borrowers up to 30 June 2016. As most of the borrowers are enjoying moratorium period, the recovery of instalment from all borrowers have not been fully started yet.

B.4. Corporate Governance in Banks

5.40 Bangladesh Bank has undertaken a number of measures in the recent years to establish good corporate governance in the banking sector. 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 the Bank Company Act, 1991 have already been amended.

C. Supervision of Banks

5.41 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

5.42 Off-site monitoring continued as a necessary complement to on-site inspection in FY16 with its various tools and procedures for intensive and rapid analysis of the financial health of the banking sector.

Banking Supervision Specialists (BSSs)

5.43 In order to strengthen banking supervision, BB has recently formed six Banking Supervision Specialist Sections in the Department of Off-site Supervision (DOS). Each section is headed by a Banking Supervision Specialist (BSS), at the Deputy General Manager level. Banking Supervision Specialists maintain extensive familiarity with the performance, risks, corporate governance and corporate structure of the portfolio banks. They collect executive summary reports of comprehensive inspections carried out by Departments of Banking Inspection and take actions accordingly. They coordinate with inspection departments to get update on recent supervisory developments. Junior Banking Supervision Specialists monitor treasury functions, capital adequacy, ADR, etc. of the portfolio banks and prepare diagnostic review report (DRR) on audited financial statements. They also examine the internal control systems to improve its resilience.

5.44 BSSs monitor the progress of memorandum of understanding (MoU) with the SCBs and specialised banks and report the findings/progress of those banks immediately to the concern senior management. 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.) was conducted by Bangladesh Bank. Meanwhile, the government has injected Taka 12.0 billion to BASIC Bank Ltd. in December 2015 as recapitalisation. On the other hand, BKB and RAKUB are also being monitored and reviewed under the MoUs of FY16. Preparation of MoUs for BKB and RAKUB for FY17 is currently under process.

Risk Management Activities of Banks

5.45 Bangladesh Bank has issued six core risks management guidelines (revised during 2015-2016), 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.

5.46 In 2015, BB introduced two reporting formats in the name of comprehensive risk management report (CRMR) and monthly risk management report (MRMR) for banks in place of previous risk management paper (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 CRMR which is submitted on a half-yearly basis. To ensure close monitoring, BB is analysing the risk management of banks on a monthly basis along with half-yearly basis. Recently, banks have been instructed to determine their risk appetite on a yearly basis for all possible measurable risk areas in line with the objectives of business growth and to send the statement to DOS by the end of first quarter of every year after taking board approval.

5.47 Banks have been instructed to establish Risk Management Division (RMD) in place of previous 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. DOS regularly evaluates the risk management activities of each bank based on the CRMR and MRMR 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.

5.48 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 a 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. Besides, this rating plays an important role in getting branch licence, AD licence, permission for dividend declaration, etc. for banks. According to the rating of December 2015, out of 56 scheduled banks, 24 banks were rated as low risk, 23 as moderate and the rest nine as high risk category banks.

5.49 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 a 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.

C.2. On-site Inspection of Banks

5.50 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 (FICSD) 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.

5.51 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.

5.52 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 are 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.

5.53 During FY16, DBI-1 conducted a total of 1216 inspections of 28 banks including head offices. At the same time, a total of 140 core risk inspections were conducted on 28 banks 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 special inspection, 208 inspections were conducted of which 152 inspections were conducted through Integrated Supervision System (ISS) software and 56 inspections were done to meet the obligation of Supervisory Review Evaluation Process. 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. During FY16, DBI-1 also arranged intensive in-house training programme focusing on different relevant areas like techniques of detection of major irregularities, financial statement analysis, discussion on newly introduced inspection guidelines, etc.

5.54 During FY16, DBI-2 conducted comprehensive inspection on 1086 bank branches including six head offices, 183 big branches and 897 small branches. At the same time, a total of 133 special inspections were conducted on SCBs including 17 risk based inspections. The department also conducted comprehensive inspection on three branches and the Head office of ICB.

5.55 During FY16, DBI-3 conducted a total of 652 comprehensive inspections on banks including five head offices, 647 branch offices including SME/agriculture. In addition, a total of 6 risk based inspections, 25 special inspections and 8 surprised inspections were also conducted by this department during the period.

5.56 During FY16, DBI-4 conducted 315 inspections on banks' head offices and branches. During the period, this department conducted comprehensive inspections in 238 branches and 20 head offices of banks to ascertain their overall soundness and regulatory compliance status. During the period, DBI-4 also carried out core risk inspections in 20 branches and 20 head offices of banks to review the implementation progress of core risk management guidelines as well as to evaluate and monitor risk management systems of those banks. Moreover, DBI-4 conducted 26 special inspections on 26 branches of different banks. This department also continuously monitors implementation progress of the recommendations made in the inspection reports.

5.57 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 FY16, the department conducted a total of 113 comprehensive inspections on authorised dealer branches of banks. The department also conducted 56 inspections on foreign exchange risk management, 53 inspections on money changers and a good number of special inspections on foreign trade and foreign exchange related irregularities. Furthermore, for the first time, this department has started inspections on off-shore banking units of scheduled banks and already conducted 18 inspections during the period.

5.58 Customers' Interests Protection Centre (CIPC) was reconstituted as a department named Financial Integrity and Customer Services Department (FICSD) on

26 July 2012. FICSD is working 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. During FY16, a total of 4791 complaints were received by the department from which a total of 4698 complaints were resolved. Resolution rate is 98.1 percent. Besides, a total of 85 special inspections were carried out on different commercial and specialised banks by this department during the period.

5.59 During FY16, FICSD received a total of 4530 complaints through the dedicated hot line numbers, e-mails and traditional letters. The department is working to investigate and resolve complains within the shortest possible time. The rate of compliance resolved has been increased notably. 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's customers of their respective areas.

5.60 Bangladesh Financial Intelligence Unit (BFIU) is the national central agency to execute the power and responsibilities conferred under the provisions of Money Laundering Prevention Act, 2012 and Anti Terrorism Act, 2009. The Money Laundering Prevention (Amendment) Act, 2015 was promulgated on 26 November 2015 to further strengthen the legal structure of anti money laundering and combating financing of terrorism regime in Bangladesh. The unit is empowered to supervise the activities of the reporting agencies including banks, financial institutions, insurers, money changers, etc. As part of its surveillance programme, BFIU carries out both on-site and off-site supervision on anti money laundering (AML) and combating financing of terrorism (CFT) activities of the reporting agencies. Two types of onsite supervisions are carried out by BFIU, namely (i) system check inspection and (ii) special inspection. System check inspections are conducted in scheduled banks on a half yearly basis to oversee and ensure the compliance of the provisions under MLPA, 2012 and ATA, 2009. During FY16, BFIU conducted system check inspections in 58 branches of different banks. Banks are obliged to submit Suspicious Transaction Reports (STR's) and Cash Transaction Reports (CTR's) to BFIU.

5.61 BFIU conducts special inspections to examine whether banks are submitting STR/CTRs properly and regularly. BFIU conducted special inspections in 76 branches of 32 banks during the fiscal year. BFIU also receives and analyses complaints from individuals and entities. Moreover, BFIU received 1307 suspicious transaction reports (STRs) during the same period. After analysing them, the unit disseminated 37 reports to Anti-Corruption Commission (ACC) and Criminal Investigation Department (CID), Bangladesh Police for necessary action at their end. BFIU has also been monitoring the status of these cases from time to time. BFIU has taken a number of initiatives including issuing some important circulars and giving instructions to the reporting agencies in order to prevent money laundering and combating terrorist financing during the period.

5.62 BFIU continues its effort to create awareness among the officials of different reporting organisations and thus encourages the reporting organisations to conduct a number of training programmes for their officials. Besides, it has arranged workshops for other law enforcing agencies. Furthermore, annual conferences for Chief Anti-Money Laundering Compliance Officer (CAMLCO) of banks, financial institutions and insurance companies were arranged separately in FY16. BFIU has signed 43 memorandum of understandings (MoUs) with FIUs of other countries to exchange of information related to ML/TF, among them eight MoUs were signed in FY16. Apart from these, BFIU has been maintaining continued engagement with all the international bodies such as APG, Egmont Group, FATF and BIMSTEC to boost international efforts in this arena.

C.3 Financial Stability and Macro Prudential Supervision

5.63 The Financial Stability Department (FSD) has been working actively to examine the stability of the financial system through macro prudential analysis. Since inception, this department has been publishing Financial Stability Report on a yearly basis to evaluate overall financial stability aiming at conveying the risks and vulnerabilities of the financial system to various stakeholders. In addition, the department has also been publishing a Quarterly Financial Stability Assessment Report (QFSR) with the aim of assessing the overall financial conditions during a quarter.

5.64 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 also been implemented with the technical assistance of the World Bank. To observe the liquidity management of banks and NBFIs, a tool called Inter-bank Transaction Matrix (ITM) has been introduced. This matrix will help to find out the institutions which may potentially face any crisis and give early warning signals for safeguarding financial institutions.

5.65 The department has developed a 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. As part of contingency plans, the department has prepared several documents under lender of last resort (LOLR) and Bank Intervention Resolution Plan (BIRP). LOLR aims to provide emergency liquidity assistance (ELA) to banks in serious liquidity problems to prevent or mitigate potential systemic effects resulted from contagion through other banks or market infrastructures. On the other hand, BIRP provides more effective tools and information in order to enable the orderly resolution of banks without any resort of taxpayers' fund.

5.66 The department has been preparing Bank Health Index (BHI) and Heat Map on a half-yearly basis to monitor the relative health of the banks from liquidity, solvency and earning perspectives. A concept paper titled as "Coordinated Supervision Framework for Bangladesh" has also been prepared with a view to better supervise the financial sector and to avoid the duplication of efforts of different regulators. The department has prepared a database called 'Central Depository for Large Credit' (CDLC) as corporate watch-list to observe the indebtedness of the corporates those may create systemic consequences.

D. Banking Sector Infrastructure for Financial Stability and Risk Management

D.1. Deposit Insurance Systems in Bangladesh

5.67 The Deposit Insurance Systems (DIS) is designed to minimise or eliminate the risk of loss that the depositors may suffer due to keeping funds with a bank. The purpose of DIS is to help increase market discipline, reduce moral hazard in the financial sector and provide safety nets at the minimum cost to the public in the event of a bank failure. The direct rationale for deposit insurance is customer protection while the indirect rationale for deposit insurance is to reduce the risk of a systemic crisis, 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.

5.68 In Bangladesh, Deposit Insurance Scheme was first introduced in August 1984 in terms of "The Bank Deposit Insurance Ordinance 1984". In July 2000, the Ordinance was repealed by an Act of the Parliament called "The Bank Deposit Insurance Act 2000". Deposit insurance systems in Bangladesh are now being administered by the said Act. In accordance to the Act, Bangladesh Bank (BB) is authorised to carry out a fund called Deposit Insurance Trust Fund (DITF). The Board of Directors of BB acts as the Trustee Board for the DITF. The DITF is now being administered and managed under the guidance of the Trustee Board. In addition, Bangladesh Bank is a member of International Association of Deposit Insurers (IADI).

5.69 In accordance with the "The Bank Deposit Insurance Act 2000", the main functions of DITF are collecting premium from all scheduled banks on a half-yearly basis (end of June/end of December) and investing the proceeds in the Government Securities and REPO. The income derived from such investments is also credited to the DITF account for further investment. In case of winding up of an insured bank, as per the said act, BB will pay to every depositor of that bank an amount equal to his/her deposits not exceeding 100,000.

5.70 To enhance the effectiveness of market discipline, BB has adopted a system of risk based deposit insurance premium rates applicable for all banks effective from period of January-June 2007. From January-June 2013, the premium rate has been increased. Moreover, proposal for the amendment of the current act 'Deposit Protection Act' has already been sent to Ministry of Finance which is now under consideration. There is a plan to bring depositors of NBFIs under the umbrella of DIS and increase the coverage limit in the amended act. For automation of premium calculation process and online submission of premium assessment information, a software named 'Information for Deposit Insurance Premium Assessment

(IDIPA)' was inaugurated by the Governor of Bangladesh Bank in February 2015.

5.71 The effectiveness of DIS in reducing systemic risk would be increased if the public is well aware of its existence and scope. With this end of view, BB has already issued a circular regarding public awareness and uploaded more information on the Bangladesh Bank website so that the public may know about the benefits and limitations of DIS on an ongoing basis.

D.2. Activities of Credit Information Bureau

5.72 Credit Information Bureau (CIB) was set up in Bangladesh Bank (BB) on 18 August 1992 with the objective of minimising the extent of default loans. CIB has been providing its online services since 19 July 2011. The Online system of CIB is playing an important role to maintain a risk free lending procedure in the banking industry. Currently, CIB online services are provided through newly developed New CIB Online Solution. The New CIB Online Solution developed by BB's internal resources started its live operation on 1 October 2015. It eliminated vendor dependency as well as reduced huge cost for maintaining the previous online system. 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 appreciably reduced time and physical movement for the banks/NBFIs in submission of credit information and CIB report generation process which ultimately make the loan processing activities faster.

Table 5.13 The recent position of DITF

Particulars	Unaudited figure (as on 30 June 2016)	Premium rate*
Total fund	49.04 billion Taka	-
Total investment	48.99 billion Taka	-
Insurable deposit to total demand and time liabilities	81.77%	-
Covered deposit of total insurable deposit	27.93%	-
Fully insured deposit	88.89%	-
Sound bank categories	-	0.08%
Early warning bank categories	-	0.09%
Problem bank categories	-	0.10%

* Effective from 2013.
Source: Bangladesh Bank.

5.73 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 and above and defaulted credit card information having outstanding amount of Taka 10000 and above. The total number of borrowers increased by around 22 percent to 1,101,046 at the end of June 2016 compared to 9,05,112 at the same month of previous year.

5.74 The total outstanding amount of loans and advances of the banking and non-banking financial institutions stood at Taka 6852.64 billion (including BLW amount) in June 2016, which was around 22 percent compared to the same period of last year. In June 2015, the amount was Taka 5601.0 billion. Furthermore, total classified outstanding amount increased by around 19 percent in June 2016 over the same period of last year. The classified amount was Taka 929.55 billion in June 2016 while it was Taka 778.39 billion in June 2015.