

# PRUDENTIAL REGULATIONS FOR BANKS : SELECTED ISSUES



**Bangladesh Bank**

**September, 2011**



**PRUDENTIAL REGULATIONS FOR BANKS :**  
**SELECTED ISSUES**

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**[Updated till September 2011]**



**BANGLADESH BANK**



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## POLICY ON CAPITAL ADEQUACY OF BANKS<sup>1</sup>

To adopt the international best practices and to make the bank's capital more risk-absorbent as well as to build the banking industry more shock resistant and stable, all scheduled banks are obligated to comply with "Guidelines on Risk Based Capital Adequacy (RBCA) for Banks - Revised Regulatory Framework in line with BASEL-II" from January 01, 2010<sup>2</sup>. These guidelines have been structured on following three aspects:

- ❖ Minimum capital requirement has been defined and to be maintained by a bank on solo basis as well as consolidated basis against RWA for credit, market, and operational risks.
- ❖ Process for assessing the overall capital adequacy aligned with comprehensive risk management of a bank.
- ❖ Framework of public disclosure on the position of a bank's risk profiles, capital adequacy, and risk management system.

The following headings containing specific instructions are issued for compliance by banks:

### 1. **Definition of Capital:**<sup>3</sup> Regulatory capital is categorized in three tiers:

1.1. Tier 1 capital called 'Core Capital' comprises of highest quality of capital elements:

- a) Paid up capital
- b) Non-repayable share premium account
- c) Statutory reserve
- d) General reserve
- e) Retained earnings
- f) Minority interest in subsidiaries
- g) Non-cumulative irredeemable preference shares
- h) Dividend equalization account

1.2. Tier 2 capital called 'Supplementary Capital' represents other elements which fall short of some of the characteristics of the core capital but contribute to the overall strength of a bank:

- a) General provision
- b) Revaluation reserves
  - Revaluation reserve for fixed assets
  - Revaluation reserve for securities
  - Revaluation reserve for equity instrument

<sup>1</sup> Guidelines on Risk Based Capital Adequacy (RBCA) issued vide BRPD Circular no. 35/2010

<sup>2</sup> Guidelines on Risk Based Capital Adequacy (RBCA) issued vide BRPD Circular no. 35/2010 (Page-1)

<sup>3</sup> Guidelines on RBCA (Page-1)

- c) All other preference shares
- d) Subordinated debt

1.3. Tier 3 capital called ‘Additional Supplementary Capital’, consists of short-term subordinated debt (original maturity less than or equal to five years but greater than or equal to two years) would be solely for the purpose of meeting a proportion of the capital requirements for market risk.

1.4. For foreign banks operating in Bangladesh-

- Tier 1 capital consists of the following items:
  - a) Funds from head office
  - b) Remittable profit retained as capital
  - c) Any other items approved by BB for inclusion in Tier 1 capital
- Tier 2 capital consists of the following items:
  - a) General provision
  - b) Borrowing from head office in foreign currency in compliance with the regulatory requirement.
  - c) Revaluation reserve for securities
  - d) Any other items approved by BB for inclusion in Tier 2 capital.

2. **Conditions for maintaining regulatory capital** :<sup>4</sup> The calculation of Tier 1 capital, Tier 2 capital, and Tier 3 capital shall be subject to the following conditions:

- a) The amount of Tier 2 capital will be limited to 100% of the amount of Tier 1 capital.
- b) 50% of revaluation reserves for fixed assets and securities eligible for Tier 2 capital.
- c) 10% of revaluation reserves for equity instruments eligible for Tier 2 capital.
- d) Subordinated debt shall be limited to a maximum of 30% of the amount of Tier 1 capital.
- e) Limitation of Tier 3: A minimum of about 28.5% of market risk needs to be supported by Tier 1 capital. Supporting of Market Risk from Tier 3 capital shall be limited up to maximum of 250% of a bank’s Tier 1 capital that is available after meeting credit risk capital requirement.

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<sup>4</sup> Guidelines on RBCA (Page-3)



**3. Eligible regulatory capital:**<sup>5</sup> In order to obtain the eligible regulatory capital for the purpose of calculating Capital Adequacy Ratio (CAR), banks are required to make following deductions from their Tier-1 capital:

a) Intangible asset e.g., book value of goodwill and value of any contingent assets, etc. which are shown as assets

b) Shortfall in provisions required against classified assets

c) Shortfall in provisions required against investment in shares

d) Remaining deficit on account of revaluation of investments in securities after netting off from any other surplus on the securities.

e) Reciprocal/crossholdings of bank's capital/subordinated debt artificially intended to inflate the capital position of banks

f) Holding of equity shares in any form exceeding the approved limit under section 26(2) of 'ব্যাংক কোম্পানী আইন, ১৯৯১' (Bank Company Act, 1991). The additional/unauthorized amount of holdings will be deducted at 50% from Tier 1 capital and 50% from Tier 2 capital.

g) Investments in subsidiaries which are not consolidated: The normal practice is to consolidate subsidiaries for the purpose of assessing the capital adequacy of banking groups. Where this is not done, deduction is essential to prevent the multiple uses of the same capital resources in different parts of the group. The deduction for such investments will be 50% from Tier 1 capital and 50% from Tier 2 capital. The assets representing the investments in subsidiary companies whose capital had been deducted from that of the parent would not be included in total assets for the purposes of computing the CAR.

Eligible Tier 2 capital will be derived after deducting components (if any) qualified for deduction. Total eligible regulatory capital will be calculated by summing up the eligible Tier 1, Tier 2 and Tier 3 capital.

**4. Minimum Capital Requirement (MCR):**<sup>6</sup> Minimum Capital Requirement (MCR) for the each scheduled bank in Bangladesh will be at least 9% of total Risk Weighted Assets (RWA) from

<sup>5</sup> Guidelines on RBCA (Page-3)

<sup>6</sup> BRPD Circular no. 10/2010 and Guidelines on RBCA (Page-4)

July 2010 to June 2011 and 10% of total RWA from July 2011 to onwards or the amount determined by BB from time to time. Moreover, banks have to maintain at least 50% of required capital as Tier 1 capital. Banks have to maintain minimum CAR on ‘Solo’ basis as well as on ‘Consolidated’ basis as per instruction(s) given by BB from time to time.

**5. Approaches for calculating RWA:**<sup>7</sup> Under the guidelines, for calculating RWA, Standardized Approach for Credit Risk, Standardized (Rule Based) Approach for Market Risk and Basic Indicator Approach for Operational Risk is being followed.

In this regard, following things are shown in Annexure-I under credit risk:

- Risk weights for Balance Sheet Exposures,
- Risk Weight for Short Term Exposures,
- Risk Weight against ECA Score (Published by OECD),
- Credit Conversion Factor under Current Exposure Method,
- Credit Conversion Factor under Original Exposure method and
- Credit Conversion Factor for Non-market-related OBS transactions.

In Annexure-II, the Capital charge weight for specific risk, Calculation of general market risk and Calculation of Capital Charge for Operational Risk are shown.

Under the standardized approach, the credit ratings assigned by the External Credit Assessment Institution (ECAI) duly recognized by Bangladesh Bank are used to assign risk weight against credit risk. BB has already recognized 04 (Four) ECAIs after assessing eligibility criteria and Risk Weights have been mapped against different credit rating of ECAIs. ECAI’s Credit Rating Categories Mapped with BB Rating Grade is shown in Annexure-III.

**6. Supervisory Review Process (SRP) - Supervisory Review Evaluation Process (SREP):**<sup>8</sup>

In respect of SRP, banks would 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 have been asked to form an exclusive body (called SRP team) where risk management unit is an integral part, and a process document (called Internal Capital Adequacy Assessment Process-ICAAP) for assessing their overall risk profile, and a strategy for maintaining adequate capital. Adequate

<sup>7</sup> Guidelines on RBCA (Chapter 2. Credit Risk; Chapter 3. Market Risk; Chapter 4: Operational Risk)

<sup>8</sup> Guidelines on RBCA (Page-37 & 51) & Process Document for SRP-SREP Dialogue on ICAAP

capital means enough capital to compensate all the risks in their business, and to develop and practice better risk management techniques in monitoring and managing their risks. Supervisory Review Evaluation Process (SREP) of BB includes dialogue between BB and the bank's SRP team followed by findings/evaluation of the bank's ICAAP. During SRP-SREP dialogue BB will review and determine additional capital to MCR of banks. For this purpose, banks are asked to provide information in specified format on risks addressed by BB under SRP in line with their own ICAAP.

**7. Reporting Requirement:**<sup>9</sup> All banks are required to submit the RBCA report (according to the prescribed formats) on quarterly basis within the next 30 days of each quarter-end to the Department of Off-site Supervision of BB.

**8. Penalty for non-compliance:**<sup>10</sup> BB may impose penalty and/or punishment as per 'ব্যাংক কোম্পানী আইন, ১৯৯১' (Bank Company Act, 1991), if a bank-

- fails to meet minimum capital or CAR within the stipulated period,
- willfully furnishes any false information in the reporting,
- fails to submit the RBCA report within stipulated time without any acceptable/ satisfactory reason.

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<sup>9</sup> Guidelines on RBCA (Page-4)

<sup>10</sup> Guidelines on RBCA (Page-5)

**ANNEXURE-I****Risk Weights for Balance Sheet Exposure<sup>11</sup>**

Sl.	Exposure Type	BB's Rating Grade	Risk Weight (%)
a.	Cash		0
b.	Claims on Bangladesh Government (other than PSEs) and BB (denominated in domestic and foreign currency)		0
c.	Claims on other Sovereigns & Central Banks		
d.	Claims on Bank for International Settlements, International Monetary Fund and European Central Bank		0
e.	Claims on Multilateral Development Banks (MDBs)		
	i) IBRD , IFC, ADB, AfDB, EBRD, IADB, EIB, EIF, NIB, CDB, IDB, CEDB		0
	ii) Other MDBs	1	20
		2,3	50
		4,5	100
		6	150
		Unrated	50
f.	Claims on public sector entities (excluding equity exposure)	1	20
		2,3	50
		4,5	100
		6	150
		Unrated	50
g.	Claims on Banks and NBFIs (denominated in domestic as well as foreign currency)		
		i) Original maturity over 3 months	
		1	20
		2,3	50
		4,5	100
		6	150
		Unrated	100
	ii) Original maturity up to 3 months		20
h.	Claims on Corporate (excluding equity exposures)	1	20
		2	50
		3, 4	100
		5, 6	150
		Unrated	125

<sup>11</sup> Guidelines on RBCA (Page-12)

Sl.	Exposure Type	Risk Weight (%)
Fixed Risk Weight Groups:		
i	Claims categorized as retail portfolio & SME (excluding consumer finance and Staff loan)	75
j	Consumer Finance	100
k	Claims fully secured by residential property (excluding Staff loan/investment)	50
l	Claims fully secured by commercial real estate	100
m	Past Due Claims	
	The claim (other than claims secured by eligible residential property) that is past due for 90 days or more and/or impaired will attract risk weight as follows (Risk weights are to be assigned to the amount net of specific provision):	
	Where specific provisions are less than 20 percent of the outstanding amount of the past due claim ;	150
	Where specific provisions are no less than 20 percent of the outstanding amount of the past due claim.	100
	Where specific provisions are more than 50 percent of the outstanding amount of the past due claim.	50
	Claims fully secured against residential property that are past due for 90 days or more and/or impaired (gross of specific provision) -where specific provision held there-against is less than 20 percent of outstanding amount	100
	Loans and claims fully secured against residential property that are past due for 90 days or more and /or impaired (gross of specific provision) -where specific provision held there-against is more than 20 percent of outstanding amount	75
n	Capital Market Exposures	125
o	Investments in venture capital	150
p	Unlisted equity investments and regulatory capital instruments issued by other banks (other than those deducted from capital) held in banking book	125
q	Investments in premises, plant and equipment and all other fixed assets	100
r	Claims on all fixed assets under operating lease	100
s	All other assets	
	i) Claims on GoB & BB (eg. advanced income tax, reimbursement of patirakkha/shadharon shanchay patra, etc.)	0
	ii) Staff loan/Investment	20
	iii) Cash items in Process of Collection	20
	iv) Claims on Off-shore Banking Units (OBU)	100
	v) Other assets (net off specific provision, if any)	100

**Risk Weight for Short Term Exposures<sup>12</sup>**

BB's Rating Grade	S1	S2, S3	S4	S5, S6
Risk Weight (%)	20	50	100	150

**Risk Weight against ECA Score (Published by OECD)<sup>13</sup>**

ECA Score	1	2, 3	4, 5 & 6	7
Risk Weight (%)	20	50	100	150

**Credit Conversion Factor under Current Exposure Method<sup>14</sup>**

Residual Maturity	Interest rate contracts	Foreign exchange contracts	Equity
1 year or less	0.0%	1.0%	6.0%
> 1 year to 5 years	0.5%	5.0%	8.0%
>5 year	1.5%	7.5%	10.0%

**Credit Conversion Factor under Original Exposure method<sup>15</sup>**

Original maturity	Interest rate contracts	Foreign exchange contracts
1 year or less	0.5%	2.0%
> 1 year to 2 years	1.0% (i.e. 0.5%+0.5%)	5.0% (i.e. 2% + 3%)
For each additional year	1.0%	3.0%

<sup>12</sup> Guidelines on RBCA (Page-14)<sup>13</sup> Guidelines on RBCA (Page-14)<sup>14</sup> Guidelines on RBCA (Page-15)<sup>15</sup> Guidelines on RBCA (Page-16)

**Credit Conversion Factor for Non-market-related OBS transactions<sup>16</sup>**

Nature of transaction	CCF
<p><u>Direct credit substitutes</u></p> <p>Any irrevocable off-balance sheet obligation which carries the same credit risk as a direct extension of credit, such as an undertaking to make a payment to a third party in the event that a counterparty fails to meet a financial obligation or an undertaking to a counterparty to acquire a potential claim on another party in the event of default by that party, constitutes a direct credit substitute (i.e. the risk of loss depends on the creditworthiness of the counterparty or the party against whom a potential claim is acquired).</p> <p>This includes potential credit exposures arising from the issue of guarantees and credit derivatives (selling credit protection), confirmation of letters of credit, issue of standby letters of credit serving as financial guarantees for loans, securities and any other financial liabilities, and bills endorsed under bill endorsement lines (but which are not accepted by, or have the prior endorsement of, another bank).</p>	100 %
<p><u>Performance-related contingencies</u></p> <p>Contingent liabilities, which involve an irrevocable obligation to pay a third party in the event that counterparty fails to fulfill or perform a contractual non-monetary obligation, such as delivery of goods by a specified date etc (i.e. the risk of loss depends on a future event which need not necessarily be related to the creditworthiness of the counterparty involved). This includes issue of performance bonds, bid bonds, warranties, indemnities, and standby letters of credit in relation to a non-monetary obligation of counterparty under a particular transaction.</p>	50%
<p><u>Short-term self-liquidating trade letters of credit</u> arising from the movement of goods (e.g. documentary credits collateralized by the underlying shipment), for both issuing and confirming banks.</p>	20 %
<p><u>Lending of securities or posting of securities as collateral</u></p> <p>The lending or posting of securities as collateral by banks. This includes repurchase/ reverse repurchase agreements and securities lending/ borrowing transaction.</p>	100 %
<p><u>Commitments with certain drawdown</u></p>	100 %
<p><u>Other commitments</u></p> <p>(a) Commitments (e.g. undrawn formal standby facilities and credit lines) with an original maturity of:</p> <p>(i) one year or less.</p> <p>(ii) over one year.</p> <p>(b) Commitments that can be unconditionally cancelled at any time without notice or effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness.</p>	<p>20 %</p> <p>50%</p> <p>0%</p>

<sup>16</sup> Guidelines on RBCA (Page-17)

**ANNEXURE-II****Capital charge weight for specific risk<sup>17</sup>**

Categories	BB rating grade	Particulars	Capital Charge Weight (%)
Government	--	--	0
Government (Other than Domestic Currency)	1		0
	2, 3	Residual term to final maturity 6 months or less	0.25
		Residual term to final maturity greater than 6 and up to and including 24 months	1
		Residual term to final maturity exceeding 24 months	1.60
	4, 5	--	10
	6	--	12
	Unrated	--	10
Qualifying	--	Residual term to final maturity 6 months or less	0.25
		Residual term to final maturity greater than 6 and up to and including 24 months	1
		Residual term to final maturity exceeding 24 months	1.60
Other	1	--	2
	2, 3	--	6
	4	--	10
	Below 4	--	12
	Unrated	--	10

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<sup>17</sup> Guidelines on RBCA (Page-27)



**Calculation of general market risk<sup>18</sup>**

a) Net weighted position	100% of Net short or long weighted position	100%
b) Vertical disallowances	Sum of 10% of Matched weighted positions in each time bands	10%
c) Horizontal disallowances	Matched weighted position within Time Zone 1	40%
	Matched weighted position within Time Zone 2	30%
	Matched weighted position within Time Zone 3	30%
	Matched weighted position between Time zone 1 & 2	40%
	Matched weighted position between Time zone 2 & 3	40%
	Matched weighted position between Time zone 1 & 3	100%
Total Capital Charge (a+ b + c) :		

**Calculation of Capital Charge for Operational Risk<sup>19</sup>**

The following formula is used for calculating capital charge against operational risk:

$$K = [(GI_1 + GI_2 + GI_3) \times \alpha] / n$$

where,

K = capital charge under the Basic Indicator Approach

GI = only positive annual gross income over the previous three years (i.e. negative or zero gross income if any shall be excluded)

$\alpha$  = 15%

n = number of the previous three years for which gross income is positive.

<sup>18</sup> Guidelines on RBCA (Page-31)

<sup>19</sup> Guidelines on RBCA (Page-35)

**ANNEXURE-III****ECAI's Credit Rating Categories Mapped with BB Rating Grade<sup>20</sup>**

BB Rating Grade	Equivalent Rating of S&P and Fitch	Equivalent Rating of Moody	Equivalent Rating of CRISL	Equivalent Rating of CRAB	Equivalent Rating of NCRL	Equivalent Rating of ECRL
1	AAA to AA	Aaa to Aa	AAA, AA+, AA-	AAA, AA1, AA2, AA3	AAA, AA+, AA, AA-	AAA, AA+, AA, AA-
2	A	A	A+, A, A-	A1, A2, A3	A+, A, A-	A+, A, A-
3	BBB	Baa	BBB+, BBB, BBB-	BBB1, BBB2, BBB3	BBB+, BBB, BBB-	BBB+, BBB, BBB-
4	BB to B	Ba to B	BB+, BB, BB-	BB1, BB2, BB3	BB+, BB, BB-	BB+, BB, BB-
5	Below B	Below B	B+, B, B-, CCC+, CCC, CCC-, CC+, CC, CC-	B1, B2, B3, CCC1, CCC2, CCC3, CC	B+, B, B-	B+, B, B-
6			C+, C, C-, D	C, D		
<b>Short-Term Rating Category Mapping</b>						
S1	F1+	P1	ST-1	ST-1	N1	ECRL-1
S2	F1	P2	ST-2	ST-2	N2	ECRL-2
S3	F2	P3	ST-3	ST-3	N3	ECRL-3
S4	F3	NP	ST-4	ST-4	N4	ECRL-4
S5,S6	B,C, D		ST-5, ST-6	ST-5, ST-6	N5	D

<sup>20</sup> Guidelines on RBCA (Page-10)

## POLICY ON LOAN CLASSIFICATION AND PROVISIONING<sup>21</sup>

The process of gradually upgrading the policies on loan classification and provisioning to the international level is going on. Measures have been taken to strengthen the credit discipline and the process of classification has been simplified. The following revised policies on loan classification and provisioning has been issued amending the previous circulars in this regard: -

### 1. Categories of Loans:

All loans and advances will be grouped into 4(four) categories for the purpose of classification, namely-

1.1 *Continuous Loan:* The loan Accounts in which transactions may be made within certain limit and have an expiry date for full adjustment will be treated as Continuous Loans. Examples are: CC, OD etc.

1.2 *Demand Loan:* The loans that become repayable on demand by the bank will be treated as Demand Loans. If any contingent or any other liabilities are turned to forced loans (i.e. without any prior approval as regular loan) those too will be treated as Demand Loans. Such as: Forced LIM, PAD, FBP, and IBP etc.

1.3 *Fixed Term Loan:* The loans, which are repayable within a specific time period under a specific repayment schedule will be treated as Fixed Term Loans.

1.4 *Short-term Agricultural Credit:* This will include the short-term credits as listed under the Annual Credit Program issued by the Agricultural Credit Department of Bangladesh Bank. Credits in the agricultural sector repayable within less than 12 months will also be included herein. Short-term Micro-Credits will include any micro-credits for less than Tk.25,000/= and repayable within less than 12 months, be those termed in any names such as Non-agricultural credit, Self-reliant Credit, Weaver's Credit or Bank's individual project credit.

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<sup>21</sup> BRPD Circular No. 05 dated June 05, 2006

## 2. **Basis for Loan Classification:**

### 2.1. Objective Criteria:

2.1.1. Any Continuous Loan if not repaid/renewed within the fixed expiry date for repayment will be treated as past due/overdue from the following day of the expiry date. This loan will be classified as Sub-standard if it remains past due/overdue for 6 months or beyond but less than 9 months, as 'Doubtful' if for 9 months or beyond but less than 12 months and as 'Bad-Debt' if for 12 months or beyond.

2.1.2. Any Demand Loan if not repaid/rescheduled within the fixed expiry date for repayment will be treated as past due/overdue from the following day of the expiry date. This Loan will be classified as Sub-standard if it remains past due/overdue for 6 months or beyond but not over 9 months from the date of claim by the bank or from the date of creation of the forced loan; likewise the loan will be classified as "Doubtful" and Bad/loss if remains past due/overdue for 9 months or beyond but not over 12 months and for 12 months and beyond respectively.

2.1.3. In case any installment(s) or part of installment(s) of a Fixed Term Loan is not repaid within the due date, the amount of unpaid installment(s) will be termed as 'defaulted installment'-

2.1.3.1. In case of Fixed Term Loans, which are repayable within maximum five years of time: -

- ❖ If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 6 months, the entire loan will be classified as 'Sub-standard'.

- ❖ If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 12 months, the entire loan will be classified as "Doubtful.

- ❖ If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 18 months, the entire loan will be classified as "Bad -Loss."

2.1.3.2. In case of Fixed Term Loans, which are repayable in more than five years of time: -

- ❖ If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 12 months, the entire loan will be classified as 'Sub-standard.'

- ❖ If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 18 months, the entire loan will be classified as 'Doubtful'.

❖ If the amount of 'defaulted installment 'is equal to or more than the amount of installment(s) due within 24 months, the entire loan will be classified as 'Bad-Debt'.

2.1.3.3. Explanation: If any Fixed Term Loan is repayable at monthly installment, the amount of installment(s) due within 6 months will be equal to the amount of summation of 6 monthly installments. Similarly, if repayable at quarterly installment, the amount of installment(s) due within 6 months will be equal to the amount of summation of 2 quarterly installments.

2.1.4. The Short-term Agricultural and Micro - Credit will be considered irregular if not repaid within the due date as stipulated in the loan agreement. If the said irregular status continues, the credit will be classified as 'Substandard ' after a period of 12 months, as 'Doubtful' after a period of 36 months and as 'Bad Debt' after a period of 60 months from the stipulated due date as per loan agreement.

2.1.5. All unclassified loans other than **Special Mention Account (SMA)** will be treated as Standard.

2.1.6. A Continuous credit, Demand loan or a Term Loan which will remain overdue for a period of 90 days or more, will be put into the "**Special Mention Account (SMA)**". This will help banks to look at accounts with potential problems in a focused manner and it will capture early warning signals for accounts showing first sign of weakness. Loans in the "Special Mention Account (SMA)" will have to be reported to the Credit Information Bureau (CIB) of Bangladesh Bank. However, it is reiterated that loans in the "**Special Mention Account**" will not be treated as defaulted loan for the purpose of section 27KaKa(3) of the Bank Company Act, 1991.

## 2.2. (B). Qualitative Judgment:

2.2.1. If any uncertainty or doubt arises in respect of recovery of any Continuous Loan, Demand Loan or Fixed Term Loan, the same will have to be classified on the basis of qualitative judgment be it classifiable or not on the basis of objective criteria.

2.2.2. If any situational changes occur in the stipulations in terms of which the loan was extended or if the capital of the borrower is impaired due to adverse conditions or if the value of the securities decreases or if the recovery of the loan becomes uncertain due to any other unfavorable situation, the loan will have to be classified on the basis of qualitative judgment.

2.2.3. Besides, if any loan is illogically or repeatedly re-scheduled or the norms of re-scheduling are violated or instances of (propensity to) frequently exceeding the loan-limit are

noticed or legal action is lodged for recovery of the loan or the loan is extended without the approval of the proper authority, it will have to be classified on the basis of qualitative judgment.

2.2.4. Despite the probability of any loan's being affected due to the reasons stated above or for any other reasons, if there exists any hope for change of the existing condition by resorting to proper steps, the loan, on the basis of qualitative judgment, will be classified as 'Sub-standard'. But even if after resorting to proper steps, there exists no certainty of total recovery of the loan, it will be classified as 'Doubtful' and even after exerting the all-out effort, there exists no chance of recovery, it will be classified as 'Bad-Debt' on the basis of qualitative judgment.

2.2.5. The concerned bank will classify on the basis of qualitative judgment and can declassify the loans if qualitative improvement does occur.

2.2.6. But if any loan is classified by the Inspection Team of Bangladesh Bank, the same can be declassified with the approval of the Board of Directors of the bank. However, before placing such case to the Board, the CEO and concerned branch manager shall have to certify that the conditions for declassification have been fulfilled.

### **3. Accounting of the interest of classified loans:**

3.1. If any loan or advance is classified as 'Sub-standard' and 'Doubtful', interest accrued on such loan will be credited to Interest Suspense Account, instead of crediting the same to Income Account. In case of rescheduled loans the unrealized interest, if any, will be credited to Interest Suspense Account, instead of crediting the same to Income Account.

3.2. As soon as any loan or advance is classified as 'Bad Debt', charging of interest in the same account will cease. In case of filing a law-suit for recovery of such loan, interest for the period till filing of the suit can be charged in the loan account in order to file the same for the amount of principal plus interest. But interest thus charged in the loan account has to be preserved in the 'Interest Suspense' account. If any interest is charged in any 'Bad-Debt' account for any other special reason, the same will be preserved in the 'Interest Suspense' account.

3.3. If classified loan or part of it is recovered i.e., real deposit is effected in the loan account, first the interest charged and not charged is to be recovered from the said deposit and the principal to be adjusted afterwards.

3.4. Interest accrued on "**Special Mention Account (SMA)**" will be credited to Interest Suspense Account, instead of crediting the same to Income Account.

#### 4. **Maintenance of provision:**

4.1. Banks will be required to maintain General Provision in the following way:

4.1.1. @ 1% against all unclassified loans (other than- (i) loans under Consumer Financing, (ii) loans against shares etc. and (iii) Special Mention Account.)<sup>22</sup>

4.1.2. @ 5% on the unclassified amount for Consumer Financing whereas it has to be maintained @ 2% on the unclassified amount for (i) Housing Finance and (ii) Loans for Professionals to set up business under Consumer Financing Scheme.

4.1.3. @ 2% against unclassified amount of any kind of funded loan disbursed to stock dealers enlisted with Stock Exchange, separate subsidiary company established by a bank company for dealing business in share brokerage and merchant banking and any other company or institution or individual for dealing such business.

4.1.4. @ 5% on the outstanding amount of loans kept in the 'Special Mention Account' after netting off the amount of Interest Suspense.

4.2. Banks will maintain provision at the following rates in respect of classified Continuous, Demand and Fixed Term Loans:

4.2.1. Sub-standard	20%
4.2.2. Doubtful	50%
4.2.3. Bad/Loss	100%

4.3. Provision in respect of Short-term Agricultural and Micro-Credits is to be maintained at the following rates:

4.3.1. All credits except 'Bad/Loss'(i.e. 'Doubtful', 'Sub-standard', irregular and regular credit accounts)	: 5%
4.3.2. 'Bad/Loss'	: 100%

<sup>22</sup> Considering the scope for further contribution of SMEs to the economy of Bangladesh and in order to boost up financing to the Small and Medium Enterprises (SMEs) sector, banks are required to maintain 1% General provision instead of 2% against unclassified loan amount for SMEs. Also, the word stipulated as Small Enterprise Financing (SEFs) has been renamed Small and Medium Enterprise Financing (SMEF) effecting from June 30, 2008. (Ref. BRPD Circular #05 dated April 29, 2008).

4.4. Banks are required to maintain general provision against Off-balance sheet exposures in the following manner:

4.3.3. @ 0.5% provision effective from December 31, 2007 and

4.3.4. @ 1% provision effective from December 31, 2008 .

#### **5. Base for Provision:**

Provision will be maintained at the above rate on the balance to be ascertained by deducting the amount of 'Interest Suspense' and value of eligible securities from the outstanding balance of classified accounts.

#### **6. Eligible Securities:**

In the definition of 'Eligible Securities' as mentioned in the above paragraph the following securities will be included as eligible securities in determining base for provision:

- 100% of deposit under lien against the loan,
- 100% of the value of government bond/savings certificate under lien,
- 100% of the value of guarantee given by Government or Bangladesh Bank,
- 100% of the market value of gold or gold ornaments pledged with the bank,
- 50% of the market value of easily marketable commodities kept under control of the bank,
- Maximum 50% of the market value of land and building mortgaged with the bank,
- 50% of the average market value for last 06 months or 50% of the face value, whichever is less, of the shares traded in stock exchange.

#### **7. Determination of Market Value of Eligible Securities:**

In determining market value of easily marketable commodities, land and building, banks are advised to follow the instructions mentioned below:

7.1. Easily marketable goods will mean pledged, easily encashable/saleable goods that remain under full control of the bank. However, while the concerned bank branch official will conduct



periodic inspection to verify as to whether issues such as the suitability of goods for use, expiry period, appropriateness of documentary evidences, up to date insurance cover, same will have to be assessed by the professional assessor from time to time.

7.2. For land and building, banks will have to ensure whether title documents are in order and concerned land and building will have to be valued by the professional valuation firm along with completion of proper documentation in favour of the bank. In absence of professional valuation firm, certificate in favour of such valuation will have to be collected from the specialized engineer. Nevertheless, temporary houses including tin-shed structure shall not be shown as building.

7.3. In order to facilitate the on-site inspection by Departments of Bank Inspection of Bangladesh Bank, banks are also advised to maintain complete statement of eligible securities on a separate sheet in the concerned loan file. Information such as description of eligible securities, their assessment by recognized firm, marketability of the commodity, control of the bank, and reasons for considering eligible securities etc. will have to be included in that sheet.

In terms of the above policies, the banks will conduct their classification- activities on quarterly basis. Detailed statements in respect of classification, provision and 'Interest suspense' accounts will have to be submitted to Bangladesh Bank within 30 days from the reference date.

## **POLICY ON SINGLE BORROWER EXPOSURE** <sup>23</sup>

As a prudential measure intended for ensuring improved risk management through restriction on credit concentration, Bangladesh Bank has from time to time advised the scheduled banks in Bangladesh to fix limits on their large credit exposures and their exposures to single and group borrowers.

In general, and as practiced internationally, exposure ceiling is derived from a bank's total capital as defined under capital adequacy standards (Tier I and Tier II Capital). Following the same practice, Bangladesh Bank issued BRPD Circular No. 08 dated March 18, 2003, recommending uniform exposure limits for both local and foreign banks. In order to enable the banks to improve their credit risk management further, Bangladesh Bank has issued this circular by consolidating all the instructions issued so far and incorporating some amendments to the previous circular.

### **1. In general case, single borrower exposure limit is 35%**

1.1. The total outstanding financing facilities by a bank to any single person or enterprise or organization of a group shall not at any point of time exceed 35% of the bank's total capital subject to the condition that the maximum outstanding against fund based financing facilities (funded facilities) do not exceed 15% of the total capital. In this case total capital shall mean the capital held by banks as per section-13 of the Bank Company Act, 1991.

1.2. Non-funded credit facilities, e.g. letter of credit, guarantee etc. be provided to a single large borrower. But under no circumstances, the total amount of the funded and non-funded credit facilities shall exceed 35% of a bank's total capital.

### **2. In case of export sector, single borrower exposure limit is 50%**

In case of export sector single borrower exposure limit shall remain unchanged at 50% of the bank's total capital. But funded facilities in case of export credit shall also not exceed 15% of the total capital.

<sup>23</sup> BRPD Circular No. 05, dated April 09, 2005

### 3. **Additional prudential norms:**

3.1. Loan sanctioned to any individual or enterprise or any organization of a group amounting to 10% or more of a bank's total capital shall be considered as large loan.

3.2. The banks will be able to sanction large loans as per the following limits set against their respective classified loans :

Rate of net classified loans	The highest rate fixed for large loan against bank's total loans & advances
Upto 5%	56%
More than 5% but upto 10%	52%
More than 10% but upto 15%	48%
More than 15% but upto 20%	44%
More than 20%	40%

3.3. In order to determine the above maximum rates of large loans, all non-funded credit facilities e.g. letter of credit, guarantee etc. included in the loan shall be considered as 50% credit equivalent. However, the entire amount of non-funded credit facilities shall be included in determining the total credit facilities provided to an individual or enterprises or an organization of a group.

3.4. A public limited company, which has 50% or more public shareholdings, shall not be considered as an enterprise/organization of any group.

3.5. In the cases of credit facilities provided against government guarantees and AAA rated Multilateral Development Banks (MDBs) guarantee, the aforementioned restrictions shall not be applicable.<sup>24</sup>

3.6. In the cases of loans backed by cash and encashable securities (e.g.FDR), the actual lending facilities shall be determined by deducting the amount of such securities from the outstanding balance of the loans.

3.7. Banks should collect the large loan information on their borrowers form Credit Information Bureau (CIB) of Bangladesh Bank before sanctioning, renewing or rescheduling large loans in order to ensure that credit facilities are not being provided to defaulters.

<sup>24</sup> BRPD Circular No.02, dated February 19, 2007

3.8. Banks must perform Lending Risk Analysis (LRA) before sanctioning or renewing large loans. If the rating of an LRA turns out to be "marginal", a bank shall not sanction the large loan, but it can consider renewal of an existing large loan taking into account other favorable conditions and factors. However if the result of an LRA is unsatisfactory, neither sanction nor renewal of large loans can be considered.

3.9. While sanctioning or renewing of large loan, a bank should judge its borrowers overall debt repayment capacity taking into consideration the borrower's liabilities with other banks and financial institutions. A banks shall examine is borrower's Cash Flow Statement, Audited Balance Sheet, Income Statement and other financial statements to make sure that its borrower has the ability to repay the loan.

3.10. Sanctioning, renewing or rescheduling of large loans should be approved by the Board of Directors in case of local banks. Such decisions should be taken by the Chief Executives in case of foreign banks. However, while approving proposals of large loans, among other things, compliance with the above guidelines must be ensured.

3.11. Considering power sector development as a government priority it has been decided that Single Borrower Exposure will not be applicable for the banks financing in order to produce and distribute electricity against the award provided by the Electricity Department or the institutions controlled by the said department. (such as- BPDB, REB, PGCB, EGCB, DPDC, DESCO, APSCL, WZPDCO, NWZPGC).<sup>25</sup>

3.12. Banks shall submit the monthly statement of large loan in the specified format (Form-L) to Department of Off-site Supervision of Bangladesh Bank within 10 days after the end of respective month.

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<sup>25</sup> BRPD Circular No. 22 dated June 14, 2010

## **POLICY FOR RESCHEDULING OF LOANS<sup>26</sup>**

Experience shows that the existing system of loan rescheduling has created impediments in the way of realizing defaulted loans. Specially, a tendency has been observed among the defaulted borrowers to avail the opportunity of loan rescheduling again and again without any definite business rationale. Some confusions have also cropped up relating to the condition of cash deposit as down payment for loan rescheduling. After careful and overall review of the aforesaid problems and in suppression of all previous instructions<sup>27</sup> the following detailed policies for rescheduling of loans are being issued for compliance by banks:

### **1. Guidelines for Consideration of Loan Rescheduling Applications:**

While considering loan rescheduling application the banks shall follow the under mentioned guidelines:

1.1 When a borrower asks for rescheduling of loans the banks shall examine the causes as to why the loan has become non-performing. If it is found from such review that the borrower has diverted the funds elsewhere or the borrower is a habitual loan defaulter the bank shall not consider the application for loan rescheduling. Instead, the bank shall take/continue all legal steps for recovery of the loans.

1.2 At the time of considering loan rescheduling proposal bank must assess the borrower's overall repayment capacity taking into account the borrower's liability position with other banks.

1.3 In order to ensure whether the borrower would be able to repay the rescheduled installments/existing liability the bank shall review the borrower's cash flow statement, audited balance sheet, income statement and other financial statements.

1.4 Bank officers should ensure, if required, by spot inspection of the borrower's company/business place, that the concerned company/business enterprise will be able to generate surplus to repay the rescheduled liability. Such inspection reports should be preserved by the banks.

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<sup>26</sup> BRPD Circular No. 01 dated January 13, 2003

<sup>27</sup> BCD Circular No. 18 dated December 11, 1995

1.5 If a bank is satisfied after due diligence mentioned above that the borrower will be able to repay, the loan may be rescheduled. Otherwise, bank shall take all legal steps to realize the loan, make necessary provision and take measures to write-off.

1.6 The rescheduling shall be for a minimum reasonable period of time.

1.7 At the time of placing the rescheduling proposal before the Board of Directors the Bank shall apprise the Board in details, what would be implications of such loan rescheduling on the income and other areas of the bank.

## **2. Rescheduling of Term Loans:**

The loans which are repayable within a specific time period under a prescribed repayment schedule are treated as Term Loans. For rescheduling such loans following policies shall, henceforth, be followed:

2.1 Application for first rescheduling will be considered only after cash payment of at least 15% of the overdue installments or 10% of the total outstanding amount of loan, whichever, is less;

2.2 Rescheduling application for the second time will be considered after cash payment of minimum 30% of the overdue installments or 20% of the total outstanding amount of loan, whichever, is less;

2.3 Application for rescheduling for more than two times will be considered after cash payment of minimum 50% of the overdue installments or 30% of the total outstanding amount of loan, whichever is less;

2.4 *Explanation:* If any loan is rescheduled once before issuance of this policy the conditions set forth in this circular for second rescheduling shall be applicable for rescheduling of such loans. Likewise, the terms for 3rd rescheduling as per this circular shall be applicable for rescheduling of any loan which has already been rescheduled twice.

## **3. Rescheduling of Demand and Continuous Loan:**

The loans which can be transacted without any specific repayment schedule but have an expiry date for repayment and a limit are treated as Continuous Loan. In addition, the loans which become repayable after those are claimed by the bank, are treated as Demand Loans. If any contingent or any other liabilities are turned to forced loan (i.e. without any prior approval as

regular loan) those also are treated as Demand Loans. For rescheduling of Demand and Continuous Loans the rates of down payment, depending on the loan amount, shall be as under:

Amount of Overdue Loan	Rates of Down payment
Up to Tk.1.00 (one) crore	15%
Tk. 1.00(one) crore to Tk. 5.00 (five) crore	10% (but not less than Tk.15.00 lac)
Tk. 5.00(five) crore and above	5% (but not less than Tk.50.00 lac)

If any Continuous or Demand Loan is rescheduled by restructuring/converting partly or wholly into Term Loan and repayment installments have been fixed, application for rescheduling such loans shall be considered on cash payment of minimum 30% of the overdue installments or 20% of the total outstanding amount of loan, whichever is less. For subsequent rescheduling minimum 50% of the overdue installments or 30% of the total outstanding amount of loan amount shall have to be deposited in cash.

#### **4. Other Terms and Conditions of Rescheduling:**

The Borrowers<sup>28</sup> whose credit facility has been rescheduled will get new loan facility subject to fulfillment of the following conditions:-

4.1. The defaulting borrower who has availed interest waiver must settle at least 15% of the compromise amount (excluding the down payment on rescheduling as per present guidelines) to avail any further credit facility from any Bank.

4.2. In case of borrowing from other Banks, the same rule will be applicable, i.e. the borrower will have to settle at least 15% of compromise amount (excluding the down payment on rescheduling as per present guidelines), then, will be allowed to take regular facility from other Banks subject to the submission of NOC (No Objection Certificate) from the rescheduling bank.

4.3. Export borrowers may be granted further credit facility (after being identified as not a wilful defaulter), if required, subject to settle at least 7.5% of the compromise amount (excluding the down payment on rescheduling as per present guidelines) being paid.

4.4. If any such issue is already there (such fresh facility has already been allowed after allowing waiver), the same will not fall under purview of this circular.

<sup>28</sup> BRPD Circular No. 02 dated February 14, 2006 & BRPD Circular No. 03 dated March 19, 2006

4.5. Information on the loan accounts rescheduled shall be reported to the Credit Information Bureau (CIB) of Bangladesh Bank. While reporting to the CIB, such rescheduled loans/advances may be shown as RS 1 for first rescheduling, RS 2 for second and so on. Interest waivers given to the entity should be mentioned as RSIW.

Where the amount equal to minimum twice the amount of principal loan disbursed has been repaid till the date of issuance of this policy, the instructions contained in this circular shall not be mandatory for rescheduling of such loan for 1(one) year from the date of this circular.

For rescheduling as above no prior approval of Bangladesh Bank will be required; however, prior approval of Bangladesh Bank shall have to be obtained if the loan is related to the director/ex-directors of a Bank Company.



## POLICY FOR LOAN WRITE OFF<sup>29</sup>

In course of conducting credit operations by banks the quality of a portion of their loan portfolio, in many cases, deteriorates and uncertainty arises in realizing such loans and advances. These loans are adversely classified as per existing rules and necessary provision has to be made against such loans. Writing off bad loans having adequate provision is an internationally accepted normal phenomenon in banking business. Owing to the reluctance of banks in Bangladesh in resorting to this system their balance sheets are becoming unnecessarily and artificially inflated. In order to avoid possible legal complications in retaining the claims of the banks over the loans written off section 28 ka has been incorporated in 2001 in the Bank Company Act, 1991. In this context the following policies for writing off loans are being issued for compliance by banks:

- Banks may, at any time, write off loans classified as bad/loss. Those loans which have been classified as bad/loss for the last five years and for which 100% provisions have been kept should be written off without delay. After issuance of this circular the process of writing off all other loans classified as bad/loss should be started immediately. Under the process the oldest bad/loss classified loans should be considered first for written off.
- Banks may write off loans by debit to their current year's income account where 100% provision kept is not found adequate for writing off such loans.
- All out efforts should be continued for realizing written off loans. Cases must be filed in the court of law before writing off any loan for which no legal action has been initiated earlier.
- A separate "Debt Collection Unit" should be set up in the bank for recovery of written off loans.
- In order to accelerate the settlement of law suits filed against the written off loans or to realize the receivable written off loans any agency outside the bank can be engaged.
- A separate ledger must be maintained for written off loans and in the Annual Report/Balance Sheet of banks there must be a separate "notes to the accounts" containing amount of cumulative and current year's loan written off.

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<sup>29</sup> BRPD Circular No. 02 dated January 13, 2003

➤ In spite of writing off the loans the concerned borrower shall be identified as defaulter as usual. Like other loans and advances, the writing off loans and advances shall be reported to the Credit Information Bureau (CIB) of Bangladesh Bank.

➤ Prior approval of Bangladesh Bank shall have to be obtained in case of writing off loans sanctioned to the director or ex-director of the bank or loans sanctioned during the tenure of his directorship in the bank to the enterprise in which the concerned director has interest (as per explanation contained in section 27(2) of the Bank Company Act, 1991).

## INTEREST RATES ON DEPOSIT AND LENDING

Banks in general are free to charge/fix their deposit and lending rate. However, the maximum cap of 7% interest rate on export credit has been fixed since January 10, 2004<sup>30</sup> by Bangladesh Bank to facilitate export earnings. The maximum rate of interest on agriculture and term loans to industrial sector is 13%. The maximum rate of interest on import financing of rice, wheat, edible oil (crude and refined), pulse, gram, onions, dates and sugar (refined & raw sugar/raw cane sugar) is in force at 12%. The key features of interest rate on deposit and lending are as follows:

- In case of Fixed Term Loan and Continuous Loan, interest will be calculated on the basis of the product of the day end balance but interest must be charged on quarterly basis.
- Banks are allowed to charge penal interest.
- The loan accounts under the Prudential Guidelines for Consumer Financing and Small Enterprise Financing will be repaid according to Equal Monthly Installment (EMI) method.
- Banks have been advised not to pay/charge any interest beyond their announced rate of interest on deposit and lending as per existing interest rate policy.
- No additional charges shall be collected along with the rate of interest/profit on loans other than the announced Schedule of Charges.
- Banks are allowed to differentiate interest rate up to a maximum of 3% considering comparative risk elements involved among borrowers in same lending category. With progressive deregulation of interest rates, banks have been advised to announce the mid-rate of the limit (if any) for different sectors and they may change interest 1.5% more or less than the announced mid-rate on the basis of the comparative credit risk.
- In cases where the maximum interest rate has been fixed by Bangladesh Bank, Banks shall report their own maximum cap. Banks have also been advised to upload their deposit and lending interest rate on their respective website and display the same in all of their head offices and branches where it can be easily visible.

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<sup>30</sup> BRPD Circular No. 01 dated January 10, 2004

## OPERATION OF SPECIAL NOTICE DEPOSIT (SND) ACCOUNT

Banks have been advised to comply with the following rules with a view to removing ambiguity and ensuring uniformity in the operation of (SND) account<sup>31</sup>:

1. All the accounts like Short Term Deposit/SND/Call Accounts shall only be termed as Special Notice Deposit (SND) account.

2. Minimum 7 days prior notice from the depositor will be required to withdraw money from the SND account.

3. Cheque book must be issued against this account to facilitate direct withdrawal.

4. Interest on the SND account will be calculated on the day end balance and accumulated interest will be credited to the same account on a half yearly basis/at the time of closing the account.

5. As this account doesn't have any fixed term, rate of interest may only vary for different amount/range of deposits. However, banks shall not differentiate rate of interest among the customers belong to same range.

6. No minimum balance fee/ incidental charge/ ledger fee/ service charge can be imposed on this account. Only account maintenance fee and account closing charge at the time of closing the account can be imposed. No charge above Taka Five Hundred as account maintenance fee on six monthly basis and no charge above Taka three hundred as account closing charge at the time of closing the account can be imposed.

7. Rate of interest for SND account has to be declared in ranges- (a) Less than 1 crore, (b) 1 crore and above but less than 25 crore, (c) 25 crore and above but less than 50 crore, (d) 50 crore and above but less than 100 crore, (e) 100 crore and above.

8. No rate of interest beyond published/announced rate can be offered.

9. Banks shall upload published/offered rate of interests on their respective websites and must submit the returns in the revised BR-15 format on a monthly basis within 7 days of the respective month.

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<sup>31</sup> BRPD Circular No. 20 dated May 16, 2010

## BANK CHARGES

Banks in general are free to fix the fees and commissions relating to the services offered by them to their customers. In applying the fees there should be no discriminations among customers for similar services. In other words, all customers are required to be treated at par for similar services.

Bangladesh Bank has issued master circular incorporating necessary instructions for rationalization of different service charges received by banks. Banks have also been advised to upload the schedule of charges in their respective websites and display the same in all of their head offices and branches, for ready reference of the clients<sup>32</sup>.

Considering the interest of small depositors it has been decided that no charge can be imposed as account maintenance fee for average deposit balance up to Taka Five Thousand (BDT 5,000/-). It has also been decided that Taka One Hundred (BDT. 100/-) at maximum may be imposed as account maintenance fee on six monthly basis for average deposit balance up to Taka Twenty Five Thousand (BDT 25,000/-)<sup>33</sup>. Taka Three Hundred (BDT. 300/-) at maximum may be imposed as account maintenance fee on six monthly basis for average deposit balance above Taka Twenty Five Thousand (BDT 25,000/-)<sup>34</sup>.

No additional service charge can be imposed on any type of loans including Export Credit since interest and service charge are included in the Rate of Interest on loans<sup>35</sup>.

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<sup>32</sup> BRPD Circular No. 19 dated December 21, 2009

<sup>33</sup> BRPD Circular No. 19 dated May 13, 2010

<sup>34</sup> BRPD Circular No. 19 dated December 21, 2009

<sup>35</sup> BRPD Circular No. 19 dated May 13, 2010

## **GUIDELINES ON MANAGING CORE RISKS IN BANKING**

Due to deregulation and globalization of banking business, banks are now exposed to diversified and complex risks. As a result, effective management of such risks has been core aspects of establishing good governance in banking business in order to ensure sustainable performance. In recognition of the importance of an effective risk management system, Guidelines on Managing Core Risks in banking has been issued in 2003 and the five core risks that have been advised to manage in these guidelines are: a) Credit Risks, b) Asset and Liability/Balance Sheet Risks, c) Foreign Exchange Risks, d) Internal Control and Compliance Risks and e) Money Laundering Risks<sup>36</sup>. A document (interpretation to measure risks using Gap Analysis) has been issued for the banks which may help banks to measure and manage their Liquidity Risk, Interest Risk and Foreign exchange risk and minimize their losses.

Guidelines on Information & Communication Technology for Scheduled Banks has been introduced to manage another core risk for the banks to take adequate measures to prevent the information from unauthorized access, modification, disclosure and destruction so that customers' interest is fully protected<sup>37</sup>. This guideline has recently been updated and renamed as Guideline on ICT Security for Banks and Financial Institutions, 2010<sup>38</sup>.

## **GUIDELINES ON ENVIRONMENTAL RISK MANAGEMENT (ERM)**

A detailed guideline on Environmental Risk Management has been introduced to assess Environmental Risk along with the Credit Risk for an overall credit rating prior to disbursement of loan/credit facility<sup>39</sup>.

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<sup>36</sup> BRPD Circular No. 17 dated October 07, 2003

<sup>37</sup> BRPD Circular No. 14 dated October 23, 2005

<sup>38</sup> BRPD Circular No. 21 dated May 20, 2010

<sup>39</sup> BRPD Circular No. 01 dated January 30, 2011

**CORPORATE GOVERNANCE IN BANK MANAGEMENT**<sup>40</sup>

Board of directors and management of a bank should comprise of the competent and professionally skilled persons with a view to ensuring good and corporate governance in the bank management. It is also inevitable to have specific demarcation of responsibilities and authorities between these controlling bodies over bank's affairs. In absence of specific division of responsibilities and authorities, even in spite of these bodies' being formed with skilled and efficient persons, the desired goals of an institution cannot be achieved due to lack of transparency and accountability of all concerned. Such kind of situation is more undesirable in an institution like bank-company as it deals with huge public money and interests of the depositors.

In view of the above, rescinding the previous instructions<sup>41</sup> the specific demarcation of responsibilities and authorities among the board of directors, its chairman, Chief Executive Officer (CEO) and adviser to the private bank in respect of its overall financial, operational and administrative policymaking and executive affairs including overall business activities, internal control, human resources management and development thereof, income and expenditure etc., along with lending and risk management issues, is outlined as follows:-

**01. Responsibilities and authorities of the board of directors:****(a) Work-planning and strategic management:**

(i) The board shall determine the objectives and goals and to this end shall chalk out strategies and work-plans on annual basis. It shall specially engage itself in the affairs of making strategies consistent with the determined objectives and goals and in the issues relating to structural change and reorganization for enhancement of institutional efficiency and other relevant policy matters. It shall analyze/monitor at quarterly rests the development of implementation of the work-plans.

(ii) The board shall have its analytical review incorporated in the Annual Report as regard the success/failure in achieving the business and other targets as set out in its annual work-plan and shall apprise the shareholders of its opinions/recommendations on future plans and

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<sup>40</sup> BRPD Circular No. 16 dated July 24 2003

<sup>41</sup> BRPD Circular No. 09 dated September 17 1996

strategies. It shall set the Key Performance Indicators (KPIs) for the CEO and other senior executives and have it evaluated at times.

**(b) Lending and risk management:**

(i) The policies, strategies, procedures etc. in respect of appraisal of loan/investment proposal, sanction, disbursement, recovery, rescheduling and write-off thereof shall be made with the board's approval under the purview of the existing laws, rules and regulations. The board shall specifically distribute the power of sanction of loan/investment and such distribution should desirably be made among the CEO and his subordinate executives as much as possible. No director, however, shall interfere, directly or indirectly, into the process of loan approval.

(ii) The board shall frame policies for risk management and get them complied with and shall monitor at quarterly rests the compliance thereof.

**(c) Internal control management:**

(i) The board shall be vigilant on the internal control system of the bank in order to attain and maintain satisfactory qualitative standard of its loan/investment portfolio. It shall review at quarterly rests the reports submitted by its audit committee regarding compliance of recommendations made in internal and external audit reports and the Bangladesh Bank inspection reports.

(ii) Banks are also advised to set up complaint Cell in their Zonal Offices for prompt settlement of the complaints received.<sup>42</sup>

**(d) Human resources management and development:**

(i) Policies relating to recruitment, promotion, transfer, disciplinary and punitive measures, human resources development etc. and service rules shall be framed and approved by the board. The chairman or the directors shall in no way involve themselves or interfere into or influence over any administrative affairs including recruitment, promotion, transfer and disciplinary measures as executed under the set service rules. No member of the board of directors shall be included in the selection committees for recruitment and promotion to different levels. Recruitment and promotion to the immediate two tiers below the CEO shall, however, rest upon

<sup>42</sup> BRPD Circular letter no-11, dated 26 July,2011



the board. Such recruitment and promotion shall have to be carried out complying with the service rules i.e., policies for recruitment and promotion.

(ii) The board shall focus its special attention to the development of skills of bank's staff in different fields of its business activities including prudent appraisal of loan/investment proposals, and to the adoption of modern electronic and information technologies and the introduction of effective Management Information System (MIS). The board shall get these programs incorporated in its annual work plan.

**(e) Financial management:**

(i) The annual budget and the statutory financial statements shall finally be prepared with the approval of the board. It shall at quarterly rests review/monitor the positions in respect of bank's income, expenditure, liquidity, non-performing asset, capital base and adequacy, maintenance of loan loss provision and steps taken for recovery of defaulted loans including legal measures.

(ii) The board shall frame the policies and procedures for bank's purchase and procurement activities and shall accordingly approve the distribution of power for making such expenditures. The maximum possible delegation of such power shall rest on the CEO and his subordinates. The decision on matters relating to infrastructure development and purchase of land, building, vehicles etc. for the purpose of bank's business shall, however, be adopted with the approval of the board.

**(f) Formation of supporting committees:**

For decision on urgent matters an executive committee, whatever name called, may be formed with the directors. There shall be no committee or sub-committee of the board other than the executive committee and the audit committee. No alternate director shall be included in these committees.

**(g) Appointment of CEO:**

The board shall appoint a competent CEO for the bank with the approval of the Bangladesh Bank.

**02. Responsibilities of the chairman of the board of directors:**

(a) As the chairman of the board of directors (or chairman of any committee formed by the board or any director) does not personally possess the jurisdiction to apply policymaking or executive authority, he shall not participate in or interfere into the administrative or operational and routine affairs of the bank.

(b) The chairman may conduct on-site inspection of any bank-branch or financing activities under the purview of the oversight responsibilities of the board. He may call for any information relating to bank's operation or ask for investigation into any such affairs; he may submit such information or investigation report to the meeting of the board or the executive committee and if deemed necessary, with the approval of the board, he shall effect necessary action thereon in accordance with the set rules through the CEO. However, any complaint against the CEO shall have to be apprised to Bangladesh Bank through the board along with the statement of the CEO.

(c) The chairman may be offered an office-room, a personal secretary/assistant, a telephone at the office and a vehicle in the business-interest of the bank subject to the approval of the board.

**03. Responsibilities of the adviser:**

The adviser, whatever name called, shall advise the board of directors or the CEO on such issues only for which he is engaged in terms of the conditions of his appointment. He shall neither have access to the process of decision-making nor shall have the scope of effecting executive authority in any matters of the bank including financial, administrative or operational affairs.

**04. Responsibilities and authorities of the CEO:**

The CEO of the bank, whatever name called, shall discharge the responsibilities and effect the authorities as follows:

(a) In terms of the financial, business and administrative authorities vested upon him by the board, the CEO shall discharge his own responsibilities. He shall remain accountable for achievement of financial and other business targets by means of business plan, efficient implementation thereof and prudent administrative and financial management.

(b) The CEO shall ensure compliance of the Bank Companies Act, 1991 and/or other relevant laws and regulations in discharge of routine functions of the bank.

(c) The CEO shall include information on violation of any law, rules, regulation including Bank Company Act, 1991 while presenting memos before the Board or the committee formed by the board.

(d) CEO will provide all sorts of information to Bangladesh Bank about the violation of Banking Companies Act, 1991 and/ or any violation of Laws, rules and regulations.

(e) The recruitment and promotion of all staff of the bank except those in the two tiers below him shall rest on the CEO. He shall act in such cases in accordance with the approved service rules on the basis of the human resources policy and sanctioned strength of employees as approved by the board. The board or the chairman of any committee of the board or any director shall not get involved or interfere into such affairs. The authority relating to transfer of and disciplinary measures against the staff, except those at one tier below the CEO, shall rest on him, which he shall apply in accordance with the approved service rules. Besides, under the purview of the human resources policy as approved by the board, he shall nominate officers for training etc.

**5) Meeting of Board of Directors etc:**

Board of Directors may meet once or more than once in a month if necessary; but Board of Directors shall meet once in every three months.

**6) Number of members in Executive Committee:**

The number of Executive Committee members shall not exceed seven.

**7) Training for Directors:**

The directors shall be aware of banking related laws, rules and regulations through proper training.

## APPOINTMENT OF DIRECTORS FROM THE DEPOSITORS OF BANKING COMPANIES RULES, 2008

Bangladesh Bank, being empowered by section 120 of Banking Companies Act, 1991 (Act No. 14 of 1991), formulated and promulgated following Rule for the fulfillment of section 15(5) of the same act. The Rule may be called “Appointment of Directors from the Depositors of the Banking Companies, Rule, 2008. While appointing directors from the depositors of banking companies under section 15(5) of Banking Companies Act, 1991 by Bangladesh Bank, procedures as stated bellow should be followed:

### 1. Fit and Proper:-

(a) Person concerned must be a depositor of the bank company. During the time of holding the post of director, he must maintain his deposit with the concerned bank.

(b) He must at least have a bachelor degree from any recognized university. He must be prominent in his profession. Depositors having higher educational qualification in Economics, Trade, Business Administration, etc. or having professional experience in Industrial Business shall be given priority at the time of appointing as director.

(c) He shall not be a director, officer/staff or advisor of any bank company, financial institution, insurance company or stock exchange.

(d) He, himself or including his family members, shall not hold share more than 1% of paid-up capital of the concerned bank company.

(e) He shall not have any business or any pecuniary relationship with the concerned bank company except maintaining deposit or holding of share not more than 1% of paid up capital of the bank.

(f) The person who was salaried staff or held an office of profit or was a director of the bank shall not be selected as director from depositors. Law advisors and external auditors of the bank also shall not be selected as director from depositors.

(g) He shall not be a member of the family of any director of the concerned bank or shall not have any involvement with the organization owned/conducted by the director of the bank any directors' owned/executed organization

(h) He shall not be engaged with any political party.

(i) He shall not be a loan, tax or bill defaulter.

(j) Fit and proper test criteria issued by Bangladesh Bank from time to time shall be applicable for appointment of directors from the depositors.

## **2. Selection procedure:-**

(a) The Board of Directors of concerned bank shall send the proposal appointment of 2 (two) directors from the depositors to Bangladesh Bank on the basis of the fit and proper test criteria mentioned above. The appointment of the director shall be effective after the approval of Bangladesh Bank. Bangladesh Bank, if necessary, may ask for additional name(s) from the board of directors of concern bank.

(b) Tenure of directors selected from the depositors shall be 3(three) years.

(c) Any director selected from the depositors shall not hold the post of director more than 2(two) tenure or six years consecutively.

(d) Any person holding the post of director from the depositors for two terms consecutively, shall not be qualified to be re-elected until completion of his/her next one term.

## **3. Others:-**

(a) If the person violate any condition of Fit and Proper Test stated in Para 1 or for the interest of depositor of concern bank company or interest of the public Bangladesh Bank may remove any director from the depositors giving reasonable opportunity to show the cause.

(b) Prior approval of Bangladesh Bank shall be necessary in case of the dismissal of any director from the depositors by the board of directors of the concern bank-company. For this purpose resolution passed by the 2/3<sup>rd</sup> majority of the board of directors to be shall be sent to Bangladesh Bank. The dismissal of the director will be effective upon receiving written approval from Bangladesh Bank.

(c) Directors appointed from the depositors shall be in addition to 13 (thirteen) members of board of Directors under the sub-clause 15(6) of the Banking Companies Act, 1991.

Explanation: For the purpose of rule, 'family' would include spouse, parents, children, brother and sister of the concerned person and all other persons dependent on him/her.

## **RESTRICTION ON LENDING TO DIRECTORS OF PRIVATE BANKS**

The following instructions on the above subject have been issued rescinding the previous one in this regard with the authority vested under Section 45 of Bank Companies Act, 1991 in public interest and for the interest of the depositors with immediate effect: -

1. Any loan facility or guarantee or security provided to a Director of a bank or to his relatives must be sanctioned by the Board of Directors of the bank and has to be specifically mentioned in the Balance sheet of the bank. However the total amount of the loan facilities extendable to a Director or to his relatives should not exceed 50% of the paid-up value of the shares of that bank held in Director's own name.
2. If the total amount of loan facilities already extended to a Director or to his relatives exceeds 50% of the paid-up value of the shares of the bank held in Director's own name, the amount in excess should be repaid within the time approved by Bangladesh Bank. Under no circumstances, renewal or extension of time of the loan facilities in excess of that 50% can be made.
3. No such loan wherein the borrower is exempted fully or partially from bearing the loss including Mudaraba or Musharaka systems of loan can be extended to any Director or any relatives of him.
4. Subject to compliance of the conditions mentioned in paragraph No.1 above, loan facilities in excess of Tk.10 lacs for funded loan and Tk.50 lacs (funded and non-funded) in favor of any Director or his relatives or proprietorship or partnership firms and private or public limited companies wherein those persons have interests, can be extended subject to obtaining no-objection from Bangladesh Bank.
5. If any Director of a bank without being apparently involved in any industrial /commercial organization, conducts or directs accounts thereof or otherwise has control thereupon or extends collateral security or guarantee against any loans thereof, he will be treated to have interest in that organization/loan account.
6. Bank loan of any public limited company will be treated as liability of a Director of the bank in proportion of the amount (percentage) of shares of that company held by him.

7. If any Director extends guarantee against any loan for any specific amount, his liability will remain limited up to that specific amount.
8. In case of extending loan facilities in favor of the organization wherein the Director has interest, all kinds of legal formalities have to be properly executed as per norms.
9. Respective rules and regulations of Bank Companies Act, 1991 regarding loan facilities in general and other instructions of Bangladesh Bank should be followed as usual.
10. For the purpose of extending loan facilities, the explanation as given under Sub-section 27(2) of Bank Companies Act, 1991 will be applicable to define the term 'Director', i.e., it will include his/her spouse, father, mother, son, daughter, brother, sister and all his dependants.
11. If any loans availed in the names of the Directors or organizations wherein they have interests, turn to defaulted ones, legal action has to be initiated instantly and inter alia the Directors have to be served with the notice under Section 17 of Bank Companies Act, 1991.
12. The quarterly statement of liabilities of the Directors and Ex-Directors of the bank as defined in the latest amendment of Bank Companies Act, 1991, will have to be submitted to Bangladesh Bank in the format as enclosed with the BRPD Circular Letter No. 8 dated 19 June, 1997.
13. Any change/cancellation/return of security, collateral security, guarantee etc, provided against the loan of any Director or Ex-Director of a bank will require prior permission from Bangladesh Bank.
14. Any change of the conditions of any loans of any Director or Ex-Director of a bank will require prior permission from Bangladesh Bank. Copies of sanction-letters of all loans of the Director or Ex-Director have to be submitted to Bangladesh Bank. Copies of the sanction-letters of existing loans have to be submitted within September 30, 1999 to Banking Regulation and policy Department. In future, copies of the sanction-letters will have to be submitted to the said Department within 1(one) week from the date of sanction of the loan with the no-objection from Bangladesh Bank but before the disbursement of the loan.



15. The above rule will also be applicable in case of those loans extended in favor of any organizations wherein any Director/ex-Director of the bank has interest or he/she was once proprietor, partner, director or guarantor thereof; i.e., any change of the security, collateral security, guarantee provided against the loans of those organizations or of the conditions of sanction will require prior permission from Bangladesh Bank. Copies of sanction-letters of such loan-accounts will have to be submitted to Banking Regulation and policy Department within October 15, 1999.

16. No remission facilities (including A/C blocking) to any loan accounts wherein bank's Director or Ex-Director has interest can be allowed without prior permission from Bangladesh Bank. However, in case of the Ex-Directors who are at present not holding any share of the bank including the Govt.-nominated Directors, the issue of waiver of interest on loans availed before they were Directors of the bank or after they ceased to be the Directors, with the permission of the Board of Directors of the bank will not require prior permission from Bangladesh Bank.

17. If re-scheduling is required in case of loans extended before the issuance of BRPD Circular No. 07 dated 5.8.99 in favor of Director or any organization wherein he has interest, time of repayment in case of term loan can be extended for maximum 03(three) years and in case of working capital latest up to 31st December, 2001. The proposal of rescheduling has to be approved by the Board of Directors of the bank and will come into effect after obtaining no-objection from Bangladesh Bank. If the history of past repayment of loan accounts of the Director or wherein they have interests, is good and at the same time repayment is not being possible for reasons beyond control and temporary inconvenience, only those accounts will be considered for rescheduling as per above procedure.

## **RULES AND REGULATIONS FOR APPOINTMENT OF CHIEF EXECUTIVE AND ADVISOR IN BANKS**

Sub-section (4) of Section 15 of Bank Companies Act, 1991 empowers Bangladesh Bank to issue regulations requiring bank companies to obtain prior approval of Bangladesh Bank in respect of appointment as well as dismissal, release or removal of Chief Executive and Adviser in bank companies.

In bank management, the issue of good governance is very important. In order to strengthen the financial base of the bank and obtain confidence of the depositors, appointing honest, efficient, experienced and suitable Chief Executive is one of the responsibilities of the Board of Directors. In order to ensure good governance the following rules are issued for compliance of the banks replacing the previous instructions in this respect:

### **1. Moral Integrity:**

In case of appointment to the post of Chief Executive /Adviser, satisfaction in respect of the concerned person should be ensured to the effects that: -

- a) (s)he has not been convicted by any Criminal Court of Law;
- b) (s)he has not violated any rules, regulations or procedures /norms set by any Controlling Authority;
- c) (s)he was not associated with any such company /organization, registration or licence of which has been cancelled or which has gone into liquidation;
- d) (s)he has not been disqualified to be the Chairman or Director or Chief Executive of any Company .

### **2. Experience and Suitability:**

a) For appointment as Chief Executive, the concerned person will have experience for at least 15 (fifteen) years as an active officer in bank or financial institution and at least for 02 (two) years in the post immediate to the post of the Chief Executive of a bank. The tenure of the Chief Executive shall be for at least 03 (three) years, which is renewable. For appointment as Adviser, 15 (fifteen) years' job experience in bank or financial institution or administrative experience will be regarded as eligibility. But, the tenure of the Adviser shall not exceed 01 (one) year.

- b) Higher academic education in the field of Economics, Banking and Finance or Business Administration will be regarded as additional qualification for the concerned person.
- c) In respect of service, the concerned person should have high record of performance.
- d) Satisfaction should be ensured that the concerned person was not dismissed from his service when he was Chairman/Director/Official of any company;
- e) No Director of the Bank or financial institution or person who has business interest in that bank will be considered eligible for appointment to the post of Chief Executive/ Adviser.

### 3. Transparency and Financial Integrity:

Before appointment as chief Executive/Adviser, satisfaction should be ensured to the effects that:

- a) The concerned person was not involved in any illegal activity while performing duties in his own or banking profession;
- b) (s)he has not suspended payment or has not compounded with his creditors;
- c) (s)he has never been adjudicated an insolvent .

4. Before appointment as Chief Executive or Adviser, prior permission in writing from Bangladesh Bank as per provision of Sub-section (4) of Section 15 of Bank Companies Act, 1991 should be obtained. In order to have such permission, full bio-data and terms and conditions of appointment (mentioning direct and indirect payable salary and allowances and facilities) should be submitted to Bangladesh Bank. The banks are required to follow the guidelines stated below while determining the salary and allowances of the Chief Executive and submitting such proposal to Bangladesh Bank: -

a) In fixing the salary and allowances of the Chief Executive of a bank, financial condition, area of operation, business-volume and earning capacity of the bank, qualifications, age and experience of the person concerned and the remuneration paid to the persons occupying same position in the peer banks shall have to be taken into consideration.

b) Total salary shall be comprised of direct salary covering '**Basic Pay**' and '**House Rent**' and allowances as '**Others**'. The allowances (e.g., provident fund, utility bill, leave-fare assistance etc.) in '**Others**' head should be specified in amount/ceiling. Besides, other facilities (e.g., car, fuel, driver etc.), as far as possible, shall have to be monetized and thus determining monthly total

salary, it shall have to be mentioned in the proposal to be submitted to Bangladesh Bank. In the proposal, Basic Pay, House Rent, Festival Allowance, other allowances and other facilities shall have to be specified in amount in Taka.

c) Terms of salary-allowances and other facilities as specified in the terms and conditions of appointment cannot be changed during the tenure. In case of renewal, proposal may be made for re-fixation of the salary considering the job performance of the incumbent Chief Executive.

d) The Chief Executive so appointed shall not get any other direct or indirect facilities (e.g., dividend, commission, bonus, club expense etc.) other than the salary-allowances and other facilities as enumerated in item no. (2).

e) The bank shall not pay any income tax for the Chief Executive, i.e., the Chief Executive so appointed shall have to pay it.

**5.** No person crossing the age of 65 years shall hold the post of Chief Executive of a bank.

## CONSTITUTION OF THE BOARD OF DIRECTORS AND FIT AND PROPER TEST FOR APPOINTMENT OF BANK DIRECTORS

Responsibilities of running the affairs of a bank-company, like other companies, are entrusted to its board of directors. The responsibilities of the board of directors of a bank-company are more important than those of other companies; because in case of a bank-company it is essential to earn and maintain confidence of the depositors as its business is mainly run with the depositors' money. The board of directors shall also have to strive to protect interests of its depositors as well as of the shareholders. It is imperative to constitute the board of directors with competent and professionally skilled persons and limit the number of directors with a view to formulating policy-guidelines and supervising business activities of the bank efficiently as well as ensuring good and corporate governance in the bank management.

Bangladesh Bank deems it necessary to issue directives for compliance of the bank-company regarding constitution of the board of directors and fit and proper test for appointment of directors in the interest of depositors and for securing proper management of the bank-companies. Therefore, in exercise of the powers conferred by section 45(1) of the Bank Companies Act, 1991, the following restrictions have been imposed regarding constitution of the board of directors and fit and proper test criteria for consideration and compliance of the appointing authority (viz.- general meeting, board of directors etc.) of the private banks regarding appointment or reappointment and filling up of casual vacancy of the offices of bank directors:

### 1. Fit and Proper Test:-

- a) The concerned person must have management/business or professional experience for at least 10 (ten) years;
- b) (S)he has not been convicted in any criminal offence or involved in any fraud/forgery, financial crime or other illegal activities;
- c) (S)he has not been subject to any adverse findings in any legal proceedings,
- d) (S)he has not been convicted in regard to contravention of rules, regulations or disciplines of the regulatory authorities relating to financial sector;
- e) (S)he has not been involved with a company/firm whose registration/license has been revoked or cancelled or which has gone into liquidation;

- f) Loans taken by him/her or allied concern from any bank or financial institution have not become defaulted;
- g) (S)he has not been adjudicated a bankrupt by a court;
- h) (S)he must be loyal to the decisions of the board of directors. However, in case of note of dissent, (s)he may record it in the minutes of the board meeting and/or bring it to the notice of Bangladesh Bank considering its merit.

2. A person, proposed as a candidate for the office of director, shall furnish along with the consent letter for the purpose of section 93 of the Companies Act, 1994 a declaration as per the attached format (**Annexure-A**) that (s)he is not disqualified to become a bank director in accordance with the above mentioned fit and proper test.

3. The declaration shall have to be signed by the concerned person (candidate) and if elected it shall have to be forwarded to Bangladesh Bank by the Chairman of the board of directors.

4. The above-mentioned restrictions for qualifications of bank directors shall be in addition to any related laws/regulations for the time being in force.

**Declaration**

I do hereby declare that I am eligible to become a director of bank-company as per the fit and proper test criteria issued by Bangladesh Bank vide BRPD Circular No. 12 dated 26 April 2003. I further declare that-

- a) I have not been convicted in any criminal offence or involved in any fraud/forgery, financial crime or other illegal activities;
- b) There is no adverse opinion/findings regarding me in any legal proceedings,
- c) I have not been convicted in regard to contravention of rules, regulations and disciplines of the regulatory authorities relating to financial sector;
- d) I have not been involved with a company/firm whose registration/license has been revoked or cancelled or which has gone into liquidation;
- e) There are no loans taken by me or my allied concern from any bank or financial institution that have become defaulted;
- f) I have not been adjudicated a bankrupt by a court;
- g) My spouse, parents, children, brothers and sisters or any other person dependent on me is not a director of this bank.

Dated:

Signature:

( )

Countersigned:

( )

Chairman, Board of Directors

..... Bank Ltd.

## CONSTITUTION OF THE AUDIT COMMITTEE OF BOARD OF DIRECTORS

Audit Committee of the Board of a bank can play an effective role in providing a bridge between the board and management, shareholders, depositors and stake-holders and help in ensuring efficient, safe and sound banking practices. Role of the audit committee is also important in evolving an effective procedure for financial reporting disclosure, developing a suitable internal control system and maintaining liaison with internal and external auditors to minimize various business risks. Moreover, new business opportunities and increased competition due to globalization of markets, increased use of electronics and information technology, increased complexity of transactions, accounting standards and regulatory requirements are contributing to essentiality and expansion of the role of audit committee. Under the above circumstances, as part of the best practices, banks are advised to constitute Board's Audit Committee and the following regulations are being issued by Bangladesh Bank for compliance by the banks:-

### **Overall Purpose/Objectives**

The audit committee will assist the board in fulfilling its oversight responsibilities including implementation of the objectives, strategies and overall business plans set by the board for effective functioning of the bank. The committee will review the financial reporting process, the system of internal control and management of financial risks, the audit process, and the bank's process for monitoring compliance with laws and regulations and its own code of business conduct.

### **Roles and Responsibilities of the Audit Committee**

The audit committee will perform:

#### *1. Internal Control*

1.1. Evaluate whether management is setting the appropriate compliance culture by communicating the importance of internal control and the management of risk and ensuring that all employees have understanding of their roles and responsibilities;

1.2. Review the arrangements made by the management for building a suitable Management Information System (MIS) including computerization system and its applications;



1.3. Consider whether internal control strategies recommended by internal and external auditors have been implemented by the management;

1.4. Review the existing risk management procedures for ensuring an effective internal check and control system;

1.5. Review the corrective measures taken by the management as regards the reports relating to fraud-forgery, deficiencies in internal control or other similar issues detected by internal and external auditors and inspectors of the regulatory authority and inform the board on a regular basis.

## *2. Financial Reporting*

2.1. Review the annual financial statements and determine whether they are complete and consistent with the accounting standards set by the regulatory authority;

2.2. Meet with management and the external auditors to review the financial statements before their finalization.

## *3. Internal Audit*

3.1. Review the activities and organizational structure of the internal audit function and ensure that no unjustified restrictions or limitations are made;

3.2. Review the efficiency and effectiveness of internal audit function;

3.3. Review that findings and recommendations made by the internal auditors for removing the irregularities detected and also running the affairs of the bank are duly considered by the management.

## *4. External Audit*

4.1. Review the auditing performance of the external auditors and their audit reports;

4.2. Review that findings and recommendations made by the external auditors for removing the irregularities detected and also running the affairs of the bank are duly considered by the management;

4.3. Make recommendations to the board regarding the appointment of the external auditors.

4.4. Compliance with existing laws and Regulations;

4.5. Review whether the laws and regulations framed by the regulatory authorities (central bank and other bodies) and internal regulations approved by the board have been complied with.

#### *5. Other Responsibilities*

5.1. Place compliance report before the board on quarterly basis regarding regularization of the errors & omissions, fraud and forgeries and other irregularities as detected by the internal and external auditors and inspectors of regulatory authorities ;

5.2. Perform other oversight functions as requested by the board and evaluate the committee's own performance on a regular basis.

#### *6. Organization*

6.1. The audit committee will comprise of 05 (five) members;

6.2. Members of the committee will be nominated by the board of directors from the directors;

6.3. Members may be appointed for a 03 (three)-year term of office;

6.4. Company secretary of the bank will be the secretary of the audit committee.

#### *7. Qualifications of the Member*

7.1. Integrity, dedication, and opportunity to spare time for the committee will have to be considered while giving nomination a director to the committee;

7.2. Each member should be capable of making valuable and effective contributions in the functioning of the committee;

7.3. To perform his or her role effectively each committee member should have adequate understanding of the detailed responsibilities of the committee membership as well as the bank's business, operations and its risks .

#### *8. Meetings*

8.1. The audit committee should hold at least 3/4 meetings in a year and it can seat any time as it may deem fit ;

8.2. The committee may invite such other persons (e.g. the CEO, head of internal audit) to its meetings, as it deems necessary;

8.3. The internal and external auditors of the bank should be invited to make presentations to the audit committee as appropriate;

8.4. To maximize effectiveness, detailed memorandum to be discussed in the meeting should be distributed to committee members well in advance of the meeting to allow proper consideration of enclosed papers;

8.5. The proceedings of all meetings will be recorded.

## **CREDIT RATING**

In terms of the BRPD Circular Letter No. 05 dated May 29, 2004 it was made mandatory for the banks to have themselves credit rated to raise capital from capital market through IPO. The issue was reviewed and with a view to protecting the interest of the prospective investors, depositors and creditors and also the bank management as a whole for their overall performances in each relevant areas including core risks of the bank, it was decided to make it mandatory from January 2007 for all banks to have themselves credit rated by a Credit Rating agency. Banks had been advised to take necessary measures from that time so that they could have their credit ratings in all relevant areas as well as the bank management.

## **IMPLEMENTATION OF CREDIT RISK GRADING MANUAL**

With the aim to fully implement a Risk Grading System, an Integrated Credit Risk Grading Manual has been developed and forwarded to the banks. Banks were advised to implement Credit Risk Grading (as described in the manual) by March 31, 2006 for all exposures (irrespective of amount) other than those covered under Consumer and Small Enterprises financing Prudential Guidelines and also under The Short-Term Agricultural and Micro-Credit. Banks were also advised to submit a compliance report by April 15, 2006 to the effect that the Credit Risk Grading has been put in place. Risk Grading Matrix provided in the Manual is the minimum standard of risk rating and banks may adopt and adapt more sophisticated risk grades in line with the size and complexity of their business. Bangladesh Bank monitors the progress of implementation of the manual/guideline through its on-site inspection teams during routine inspection.

Banks have been advised to adopt the credit risk grading system outlined in the other two separate manuals (Credit Risk Grading Manual-Bank, Credit Risk Grading Manual-NBFI) for assessing credit risk in case of taking exposure on another Bank/NBFI.

Banks have been advised to continue their regular monitoring to ensure the proper utilization of the loan/investment as stipulated in the loan application.

## PRUDENTIAL GUIDELINES FOR CONSUMER FINANCING AND SMALL ENTERPRISE FINANCING

Prudential Guidelines on Consumer Financing and Small Enterprise Financing has been issued by Bangladesh Bank containing the minimum set of regulations<sup>43</sup>. Due to significant increase in credit disbursement in the arena of Consumer Financing and encouraging credit flow in the Small Enterprise Financing sector in the recent time, two separate guidelines have been issued to the banks for better management of credit in those two sectors where-in loans will have to be classified into 8(eight) categories (in light of Credit Risk Grading Manual). Banks had been advised to implement the guidelines by 31 December 2005. Bangladesh Bank monitors the progress of implementation of these Regulations/Guidelines through its on-site inspection teams through routine inspection.

### PRUDENTIAL REGULATIONS FOR CONSUMER FINANCING

#### **(Regulation for Housing Finance)<sup>44</sup>:**

Regulation 23:

"The maximum per party limit in respect of housing finance by the banks will be Tk. 10 (ten) million. The housing finance facility shall be provided at a maximum debt equity ratio of 80:20."

Regulation 25:

"Banks are free to extend mortgage loans for housing, for a period not exceeding 25 (twenty five) year. Banks should be attentive to adequate asset liability matching".

In case of all kinds of consumer financing including car loan, the 50: 50 debt equity ratio shall be maintained<sup>45</sup>.

<sup>43</sup> BRPD Circular No. 07 dated November 3 2004

<sup>44</sup> BRPD Circular No. 23 dated June 16 2010

<sup>45</sup> BRPD Circular No. 34 dated December 12 2010

## GUIDELINES ON ISLAMIC BANKING

In view of some basic differences in Shariah based Islamic Banking and interest based banking BB has introduced guidelines on Islamic Banking to bring greater transparency and accountability and therefore governance to the Islamic Banking<sup>46</sup>.

## MAINTAINING ADEQUATE SECURITY OF LOCKERS

Bangladesh Bank has issued detail guidelines on maintaining adequate security of lockers. Accordingly, Banks are now to observe the minimum safety and security measures at branches/places where safe deposit lockers facilities are offered to general public so that the security procedures are well documented and the concerned staff/officers are well trained about the procedures. Banks are also to carry out proper due diligence process on the security agencies, as well as guards posted at their branches. Besides, corporate group insurance as per categories and sizes of lockers are to be maintained by the banks so that in case of any loss arising due to breakage/damage to the lockers could be paid to the locker holders<sup>47</sup>.

## RESERVE REQUIREMENTS

The Statutory Liquidity Ratio (**SLR**) for the scheduled banks, except banks operating under the Islamic Shariah and the specialized banks is 19%<sup>48</sup> of their demand and time liabilities, excluding interbank items since December 15, 2010. The SLR for the Islamic banks is 11.5%<sup>49</sup> the specialized banks except BASIC bank are exempted from maintaining SLR. The Cash Reserve Requirement (**CRR**) for the scheduled banks with the Bangladesh Bank is 6%<sup>50</sup> of their total demand and time liabilities. It may be noted that banks are required to maintain CRR daily at the rate of 6% on average on bi-weekly basis provided that the CRR would not be less than 5.5% in any day with effect from December 15, 2010.

<sup>46</sup> BRPD Circular No. 15 dated November 11 2009

<sup>47</sup> BRPD Circular No. 02 dated January 31 2008

<sup>48</sup> MPD Circular No. 05 dated December 01 2010

<sup>49</sup> MPD Circular No. 05 dated December 01 2010

<sup>50</sup> MPD Circular No. 04 dated December 01 2010

## **DISCLOSURE REQUIREMENTS FOR BANKS**

The forms of financial statements of banks and directives for preparation thereof have been amended in line with International Accounting Standards with a view to providing the investors, depositors and stakeholders with transparent and adequate idea about the bank<sup>51</sup>.

## **PROHIBITION ON BANK LOAN FOR PURCHASING LAND**

The value of land has been increased abnormally due to increasing trend of purchasing and demand for land. There has been a negative impact over the economy because of increasing flow of credit from banks to such unproductive sector. In this context, it has now been decided that banks shall not provide any loan/credit facility for purchasing land<sup>52</sup>.

## **OPERATION OF MERCHANT BANKING BY BANKING COMPANIES**

Banks are advised to operate merchant banking activities constituting separate legal entity i.e. subsidiary company to protect the interest of the depositors<sup>53</sup>.

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<sup>51</sup> BRPD Circular No. 14 dated June 25 2003

<sup>52</sup> BRPD Circular No. 16 dated April 27 2010

<sup>53</sup> BRPD Circular No. 12 dated October 14 2009

## BANK DEPOSIT INSURANCE SCHEME

The Bank Deposit insurance Act, 2000 established the rules governing the role of insurer, the level of coverage provided and the laws governing the payments in event of a bank failure. Under the law deposits of all scheduled banks are insured up to BDT 100,000 per depositor. The Act is as under:-

**01. Short title.** - This Act may be called the Bank Deposit Insurance Act 2000.

**02. Definitions.** - In this Act, unless there is anything repugnant in the subject or context -

'Deposit' means in case of any scheduled bank, the summation of unpaid residue of its depositors' accounts;

'Trustee Board' means the Trustee Board of the fund as mentioned under Section 8 hereof;

'Scheduled Bank' means the Scheduled Bank as defined under Article 2(j) of the Bangladesh Bank Order, 1972 (P.O.No.127 of 1972);

'Fund' means the Trust Fund as preserved under Section 3 hereof;

'Auditor' means chartered accountant as defined under Article 2(1)(b) of the Chartered Accountants Order, 1973 (P.O.No.2 of 1973);

'Premium' means premium payable by the insured bank as specified under Section 5 hereof;

'Bangladesh Bank' means Bangladesh Bank established under Bangladesh Bank Order, 1972(P.O.No.127 of 1972);

'Insurance' means deposit insurance;

'Insured Bank' means bank insured under this Act.

### 03. Deposit Insurance Trust Fund.-

(1) Bangladesh Bank shall maintain a Fund in the name of Deposit Insurance Trust Fund and monies of the Fund can be invested by Bangladesh Bank in any approved sector.

(2) The following monies will be deposited in the Fund namely: -

Money received from insured bank;

(a) Return on investment of monies of the Fund;

Money received from the bank liquidated under Section 7 hereof;

(b) Income received from other sources.



(3) Monies of the Fund shall not be spent for any purposes other than for repayment of dues of the depositors of the bank liquidated under the provision of Section 7 hereof and for the cost of maintenance of the Fund;

(4) Nothing of Income Tax Ordinance 1984 (XXXVI of 1984) shall apply to the income of the Fund.

**04. Insured Bank.** - Notwithstanding anything contained in any other law for the time being in force,

- (a) All scheduled banks existing on the date of enforcement of this Act shall be deemed to have been insured with the Fund from the same date; and
- (b) All scheduled banks to be established after enforcement of this Act, shall be insured with the Fund.

**05. Premium of the Insured Bank. –**

(1) Each insured bank shall pay the premium to the Fund @ 0.07% per annum on such portion of its deposit as may be determined by Bangladesh Bank from time to time.

But provided that, Bangladesh Bank, with the prior approval (previous sanction) of the Government, shall have the power to increase or decrease the rate or premium.

- (2) Insured bank shall pay its premium from its expenditure account.
- (3) Premium shall have to be paid at such time and mode as specified by Bangladesh Bank.

(4) If any insured bank fails to pay its premium, Bangladesh Bank shall have the power to direct as to the deposit of such premium to the Fund by debiting the amount equal to that of the premium from the account of the said bank maintained with Bangladesh Bank.

**06. Action against failure for more than once in payment of premium .-** If any insured bank fails for more than once to pay the premium, Bangladesh Bank, allowing the chance of hearing and by notification in the Official Gazette, shall have the power to direct as to refraining any insured bank from accepting deposit for the time as specified in the notification .

**07. Liability of the Fund.-**

(1) If the order is passed for liquidation of any insured bank, Bangladesh Bank shall pay each of its depositors the amount equal to one's deposit, not exceeding maximum Tk. 01 (one) lac, from the Fund.

(2) If any depositor has more than one account in the liquidated bank and the balances of the accounts altogether even if stand more than Tk. 01 (one) lac, he shall not be paid back more than Tk. 01 (one) lac. The Official Liquidator against the net asset of the liquidated bank shall adjust such payment with the amount payable to the depositors.

(3) The Official Liquidator, whatever he might be termed, within less than 90 days after assuming his office, shall submit to Bangladesh Bank the list of deposits of the depositors in the form as specified by Bangladesh Bank.

(4) The Trustee Board shall arrange for payment from the Fund the amounts due to the depositors in terms of the provisions of Sub-section (1) within less than 90 days after receipt of the list as specified under Sub-section (3) hereof .

(5) If the amount of the deposited monies of the Fund falls short of the payable amount, Government shall, through Bangladesh Bank lend the Fund the amount of short-fall @ Bank-Rate-based interest.

(6) Notwithstanding anything contained in this Section, the amount payable to any depositor shall be determined net of any claims of the insured bank legally due to it.

**08. Trustee Board.-** There shall be a Trustee Board for operation and administration of the Fund and the Board of Directors of Bangladesh Bank shall be the Trustee Board of the Fund .

**09. Annual Report. -** The Trustee Board shall submit to the Government the copy of annual accounts of the Fund certified by the Auditor and signed by the Governor of Bangladesh Bank and the Report on activities within 2(two) months from the date of preparation of such accounts.

**10. Repeals and Savings. –**

- (1) The Bank Deposit Insurance Ordinance, 1984 (LIII of 1984) is hereby repealed.
- (2) All monies of the Deposit Insurance Fund preserved under the repealed Ordinance shall be transferred to the Fund.

## GREEN BANKING

### Policy Guidelines

Bangladesh is one of the most climate change vulnerable countries. Financial institutions of Bangladesh can play an important role to protect environmental degradation. A comprehensive Policy Guidelines for Green Banking has been issued with a view to developing a strong and environment friendly banking system<sup>54</sup>.

### **Inclusion of Solar Energy System for Establishment of New SME/ Agricultural Branch<sup>55</sup>**

SME/Agriculture branches to be established/opened will be required to be environment friendly where there will be the availability of using natural light, renewable energy, power and energy saving bulbs, other equipments, efficient use of water and refined water. These branches will be required to ensure that the solar system is in place in the branch and the same must be ensured in the application for obtaining license for the branches having permission in principle.

## FINANCIAL INCLUSION

Bangladesh is a small country with large population. A considerable portion of the population live below poverty level. The major portion of that population live in rural areas, they are illiterate and depend mostly on agriculture. Financially excluded sections largely comprise marginal farmers, laborers, oral lessees, self employed and unorganized sector enterprises, urban dwellers, ethnic minorities and socially excluded groups, senior citizen, women etc. Poor/low income earners cannot be served by conventional retail banking. Technological and institutional innovation is required to expand financial inclusion.

Bangladesh Bank (BB), as a Central Bank has already taken several initiatives to bring about financial inclusion.

**Bank Account for Farmers:** A farmer can open an account by depositing Taka 10/- (ten) only at any state owned commercial and specialized bank against national ID card/birth registration card and 'agricultural equipment assistance card' issued by the Department of Agricultural Extension.

<sup>54</sup> BRPD Circular No. 02 dated February 02 2011

<sup>55</sup> BRPD Circular Letter No. 02 dated June 20 2011

There will be no bindings for maintaining minimum balance on the said account and banks shall not impose any charges/fees on these accounts. Due to close monitoring of BB the number of farmers' accounts has gone up to 9,195,356 as of March, 2011.

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

**Bank Account for Hardcore Poor:** A hardcore poor can open bank account by depositing taka 10/- (ten) only at any state owned commercial and specialized bank against national ID card and registration card issued by the Ministry of Food & Disaster Management. There will be no bindings for maintaining minimum balance on the said account and banks shall not impose any charges/fees on these accounts.

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

**Bank Account for Freedom Fighters<sup>56</sup>:** A freedom fighter can open bank account by depositing taka 10/- (ten) only at any state owned commercial and specialized bank against national ID card and Payment Receipt Book for freedom fighter's allowance. There are no bindings for maintaining minimum balance on the said account and banks shall not impose any charges/fees on these accounts.

**Bank Account for Beneficiaries under Social Security Program<sup>57</sup>:** Beneficiaries under Social Security Program can open bank account by depositing taka 10/-(ten) only at any state owned commercial and specialized bank against national ID card and Payment Receipt Book containing Pension Payment Order (PPO) for the beneficiaries. There are no bindings for maintaining minimum balance on the said accounts and banks shall not impose any charges/fees on these

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<sup>56</sup> BRPD Circular No.0 4 dated April 11 2011

<sup>57</sup> BRPD Circular Letter No. 05 dated June 19 2011

accounts. Transactions may also be carried on through vouchers in case of insufficiency of check books.

**Bank Account for Distressed People having Grant from Hindu Religious Welfare Trust**<sup>58</sup>

Beneficiaries under Hindu Religious Welfare Trust can open bank account by depositing taka 10/- (ten) only at any state owned commercial and specialized bank against national ID card and certificate issued by the Trust. There are no bindings for maintaining minimum balance on the said accounts.

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<sup>58</sup> BRPD Circular No-07 dated September 18,2011



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