Banking Sector Performance, Regulation and Bank Supervision

5.1 Bangladesh Bank continued to focus on strengthening the financial system and improving functioning of its various segments. The broad parameters of the reforms undertaken during the year comprised ongoing deregulation of the operation of institutions within the BB's regulatory ambit, tightening of prudential regulation and improvement in supervisory oversight, expanding transparency and market disclosure, all with a view to improving overall efficiency and stability of the financial system. The following paragraphs highlight the recent regulatory and supervisory measures initiated by BB for banks and financial institutions and also the industry statistics of the banking sector and the performances trends.

A. Banking Sector Performance

5.2 The banking sector of Bangladesh comprises four categories of scheduled banks. These are state-owned commercial banks (SCBs), state-owned development finance institutions (DFIs), private commercial banks (PCBs) and foreign commercial banks (FCBs). The number of banks remained unchanged at 48 in 2008. These banks had a total number of 6886 branches as of December 2008. The number of bank branches increased from 6717 to 6886 owing mainly to opening of new branches by the PCBs during the year. Structure of the banking sector with breakdown by type of banks is shown in Table 5.1 below:

Table 5.1 Banking system structure

(billion Taka)

Bank types	2007						2008					
	Number of banks	Number of branches	Total assets	% of industry assets	Deposits	% of deposits	Number of banks	Number of branches	Total assets	% of industry assets	Deposits	% of deposits
SCBs	4	3383	917.9	33.1	699.7	32.6	4	3386	1030.9	31.1	758.8	29.7
DFIs	5	1359	201.7	7.3	115.6	5.4	5	1362	222.3	6.7	137.8	5.4
PCBs	30	1922	1426.6	51.4	1150.2	53.5	30	2082	1794.5	54.2	1450.7	56.6
FCBs	09	53	227.7	8.2	183.4	8.5	09	56	265.8	8.0	214.1	8.4
Total	**48**	**6717**	**2773.9**	**100.0**	**2148.9**	**100.0**	**48**	**6886**	**3313.5**	**100.0**	**2561.4**	**100.0**

5.3 In 2008, the SCBs held 31.1 percent of the total industry assets as against 33.1 percent in 2007. PCBs' share rose to 54.2 percent in 2008 as against 51.4 percent in 2007. The FCBs held 8.0 percent of the industry assets in 2008, showing a declining trend by 0.2 percentage points over the previous year. The DFIs' share of assets was 6.7 percent in 2008 against 7.3 percent in 2007.

5.4 Total deposits of the banks in 2008 rose to Taka 2561.4 billion from Taka 2148.9 billion in 2007 showing an overall increase by 19.2 percent. The SCBs' (comprising the largest 4 banks) share in deposits decreased from 32.6 percent in 2007 to 29.7 percent in 2008. On the other hand, PCBs' deposits in 2008 amounted to Taka 1450.7 billion or 56.6 percent of the total industry deposit against Taka 1150.2 billion or

Chart 5.1

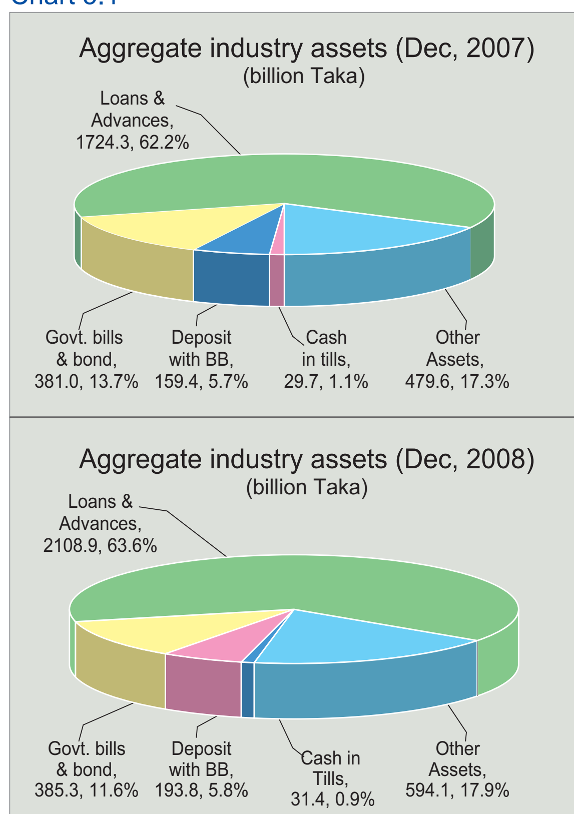
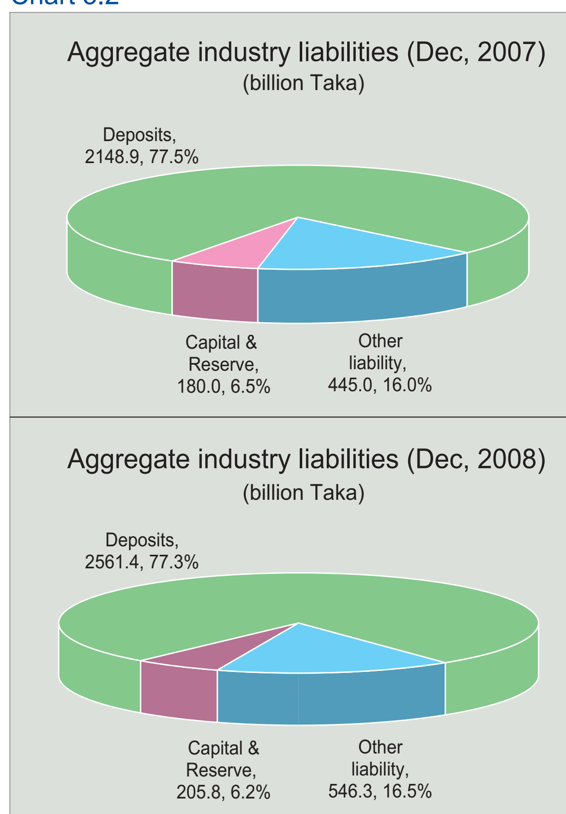


Chart 5.2



53.5 percent in 2007. FCBs' deposits in 2008 rose by Taka 30.7 billion or 16.7 percent over the year. The DFIs' deposits in 2008 were Taka 137.8 billion against Taka 115.6 billion in 2007 showing an increase of 19.2 percent over the year.

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5.5 **Assets:** Aggregate industry assets in 2008 registered an overall increase by 19.5 percent over 2007. During this period, SCBs' assets increased by 12.3 percent and those of the PCBs' increased by 25.8 percent. Loans and advances played a major role on the uses of fund. Loans and advances amounting to Taka 2108.9 billion out of aggregate assets of Taka 3313.5 billion constituted significant portion (63.6 percent). Cash in tills were Taka 31.4 billion (0.9 percent); deposits with BB were Taka 193.8 billion (5.8 percent); other assets were Taka 594.1 billion (17.9 percent) and investment in government bills and bonds were Taka 385.3 billion (11.6 percent).

5.6 **Latities:** The aggregated liability portfolio of the banking industry in 2008 was Taka 3313.5 billion of which deposits constituted Taka 2561.4 billion (77.3 percent) continued to be the main sources of fund of banking industry. Capital and reserves of the banks were Taka 205.8 billion (6.2 percent) 2008, as against Taka 180.0 billion (6.5 percent) in 2007.

Pforme ad Rtigofba

5.7 Performance of the banking sector has been evaluated through CAMELS rating which involves analysis and evaluation of the six crucial dimensions of banking operations. The six indicators used in the rating system are (i)

Capital adequacy, (ii) Asset quality, (iii) Management soundness, (iv) Earnings, (v) Liquidity, and (vi) Sensitivity to market risk.

Capital Adequacy

5.8 Capital adequacy focuses on the total position of banks' capital and protects the depositors from the potential shocks of losses that a bank might incur. It helps absorbing major financial risks (like credit risk, market risk, foreign exchange risk, interest rate risk). Banks have to maintain Capital Adequacy Ratio (CAR) of not less than 10.0 percent with at least 5.0 percent in core capital or Taka 2.0 billion as capital, whichever is higher.

5.9 Table 5.2 shows that as on 31 December 2008 the SCBs, DFIs, PCBs and FCBs maintained CAR of 6.9, -5.3, 11.4 and 24.0 percent respectively. 2 DFIs and 5 PCBs (including 2 problem banks) could not maintain required CAR. FCBs maintained CAR of 24.0 percent in 2008 though 4 out of 9 FCBs could not maintain minimum capital for Taka 2.0 billion but they were permitted to be adjusted those shortfall within 30 June 2009. The CAR of the banking industry was 10.1 percent in 2008 as against 9.6 percent in 2007.

Asset Quality

5.10 The asset composition of all commercial banks shows the concentration of loans and advances (63.6 percent). The high concentration of loans and advances indicates vulnerability of assets to credit risk, especially since the portion of non-performing assets is significant. A huge non-performing loan portfolio has been the major predicament of banks particularly of the state-owned commercial banks.

5.11 The most important indicator intended to identify problems with asset quality in the loan portfolio is the ratio of gross non-performing loans (NPLs) to total loans and net NPLs to net

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

(Percent)

Bank types	2000	2001	2002	2003	2004	2005	2006	2007	2008
SCBs	4.4	4.3	4.1	4.3	4.1	-0.4	1.1	7.9	6.9
DFIs	3.2	3.9	6.9	7.7	9.1	-7.5	-6.7	-5.5	-5.3
PCBs	10.9	9.9	9.7	10.5	10.3	9.1	9.8	10.6	11.4
FCBs	18.4	16.8	21.4	22.9	24.2	26.0	22.7	22.7	24.0
Total	**6.7**	**6.7**	**7.5**	**8.4**	**8.7**	**5.6**	**6.7**	**9.6**	**10.1**

Chart 5.3

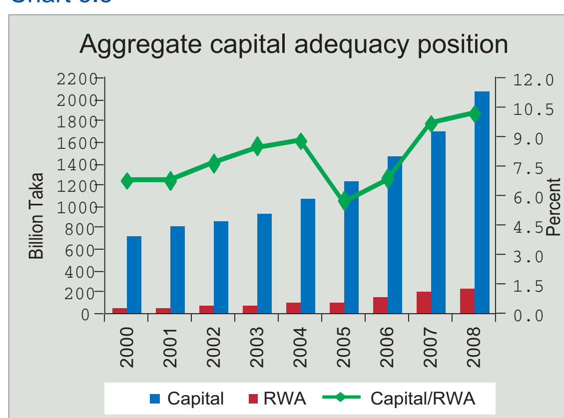


Table 5.3 NPL ratios by type of banks

(Percent)

Bank types	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
SCBs	45.6	38.6	37.0	33.7	29.0	25.3	21.4	22.9	29.9	25.4
DFIs	65.0	62.6	61.8	56.1	47.4	42.9	34.9	33.7	28.6	25.5
PCBs	27.1	22.0	17.0	16.4	12.4	8.5	5.6	5.5	5.0	4.4
FCBs	3.8	3.4	3.3	2.6	2.7	1.5	1.3	0.8	1.4	1.9
Total	**41.1**	**34.9**	**31.5**	**28.0**	**22.1**	**17.6**	**13.6**	**13.2**	**13.2**	**10.8**

total loans. FCBs have the lowest and DFIs have the highest ratio of gross NPLs to total loans. SCBs have gross NPLs to total loans ratio of 25.4 percent whereas in case of PCBs, FCBs and DFIs, the ratios are 4.4, 1.9 and 25.5 percent respectively.

5.12 The ratio of NPL to total loans of all the banks shows an encouraging trend since its decline from the peak (41.1 percent) in 1999, although the aggregate ratio was still as high as 10.8 percent in December 2008. The reason is being high NPL of the SCBs and the DFIs.

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

5.14 It appears from the Table 5.3(a) and Chart 5.4(a) that the ratio of net NPLs (net of provisions and interest suspense) to net total loans (net of provisions and interest suspense) stands at 5.9 percent (SCBs), 17.0 percent (DFIs), 0.9 percent (PCBs) and 2.8 percent (banking sector) in 2008. It shows from Chart 5.5 that SCBs' and DFIs' non-performing portfolios were still high after adjustment of actual provision and interest suspense, whereas FCBs have excess provision against their NPLs.

5.15 Chart 5.5 displays the amounts in NPLs of the 4 types of banks since 1999 through 2008. Amount of NPLs of the SCBs decreased from Taka 128.9 billion in 1999 to Taka 127.6 billion in 2008. The PCBs recorded a total increase of Taka 7.8 billion in their NPL accounts, which stood at Taka 57.0 billion in 2008 as against Taka 45.3 billion in 1999. The amount of NPLs of the DFIs decreased to Taka 37.3 billion in 2008 from Taka 63.3 billion in 1999. It shows from the Chart 5.4 that the decline in NPLs to total loans ratio in the recent

Chart 5.4

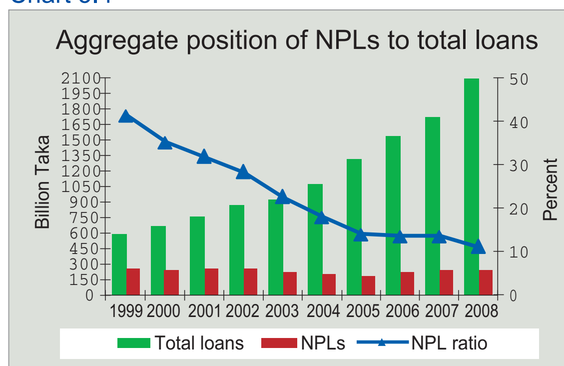


Table 5.3(a) Ratio of net NPL to total loans by type of banks

(Percent)

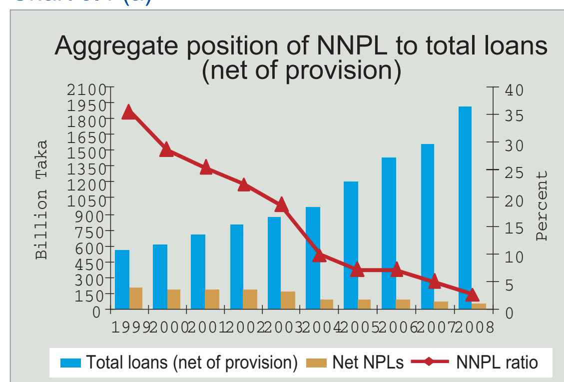
Bank types	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
SCBs	41.3	34.1	32.8	30.1	28.3	17.6	13.2	14.5	12.9	5.9
DFIs	58.5	54.6	54.5	48.0	38.3	23.0	22.6	23.6	19.0	17.0
PCBs	21.2	15.5	10.5	10.5	8.3	3.4	1.8	1.8	1.4	0.9
FCBs	0.9	-0.1	-0.3	-0.4	0.1	-1.5	-2.2	-2.6	-1.9	-2.0
Total	**35.6**	**28.8**	**25.6**	**22.6**	**18.8**	**9.8**	**7.2**	**7.1**	**5.1**	**2.8**

Table 5.4 Required provision and provision maintained -all banks

(billion Taka)

All banks	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Amount of NPLs	238.8	228.5	236.0	238.6	203.2	187.3	175.1	200.1	226.2	224.8
Required provision	100.2	98.4	101.6	106.8	92.5	87.8	88.3	106.1	127.2	136.1
Provision maintained	51.5	58.1	61.4	59.6	37.3	35.9	42.6	52.9	97.1	126.2
Excess(+)/ shortfall(-)	-48.7	-40.3	-40.2	-47.2	-55.2	-51.9	-45.7	-53.2	-30.1	-9.9
Provision maintenance ratio (%)	51.4	59.1	60.5	55.8	40.3	40.9	48.2	49.9	76.3	92.7

Chart 5.4 (a)



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

Loan Loss Provisioning of the Banks

5.16 Table 5.4 shows the aggregate amount of NPLs required loan loss provision and actual provision maintained there against by the banks from 1999 to 2008.

5.17 Table 5.4 and Chart 5.6 depict that in aggregate, the banks have been continuously failing to maintain the required level of provisions against their NPLs. During the years from 1999 through 2008, the banks maintained 60.5 percent of the required provision in 2001; which increased thereafter to 92.7 percent in 2008. The main reasons for the shortfall in provision adequacy is the inability of some SCBs, DFIs and PCBs including those in problem bank category to make sufficient provisions due to inadequate profits and also transferred provision for write-offs. Notably the FCBs are much better in that they have been able to make adequate provisions in the recent years. A comparative position of loan loss provision as of end 2007 and 2008 is shown in Table 5.5.

5.18 27 out of 30 PCBs could maintain required provision, the remaining 3 failed due to their poor asset portfolios and earning level.

Weighted Average Deposit and Lending Rates

5.19 Banks' weighted average deposit rate increased from 6.94 percent to 7.31 percent and weighted average lending rate increased from 12.29 percent to 12.31 percent during the first half of FY09 (30-06-08 to 31-12-08). The spread between lending and deposit rates decreased from 5.39 to 5.00 percent during the same period. Weighted average deposit and lending rates along with the spread during 30/06/2001 to 31/12/2008 have been shown in Table 5.6 and Chart 5.7.

Chart 5.5

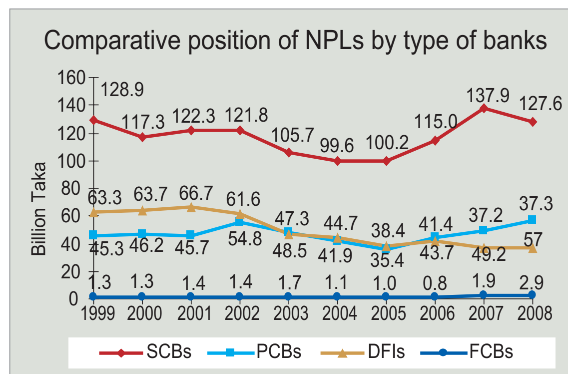


Chart 5.6

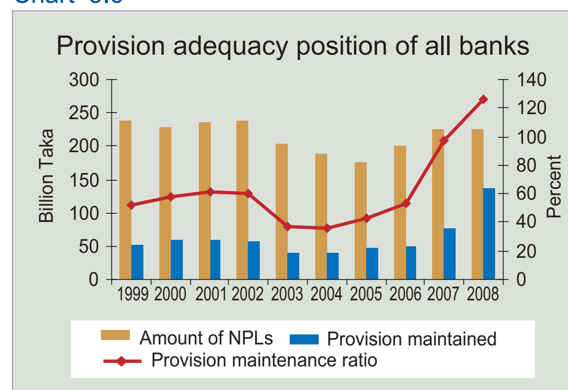
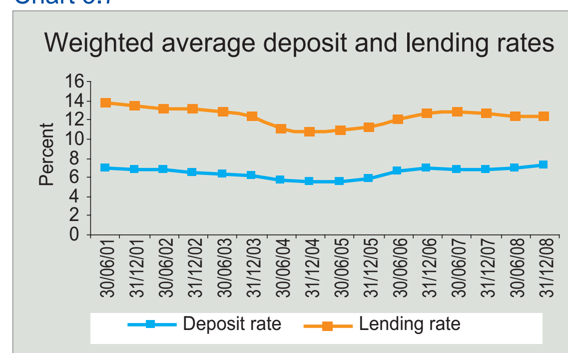


Table 5..5 Comparative position of provision adequacy

(billion Taka)

Year	Items	SCBs	DFIs	PCBs	FCBs
2007	Required provision	71.4	17.3	34.9	3.5
	Provision maintained	56.5	8.7	28.2	3.8
	Provision maintenance ratio (%)	79.1	50.3	80.8	108.6
2008	Required provision	73.1	17.0	41.3	4.6
	Provision maintained	75.6	8.6	37.0	5.0
	Provision maintenance ratio (%)	103.4	50.6	89.6	108.7

Chart 5.7



Writing-off Bad Debts

5.20 To wipe out unnecessarily and artificially inflated size of balance sheet, uniform guidelines of write-off have been introduced in 2003. According to the policy, banks may, at any time, write-off loans classified as bad/loss. Those loans, which have been classified as bad/loss for last 5 years and above and loans for which 100 percent provisions have been kept, should be written-off without delay. The total amount of written-off bad debts from June 2004 to June 2009 in different bank categories is given in Table 5.7. It is revealed from the Table 5.7 that banks have been able to write-off an amount of Taka 22.5 billion during 01/07/2008 to 30/06/2009.

Management Soundness

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

5.22 It transpires from Table 5.8 and Chart 5.8 that expenditure-income (EI) ratio of the DFIs was very high with 175.3 percent in 2000. This was mainly because the DFIs made loan loss provisions by debiting 'loss' in their books. The position, however, improved after 2000 and the

Table 5.6 Weighted average deposit and lending rates (30/06/2001-31/12/2008)

(Percent)

Date	Weighted average		Spread
	Deposit rate	Lending rate	
30/06/01	7.03	13.75	6.72
31/12/01	6.75	13.42	6.67
30/06/02	6.74	13.16	6.42
31/12/02	6.49	13.09	6.60
30/06/03	6.30	12.78	6.48
31/12/03	6.25	12.36	6.11
30/06/04	5.65	11.01	5.36
31/12/04	5.56	10.83	5.27
30/06/05	5.62	10.91	5.31
31/12/05	5.90	11.25	5.35
30/06/06	6.68	12.06	5.38
31/12/06	6.99	12.60	5.61
30/06/07	6.85	12.77	5.92
31/12/07	6.77	12.75	5.98
31/06/08	6.94	12.29	5.39
31/12/08	7.31	12.31	5.00

Table 5.7 Writing-off bad debts in different bank categories (30/06/2004 - 30/06/2009)

(billion Taka)

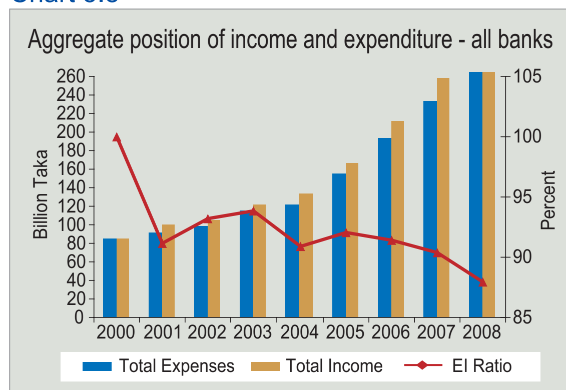
Bank Types	30/06/04	30/06/05	30/06/06	30/06/07	30/06/08	31/12/08	30/06/09
SCBs	26.3	29.7	35.7	42.8	48.4	63.8	64.5
DFIs	17.4	27.6	28.6	30.4	31.0	31.6	31.8
PCBs	21.2	32.9	40.7	45.5	54.0	49.4	54.7
FCBs	0.9	1.1	1.5	1.6	1.7	1.7	2.0
Total	**65.8**	**91.3**	**106.5**	**120.3**	**130.5**	**151.1**	**153.0**

Table 5.8 Expenditure-income ratio by type of banks

(Percent)

Bank types	2000	2001	2002	2003	2004	2005	2006	2007	2008
SCBs	99.4	99.0	98.5	98.8	102.3	101.9	100.0	100.0	89.6
DFIs	175.3	89.1	95.9	101.1	104.0	103.9	103.5	107.7	103.7
PCBs	90.8	88.1	91.9	93.1	87.1	89.3	90.2	88.8	88.4
FCBs	77.7	75.7	78.3	80.3	76.3	70.8	71.1	72.9	75.8
Total	**99.9**	**91.2**	**93.3**	**93.9**	**90.9**	**92.1**	**91.4**	**90.4**	**87.9**

Chart 5.8



ratio came down to 89.1 percent and 95.9 percent in 2001 and 2002 respectively but again rose to 101.1 percent in 2003 and later on 103.7 in 2008 due to operating loss incurred by BKB and RAKUB. The EI ratio of the SCBs exceeded 102.3 percent in 2004, situation improved to 89.6 percent in 2008. Very high EI ratio of SCBs was mainly attributable to high administrative and overhead expenses; suspension of income against NPLs. EI ratio of PCBs is substantially high due to deduction of loan loss provision, other assets and corporate tax from current income.

Earnings and Profitability

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

5.24 Earnings as measured by return on assets (ROA) and return on equity (ROE) vary largely within the industry. Table 5.9 shows ROA and ROE by types of banks and Chart 5.9 shows the aggregate position of these two indicators for all banks. Analysis of these indicators reveals that the ROA of the SCBs have been almost zero percent considering huge provision shortfall and that of the DFIs even worse. PCBs had an inconsistent trend but satisfactory and FCBs' return on assets ratio has been consistently strong during last 9 years.

5.25 SCBs return on equity ratio was 3.0 percent in 2003, but it rose to 22.5 in 2008. In case of DFIs, the ROE position remained worse (-6.9 percent) in 2008. The ROE of PCBs and FCBs were satisfactory in 2008.

Table 5.9 Profitability ratios by type of banks

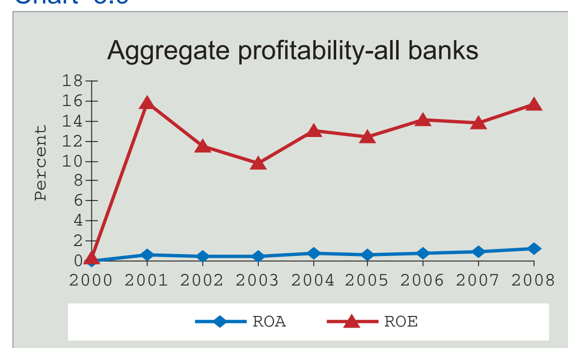
(Percent)

Bank types	Return on assets (ROA)									Return on equity (ROE)								
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2000	2001	2002	2003	2004	2005	2006	2007	2008
SCBs	0.1	0.1	0.1	0.1	-0.1	-0.1	0.0	0.0	0.7	1.7	2.4	4.2	3.0	-5.3	-6.9	0.0	0.0	22.5
DFIs	-3.7	0.7	0.3	0.0	-0.2	-0.1	-0.2	-0.3	-0.6	-68.0	12.3	5.8	-0.6	-2.1	-2.0	-2.0	-3.4	-6.9
PCBs	0.8	1.1	0.8	0.7	1.2	1.1	1.1	1.3	1.4	17.0	20.9	13.6	11.4	19.5	18.1	15.2	16.7	16.4
FCBs	2.7	2.8	2.4	2.6	3.2	3.1	2.2	3.1	2.9	27.3	32.4	21.5	20.4	22.5	18.4	21.5	20.4	17.8
Total	**0.0**	**0.7**	**0.5**	**0.5**	**0.7**	**0.6**	**0.8**	**0.9**	**1.2**	**0.3**	**15.9**	**11.6**	**9.8**	**13.0**	**12.4**	**14.1**	**13.8**	**15.6**

Net Interest Income

5.26 Aggregate net interest income (NII) of the industry has been positive and consistently increased from Taka 8.4 billion in 2000 to Taka 70.9 billion in 2008. However, the NII of the SCBs was a negative amount of Taka 1.2 billion in 2000. The trend continued and the SCBs' NII was -1.8 billion (2001), -1.5 billion (2002), -0.3 billion (2003), -1.1 billion (2004) but in 2005 their

Chart 5.9



positive NII was Taka 7.7 billion and it was Taka 7.9 billion in 2008. The DFIs had a consistent positive trend since 2000 and it was Taka 1.9 billion in 2008.

5.27 Since 2005, SCBs have been able to increase their net interest income (NII) by reducing their cost of fund. The NII of the PCBs has been very high over the period from 2000 through 2008. Overall industry NII shows a consistently upward trend. The trend of NII indicates that the PCBs and the FCBs are charging interests at very high rates on their lending as compared to the interest they are paying to the depositors.

Table 5.10 Net interest income by type of banks

(billion Taka)

Bank types	2000	2001	2002	2003	2004	2005	2006	2007	2008
SCBs	-1.2	-1.8	-1.5	-0.3	-1.1	7.7	9.0	7.4	7.9
DFIs	1.0	2.7	1.4	1.3	1.8	1.0	1.7	1.4	1.9
PCBs	6.1	9.2	10.2	12.0	13.7	21.0	25.4	36.1	48.5
FCBs	2.5	3.3	3.4	3.6	4.2	5.6	8.2	9.9	12.6
Total	**8.4**	**13.4**	**13.5**	**16.6**	**18.3**	**35.3**	**44.3**	**54.8**	**70.9**

Chart 5.10

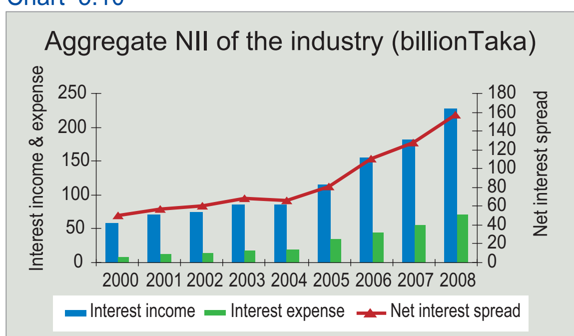


Table 5.11 Liquidity ratio by type of banks

(Percent)

Bank types	Liquid assets									Excess liquidity								
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2000	2001	2002	2003	2004	2005	2006	2007	2008
SCBs	26.5	25.7	27.3	24.4	22.8	20.0	20.1	24.9	32.9	6.5	5.7	7.3	8.4	6.8	2.0	2.1	6.9	14.9
DFIs	16.2	15.3	13.7	12.0	11.2	11.2	11.9	14.2	13.7	9.9	8.9	6.9	5.8	4.7	6.2	3.8	5.6	4.9
PCBs	24.8	24.2	26.3	24.4	23.1	21.0	21.4	22.2	20.7	6.8	6.2	8.5	9.8	8.8	5.1	5.6	6.4	4.7
FCBs	34.7	34.1	41.6	37.8	37.8	41.5	34.4	29.2	31.3	14.8	14.3	21.8	21.9	21.9	23.6	16.4	11.2	13.3
Total	26.1	25.3	27.2	24.7	23.4	21.7	21.5	23.2	24.8	7.5	6.7	8.7	9.9	8.7	5.3	5.1	6.9	8.4

Liquidity

5.28 Commercial bank's demand and time liabilities are at present subject to a statutory liquidity requirement (SLR) of 18 percent inclusive of average 5 percent (at least 4.5 percent in any day) cash reserve requirement (CRR) on bi-weekly basis. The CRR is to be kept with the BB and the remainder as qualifying secure assets under the SLR, either in cash or in government securities. SLR for the banks operating under the Islamic Shariah is 10 percent and the specialised banks (except Basic Bank Ltd.) are exempted from maintaining the SLR. Liquidity indicators measured as percentage of demand and time liabilities (excluding inter-bank items) of the banks indicate that all the banks had excess liquidity.

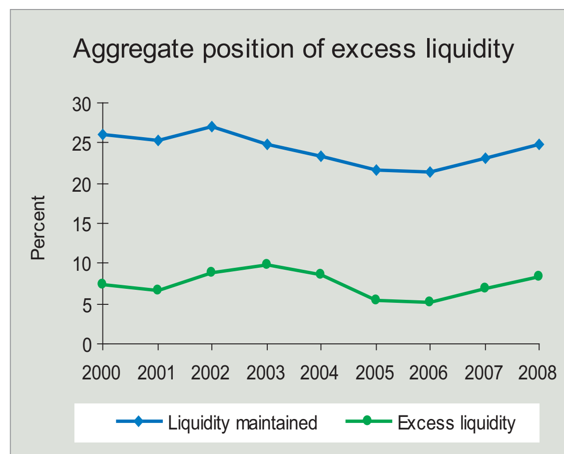
5.29 Table 5.11 and Chart 5.11 show that the SCBs are having the highest liquidity ratios followed by the FCBs. This situation of constant surplus of liquidity warrants creation of effective demand for credit at lower costs.

CAMELS Rating

5.30 Performance indicators of the banking industry depict a trend similar to that of the state-owned banks, which is understandable due to their predominant market share. CAMELS ratings indicate that financial performance of the PCBs and FCBs in general has been better than that of the industry average. Any bank rated 4 or 5 i.e., 'Marginal' or 'Unsatisfactory' under composite CAMELS

rating is generally identified as a Problem Bank. Activities of the problem banks are closely monitored by the Central Bank. BB issues directives from time to time to the problem banks to bring them in good shape. One of the private commercial banks rated CAMELS 5 is still in the problem bank list (seven banks put in this category in the mid nineties). Up to 2005, six such banks were taken off from the problem bank list phase by phase because of their improved performance. Only that very bank was not able to lift its name from the list of problem bank. That bank was categorised as a problem bank mainly due to shortfall of capital, liquidity crisis and large amount of adversely classified loans which had adversely affected the interest of the depositors and therefore BB dissolved the board of directors and removed the chief executive officer of the bank on June 2006 and appointed an administrator to the bank to restore confidence of the depositors and run the bank properly. Simultaneously legal action has already been initiated against the corrupted personnel. The Government, in January 2007, imposed a moratorium (suspension) for six months on all activities of the bank except some kinds of transactions, including limited level of deposit withdrawal. Later on, BB extended the moratorium for twice. The moratorium was imposed for the reconstruction of the bank following an acute financial crisis and fragility including rampant corruption by a section of directors as well as part of management. However, BB lifted moratorium, which came into effect on 5 May 2008. In the meantime, under a reconstruction scheme a foreign financial group purchased 50.1 percent shares of that bank and took over the management of the bank. The bank already changed its name and started its activities in a new name. The performance of that bank has been monitored in accordance with the "Revised Business Plan" submitted by the bank.

Chart 5.11



Later on, another three banks were included in the problem bank list for their unsoundness and unhealthy financial position. 2 out of the 3 banks have already got rid of the list of problem banks due to their overall good performance. Now there are two problem banks and it is expected that in the near future, under the proper monitoring and guidance of BB, both the existing problem banks will come out from the list of problem banks.

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

5.31 BB had introduced Early Warning System (EWS) of supervision from March 2005 to address the difficulties faced by the banks in any of the areas of CAMELS. Any bank found to have faced difficulty in any areas of operation, is brought under Early Warning category and monitored very closely to help improve its performance. Presently 7 banks are monitored under EWS.

5.32 As of end 2008, CAMELS rating of 2 banks was 1 or Strong; 28 banks were rated 2 or Satisfactory; rating of 10 banks was 3 or Fair; 4 were rated 4 or Marginal and 4 banks got 5 or Unsatisfactory rating.

Islamic Banking

5.33 Alongside the conventional interest based banking system, Bangladesh entered into an Islamic banking system in 1983. At present, out of 48 banks in Bangladesh, 7 PCBs are operating as full-fledged Islamic banks and 20 branches of 9 conventional banks are partially involved in Islamic banking. The Islamic banking industry continued to show strong growth since its inception in 1983 to June 2009 in tandem with the growth in the economy, as reflected by the increased market share of the Islamic banking industry in terms of assets, financing and deposits of the total banking system. The entire picture is given at Table 5.12. Total deposits of the Islamic banks and Islamic banking branches of the conventional banks stood at Taka 464.4 billion at end June 2009. This was 26.0 percent of the deposits of all private commercial banks and 17.8 percent of the deposits of the total banking system at the end of June 2009. Total investment of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 434.4 billion at end June 2009. This was 29.3 percent of all private banks and 22.4 percent of the total banking system of the country.

Deposit Insurance Scheme

5.34 Deposit Insurance Scheme was introduced in Bangladesh in August 1984, to act as a safety net. It aims at minimizing or eliminating the risk of loss of depositors' fund with banks. Deposit insurance in Bangladesh is now being governed by the Bank Deposit Insurance Act 2000. A Deposit Insurance Trust Fund (DITF) has also

Table 5.12 Comparative Position of the Islamic Banking Sector (as at end June 2009)

(In billion Taka)

	Group of Banks				
Particulars	Islamic Banks	Islamic Banking Branches	Islamic Banking Sector	Private Commercial Banks[1]	All Banks[2]
1	2	3	4=2+3	5	6
1. Number of Banks	7	9	16	30	48
2. Number of Branches	429	20	44 9	2185 (20.6)	6936 (6.5)
3. Number of Accounts* (in thousand)	5048	n.a	5048	11961 (42.2)	37573 (13.4)
3. Number of Employees	15627	40 3	16030	n.a	n.a
4. Deposits	428.0	36.4	464.4	1783.3 (26.0)	2603.1 (17.8)
5. Investments (Credits)	411.5	22.8	434.4	1483.3 (29.3)	1939.9 (22.4)
6. Investment Deposit Ratio	0.96	0.62	0.94	0.83	0.75
7. Liquidity: Excess (+)/ Shortfall(-)@	35.0	-	35.0	171.0 (20.5)	347.6 (10.0)

Notes : 1/ Figures in the parentheses in column 5 indicate share of percentage of the Islamic banking sector to all private banks.
2/ Figures in the parentheses in column 6 indicate share of percentage of the Islamic banking sector to all banks.
* Figures as at end December 2008.
@ Conventional banks which have Islami banking branches do not maintain SLR individually.
The Head Offices of the respective banks maintain combinedly SLR and liquidity position. n.a = not available

Sources : Research Department, Statistics Department and Banking Regulation & Policy Department, Bangladesh Bank and Central Accounts Departments of all Islamic banks and conventional banks having the Islamic banking branches.

been introduced for providing limited protection (not exceeding Taka 1.0 lac) to a small depositor in case of winding up of any bank. The Board of Directors of BB is the Trustee Board for the DITF. The DITF is now being administered and managed under the guidance of the Trustee Board. BB is now a member of International Association of Deposit Insurers (IADI). As at end June 2009 the total asset of the DITF stood at Taka 11.27 billion of which taka 11.24 billion was invested in Government securities. Revised risk based premium rate was introduced in January 2007. As per new schedule, the banks under problem bank category will have to pay 0.09 percent whereas other banks will pay 0.07 percent as premium on their deposits. To inform the public and for stabilising the payment system in the banking sector, the information regarding deposit insurance scheme, its nature, operating procedures, level of coverage, premium rates and last audited balance sheet (as on 30 June 2008) have been disclosed in BB website. It is mentionable that Board of Directors of BB as the Trustee of the DITF has recently approved new risk based premium rate and amount of coverage, which will come into force after Government approval.

B. Legal Reforms and Prudential Regulations

5.35 As part of the ongoing efforts to strengthen the banking system through the adoption of policies aimed at both improving the financial strength of banks as well as bringing about greater transparency in their operations, several policy measures were initiated during FY09.

Capital Adequacy of the Banks

5.36 With a view to strengthening the capital base of banks and making them prepared for the implementation of Basel II accord, banks are required to maintain a ratio of capital to risk-weighted assets of not less than 10 percent with at least 5 percent in core capital effective from 31 December 2007. However, minimum capital requirements (paid up capital and statutory reserve) for all banks has been raised to Taka 4.0 billion of which the paid up capital shall be minimum Taka 2.0 billion. Banks having capital shortfall will have to meet the shortfall by 11 August 2011.

Any banking company can invest up to a maximum 10 percent of its total capital in any bond/debentures of a company approved by Securities and Exchange Commission effective from 28 January 2008.

Interest Rate Policy

5.37 Banks in general are free to charge/fix their deposit and lending rate. However, the maximum cap of 7 percent interest rate on export credit has been fixed by BB to facilitate export earning. Considering the existing inflation rate and global economic situation, the maximum rate of interest on agriculture, term loans and working capital for large and medium scale industry, housing sector loan, trade financing and financing to Non-Bank Financial Institutions by banks has been fixed at 13 percent. Also, with a view to ensuring adequate supply of essential commodities and keeping the price of these commodities within a reasonable limit during Ramadan, the rate of interest on import financing of edible oil (crude and refined), chickpeas, lentils, beans, onions, spices, dates, fruits and sugar (refined & raw sugar/raw cane sugar) has been fixed to a maximum of 12 percent.

Banks are allowed to differentiate interest rate up to a maximum of 3 percent 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 percent 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 BB, banks shall report their own maximum cap. Banks have also been advised to upload their deposit and lending interest rate in their respective website.

Banks have been advised to display the complete schedule of charges in suitable visible places in their branches and head offices for the information of their customers and upload the same in their respective website as well.

Maintaining Adequate Security of Lockers

5.38 BB has issued detailed 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.

SCB Reforms Programme

5.39 With a view to minimizing the losses and improving the soundness and efficiency of the banking sector, the Government of the People's Republic of Bangladesh (GOB) has already corporatized 3 SCBs (Agrani, Janata, and Sonali Bank). After corporatisation, the Board of Directors of the above three SCBs have been reconstructed and the power and accountability of the board have also been increased. The performance of the CEOs of these three SCBs is being closely monitored under some sets of indicators on quarterly basis by SCB monitoring cell. The banks are running under their respective Memorandum and Articles of Association and a positive impact of these changes is observed from the financial indicators of these banks. The benefits of corporatization in the form of efficiency and profitability hopefully will be more visible on the upcoming years. Rupali Bank Limited was converted into public limited company previously. All these four banks have signed Memorandum of Understanding (MoU) with BB and the banks are being closely monitored by the DOS of BB.

Maintaining General Provision against Off-balance Sheet Item

5.40 It is further to mention that banks are advised to maintain general provision against Off-balance sheet exposures in the following manner

1. 0.5 percent provision effective from 31 December 2007 and
2. 1.0 percent provision effective from 31 December 2008

Progress of Basel II implementation in Bangladesh

5.41 BB has commenced the implementation of Basel II from January 2009 and has provided banks with a Guideline on ‘Risk Based Capital Adequacy for Banks (Revised regulatory capital framework in line with Basel II)’ vide BRPD circular no. 9/2008. (Box 5.1)

The framework is based on three mutually reinforcing pillars: (i) new and considerably more sophisticated minimum capital requirements, (ii) banks’ own assessments of their capital adequacy and enhanced supervision of capital management, and (iii) materially increased disclosure requirements.

All scheduled banks submit their reporting according to Basel II guideline on quarterly basis. To review the implementation progress, BB has arranged meeting with all banks on the basis of their difficulties in implementation of the guideline.

Box 5.1

Revised regulatory framework for Capital adequacy in line with Basel II

Banks operating in Bangladesh are maintaining Risk Based Capital (Basel I) instead of capital-to-liabilities approach from 1996. According to Basel I banks are maintaining Minimum Capital Requirement (MCR) on the basis of Risk-Weighted Asset (RWA) and Risk Weights were fixed i.e. 0%, 20%, 50%, & 100%. But this 'one size fits to all' approach nowadays lost its acceptability. To make the bank capital more risk sensitive and more shock absorbent Bangladesh Bank (BB) decided to introduce Basel II. In order to make the banks prepared Bangladesh Bank (BB) started parallel run of Basel I & Basel II for one year from January 01, 2009 and has formally introduced Basel II rules titled Risk Based Capital Adequacy (RBCA) for banks (Revised Regulatory Capital framework in line with Basel II) from January 2010. The techniques of calculating RWA will follow Standardized Approach for Credit Risk, Standardized (Rule Based) Approach for Market Risk and Basic Indicator Approach for Operational Risk. In Standardized Approach, risk weight of exposures will be differentiated based on external credit rating and the risk weights will be directly related to the credit rating of the counter party. For this purpose, a guideline on recognition of Eligible External Credit Assessment Institutions (ECAIs) has been published through BRPD circular 07/2008. BB has already completed recognition process by ensuring ECAIs eligibility criteria. BB has mapped RW with ECAI's rating grade. Lose

In addition to computing MCR banks have to calculate **Adequate Capital** according to procedure as stated in the Supervisory Review Process (SRP) of Basel II. For calculating the Adequate Capital, preparation of a Process Document i.e. Internal Capital Adequacy Assessment Process (ICAAP) is an enormous job for the banks. The areas to be covered by the process document are review and evaluation of risk management and planning for adequate capital against comprehensive risk profile of the individual banks. Comprehensive risk profile is defined as; Credit + Market + Operational + other risks which are not captured by MCR e.g. Residual risk, liquidity risk, loan pricing risk, risk appear from stress test of a bank, etc. Thus, ICAAP will establish link between Capital Adequacy and level of Risk Management of bank assets.

With a view to settle roadmap on implementing Basel II rule, BB conducted two sorts of study i.e. to assess supervisory effectiveness of BB and readiness of banks for adopting Basel II. Both the studies show , operational independence of BB; supervisory tools, existing prudential regulations for core risk management as introduced in the banking industry as well as capability of banks to identify measure and mitigate the risks running favorable position for launching Basel II regime. Accordingly, roadmap on Basel II implementation was declared in 2007 and compliance by banks parallel to current regulation launched from January 2009. BB is pursuing consultative approach to implement Basel II in Bangladesh. A National Steering Committee headed by Deputy Governor of BB, a Coordination Committee headed by an Executive director and Basel II Implementation Cell has been formed.

Banks would maintain cushion named 'Specific Provision' through 'loan classification' process. Specific provision is one sort of reserve fund; it's not part of regulatory capital. Such cushion fund is purposive and maintained to meet expected losses from classified loan & advances. On Regulatory Capital is maintained to meet unexpected loss.

A comparison of computing capital charge under Basel I and Basel II are shown below :

Basel I:	Basel II:
Case-1 Tk. 100 million corporate loan/investment with client's credit rating '1'would necessitate Tk.100 m x 100% x 10% = BDT 10 million capital charge. **Case-2** Tk. 100 million corporate loan/investment with client's credit rating '5' would necessitate Tk. 100 m x 100% x 10% = BDT 10 million capital charge. In the two cases above, borrower of 1st case is better than that of 2nd case-2 in consideration of credit rating. But as per Basel I rules, necessitate equal amount of capital charge and ignore good or worse status of borrower/client.	**Case-1** Tk. 100 million corporate loan/investment with client's credit rating '1'would necessitate Tk.100 m x 20% x 10% = BDT 2 m capital charge. [Since the corporate credit rating '1' mapped with 20 % RW as per RBCA guidelines (Basel II rules) for banks in Bangladesh] **Case-2** Tk. 100 million corporate loan with client's credit rating '5' would necessitate Tk. 100 Crore x 150% x 10% = BDT 15 m capital charge. [Since the corporate credit rating '5' mapped with 150 % RW as per RBCA guidelines] In the Two cases above 1st case necessitate lower amount of capital than that of 2nd case in consideration of good or worse status respectively. It established rationality.

Box 5.1

Revised Regulatory Framework for Capital Adequacy in line with Basel II *(Contd.)*

An impact study (30th June, 2009) and steps taken by BB during parallel run period : (Taka In crore)

	SCBs (4)	Specialised Bank (5)	Private Bank (23)	Islamic Bank (7)	Foreign Bank (9)	Total
A. BASEL I						
Risk Weighted Assets (RWA)	45,003	17,889	96,681	37,146	16,647	213,369
Capital Adequacy Ratio(CAR)	9.07%	0.21%	12.70%	10.27%	28.26%	11.68%
B. BASEL II						
Risk Weighted Assets (RWA)	62,568	17,923	134,986	44,953	23,816	284,248
Capital Adequacy Ratio(CAR)	6.44%	0.41%	9.06%	6.07%	19.78%	8.36%
C. Changes in RWA & CAR						
Change in RWA (+/-)	+39.03%	+0.19%	+39.62%	+21.02%	+43.06%	+33.22%
Change in CAR (+/-)	-2.63%	+0.20%	-3.64%	-4.20%	-8.48%	-3.32%

The reasons for increase in RWA are, Basel II considers additional two risks named Market Risk and Operational Risk along with Credit risk for calculating Risk Weighted Asset (RWA). It is observed in the submitted statement that no borrower/client of the banks complete their credit rating by ECAIs and reporting was based on Unrated (125%). Adopting Supervisory Review Process (SRP) to determine Adequate Capital and disclosure framework are in progress.

In this regard meeting with each bank separately have been completed in the presence of the Managing Director/ CEOs. Most of the Banks mentioned that they are trying to motivate clients for getting the credit rating they optimistically expect 10-15% corporate will get their credit rating within March 2010. One of the common findings of one-to-one meeting with Banks is that most of the Banks concentrated on calculation of Minimum Capital Requirement (MCR) under Pillar 1 of Basel II and honestly confessed that they are now serious about the Adequate Capital as required under Supervisory Review Process (SRP). Each bank is drafting Internal Capital Adequacy Assessment Process (ICAAP) to correlate risk management with the determination of Adequate Capital. Accordingly, BB has asked each bank to submit their action-plan regarding: (i) Credit rating (ii) Time frame for drafting and approving ICAAP and (iii) Capital growth plan. So, hope banks are active enough and good number of bank borrowers will get their credit rating by the end of 1st quarter of 2010. Banks have already agreed to complete drafting as well as approving ICAAP and disclosure framework (provided in the RBCA guideline) during the 1st quarter of 2010.

Corporate Governance in Banks

5.42 Liquidity and solvency problems caused by poor governance in banks can have harmful systematic consequences in the broader economy reliant on banks for credit and payment services. High priority is therefore accorded to give corporate governance in banks, putting in place checks and balances comprising a mix of legal, regulatory and institutional provisions specifying the roles and accountabilities of the board, the executive management, external and internal audit, disclosure and transparency prescriptions (Box 5.2).

Corporate governance is a sine-qua-non for a sound financial system in PCBs. Good corporate governance can contribute substantially to a shared working environment between banks and its' supervisors. It supports not only a well-managed banking system but also necessary to protect depositors' interest. BB has taken several measures in recent times to put in place good corporate governance in banks. These include fit and proper test for appointment of chief executive officers of PCBs; constitution of audit committee of board and enhanced disclosure requirements etc. In continuation of the above reforms, the roles and functions of the Board and

Box 5.2

Lessons from the Financial Crisis - The Importance of Strengthening Risk Management and Corporate Governance

The financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements. When they were put to a test, corporate governance routines did not serve their purpose to safeguard against excessive risk taking in a number of financial services companies. In 2008, a series of banks and financial institutions failures triggered a financial crisis that effectively halted global credit markets and required unprecedented government intervention. By mid 2008, it was clear that the crisis in the sub-prime market in the US, and the associated liquidity squeeze, were having a major impact on financial institutions and banks in many countries. Management oversight and supervisory slackness have also proved ineffective in some areas. The current turmoil in financial institutions is sometimes described as the most serious financial crisis since the Great Depression. It is therefore natural for each concern to examine this situation and assess the main lessons for corporate governance in general as because if there is one major lesson to draw from the crisis, it is that corporate governance matters. The risk management systems have failed in many cases due to corporate governance procedure. Other aspects of the corporate governance framework that contributed to the failures that include credit rating agencies, accounting standards and regulatory issues. When times were good, it seems that many took their eye off the ball and now we see the consequences. A firm’s rising share price is not necessarily a sign of good corporate governance. History tells us that it could actually be the opposite.

The risk management function needs to be independent and empowered to build a genuinely risk-aware culture in each organization, by clearly articulating and monitoring the company’s risk tolerance. Every risk exposure that a financial institution takes must be measured with a well defined financial model using data from the financial statements of the customers which reflect true and fair picture of the company. These are indispensable tools for developing business and gauging capital adequacy. Liquidity risk management is distinct from capital adequacy. Specially in a volatile market where competition is intense, liquidity risk plays a major role. Actually the crisis in discussion started as liquidity risk and later transformed into credit risk when financial institutions could not support the asset they were holding and ultimately, price of the assets declined resulting in a total meltdown. Fair valuation of the asset possessed by the bank and disclosure of classification of such asset is very important. Mortgage back securities lost their value over night due to the fair value determination based on market dynamics. Effective risk management is based on a foundation of good corporate governance and rigorous internal controls. It is vital that managers make certain that their commitment to an environment that includes effective risk management and rigorous controls filters fully down the line to all employees in their organisation. Official regulation and supervision provide a second line of defense against financial instability. Official supervision must evolve in line with the way financial institutions manage their activities, which is increasingly across business lines rather than across legal entities. The Basel Committee on Banking Supervision has developed principles for sound and effective banking supervision and continues to add to its guidance on minimum and advanced supervisory practices. Its proposed revisions to the Basel Capital Accord call for these principles to be applied to all internationally active banks within a more dynamic, risk-based, and process-oriented framework. The revisions are intended to align regulatory capital requirements more closely with underlying risks and to provide banks and their supervisors with a range of options for the assessment of capital adequacy. The third line of defense against financial instability is effective market discipline, an increasingly importantly of policymakers in a global marketplace. If market discipline is to be effective, however, it must be supported by substantial and meaningful public disclosure— as well as sound accounting standards and an efficient and credible legal framework. Integrity of auditor can play a large role for depicting a true picture in the financial statements. An effective risk management and control structure is not sufficient, however, if it is not accompanied by an institutional culture that ensures that written policies and procedures are actually translated into practice. Ultimately, an institution's culture is determined by the board of directors and the senior management it installs. Board of directors of a financial institution is the linkage between share-holders and the management of the bank, setting policies to achieve goals of the bank; setting over-all culture of the organisation. A board well composed with representative form independent members, stake-holders; having expertise in financial industry depositors will not only set the policy to avoid uncompensated risk, but a strategy to achieve long term goals as well.

With a view to ensuring good and corporate governance in the bank management in Bangladesh, Bangladesh Bank has issued detailed guidelines covering the specific demarcation of responsibilities and authorities among the board of directors, its chairman, Chief Executive Officer (CEO) of and adviser to the private bank in respect of its overall financial, operational and administrative policy making 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.

Management were redefined and clarified with a view to specifying the powers of the management and restricting the intervention of directors in day-to-day management of the bank.

Corporate Social Responsibility

5.43 Corporate social responsibility (CSR) is mainly about the awareness of and actions in support of environmentally sustainable societal development. Yet to be mainstreamed into corporate practice with a firmed up definition, CSR actions aim at mitigating the diverse environmental impacts of the activities of the business, and at reducing inequalities and alleviating deprivation and poverty in the communities across the country. In the wide range of possible CSR actions, each business is expected to focus on areas of their core strength, working separately or in network with others. Well chosen, well executed CSR actions can enhance the longer run competitive position of a business; bringing in environmentally sounder practices, increased employee loyalty and commitment, actual and potential increase in customer base.

CSR activities are yet to be mainstreamed into corporate practice in Bangladesh, in the banking sector or elsewhere. A few FCBs and multinational corporate are undertaking CSR actions in Bangladesh, in line with the practices in their home countries. Many local banks and other businesses are already spending money philanthropically out of their profits in improving welfare of the poorer sections of the society; their actions should to be easy to be formalized into CSR initiatives, with appropriate sensitisation and encouragement. Well chosen CSR actions by banks may serve to fill prevailing market gaps and market failures, such as scant availability of business loans for SMEs and crop loans for small farmers. To this end, BB has issued guidelines for mainstreaming CSR in the financial sector in Bangladesh, encouraging banks and financial institutions to embrace CSR voluntarily in their management strategies, objective, and practices. BB also directed the banks to include their CSR activities in their Annual Report as a part of fair disclosures.

Activities of Credit Information Bureau

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

5.45 The workload of the bureau kept on increasing unabated in terms of number of requests, number of borrowers and owners, number of reporting banks/financial institutions. CIB database consists of detailed information in respect of individual borrowers, owners and guarantors; the total number of 2,054,256 which was (end June 2009 active & inactive) recording increased of 24.08 percent over the previous period (1,655,591 as of end June 2008). The number of CIB reports supplied during FY09 (end June 2009) stood at 848,114 as compared to 764,461 in the FY08 (end June 2008). As per existing service standard, the credit reports are supplied within 5 working days of receiving the request, the volume of which was around 3800 per day during FY09.

5.46 The achievement of Credit information bureau in fulfilling its objectives of bringing down the extent of default loan has been found quite remarkable. As per reporting of scheduled banks/financial institutions, the classified loan

decreased during FY09 (end June 2009).The classified loan decreased to 9.57 percent at end June 2009 compared to 11.93 percent in the preceding year (end June 2008). The percentage of such classified loan was 34.90 in December 2000. It may be mentioned that with effect from June 2004 quarter the amount of "Written-off" loan was excluded from both classified and outstanding loans, and after exclusion the percentage of classified loan stood at 9.57 as on 30 June 2009.

5.47 In order to ensure prompt collection of credit data from the sources as well as instantaneous delivery of credit report to the users by applying latest computer technology, the CIB started diagnostic analysis of the customer and the central bank with effect from 13 July 2007 under DFID financial assistance programme aimed at implementing on-line services between the bureau and lending institutions. The selected vendor CRIF (Italy) of CIB online project has started project work from 3 May 2009. The project of implementing on-line connectivity between CIB and the Head Offices of the banks and financial institutions is expected to be completed by 1 October 2010.

C. Supervision of Banks

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

On-site Inspection of Banks

5.49 BB, being the Central Bank of the country, is entrusted with the responsibility to regulate and supervise the banks and financial institutions operating in the country. Inspection of banking companies is assigned on BB under article 7A (f) of the Bangladesh Bank Order 1972 and section 44 of the Banking Companies Act 1991. As part of Bank's statutory function, three departments of the BB namely Department of Banking Inspection-1 (DBI-1), Department of Banking Inspection-2 (DBI-2) and Foreign Exchange Inspection and Vigilance Department (FEIVD) are conducting the inspection activities. These three departments conduct on-site inspection on SCBs, DFIs, PCBs (including banks under Islamic Shariah), FCBs and other institutions including Investment Corporation of Bangladesh (ICB) and Money Changers. Basically, two types of inspections are conducted namely (i) comprehensive inspection, and (ii) special inspection.

The broad objectives of on-site inspection are as follows:

- To ensure safety, stability and discipline in banking sector;
- To ensure compliance of banking laws, rules and regulations;
- To evaluate quality and performance of bank management and Board of Directors;
- To identify weaknesses which are to be addressed to strengthen the banks and
- To evaluate financial soundness and operational efficiency of the banks.

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

conducted on the banks on specific/particular issue(s) as well as to investigate complaints received from the depositors, general public or institutions. Moreover to oversee risk management practice of the banks and implementation of core risk management guidelines by the banks, system inspections were conducted.

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

5.51 DBI-1 and DBI-2 conducted a total number of 1989 inspections throughout banking sectors under comprehensive inspection programme during FY09 including 46 Head Offices, 520 big branches and 1423 small branches. Under the special inspection programme, a total number of 538 inspections were carried out by DBI-1 and 2 regarding risk-based audits and others during FY09.

5.52 FEIVD conducted inspection on foreign trade financing, treasury functions of banks, foreign exchange risk management of banks; foreign exchange transactions of banks and money changers. In FY09, FEIVD conducted a total number of 219 inspections including 35 head offices, 184 authorised dealer branches. Besides, FEIVD conducted 160 special inspections on various banking irregularities, 46 special inspections on foreign exchange risk management, and 239 inspections on money changers.

Financial Institutions

5.53 Financial Institutions (FIs) represent one of the most important segments of financial system and play very important role in mobilizing and channeling resources in Bangladesh. Non-Bank Financial Institution comprises investment and finance companies, leasing companies etc. FIs numbering 29 as of December 2008 (starting from IPDC in 1981) are regulated by the Financial Institutions Act, 1993 and the regulations made there under. In view of their increased role in financing industry, trade and commerce, transport, Information technology, housing etc. the minimum capital requirement of the FIs was raised to Taka 0.25 billion vide FID circular 2, dated 29 June 2003, Most of the FIs (except One) have raised their required capital. 20 FIs have issued IPO, three of them are given waiver from issuing IPO (Initial Public Offering) and rest of them have been asked to issue IPO and raise their capital as required level. FIs are allowed to participate in the call money market upto 15 percent of their total net assets. Total investment of FIs in different sectors up to 30 June 2009 were Taka 131.65 billion. Investment in capital market was Taka 8.26 billion. Since December 2000, classification of loan/lease and provisioning there against has been introduced for FIs like the banking companies. As on 30 June 2009, total classified loan/lease stood at Taka 8.91 billion or 7.22 percent of total loan/lease which shifted to 7.84 percent as of 30 September, 2009.