Banking Sector Performance, Regulation and Bank Supervision

5.1 Bangladesh Bank (BB) 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 (i.e. Stress Testing & Risk Management Guidelines) initiated by BB for banks and financial institutions and 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 financial institutions (DFIs), private commercial banks (PCBs) and foreign commercial banks (FCBs). The number of banks remained unchanged at 48 in 2009. These banks had a total number of 7095 branches as of December 2009. The number of bank branches increased from 6886 to 7095 owing mainly to opening of new branches by the PCBs during the year. At the end of FY10, the total number of banks decreased to 47 with branches totalling 7246 (Appendix-3, Table-I). 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	2008						2009					
	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	3386	1030.9	31.1	758.8	29.6	4	3387	1135.6	28.6	869.1	28.6
DFIs	5	1362	222.3	6.7	137.8	5.4	5	1365	261.9	6.6	161.1	5.3
PCBs	30	2082	1794.5	54.2	1450.7	56.6	30	2285	2275.7	57.4	1792.4	59.0
FCBs	09	56	265.8	8.0	214.1	8.4	09	58	292.6	7.4	215.0	7.0
Total	**48**	**6886**	**3313.5**	**100.0**	**2561.4**	**100.0**	**48**	**7095**	**3965.8**	**100.0**	**3037.6**	**100.0**

5.3 In 2009, the SCBs held 28.6 percent of the total industry assets as against 31.1 percent in 2008. PCBs' share rose to 57.4 percent in 2009 as against 54.2 percent in 2008. The FCBs held 7.4 percent of the industry assets in 2009, showing a declining trend by 0.6 percentage points over the previous year. The DFIs' shares of assets were 6.6 percent in 2009 against 6.7 percent in 2008.

5.4 Total deposits of the banks in 2009 rose to Taka 3037.6 billion from Taka 2561.4 billion

Chart 5.1

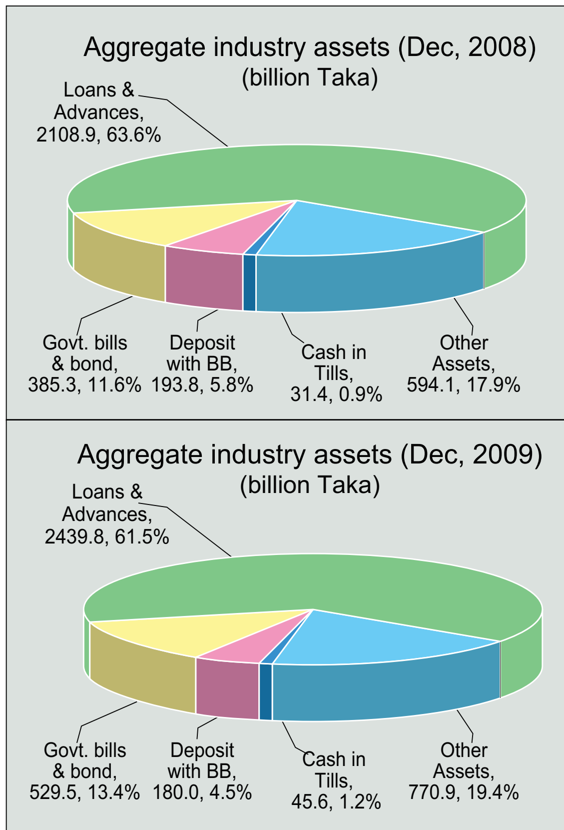
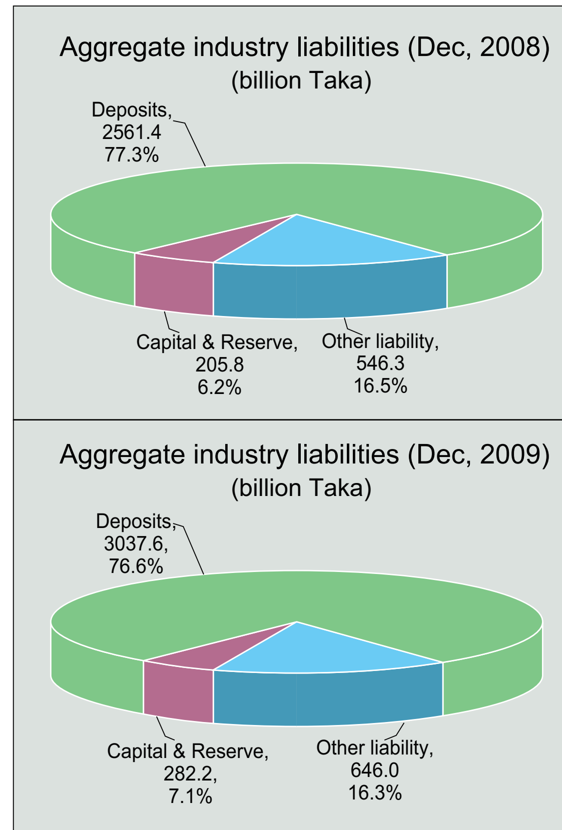


Chart 5.2



in 2008 showing an overall increase by 18.6 percent. The SCBs' (comprising the largest 4 banks) share in deposits decreased from 29.6 percent in 2008 to 28.6 percent in 2009. On the other hand, PCBs' deposits in 2009 amounted to Taka 1792.4 billion or 59.0 percent of the total industry deposit against Taka 1450.7 billion or 56.6 percent in 2008. FCBs' deposits in 2009 rose only by Taka 0.9 billion over the year. The DFIs' deposits in 2009 were Taka 161.1 billion against Taka 137.8 billion in 2008 showing an increase of 16.9 percent over the year.

Aggregate Balance Sheet

5.5 **Assets:** Aggregate industry assets in 2009 registered an overall increase by 19.4 percent over 2008. During this period, SCBs' assets increased by 10.2 percent and those of the PCBs' increased by 26.8 percent. Loans and advances played a major role on the uses of fund. Loans and advances amounting to Taka 2439.8 billion out of aggregate assets of Taka 3965.8 billion constituted the most significant portion (61.5 percent). Cash in tills were Taka 45.6 billion (1.2 percent); deposits with BB were Taka 180.0 billion (4.5 percent); other assets were Taka 771.0 billion (19.4 percent) and investment in government bills and bonds were Taka 529.5 billion (13.4 percent) (Chart 5.1).

5.6 **Liabilities:** The aggregate liability portfolio of the banking industry in 2009 was Taka 3965.8 billion of which deposits constituted Taka 3037.6 billion (76.6 percent) continued to be the main sources of fund of

banking industry. Capital and reserves of the banks were Taka 282.2 billion (7.1 percent) in 2009, as against Taka 205.8 billion (6.2 percent) in 2008.

Performance and Rating of Banks

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 (including implementation status of Core Risk Management Guidelines), (iv) Earnings, (v) Liquidity, and (vi) Sensitivity to market risk.

Capital Adequacy

5.8 Capital adequacy focuses on the total position of banks' capital and 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, etc.). Banks in Bangladesh were instructed, under Basel -I, 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 2009 the SCBs, DFIs, PCBs and FCBs maintained CAR of 9.0, 0.4, 12.1 and 28.1 percent respectively. 1 SCB, 1 DFI and 4 PCBs (including 2 problem banks) could not maintain required CAR. The CARs for the SCBs, DFIs, PCBs and FCBs were 5.7, -2.6, 8.7 and 16.7 percent respectively at the end of FY10 (Appendix-3, Table-II). All foreign banks have maintained minimum capital for Taka 2.0 billion. The CAR of the banking industry was

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

(Percent)

Bank types	2001	2002	2003	2004	2005	2006	2007	2008	2009
SCBs	4.3	4.1	4.3	4.1	-0.4	1.1	7.9	6.9	9.0
DFIs	3.9	6.9	7.7	9.1	-7.5	-6.7	-5.5	-5.3	0.4
PCBs	9.9	9.7	10.5	10.3	9.1	9.8	10.6	11.4	12.1
FCBs	16.8	21.4	22.9	24.2	26.0	22.7	22.7	24.0	28.1
Total	**6.7**	**7.5**	**8.4**	**8.7**	**5.6**	**6.7**	**9.6**	**10.1**	**11.6**

Chart 5.3

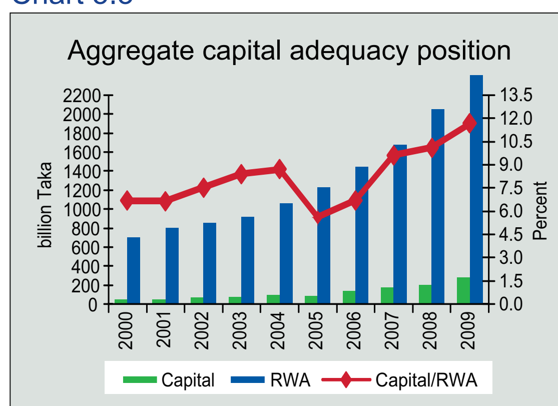


Table 5.3 NPL ratios by type of banks

(Percent)

Bank types	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
SCBs	38.6	37.0	33.7	29.0	25.3	21.4	22.9	29.9	25.4	21.4
DFIs	62.6	61.8	56.1	47.4	42.9	34.9	33.7	28.6	25.5	25.9
PCBs	22.0	17.0	16.4	12.4	8.5	5.6	5.5	5.0	4.4	3.9
FCBs	3.4	3.3	2.6	2.7	1.5	1.3	0.8	1.4	1.9	2.3
Total	**34.9**	**31.5**	**28.0**	**22.1**	**17.6**	**13.6**	**13.2**	**13.2**	**10.8**	**9.2**

11.6 percent in 2009 as against 10.1 percent in 2008. It stood at 7.9 percent at the end of FY10 (Appendix-3, Table-II).

Asset Quality

5.10 The asset composition of all commercial banks shows the concentration of loans and advances (61.5 percent). The high concentration of loans and advances indicates vulnerability of assets to credit risk, especially because of having significant portion of

non-performing assets. A huge non-performing loan portfolio has been the major predicament of banks particularly of the state-owned commercial banks. However, investment of banks in bills, bonds, shares etc also demonstrates somewhat concentration, which is 14.7% of Total Assets.

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 total loans. FCBs have the lowest and DFIs have the highest ratio of gross NPLs to total loans. SCBs had gross NPLs to total loans ratio of 21.4 percent whereas in case of PCBs, FCBs and DFIs, the ratios were 3.9, 2.3 and 25.9 percent respectively at the end of December 2009. The gross NPLs to total loans ratios for the SCBs, PCBs, FCBs and DFIs were recorded as 20.5, 3.7, 2.4 and 24.6 percent respectively at the end of FY10 (Appendix-3, Table -III).

5.12 The ratio of NPL to total loans of all the banks shows an encouraging trend since its decline from the peak (34.9 percent) in 2000, although the aggregate ratio was still as high as 9.2 percent in December 2009. The reason is being high NPL of the SCBs and the DFIs. The ratio ended up 8.7 percent at the end of FY10 (Appendix-3, Table -IV).

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 accumulated bad loans because of poor

Chart 5.4

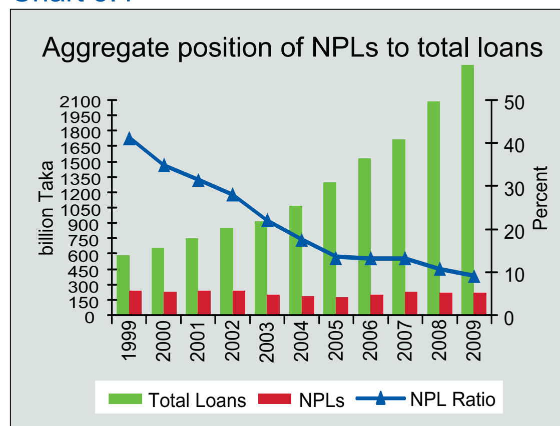


Table 5.3(a) Ratio of net NPL to total loans by type of banks

(Percent)

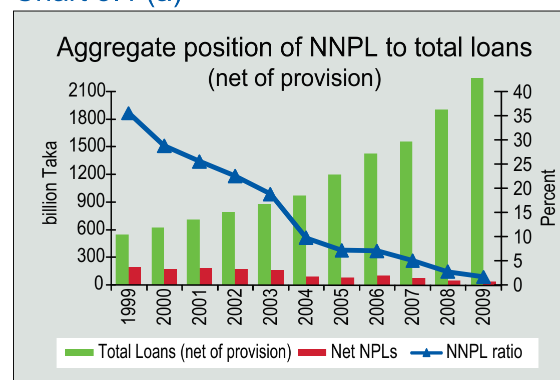
Bank types	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
SCBs	34.1	32.8	30.1	28.3	17.6	13.2	14.5	12.9	5.9	1.9
DFIs	54.6	54.5	48.0	38.3	23.0	22.6	23.6	19.0	17.0	18.3
PCBs	15.5	10.5	10.5	8.3	3.4	1.8	1.8	1.4	0.9	0.5
FCBs	-0.1	-0.3	-0.4	0.1	-1.5	-2.2	-2.6	-1.9	-2.0	-2.3
Total	28.8	25.6	22.6	18.8	9.8	7.2	7.1	5.1	2.8	1.7

Table 5.4 Required provision and provision maintained -all banks

(billion Taka)

All banks	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Amount of NPLs	228.5	236.0	238.6	203.2	187.3	175.1	200.1	226.2	224.8	224.8
Required provision	98.4	101.6	106.8	92.5	87.8	88.3	106.1	127.2	136.1	134.8
Provision maintained	58.1	61.4	59.6	37.3	35.9	42.6	52.9	97.1	126.2	137.9
Excess(+)/ shortfall(-)	-40.3	-40.2	-47.2	-55.2	-51.9	-45.7	-53.2	-30.1	-9.9	3.1
Provision maintenance ratio (%)	59.1	60.5	55.8	40.3	40.9	48.2	49.9	76.3	92.7	102.3

Chart 5.4 (a)



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 1.9 percent (SCBs), 18.3 percent (DFIs), 0.5 percent (PCBs) and 1.7 percent (banking sector) in 2009. It reveals from the table that DFIs' non-performing portfolios were still high after adjustment of actual provision and interest suspense, whereas FCBs had excess provision against their NPLs. The net NPLs to net total loans ratios were 3.4, 15.3, 0.25 and 1.7 percent for the SCBs, DFIs, PCBs and all banks respectively at the end of FY10 (Appendix-3, Table -IV).

5.15 Chart 5.5 displays the amounts in NPLs of the 4 types of banks since 2000 through 2009. Amount of NPLs of the SCBs increased from Taka 117.3 billion in 2000 to Taka 121.6 billion in 2009. The PCBs recorded a total increase of Taka 21.5 billion in their NPL accounts, which stood at Taka 67.7 billion in 2009 as against Taka 46.2 billion in 2000. The amount of NPLs of the DFIs decreased to Taka 42.9 billion in 2009 from Taka 63.7 billion in 2000. It shows from the Chart 5.4(a) that the decline in NPLs to total loans ratio in the recent 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 2000 to 2009.

Chart 5.5

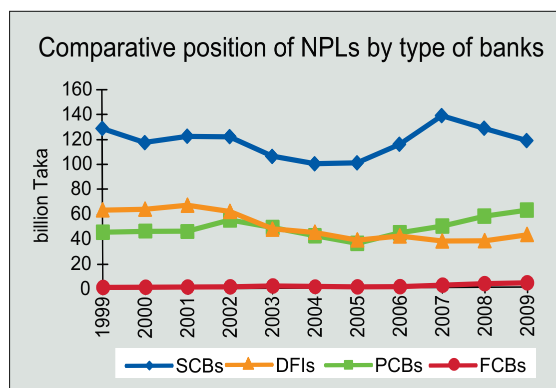


Chart 5.6

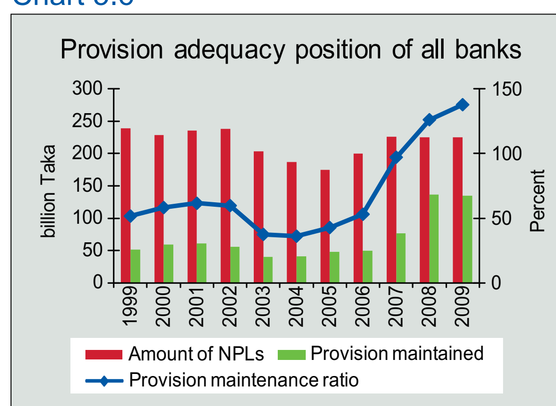
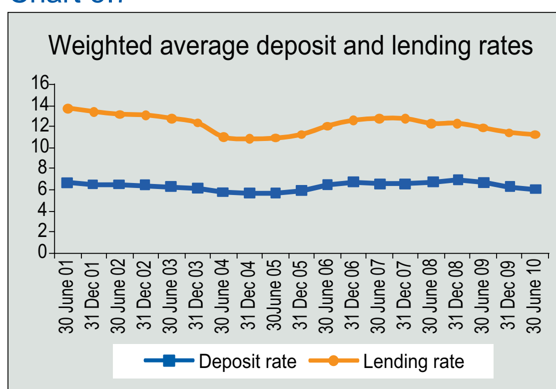


Table 5..5 Comparative position of provision adequacy

(billion Taka)

Year	Items	SCBs	DFIs	PCBs	FCBs
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
2009	Required provision	66.0	17.5	46.5	4.6
	Provision maintained	79.5	8.9	43.6	5.9
	Provision maintenance ratio (%)	120.5	50.9	93.8	128.3

Chart 5.7



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 from 2000 through 2009. Table 5.4 shows that in 2009 the banking sector has been able to maintain 100% or more provision for the first time. During the years from 2000 through 2009, the banks maintained 60.5 percent of the required provision in 2001; which increased thereafter to 102.3 percent in 2009. The main reasons for the shortfall in provision adequacy from 2000 through 2008 was the inability of some SCBs, DFIs and PCBs including those in problem bank category to make sufficient provisions due to inadequate profits and 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 2008 and 2009 is shown in Table 5.5.

5.18 Twenty eight out of thirty PCBs could maintain required provision, the remaining 2 failed due to their poor asset portfolios and earning level, at the end of December 2009.

Weighted Average Deposit and Lending Rates

5.19 Banks weighted average deposit rate decreased from 6.33 percent to 5.96 percent and weighted average lending rate decreased from 11.44 percent to 11.23 percent during the second half of FY10 (31/12/2009 to 30/06/2010). The spread between lending and deposit rates increased from 5.11 percent to 5.27 percent during the same period. Weighted average deposit and lending rates along with the spread during 30/06/2001 to 30/06/2010 have been shown in table 5.6 and 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

Table 5.6 : Weighted average deposit and lending rates (From 30 June 2001 to 30 June 2010)

(Percent)

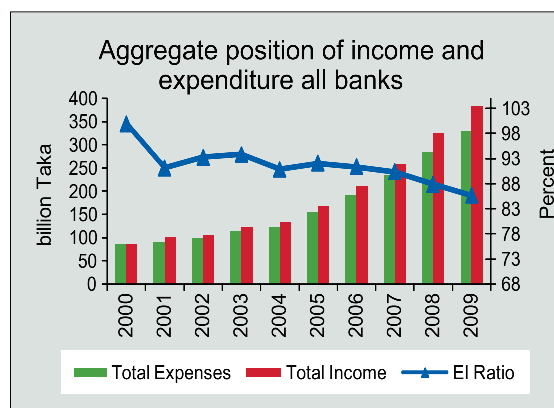
Date	Weighted average		Spread
	Deposit rate	Lending rate	
30 June 01	7.03	13.75	6.72
31 Dec 01	6.75	13.42	6.67
30 June 02	6.74	13.16	6.42
31 Dec 02	6.49	13.09	6.60
30 June 03	6.30	12.78	6.48
31 Dec 03	6.25	12.36	6.11
30 June 04	5.65	11.01	5.36
31 Dec /04	5.56	10.83	5.27
30 June 05	5.62	10.91	5.31
31 Dec 05	5.90	11.25	5.35
30 June 06	6.68	12.06	5.38
31 Dec 06	6.99	12.60	5.61
30 June 07	6.85	12.77	5.92
31 Dec 07	6.77	12.75	5.98
30 June 08	6.94	12.29	5.39
31 Dec 08	7.31	12.31	5.00
30 June 09	7.01	11.87	4.86
31 Dec 09	6.33	11.44	5.11
30 June 10	5.96	11.23	5.27

Table 5.7: Writing-off bad debts in different bank categories (From 30 June 2004 to 30 June 2010)

(billion Taka)

Bank types	30/6/04	30/06/05	30/06/06	30/06/07	30/06/08	30/06/09	30/06/10
SCBs	26.3	29.7	35.7	42.8	48.4	64.5	70.5
DFIs	17.4	27.6	28.6	30.4	31.0	31.8	31.8
PCBs	21.2	32.9	40.7	45.5	49.4	54.7	69.6
FCBs	0.9	1.1	1.5	1.6	1.7	2.0	2.1
Total	**65.8**	**91.3**	**106.5**	**120.3**	**130.5**	**153.0**	**174.0**

Chart 5.8



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 immediately. The total amount of written-off bad debts from June 2004 to June 2010 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 21.0 billion during 1 July 2009 to 30 June 2010.

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 based on 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 ratio came down to 89.1 percent and 95.9 percent in 2001 and 2002 respectively. However, it again rose to 101.1 percent in 2003. Later on, in 2008 and 2009 EI ratios were 103.7 percent and 112.1 percent due to huge operating loss incurred by BKB and RAKUB. The EI ratio of the SCBs exceeded 102.3 percent in 2004, situation improved to 75.6 percent in 2009. 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.

Table 5.8 Expenditure-income ratio by type of banks

(Percent)

Bank types	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
SCBs	99.4	99.0	98.5	98.8	102.3	101.9	100.0	100.0	89.6	75.6
DFIs	175.3	89.1	95.9	101.1	104.0	103.9	103.5	107.7	103.7	112.1
PCBs	90.8	88.1	91.9	93.1	87.1	89.3	90.2	88.8	88.4	72.6
FCBs	77.7	75.7	78.3	80.3	76.3	70.8	71.1	72.9	75.8	59.0
Total	**99.9**	**91.2**	**93.3**	**93.9**	**90.9**	**92.1**	**91.4**	**90.4**	**87.9**	**72.6**

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) differ 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 considering huge provision shortfall, the ROA of the SCBs have been less than one percent, which is even

Box 5.1

Bangladesh's first ever Sovereign Credit Rating

April 2010 heralded an important landmark in the economic history of Bangladesh–country's first ever-sovereign credit rating announced by world's top international credit rating agencies Standard & Poor's (S&P) and Moody's. The ratings assigned by S&P and Moody's were BB- and Ba3 respectively with stable outlook. Pertinently, it is mentioned that Government of Bangladesh decided to obtain country's sovereign credit rating and conferred mandate to BB for taking necessary steps. BB played the key role for obtaining sovereign credit rating by hiring international credit rating agencies on behalf of the Government.

Types of ratings with Bangladesh's score (April, 2010)

Standard and Poor's		Moody's	
Credit Ratings	**Result**	**Credit Ratings**	**Result**
Long Term Foreign Currency Ratings	BB-/Stable	Foreign and Local Currency Bond Ratings	Ba3/Stable
Short Term Foreign Currency Ratings	B/Stable	Foreign Currency Bond Ceiling	Ba2/Stable
Long Term Local Currency Ratings	BB-/Stable	Foreign Currency Deposit Ceiling	B1/Stable
Short Term Local Currency Ratings	B/Stable	Local Currency Bond Ceiling	Baa3
Transfer and Convertibility (T&C) Assessment	BB-/Stable	Local Currency Deposit Ceiling	Baa3

Comparative position of Bangladesh among some countries*

Country	India	Bangladesh	Pakistan	Sri Lanka	Indonesia	Thailand	Vietnam	Malaysia
S&P	BBB-	BB-	B-	B+	BB	BBB+	BB	A-
Moody	Baa3	Ba3	B3	B1	Ba2	Baa1	Ba3	A3

*As of 30 November 2010.

In the global financial arena, the BB- and Ba3 sovereign credit ratings by S&P and Moody's respectively, ranked Bangladesh only behind India in South Asia. Besides, Moody's rating put Bangladesh at par with the Philippines, Vietnam and Turkey. Bangladesh is rated one notch above Sri Lanka and Cambodia, but one notch below Indonesia.

In assigning ratings to Bangladesh, the rating agencies highlighted strong and stable economic growth free from major macroeconomic imbalances resilient to domestic and external shocks despite fiscal constraints over the past decade, strong and resilient RMG sector, robust inflow of workers' remittance, strong foreign exchange reserve and substantial donor support, robust domestic demand underpinned by strong remittances, growing MFI activities and social safety net payments, minimal foreign commercial borrowing and sustainable external debt servicing profile with absence of any default repayment history as main strengths behind ratings. On the whole, the agencies found that Bangladesh has favourable growth prospects which led to achieving rating in the BB/Ba category, a level similar to many Asia's first growing emerging market economics.

Country ratings bestow identity to a nation in the international arena regarding its strength and shock absorbing capacity, with special reference to its repayment capacity to sustain debt obligation. Sovereign credit rating for Bangladesh by two international rating agencies regarded Bangladesh as a reliable destination for international creditors and investors. Global investors view Bangladesh's rating as 'positive for growth. It will encourage foreign investment inflows and reduce borrowing costs.

Ratings in fact enabled Bangladesh to achieve an international comparability, having benchmark for the country's whole economic status as assigned by S&P and Moody's.

Table 5.9 Profitability ratios by type of banks

(Percent)

Bank types	Return on assets (ROA)									Return on equity (ROE)								
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2001	2002	2003	2004	2005	2006	2007	2008	2009
SCBs	0.1	0.1	0.1	-0.1	-0.1	0.0	0.0	0.7	1.0	2.4	4.2	3.0	-5.3	-6.9	0.0	0.0	22.5	26.4
DFIs	0.7	0.3	0.0	-0.2	-0.1	-0.2	-0.3	-0.6	0.4	12.3	5.8	-0.6	-2.1	-2.0	-2.0	-3.4	-6.9	-171.7
PCBs	1.1	0.8	0.7	1.2	1.1	1.1	1.3	1.4	1.6	20.9	13.6	11.4	19.5	18.1	15.2	16.7	16.4	21.0
FCBs	2.8	2.4	2.6	3.2	3.1	2.2	3.1	2.9	3.2	32.4	21.5	20.4	22.5	18.4	21.5	20.4	17.8	22.4
Total	**0.7**	**0.5**	**0.5**	**0.7**	**0.6**	**0.8**	**0.9**	**1.2**	**1.4**	**15.9**	**11.6**	**9.8**	**13.0**	**12.4**	**14.1**	**13.8**	**15.6**	**21.7**

worse in case of the DFIs. 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 2.4 percent in 2001, but it rose to 26.2 in 2009. In case of DFIs, the ROE position remained worse (-171.7 percent) in 2009 due to huge loss of Bangladesh Krishi Bank. The ROE of PCBs and FCBs were strong in 2009.

Net Interest Income

5.26 Aggregate net interest income (NII) of the industry has been positive and consistently increased from Taka 13.4 billion in 2001 to Taka 81.5 billion in 2009. However, the NII of the SCBs was a negative amount of Taka 1.8 billion in 2001 and had become positive (Taka 7.7 billion) in 2005. In 2009 the NII of SCBs was Taka 12.1 billion. The DFIs had a positive trend since 2001 and it was Taka 1.9 billion in 2009.

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 shown incredibly high trends over the period from 2001 through 2009. 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.

Chart 5.9

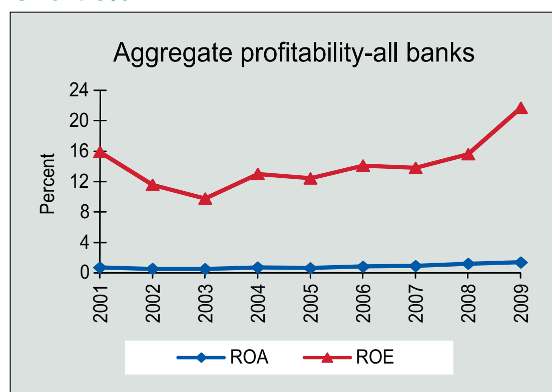


Chart 5.10

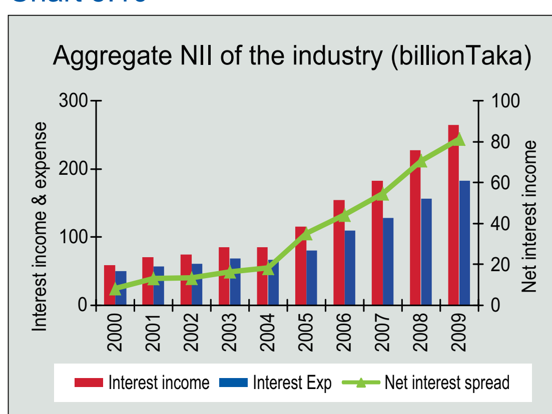


Table 5.10 : Net interest income by type of banks

(billion Taka)

Bank types	2001	2002	2003	2004	2005	2006	2007	2008	2009
SCBs	-1.8	-1.5	-0.3	-1.1	7.7	9.0	7.4	7.9	12.1
DFIs	2.7	1.4	1.3	1.8	1.0	1.7	1.4	1.9	1.9
PCBs	9.2	10.2	12.0	13.7	21.0	25.4	36.1	48.5	56.7
FCBs	3.3	3.4	3.6	4.2	5.6	8.2	9.9	12.6	10.7
Total	**13.4**	**13.5**	**16.6**	**18.3**	**35.3**	**44.3**	**54.8**	**70.9**	**81.5**

Table 5.11 : Liquidity ratio by type of banks (Percent)

Bank types	Liquid assets									Excess liquidity								
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2001	2002	2003	2004	2005	2006	2007	2008	2009
SCBs	25.7	27.3	24.4	22.8	20.0	20.1	24.9	32.9	25.1	5.7	7.3	8.4	6.8	2.0	2.1	6.9	14.9	17.6
DFIs	15.3	13 .7	12.0	11.2	11.2	11.9	14.2	13.7	9.6	8.9	6.9	5.8	4.7	6.2	3.8	5.6	4.9	7.1
PCBs	24.2	26.3	24.4	23.1	21.0	21.4	22.2	20.7	18.2	6.2	8.5	9.8	8.8	5.1	5.6	6.4	4.7	5.3
FCBs	34.1	41.6	37.8	37.8	41.5	34.4	29.2	31.3	31.8	14.3	21.8	21.9	21.9	23.6	16.4	11.2	13.3	21.8
Total	25.3	27.2	24.7	23.4	21.7	21.5	23.2	24.8	20.6	6.7	8.7	9.9	8.7	5.3	5.1	6.9	8.4	9.0

Liquidity

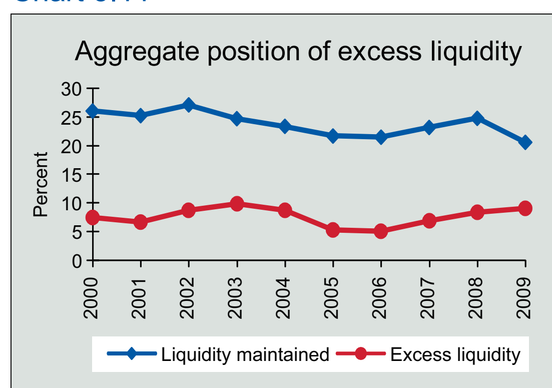
5.28 Commercial bank's demand and time liabilities are at present subject to a statutory liquidity requirement (SLR) of 18.5 percent inclusive of average 5.5 percent (at least 5 percent in any day) cash reserve ratio (CRR) on bi-weekly basis. The CRR is to be kept with the BB and the remainder as qualifying secured assets under the SLR, either in cash or in government securities. SLR for the banks operating under the Islamic Shariah is 10.5 percent. 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- 5.10 show that the FCBs are having the highest liquidity ratios followed by the SCBs. 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

Chart 5.11



'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 financially sound condition. One of the seven private commercial banks rated 5 in CAMELS rating in the mid nineties is still in the problem bank list. Up to 2005, six such banks were taken off from the problem bank list phase by phase because of their improved performance. Only that every 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 is being monitored in accordance with the "Revised Business Plan" submitted by the bank.

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 5 banks are monitored under EWS.

5.32 As of end 2009, CAMELS rating of 3 banks was 1 or Strong; 32 banks were rated 2 or Satisfactory; rating of 8 banks was 3 or Fair; 4 were rated 4 or Marginal and 1 bank 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. In FY10 out of 47 banks in Bangladesh, 7 PCBs are operating as full-fledged Islamic banks and 20 branches of 9 conventional banks are 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 532.6 billion at end December 2009. This was 29.7 percent of the deposits of all private commercial banks and 17.5 percent of the deposits of the total banking system at the end of December 2009. Total investment of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 492.9 billion at end of December 2009. This was 33.2 percent of the investment of all private banks and 20.2 percent of the investment of the total banking system of the country.

Table 5.12 : Comparative Position of the Islamic Banking Sector (as of end December 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	47
2. Number of Branches	501	20	521	2285 (22.8)	7095 (7.3)
3. Number of Accounts* (in thousand)	5916	-	-	14045 (42.1)	33508 (13.4)
3. Number of Employees	15943	1013	16956	n.a	n.a
4. Deposits	470.2	62.4	532.6	1792.4 (29.7)	3037.8 (17.5)
5. Investments (Credits)	456.0	36.9	492.9	1483.3 (33.2)	2439.8 (20.2)
6. Investment Deposit Ratio	1.0	0.6	0.9	0.8	0.7
7. Liquidity: Excess (+)/ Shortfall(-) @	33.8	-	-	138.1 (24.5)	335.0 (10.1)

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 of end December 2009.
@ 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.

Deposit Insurance Scheme

5.34 Deposit Insurance Scheme was introduced in Bangladesh in August 1984, to act as a safety net. It aims at minimising or eliminating the risk of loss of depositors' fund with banks. Deposit insurance in Bangladesh is now being governed by the Bank Deposit Insurance Act 2000. A Deposit Insurance Trust Fund (DITF) has also been created for providing limited protection (not exceeding Taka 0.01 million) to a small depositor in case of winding up of any bank. The Board of Directors of Bangladesh Bank is the Trustee Board for the DITF. The DITF is now being administered and managed under the guidance of the Trustee Board. Bangladesh Bank is now a member of International Association of Deposit Insurers (IADI). As at end of June 2010 the total asset of the DITF stood at Taka 14.50 billion of which Taka 14.00 billion were invested in Government securities. Revised risk based premium rate was introduced from January 2007. As per new schedule, the banks under problem bank category will have to pay 0.09 percent 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 etc. and last audited balance sheet (as on 30-06-2009) has been disclosed in Bangladesh Bank website. It is mentionable that Board of Directors of Bangladesh Bank as the Trustee of the DITF has 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 FY10.

Capital Adequacy of the Banks

5.36 BB has introduced a new Risk Based Capital (RBCA) framework for banks from 2009 in line with Basel-II. One year parallel run of Basel-II with Basel-I was in practice for capital adequacy during FY09. Basel-II has fully come in to force from January 2010 as a requlatory compliance. Under the new capital adequacy framework (Basel-II), BB is entrusted with ensuring that banks are accurately assessing all the risk they are exposed to and maintaining the required capital in commensurate with their risk profile.

Under Basel-I banks were required to maintain a ratio of capital to risk-weighted assets, i.e. CAR, of not less than 10 percent with at least 5 percent in core capital or Taka 2 billion, whichever is higher. However, banks have been instructed to raise their capital to Taka 4.0 billion of which paid up capital shall be minimum Taka 2.0 billion with effect from 11 August 2011. Moreover, BB has reviewed the minimum regulatory Capital Adequacy Ratio(CAR) and minimum Capital Requirement (MCR) of the banks in the year 2010 through revising the existing RBCA policy and banks' past capital adequacy reporting. MCR has been phased out to 8% of risk-weighted assets(RWA) up to June 2010, 9% up to June 2011 and 10% from July 2011 onward.

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.

Rationalisation of Schedule of charges

5.37 Bangladesh Bank has rationalised the charges of some services to ensure the interest of depositors/investors/customers and advised all Scheduled Banks to display the complete schedule of charges in suitable visible places in their Branches and Head Offices' for their customer's information and up-load the same in their respective websites for the convenience of the customers.

Considering the interest of the small depositors it has been decided that no charge can be imposed as account maintenance fee for average deposit balance up to Taka 5000. It has also been decided that Taka100 at maximum may be imposed as account maintenance fee on six monthly basis for average deposit balance up to Taka 25000.

Rationalisation of Rate of Interest

5.38 Banks in general are free to charge/fix their deposit and lending rate. However, the maximum cap of 7% interest on export credit has been fixed since 10 January 2004 by Bangladesh Bank to facilitate export earnings. 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 NBFI's by banks has been fixed at 13%. 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

Box 5.2

Basel II: SRP–SREP Dialogue on Capital Adequacy

Bangladesh Bank (BB) has introduced guidelines on Risk Based Capital Adequacy (RBCA) for banks, to make the banks' capital more risk sensitive and shock absorbent. Banks operating in Bangladesh have entered into Basel-II regime and the guidelines as statutory compliance have come into force from January 01, 2010. Beneath the Basel-II regime, SRP–SREP dialogue stands for an exclusive meeting between the team of Supervisory Review Process (SRP) of a scheduled bank and the team of Supervisory Review Evaluation Process (SREP) of BB on capital adequacy. The objective of the dialogue is to determine the adequate level of capital needed for a bank beyond minimum capital by reviewing the Internal Capital Adequacy Assessment Process (ICAAP). In other words, the dialogue targets to review the process by which a bank assesses its level of risk management and capital adequacy, and quality of capital held that checked by stress testing. The intensity and frequency of the dialogue will depend on the level of complexity and magnitude of the banks' activities as well as the difference between the capital requirements assessed by the banks and BB.

In order to calculate Capital Adequacy Ratio (CAR), banks are required to calculate their Risk Weighted Assets (RWA) on the basis of credit, market and operational risks. Total RWA will be determined by multiplying the amount of capital charged for market risk and operational risk by the reciprocal of the minimum CAR and adding the resulting figures to the sum of risk weighted assets for credit risk. The CAR is then calculated by taking eligible regulatory capital as numerator and total RWA as denominator. Banks need to maintain CAR on 'Solo' basis as well as on 'Consolidated' basis. Subsequent to one year trial run of the RBCA guideline in 2009, the overall situation were reviewed and considering the same it has been decided that all scheduled banks will maintain regulatory Capital Adequacy Ratio (CAR) and Minimum Capital Requirement (MCR) as per following timetable: From January 01, 2010 - June 30, 2010 the CAR will be ≥ 8% and MCR 8% of RWA; From July 01, 2010 - June 30, 2011, the CAR will be ≥ 9% and MCR 9% of RWA; From July 01, 2011 to onwards the CAR will be ≥ 10% and MCR 10% of RWA. Banks have to maintain at least 50% of required capital as Tier-1 capital. Banks should have Adequate Capital to meet comprehensive risk profile. That is along with credit, market, operational risks banks will allocate capital against other risks which are not captured in calculating MCR. Some of these risks are namely residual risk, credit concentration risk, interest rate risk, liquidity risk, model risk, settlement risk, country risk etc.

Residual risk is one of the vital risks of banks and NBFIs. While institutions mitigate risks by way of collaterals, the collaterals can pose additional risks (legal and documentation risks), which may deteriorate the risk mitigation system e.g. the error in documentation, delayed liquidation procedure, overvaluation of the collateral etc. may be causes of shock which need to be quantified to calibrate with capital. Banks must be proficient to prove that they have proper risk management procedures in place to control the risk. Credit concentration risk may arise from exposure to a single entity/group and/or exposures in the same economic or geographic sector and/or credit concentration in dependent industries. Downturn in concentrated activities and/or areas may cause huge losses to a bank relative to its capital and can threaten the bank's health or ability to maintain its core operations. Banks and FIs often mismatch of their assets and liabilities. In doing so, they expose themselves to interest rate risk. Interest rate changes impact on the overall market value of an FI's assets and liabilities and ultimately its net worth. Each bank should have own value-at-risk model to assess the interest rate risk of the banking book. Liquidity risk occurs when a bank is unable to fulfill its commitments in time when payment falls due. Banks should come up with estimates on their liquidity risk, comparing their liquid assets to short-term liabilities. The purpose of daily liquidity measurements is to ensure that the institution remains solvent in its day-to-day operations at all times. In order to maintain immediate liquidity, analyses are to be carried out concerning future liquidity as well. Regulations and procedures are to be implemented which serve the ongoing and forward-looking measurement and management of the institution's financing position. Model risks comes out of under-estimation of assessment procedure, valuation, strategic plan, introducing system etc. and leads to the bank's financial losses. Model risk may be caused by the negligence, knowledge limits, insufficient data or changes which make approaches imperfect. To check these issues how core risks management models are implemented would be evaluated by SREP team.

The bank's internal control structure is essential to the capital assessment process. Effective control of the capital assessment process includes an independent review and, where appropriate, the involvement of internal or external audits. The bank's board of directors has a responsibility to ensure that management establishes a system for assessing the various risks, develops a system to relate risk to the bank's capital level, and establishes a method for monitoring compliance with internal policies. The bank should conduct periodic reviews of its risk management process to ensure its integrity, accuracy, and reasonableness through stress testing. A bank should have written policies and procedures governing the stress testing program. The operation of the program should be appropriately documented.

During SRP-SREP dialogue, BB will review and evaluate banks' ICAAP and its strategies, as well as their ability to monitor and ensure their compliance with CAR. BB will take appropriate supervisory action if they are not satisfied with the result of this process. BB expects banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum. BB will intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk profile of a particular bank and will take rapid remedial measures if capital is not maintained or restored.

interest on import financing of edible oil (unrefined 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%.

Banks are allowed to differentiate rate of interest 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 rate of interest 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 in their respective website.

Loan Rescheduling Policy

5.39 Banks have been advised that rescheduling with down payment may take place for Short Term Agricultural Credit as per clause 1.02 of BRPD circular No. 01/2003.Bangladesh Bank issued necessary instructions to the banks to facilitate the borrowers affected due to global recession by providing them with rescheduling facility without necessary down payment till 30 June 2010 on the basis of banker-customer relationship considering merit of the case.

Bank Account for Farmers

5.40 Considering contribution of the farmers to the economic activities especially in agricultural activities, it has been decided that a farmer can open an account by depositing 10 Taka only at any state owned commercial and specialised bank against National ID Card/Birth Registration Card and Agricultural Equipment Assistance Card issued by the Department of Agricultural Extension. There will be no bindings for maintaining minimum balance on the said account and banks shall not impose any charges/fees on these accounts. Bangladesh Bank (BB) monitors the account opening activities on weekly basis. Due to close offsite monitoring of BB the number of bank account for farmers has gone up to 8,870,140 as of July 2010. On-site inspection by Inspection Departments of BB is also being taken care for monitoring the account opening activities.

Assistance for Export Oriented Ship Industry

5.41 Bangladesh Bank has issued necessary instructions to facilitate export oriented ship industry in the backdrop of increasing demand of ocean going ship in the world market. Those instructions issued with a view to increasing export earnings as well as creating huge employment. The commission charged by the local bank against guarantee of advance to exporters by indenters/buyers in addition to Add Confirmation Charge imposed by foreign banks for exporting ship shall not exceed yearly 1.50 percent. The existing instruction shall also be applicable in case of opening L/C for this industry. In this case, commission for opening sight L/C will be 0.40% at maximum, 0.50% for opening deferred/usance L/Cs, maximum 0.25% commission for opening L/C by 100% cash margin, and commission for opening Back to back L/C 0.40% at maximum in each quarter. In any case commission for opening L/C shall not be in excess of 2% yearly.

No Loan/Investment Facility for Purchasing of Land

5.42 Banks have been advised not to provide any loan/investment facility for purchasing of land.

Box 5.3

Progress of Basel-II implementation in Bangladesh

Bangladesh Bank has introduced the 'Risk Based Capital Adequacy (RBCA) for Banks' (Revised regulatory capital framework in line with Basel II) from 1 January 2009. Subsequent to one year parallel run period the revised framework has fully come into force from 1 January 2010. The guidelines of the same is available at BB website www.bangladeshbank.org.bd./www.bb.org.bd.

Since introducing the regulatory framework in line with Basel-II BB has conducted Quantitative Impact Study (QIS) and made several revisions and included new issues vide BRPD circular no. 13/2010, 10/2010, 05/2009, 13/2009, 20/2009, 9/2008 and BRPD Circular Letter No- 05/2009.

As per guideline on 'Risk Based Capital Adequacy for Banks, calculation of RWA will follow Standardised Approach for Credit Risk, Standardised Approach for Market Risk and Basic Indicator Approach for Operational Risk.

Under the Standardised Approach of the Risk Based Capital Adequacy framework (Basel II), Risk Weighted Asset (RWA) against credit risk is to be determined on the basis of credit rating assessed by External Credit Assessment Institutions (ECAIs).

On the basis of QIS, a partial modification has been made and accordingly all scheduled banks are instructed to maintain regulatory Capital Adequacy Ratio (CAR) and Minimum Capital Requirement (MCR) as per following timetable:

Capital Adequacy Ratio (CAR)	From 1 January 2010 -30 June 2010	From 1 July 2010 -30 June 2011	From 1 July 2011 to onwards
	CAR ≥ 8%	CAR ≥ 9%	CAR ≥ 10%
$CAR = \frac{\text{Eligible Regulatory Capital}}{\text{Risk Weighted Assets (RWA)}}$ X 100			
MCR	8% of RWA**	9% of RWA**	10% of RWA**
**MCR will be the above stipulated percentage of RWA or the amount of MCR fixed by Bangladesh Bank from time to time Which one is higher.			
In every case, at least 50% of the CAR and MCR must be constituted by Tier-I capital components.			

Total Eligible Regulatory Capital would be calculated by summing up of eligible Tier-1 (Core Capital), Tier-2 (supplementary Capital) and Tier 3 (additional supplementary Capital).

In order to obtain the optimum level of Eligible Regulatory Capital for the purpose of calculating Minimum Capital Requirements (MCR), banks are required to make the following deductions from their Tier-1 capital; Tier-2 capital;

Book value of goodwill and value of any contingent assets which are shown as assets

Shortfall in provisions required against classified assets

Shortfall in provisions required against investment in shares

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

Reciprocal /crossholdings of bank capital/subordinated debt artificially intended to inflate the capital position of banks

Any investment exceeding the approved limit under section 26(2) of 'ব্যাংক কোম্পানী আইন, ১৯৯১' (Banking Company Act, 1991). The additional amount of investment will be deducted at 50% from Tier 1 capital and 50% from Tier 2 capital.

Investments in subsidiaries which are not consolidated. The deduction for such investments will be 50% from Tier 1 capital and 50% from Tier 2 capital.

In addition to, computing MCR, banks have to calculate ADEQUATE CAPITAL on the basis of banks own Supervisory Review Process (SRP). Under the SRP, adequate capital will be determined on the basis of comprehensive risk management of banks. For this, each bank should have an exclusive SRP

Box 5.3

Progress of Basel-II implementation in Bangladesh

(Contd.)

team and a process document (called Internal Capital Adequacy Assessment Process-ICAAP). The areas to be covered by the process document are review of risk management and planning for adequate capital against comprehensive risk profile including credit, market, operational and all other risks which are not captured in the process of determining MCR. Stress testing as tool for forward looking risk management is an integral part of SRP. On the basis findings of stress test, banks will maintain some provision proactively in addition to adequate capital. BB will evaluate all these issues through the methods of SRP-SREP dialogue.

With a view to moving forwards to the advanced approaches of Basel-II, BB is revisiting the RBCA guidelines. A consolidated circular (ref. BRPD circular no. 24 Dated:3 August 2010) has already been issued which has incorporated all instructions issued on the subject till 31 July 2010 and has also included several new instructions. Roadmap on Basel-II implementation in Bangladesh sates that bank will progressively move towards Advanced approaches i.e Internal Rating Based (IRB) approach for calculating RWA from the year 2012.

Findings on January-March Quarter reporting on Risk Based Capital Adequacy (Basel-II)

A comparative study on calculation of MCR under Basel-I and Basel-II has been made on the basis of second regulatory reporting of Basel-II on the second quarter of year 2010 (i.e., on 30 June 2010) with the just ended Basel I regime at last quarter of 2009 (i.e., 31 December 2009). Reporting shows that the RWA have been increased and CARs have been decreased under Basel-II in every cluster of banking sector.

Position on CAR & RWA under Basel-I and Basel-II (cluster wise) are stated in the following table.

(billion Taka)

Cluster of Banks	Basel-I (31-12-2009)			Basel-II (30-06-2010)		
	RWA	MCR	CAR	RWA	MCR	CAR
SCBs (4)	491.73	49.17	9.0%	820.57	65.65	5.7%
Specialised (5)	200.29	20.03	0.4%	249.49	19.96	-2.6%
Private (30)	1537.26	153.73	12.1%	2530.52	203.69	8.7%
Foreign (9)	174.93	17.49	28.1%	284.81	29.24	16.7%
All Banks	**2404.21**	**240.24**	**11.7%**	**3885.39**	**318.54**	**7.9%**

The main reasons behind these are considered as follows:

- Basel-II considers additional two risks named **Market Risk** and **Operational Risk** along with **Credit risk** for calculating Risk Weighted Asset (RWA).
- Basel-II reporting was based on the risk weight considering most of the counterparties as ***"Unrated"*** and RW of which is higher than RW of Basel I. Suppose in case of RW of unrated corporate under Basel II is 125% where as under Basel I it was 100%.
- Highest increase shows in RWA of private sector banks as their most of the credits are concentrated in corporate clients. There is ample scope of reducing RWA after completion of credit rating as they have many credible borrowers.
- RWA in specialised banks have been decreased due to most of their credit concentration is limited in small and retail enterprise of private sector that attracts fixed 75% RW under Basel II as against 100% of Basel I. CAR of these banks shows negative as they have lot of capital shortfall.

SCB Monitoring Cell

5.43 The Government of the People's Republic of Bangladesh (GOB) has already corporatised 3 SCBs (Sonali, Janata and Agrani) for improving the soundness and efficiency of the banking sector. Rupali Bank has been converted into public limited company on 14 December 1986. After restructuring, the performance of Sonali, Janata and Agrani Bank Limited are comparatively better than the previous years. A positive impact is observed from the financial indicators of these four banks. Meanwhile, Rupali Bank Limited has submitted a "Recapitalisation & Progressive 5 years Transitional Plan" to the Bank and Financial Institution Division, Ministry of Finance. The plan is in the process of finalisation by the Ministry of Finance. Furthermore, the overall progress of these four banks are monitored and reviewed under the MOU (Memorandum Of Understanding) signed by the respective bank at the beginning of the year 2010. On the other hand, the preparation of MOU (Memorandum Of Understanding) for Bangladesh Krishi Bank and Rajshahi Krishi Unnayan Bank for 2010-11 financial year is under process.

Cash Reserve Requirement of Scheduled Banks with Bangladesh Bank

5.44 In pursuance of the objectives of monetary policy, the amount of Cash Reserve Requirement (CRR) has been increased to 5 percent from 4.5 percent of the banks' total demand and time liabilities effective from 1 October 2005 and remained unchanged thereafter. However, the banks are allowed to maintain CRR at the rate of 5.5 percent bi-weekly average basis subject to the condition that the amount of CRR maintained should not be less than 5.0 percent in any day from 15 May 2010.

Statutory Liquidity Requirement of Scheduled Banks

5.45 Statutory Liquidity Requirement (SLR) of scheduled banks, excluding those banks and branches of conventional banks based and operated on Islamic Shariah and also the specialised banks (except Basic Bank Ltd.), has been increased to 18.5 percent (of total demand and time liabilities excluding inter-bank items) effective from 15 May 2010.

The rate of SLR to be maintained including cash reserve with BB by the banks and branches of conventional banks based and operated on Islamic Shariah has also been increased to 10.5 percent (of total demand and time liabilities excluding inter-bank items) effective from 15 May 2010. Except for the Basic Bank Ltd. the privilege of exemption from maintenance of SLR for the specialised banks also remains unchanged.

Progress of Basel- II implementation in Bangladesh

5.46 BB has commenced the implementation of Basel-II from January 2010 as regulatory compliance 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. 24/2009. (Box 5.3)

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 reports according to Basel-II guideline on quarterly basis. To review the successful implementation

of Basel II, BB has arranged meeting with all banks on the basis of their difficulties in implementation of the Risk Based Capital Adequacy (RBCA) guideline.

Corporate Governance in Banks

5.47 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. 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 past to put in place good corporate governance in banks. These include fit and proper test for appointment of chief executive officers of PCBs; constitution of audit committee of board and enhanced disclosure requirements etc. In continuation of the above reforms, the roles and functions of the Board and Management were redefined and clarified with a view to specifying the powers of the management and restricting the intervention of directors in day-to-day management of the bank.

Corporate Social Responsibility

5.48 Corporate social responsibility (CSR) is mainly about the awareness of and actions in support of environmentally sustainable societal development. CSR actions aim at mitigating the diverse environmental impacts of the activities of the business, and at reducing inequalities and alleviating deprivation and poverty in the communities across the country. Out of forty seven scheduled banks in Bangladesh, forty six had engagement in CSR practices in some form or other in 2009. In terms of direct monetary expenditure, engagements of banks in CSR initiatives are increasing, particularly following issuance of BB guidance (DOS Circular No 01 Dated 1st June 2008):

Year	2007	2008	2009
CSR expenditure (million Taka)	226.4	410.7	553.8

CSR expenditures of banks have far largely been in the form of passive grants and donations. Banks were particularly responsive to emergency support needs of population groups affected in natural and manmade disasters. Apart from one-off grants and giveaways, some banks have engagements in longer term continuing support commitments, in areas of education and healthcare. Besides the passive engagements by way of grants/donations banks are now getting actively engaged in socially responsible business operations, by way of increased lending to under-served economic sectors like agriculture and SMEs, towards fuller financial inclusion and faster poverty eradication.

Some banks have shown commitment for environmental sustainability in own and client businesses. Their actions have not however gone beyond compliance with relevant government laws and regulations. Proactive initiatives of helping arrest environmental degradation, like adoption of more energy efficient, and harmful emission/effluence reducing internal practices and processes have been largely absent in the CSR initiatives, even of branches of foreign banks with such

practices in their home offices. In addition, banks are yet to adopt practices of prior stakeholder consultations (an important element indicated in BB's guidance circular) in drawing up their CSR programs and to adopt separate reporting of their CSR activities in comprehensive formats such as the GRI.

Activities of Credit Information Bureau

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

5.50 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 24,80,511 (end June 2010) recording an increase by 20.8 percent over the previous period (20,54,256 as of end June, 2009). The number of CIB reports supplied during FY10 (end June 2010) stood at 10,02,674 compared to 8,48,114 in the FY09 (end June 2009). As per existing service standard, the credit reports are supplied within 5 working days of receiving the request, the volume of which was around 4300 per day during FY10.

5.51 As per reporting of scheduled banks/ financial institutions, the classified loan increased during FY10 (end June 2010). The classified loan increased to 13.1 percent at the end of June 2010 compared to 9.6 percent in the preceding year (end June 2009). The percentage of such classified loan was 34.9 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 13.1 as on 30 June 2010.

5.52 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 the lending institutions. The selected vendor CRIF (Italy) of CIB online project has started project work from 3 May 2009. CIB will go for real time from September 2010. It will run parallely with the current system upto December 2010 and from June 2011 the CIB will fully run online.

C. Supervision of Banks

5.53 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 (ii) on-site supervision. Department of Off-site Supervision (DOS) is vigilant to conduct off-site supervision on 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

5.54 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 Company Ain 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), 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 are conducted.

5.55 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.

5.56 DBI-1 and DBI-2 conducted a total number of 2151 inspections throughout banking sectors under comprehensive inspection programme during FY10 including 49 Head Offices, 577 big branches and 1525 small branches. Under the special inspection programme, a total number of 872 inspections were carried out by DBI-1 and DBI-2 regarding risk-based audits and others during FY10.

5.57 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 FY10, FEIVD conducted a

total number of 230 inspections including 45 head offices, 185 authorised dealer branches. Besides, FEIVD conducted 379 special inspections on various banking irregularities, 46 special inspections on foreign exchange risk management, and 217 inspections on money changers.

Financial Institutions

5.58 Financial Institutions (FIs) represent one of the most important segments of financial system and play very important role in mobilising and channeling resources in Bangladesh. Non-Bank Financial Institution comprises investment and finance companies, leasing companies etc. FIs numbering 29 as of June 2010 (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 0.5 billion vide FID circular 9, dated 4 December 2009, Most of the FIs (except two) have raised their required capital. 25 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 to 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 2010 were Taka 163.5 billion. Investment in capital market was Taka 15.4 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 2010, total classified loan/lease stood at Taka 11.3 billion or 6.9 percent of total loan/lease.