Banking Sector Performance, Regulation and Bank Supervision

5.1 Bangladesh Bank (BB) has been continuing its efforts to improve the performance of the banking sector and ensure a sound, efficient and resilient financial system. In FY 2016-17, BB has adopted a number of policy measures giving emphasis on risk management and corporate governance in the banks, periodic review of stability of the individual bank as well as the whole banking system, exercise of stress testing, monitoring of large borrowers, prevention of fraud-forgeries and strengthening of internal control and compliance system through self-assessment of anti-fraud internal controls etc. Monitoring of scheduled banks' investment in shares has been made stringent in light of the amendment brought in the Bank Company Act, 1991 (amended up to 2013). Performance of Risk Management Committee at the board level is being evaluated regularly to ensure proper risk management practice in the banks. The review of the guideline namely 'Risk Management Guideline for Banks' issued in 2012 is now in process to facilitate banks in adopting contemporary methods to deal with various risk issues prudently. Besides, all core risks management guidelines have been revised recently for timely identification, measurement, control, and monitoring of all existing and probable risks of banks.

Banking Sector Performance

5.2 The banking sector in Bangladesh comprises four categories of scheduled banks - State-Owned Commercial Banks (SCBs), State-Owned Development Financial Institutions (DFIs), Private Commercial Banks (PCBs) and Foreign Commercial Banks (FCBs). One newly licensed private commercial bank has started its operation in 2016. Therefore, the number of scheduled banks increased to 57 in 2016 from 56 in 2015 and the number of bank branches increased to 9654 in December 2016 from 9397 in December 2015. At the end of June 2017, total number of bank branches increased further to 9720 (Appendix 4, Table1). Information on the banking structure is shown in Table 5.1.

5.3 In 2016, the SCBs held 27.60 percent share of the total assets which was 27.53 percent in 2015. PCBs' share of the total assets increased from 64.50 percent in 2015 to 65.02 percent in 2016. The FCBs held 4.80 percent share of the total assets in 2016, showing a decline of 0.35 percentage points over the previous year. The DFIs' share of the total assets was 2.58 percent in 2016 against 2.82 percent in 2015.

5.4 Total deposits of the banks in 2016

Table 5.1 Banking systems structure

(billion BDT)

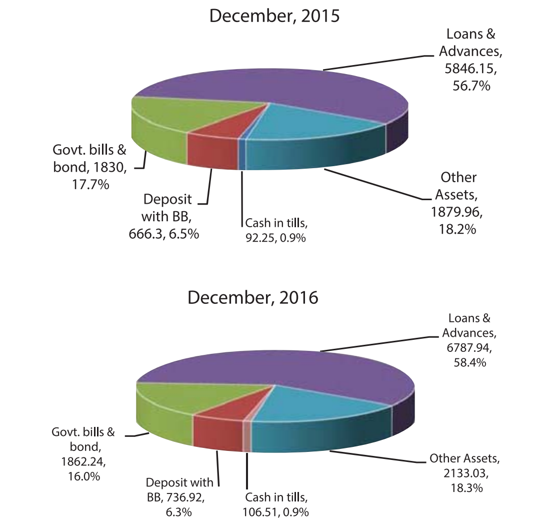
Bank types	2015						2016					
	Number of banks	Number of branches	Total assets	Share of industry assets	Deposits	Share of deposits	Number of banks	Number of branches	Total assets	Share of industry assets	Deposits	Share of deposits
SCBS	6	3690	2839.6	27.5	2254.8	28.44	6	3710	3209.5	27.6	2535.4	28.4
DFIS	2	1406	291.4	2.8	226.6	2.86	2	1407	299.5	2.6	249.4	2.8
PCBS	39	4226	6652.9	64.50	5110.4	64.46	40	4467	7560.0	65.0	5788.0	64.8
FCBS	9	75	530.8	5.2	336.8	4.25	9	70	557.6	4.8	361.1	4.0
Total	56	9397	10314.7	100.0	7928.6	100	57	9654	11626.6	100.0	8933.9	100.0

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

Source : BRPD and DOS, BB.

Chart 5.1 Aggregate Industry Assets

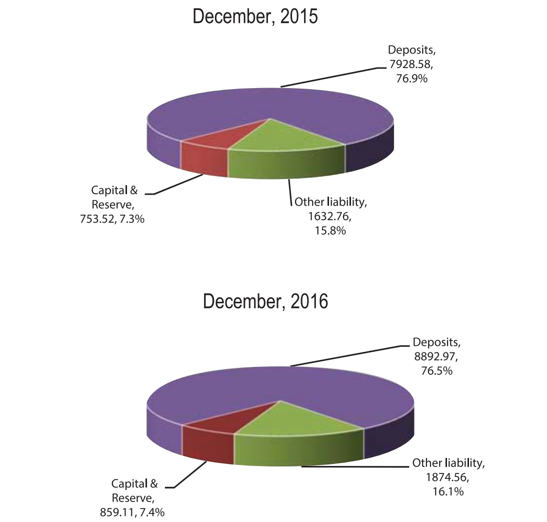
(Billion BDT)



Source: DOS, BB.

Chart 5.2 Aggregate Industry Liabilities

(Billion BDT)



Source: DOS, BB.

rose to BDT 8933.9 billion from BDT 7928.6 billion in 2015 showing an overall increase of 12.7 percent. The SCBs' share in total deposits slightly decreased from 28.4 percent in 2015 to 28.4percent in 2016. PCBs' deposits in 2016 stood at BDT 5788.0 billion or 64.8 percent of the total deposits compared to BDT 5110.4 billion or 64.5 percent in 2015. FCBs' deposits in 2016 slightly increased by BDT 24.4 billion over the year 2015 although, their contribution to total deposits decreased slightly. The DFIs' deposits in 2016 was BDT 249.4 billion against BDT 226.6 billion in 2015 showing an increase of 10.1 percent over the year.

Aggregate Balance Sheet

5.5 Total industry assets in 2016 showed an overall increase of 12.7 percent over 2015. During this period, the SCBs' assets increased by 13.0 percent and those of the PCBs increased by 13.6 percent. Loans and advances of BDT 6739.2 billion constituted the most significant portion (57.96 percent) of the sector's aggregate assets of BDT 11626.7 billion. Cash in hand including foreign currencies was BDT 106.5 billion; deposits with BB were BDT 736.9 billion; other assets were BDT 1904.4 billion and investment in government bills and bonds were BDT 2139.6 billion. (Chart 5.1 and chart 5.2).

5.6 Deposits continued to be the main sources of funds of the banking industry and constituted 76.8 percent (BDT 8933.9 billion) of total liability in 2016. Capital and reserves of the banks were BDT 837.7 billion (7.2 percent) in 2016 compared to BDT 753.5 billion (7.4 percent) in 2015.

Capital Adequacy

5.7 Capital adequacy focuses on the total position of the banks' capital and the protection of depositors and other creditors from the potential losses that a bank might incur. It helps absorbing all possible financial risks related to credit, market, operation, interest rate, liquidity, reputation, settlement, strategy, environment and climate change etc. Under Basel-III, the banks in Bangladesh are instructed to maintain the Minimum Capital Requirement (MCR) at 10.0 percent of the Risk Weighted Assets (RWA) or BDT 4.0 billion as capital, whichever is higher. Under the Supervisory Review Process (SRP), banks are directed to maintain a level of “adequate” capital which is higher than the minimum required capital and sufficient to cover for all possible risks in their business. This higher level of capital for the banks is usually determined and finalized through SP-SREP (Supervisory Review Evaluation Process, the central bank’s assessment) dialogue. The amount of capital was BDT 205.8 billion as on 31 December 2008 which increased to BDT 837.58 billion at the end of December 2016, showing capital growth of 306.98 percent (chart 5.3).

5.8 Table 5.2 shows that on 31 December 2016, in aggregate, the SCBs, DFIs, PCBs and FCBs maintained CRAR of 5.86, -33.67, 12.36 and 25.37 percent respectively. However, individually, 3 SCBs, 2 PCBs and 2 DFIs failed to maintain the minimum required Capital to Risk Weighted Assets Ratio (CRAR). The CRAR of the banking industry as a whole was 10.80 percent at the end of December 2016 as against 10.84 percent at the end of December 2015. The CRAR of the industry was 10.86 percent at the end of June 2017 (chart 5.3).

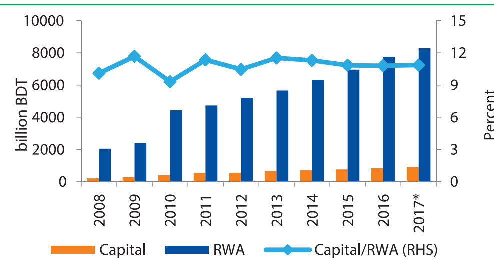
Table 5.2 Trends of Capital to Risk Weighted Assets Ratio by Type of Banks

(percent)

Bank types	2009	2010	2011	2012	2013	2014	2015	2016	End June 2017
SCBs	9.0	8.9	11.7	8.1	10.8	8.3	6.4	5.9	7.0
DFIs	0.4	-7.3	-4.5	-7.8	-9.7	-17.3	-32.0	-33.7	-32.8
PCBs	12.1	10.1	11.5	11.4	12.6	12.5	12.4	12.4	12.2
FCBs	28.1	15.6	21.0	20.6	20.2	22.6	25.6	25.4	23.3
Total	11.6	9.3	11.4	10.5	11.5	11.3	10.8	10.8	10.9

Source: Bangladesh Bank.

Chart 5.3 Trends of Aggregate Capital Adequacy Position



*30 June 2017
Source: Department of Off-site Supervision (DOS), BB.

Asset Quality

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

5.10 The most important indicator to demonstrate the asset quality in the loan portfolio is the ratio of gross Non-Performing Loans (NPLs) to total loans and net NPLs to net total loans. At the end of December 2016, the gross NPL ratio to total loans of the banking sector stood at 9.23 percent. Table 5.3 shows that PCBs had the lowest and DFIs had the highest ratio of gross NPLs to total loans. SCBs’ gross NPLs to total loans ratio was 25.05 percent and the NPL ratio of DFIs, PCBs and FCBs were 26.02, 4.58 and 9.56 percent respectively at end December 2016 (Table 5.3). The gross NPL ratios to total loans for the SCBs, PCBs, FCBs and DFIs were recorded as 26.84, 5.77, 7.89 and 23.79 percent respectively at the end of June 2017.

5.11 The ratio of NPL to total loans of all banks had shown an overall declining trend from its peak (34.9 percent) in 2000 up to 2011 (6.1 percent). Then, it increased in 2012 (10.0 percent) and decreased again in 2013 (8.9 percent). Afterward, the ratio increased in 2014 (9.69 percent) and again declined in 2015 (8.79 percent). In 2016, it increased to 9.23 percent due mainly to increase in total classified loans, defaulted outstanding and non-recovery of the interest charged on loans. At the end of June 2017, the ratio of NPL to total loans of the industry stood at 10.13 percent. (Chart 5.4)

Box 5.1 A note on Integrated Supervision System (ISS) in Bangladesh

Bangladesh Bank has developed/incorporated various monitoring tools and techniques to strengthen the supervision of banks and FIs time to time. Enterprise Data Warehouse (EDW) and Foreign Exchange Monitoring Dash Board are some of the milestones of BB's supervision strengthening endeavors. Considering some bitter experiences associated with financial scam that took place in the banking industries , BB has started a comprehensive supervision research in late 2012 to develop a more effective supervision and monitoring tool in order to strengthen its existing supervision system. Integrated Supervision System (ISS) is the outcome of that initiative. ISS Software was formally inaugurated by the honorable Governor on 8th October, 2013. Subsequently, mandatory ISS reporting of banks' head offices and branches started from March, 2014. As of 30 June 2017, 57 scheduled bank's head offices and total 9771 branches have come under ISS reporting coverage.

ISS is an Oracle Business Intelligence Enterprise Edition (OBIEE) based monitoring tool integrating the information of a bank's overall activities i.e. balance sheet exposure, off-balance sheet exposure, credit operation, foreign exchange business, money market operation and regulatory compliance related to their head office to root level branch operations. This web based tool has enabled integration of the existing multifold supervision mechanism of BB. ISS aims to ensure the supervision effectively at all level of supervision structure from BB to the branch management of a scheduled bank. ISS also aims to adopt risk-based supervision approach with a view to minimize the supervision frequency and increase supervision coverage and to facilitate effective and timely supervisory decision making process.

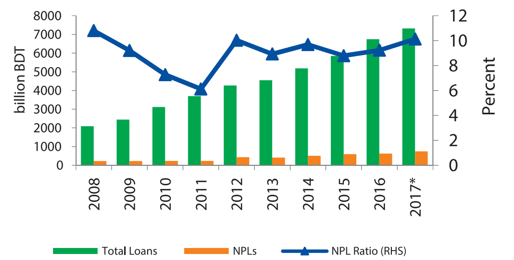
Functions of Integrated Supervision Management Department (ISMD) are directly mandated to ISS. During the FY2016-17, a total of 15 risk/observation reports (covering issues related with credit, foreign exchange and operational risk) on bank branches were generated using the data of ISS. Based on these reports, ISMD has given instructions to respective banks to take necessary action and banks' compliances to those instructions were ensured as well. Additionally, ISMD prepared reports named "Report for Bank's Observer" based on ISS data which were provided to the honorable Observers appointed to some problem banks by BB. During FY2016-17, ISMD continued its ISS data support role not only to Bank Inspection Departments (DBIs) for their selection of branches to conduct on-site inspections but also to their inspection teams. In these process ISMD, using ISS data, has assessed different level of risks that were anticipated to prevail on a number of branches of different banks and shared the assessment to respective DBIs for their action. Moreover, ISMD itself, under its jurisdiction, has conducted some risk based inspection on selective bank branches and their head offices. ISMD inspection teams have found various irregularities including manipulation of credit data and data on other sensitive issues. In order to support further development of BB's risk-based supervision activities, ISMD has developed Pre-Inspection Assessment Report (PIAR), an excel-based risk calculator of bank branch, which is mandatory to use for an on-site inspection team before starting their inspection on the selected branch. Development process of two more tools (PIAR for Bank's Head Office and PIAR for Foreign Exchange Inspection) is going on. Apart from these, initiative has been taken to prepare "Bank branch Risk Index" which is expected to be used in near future for selection of branch to conduct inspection by DBIs.

5.12 The SCBs and DFIs continue to have high level of NPLs due mainly to substantial loans provided by them on considerations other than commercial criteria. Poor appraisal and inadequate follow-up and supervision of the loans disbursed by the SCBs and DFIs in the past eventually resulted in these poor quality assets. Furthermore, these banks were reluctant to write-off the historically accumulated bad loans because of poor quality of collaterals. However, recovery of NPLs has witnessed some signs of improvement, mainly because of the steps taken with regard to internal restructuring of these banks to strengthen their loan recovery mechanism and write-off measures initiated in recent years.

5.13 Table 5.3 (a) and chart 5.4 show that in 2016, the ratio of net NPLs (net of provisions and interest suspense) to net total loans (net of provisions and interest suspense) was 2.3 percent for the banking sector and it was 11.1 percent for SCBs. The table illustrates that SCBs' and DFIs' non-performing portfolios have increased in 2016 as compared to that of the last year. The net NPLs to net total loans ratios were 10.5, 0.1, and 1.9 percent for the DFIs, PCBs and FCBs respectively at the end of December 2016. The ratios were 11.6, 8.8, 0.7 and 0.9 percent for SCBs, DFIs, PCBs and FCBs respectively at the end of June 2017.

5.14 Table 5.3 (b) and chart 5.5 show the amount of NPLs of the four types of banks since 2009 to 2016. The amount of NPLs of the SCBs increased from BDT 117 billion in 2009 to BDT 310.3 billion in 2016. The amount of NPLs of the PCBs stood at BDT 230.6 billion in 2016 increasing from BDT 61.7 billion in 2009. The amount of NPLs of the DFIs increased to BDT 56.8 billion in 2016 from BDT 42.1 billion in 2009. The amount of NPLs of the FCBs increased to BDT 24.1 billion in 2016 as against BDT 3.5 billion in 2009. The table also demonstrates that total NPLs of the banking sector have increased to BDT 621.8 billion in 2016 as compared to BDT 594.1 billion in 2015 and the amount of NPLs has increased in all types of banks except PCBs in 2016 as compared to the last year. The amount of NPLs of SCBs, DFIs, PCBs and FCBs stood at BDT 345.8, 55.2, 317.3 and 23.2 billion respectively at the end of June 2017.

Chart 5.4 Trends of Aggregate Position on NPLs to Total Loans



*Up to 30 June 2017
Source: Department of Off-site Supervision (DOS), BB.

Table 5.3 Trends of NPL Ratios by Type of Banks

(percent)

Bank types	2009	2010	2011	2012	2013	2014	2015	2016	End June 2017
SCBs	25.4	21.4	15.7	11.3	23.9	19.8	21.5	25.1	26.8
DFIs	25.5	25.9	24.2	24.6	26.8	26.8	23.2	26.0	23.8
PCBs	4.4	3.9	3.2	2.9	4.6	4.5	4.9	4.6	5.8
FCBs	1.9	2.3	3.0	3.0	3.5	5.5	7.8	9.6	7.9
Total	10.8	9.2	7.3	6.1	10.0	8.9	8.8	9.2	10.1

Source: Bangladesh Bank.

Table 5.3 (a) Ratio of net NPL to Total Loans by Type of Banks

(percent)

Bank types	2009	2010	2011	2012	2013	2014	2015	2016	End June 2017
SCBs	1.9	1.9	-0.3	12.8	1.7	6.1	9.2	11.1	11.6
DFIs	18.3	16.0	17.0	20.4	19.7	25.5	6.9	10.5	8.8
PCBs	0.5	0.00	0.2	0.9	0.6	0.8	0.6	0.1	0.7
FCBs	-2.3	-1.7	-1.8	-0.9	-0.4	-0.9	-0.2	1.9	0.9
Total	1.7	1.3	0.7	4.4	2.0	2.7	2.3	2.3	2.6

Source: Bangladesh Bank.

Table 5.3 (b) Amount of NPLs by Type of Banks

(billion BDT)

Bank types	2009	2010	2011	2012	2013	2014	2015	2016	End June 2017
SCBs	117.5	107.6	91.7	215.2	166.1	227.6	272.8	310.3	345.8
DFIs	42.1	49.7	56.5	73.3	83.6	72.6	49.7	56.8	55.2
PCBs	61.7	64.3	72.0	130.4	143.1	184.3	253.3	230.6	317.3
FCBs	3.5	5.5	6.3	8.5	13.0	17.1	18.2	24.1	23.2
Total	224.8	227.1	226.4	427.3	405.8	501.6	594.1	621.8	741.5

Source: Bangladesh Bank.

5.15 Table 5.4 and chart 5.6 show that, the banking sector continuously failed to maintain the required level of provision against their NPLs from 2009 to 2016 except the year 2009

Box 5.2: Corporate Governance in the Banking Sector

The primary objective of corporate governance should be safeguarding stakeholders' interest in conformity with public interest on a sustainable basis. Among stakeholders, particularly with respect to retail banks, shareholders' interest would be secondary to depositors' interest. Corporate governance determines the allocation of authority and responsibilities by which the business and affairs of a bank are carried out by its board and senior management, including how they • set the bank's strategy and objectives; • select and oversee personnel; • operate the bank's business on a day-to-day basis; • protect the interests of depositors, meet shareholder obligations, and take into account the interests of other recognised stakeholders; • align corporate culture, corporate activities and behaviour with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations; and • establish control functions.

Accordingly, Bangladesh Bank has taken several supervisory initiatives in accordance with local & international regulatory frameworks. Among them, directives on formation and responsibilities of Board of Directors of a Bank-Company, Directives on appointment and responsibilities of Chief executive officer, Directives on appointment of advisor and consultant, Directives on Transactions with Bank-Related Persons and Directives on significant shareholders of a bank are worth mentioning. In 2013, Bangladesh Bank issued the BRPD circular no. 11 which is associated with the formation and responsibilities of Board of Directors. This circular includes such provisions as appointment of bank directors in terms of director's fit & proper criteria, dismissal, termination or removal of any director from the post, appointment of independent & alternate directors. This circular also includes provisions on responsibilities of Board in case of work-planning & strategic management, credit & risk management, internal control management, human resources management & development , financial management, appointment of CEO, board meeting as well as formation of different committees like executive committee, audit committee, risk management committee etc. Moreover, in 2014 Bangladesh Bank issued BRPD circular no. 4 regarding the related-party transactions for ensuring proper utilization of bank's fund and maintaining confidence of the depositors. As per this circular any loan facility or guarantee or security provided to a Director of a bank or to his relatives must be sanctioned by the Board of Directors of the bank and has to be specifically mentioned in the Balance sheet of the bank. In this case, prior approval from BB is required for providing funded facilities amounting BDT 5.00 million ro above and composite facilities comprising funded & non-funded facilities amounting BDT 10.00 million or above to a bank director, to his/her relatives, to his/her proprietorship/partnership firms and to any private or public company where he/she is acting as a director. Total amount of loans and advances guarantees and other credit facilities provided to a bank director, his/her proprietorship/partnership firms, any private or public company where he/she is acting as a director should not exceed 50% of the face value of shares of that bank held in directors own name. In addition, as per this circular Banks are obliged to comply a number of provisions relating to such transactions that are incorporated in Section 17, 18, 26Ga, 27 & 28 of the Bank Company Act, 1991 (Amended upto 2013).

and 2011. From 2012 to June 2017 banking sector showed shortfall in mainting provision and it showed increasing trend.

5.16 The main reason for the shortfall in provision was the inability of some SCBs and PCBs, including those in the problem bank category due to increase in classified loans, poor quality and inadequacy of collaterals, low profit and provision transfer for write-offs. On the other hand, the FCBs were in a much better position since they were able to keep adequate provisions. A comparative position of loan loss provisions at the end of 2015, 2016 and 2017(end June) is shown in Table 5.5.

5.17 37 out of 40 PCBs were able to maintain the required provision at the end of December 2016, but the remaining three failed due to their poor asset portfolios and earning levels.

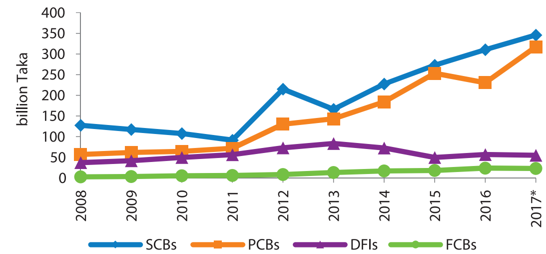
5.18 In order to rectify an unnecessarily and artificially inflated size of the balance sheet, a uniform guideline for write-off was introduced in 2003. Banks may write off bad/loss loans complying with the conditions covered by the guideline. The total amount of written-off loans from June 2010 to June 2016 by different bank categories is given in Table 5.6.

Management Soundness

5.19 It is difficult to draw any conclusion about the quality of management based solely on the quantitative indicators. Nevertheless, the total expenditure to total income, operating expenses to total expenses, earnings and operating expenses per employee, and interest rate spread are generally used to determine management soundness. Technical competence and leadership of mid and senior level management, compliance with rules/ regulations/plan and response to changing circumstances, etc. are taken into consideration in evaluating the quality of management.

5.20 As evident from Table 5.7 and Chart 5.7, in 2016 the expenditure-income (EI) ratio of the DFIs was the highest among the bank categories, which was mainly attributable to poor non-interest income and higher operating expenses. The EI ratio of the DFIs increased from 113.9 percent in 2015 to 137.8 percent in 2016. The EI ratio of the SCBs was 90.2 percent in 2016, the second highest, which could mainly be attributable to high administrative and operating expenses. In 2016, The EI ratio of PCBs and FCBs were 73.5 percent and 45.7

Chart 5.5 Comparative position of NPLs by type of banks



*Up to 30 June 2017
Source: Bangladesh Bank.

Table 5.4 Required provision and provision maintained –all banks

(billion BDT)

All Banks	2009	2010	2011	2012	2013	2014	2015	2016	End June 2017
Amount of NPLs	224.8	227.1	226.4	427.3	405.8	501.6	594.1	621.7	741.5
Required Provision	134.8	149.2	148.2	242.4	252.4	289.6	308.9	362.1	436.4
Provision maintained	137.9	142.3	152.7	189.8	249.8	281.6	266.1	307.4	374.5
Excess(+)/ shortfall(-)	3.1	-6.9	4.6	-52.6	-2.6	-7.9	-42.8	-54.7	-61.9
Provision maintenance ratio (%)	102.3	95.4	103.0	78.3	99.0	97.2	86.1	84.9	85.8

Source: Bangladesh Bank.

percent respectively, which decreased slightly in 2016 as compared to the previous year. At the end of June 2017, the EI ratio of SCBs and DFIs stood at 87.9 and 132.8 percent respectively whereas those of PCBs and FCBs stood at 74.5 and 45.5 percent respectively.

Earnings and Profitability

5.21 Although there are various indicators of earnings and profitability, the most representative and widely used one is return on assets (ROA), which is supplemented by return on equity (ROE) and net interest margin (NIM).

5.22 Earnings as measured by ROA and ROE differ greatly within the banking industry. Table 5.8 shows ROA and ROE by four types of banks over the period 2009-2017(June).

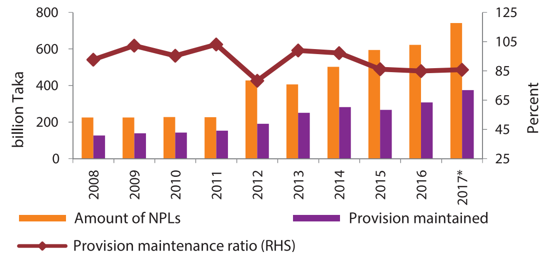
Analysis of these indicators reveals that the ROA of the SCBs and DFIs was negative and less than the industry average. ROA of the PCBs showed a consistently strong position up to 2010, but it was in a decreasing trend during 2011-2012 due to declining net profit. However, after 2012 it has been consistently increasing. The table also shows that though FCBs' ROA showed a decreasing trend from 2014, it remains in a strong position.

5.23 Table 5.8 also presents that ROE of the SCBs stood at -6.02 percent in 2016, but it has deteriorated as compared to -1.47 percent in the last year. ROE of the DFIs was also negative which stood at -13.88 percent in 2016. ROE of the PCBs increased to 11.09 percent in 2016 from 10.75 percent in 2015. ROE of the FCBs declined to 13.08 percent in 2016 from 14.6 percent in 2015. At the end of June 2017, ROE of SCBs, DFIs, PCBs and FCBs stood at -19.38,-814, 7.50 and 10.81 percent respectively. Trends of aggregate profitability of all banks are given in chart 5.8.

5.24 Aggregate net interest income of the banking industry in 2016 stood at BDT 328.66 billion which was BDT 292.90 billion in 2015 (Chart 5.9). NII of the SCBs increased to BDT 49.47 billion in 2016 from BDT 40.4 billion in 2015. NII of the DFIs decreased to BDT 0.93 billion in 2016 from BDT 1.7 billion in the last year. PCBs held the major portion (77.32 percent) of NII of the banking industry in 2016 like previous years. NII of the PCBs increased to BDT 254.11 billion from BDT 222.64 billion in the last year. NII of FCBs declined slightly from BDT 28.2 billion in 2015 to BDT 24.15 billion in 2016. The NII of the banking industry stood at BDT 165.42 billion at the end of June 2017. (Table 5.9)

5.25 SCBs have been able to increase their net interest income (NII) by reducing their cost

Chart 5.6 Provision adequacy position of all banks



*Up to 30 June 2017
Source: Bangladesh Bank.

Table 5.5 Comparative position of provision adequacy

(billion BDT)

Year	Items	SCBs	DFIs	PCBs	FCBs
2015	Required provision	140.4	26.4	126.0	16.1
	Provision maintained	94.7	28.4	126.6	16.5
	Provision maintenance ratio (%)	67.5	107.6	100.5	102.5
2016	Required provision	174.0	27.8	144.2	16.0
	Provision maintained	113.2	28.4	149.4	16.4
	Provision maintenance ratio (%)	65.1	102.2	103.6	102.5
2017 June	Required provision	205.3	27.8	186.1	17.1
	Provision maintained	131.7	28.8	196.3	17.7
	Provision maintenance ratio (%)	64.2	103.3	105.5	103.3

Source: Bangladesh Bank.

of funds from 2009 to 2011. In 2012, the NII of SCBs dropped, and deteriorated afterwards. The NII of the PCBs had been significantly high since 2009. Overall NII of the banking industry showed a consistently upward trend from 2009 to 2016 though it went reverse in 2013 due to lacklustre performance of the SCBs (Table 5.9).

Liquidity

5.26 Presently, the commercial banks have to maintain CRR (cash reserve ratio) averaging 6.5 percent daily on a biweekly basis against average total demand and time liabilities (ATDTL) of the second preceding month, with an obligation to maintain daily minimum 6.0 percent cash against the same ATDTL held by the bank. The current rate of SLR (statutory liquidity reserve) for conventional banks is 13.0 percent of ATDTL. In case of Islamic Shariah based commercial banks, the rate of SLR is 5.5 percent of their ATDTL. Three banks (two specialized banks and BDBL) are exempted from maintenance of SLR, but they have to maintain the CRR at the stated rate. The banks maintain CRR in cash with Bangladesh Bank. However, they are allowed to hold government approved securities (unencumbered portion) including Government Islamic Investment Bond (GIIB) for maintenance of the SLR.

5.27 Table 5.10 shows that in 2016 the FCBs have the highest liquidity ratios followed by the SCBs. It is observed that the liquidity ratio of the banking system show steady trend (percentage of liquid assets in total assets) during the last few years although the ratio for DFIs is zero as they do not need to maintain SLR.

CAMELS Rating

5.28 CAMELS rating is a supervisory tool to assess and review the financial soundness of the banking companies. It helps BB to remain always vigilant over the banks and identify those banking companies which have problems and require close supervision. The previous CAMELS rating guideline has been reviewed by the Department of Off-site Supervision with a view to assessing the banks' soundness more accurately, reflecting the banks' financial condition and management issues more pragmatically, making the guideline more country perspective oriented and making an effort to address good governance issues in the banking sector. The revised CAMELS rating guideline came into effect from 2013.

5.29 The revised CAMELS rating guideline has brought not only major changes in ratios or indicators but also modifications in the questionnaire for evaluation of qualitative issues. Basel-III principles related to capital adequacy have also been reflected in the guideline. Along with emphasizing best quality capital,

Table 5.6 Trends of Writing-off bad debts in different bank categories

(billion BDT)

Bank Types	30 June 2010	30 June 2011	30 June 2012	30 June 2013	30 June 2014	30 June 2015	30 June 2016	31 Dec 2016
SCBs	70.5	82.4	72.9	107.2	154.8	210.3	220.4	222.2
DFIs	31.8	32.0	24.5	32.6	34.2	5.6	5.6	5.6
PCBs	69.6	77.1	64.9	109.7	127.7	155.5	189.4	211.5
FCBs	2.1	2.4	2.6	3.7	4.4	5.1	7.2	8.1
Total	174.0	193.9	164.9	253.3	321.1	376.5	423.2	447.3

Source: Bangladesh Bank.

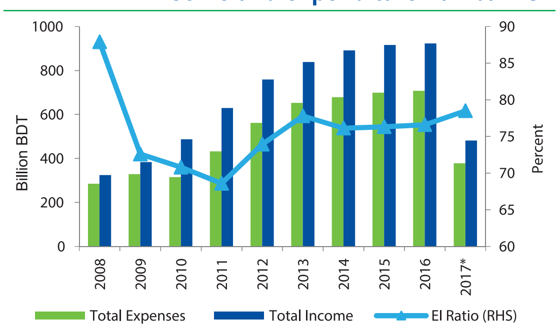
Table 5.7 Trends of Expenditure-income ratio by type of banks

(percent)

Bank types	2009	2010	2011	2012	2013	2014	2015	2016	End June 2017
SCBs	75.6	80.7	62.7	73.2	84.1	84.1	84.5	90.2	87.9
DFIs	112.1	87.8	88.6	91.2	94.8	99.5	113.9	137.8	132.8
PCBs	72.6	67.6	71.7	76.0	77.9	75.8	75.5	73.5	74.5
FCBs	59.0	64.7	47.3	49.6	50.4	46.8	47.0	45.7	45.5
Total	72.6	70.8	68.6	74.0	77.8	76.1	76.3	76.6	78.5

Source: Bangladesh Bank.

Chart 5.7 Trends of Aggregate position of income and expenditure - all banks



*Up to 30 June 2017

Source: Bangladesh Bank.

investments in the capital market, the amount of off-balance sheet items in comparison to the capital of the banks, large loan exposures to capital, etc. are considered to calculate capital adequacy. HHI (Herfindahl-Hirschman Index) has been incorporated in the updated CAMELS rating guideline to analyze loan concentration, as a complement to percentages of classified loans and provisioning in the evaluation of asset quality. The amount of loan disbursed to different risk associated sectors has been

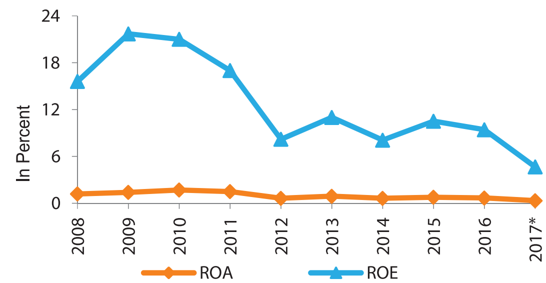
Table 5.8 Trends of Profitability ratio by type of banks

(percent)

Bank types	ROA									ROE								
	2009	2010	2011	2012	2013	2014	2015	2016	2017 June	2009	2010	2011	2012	2013	2014	2015	2016	2017 June
SCBs	1.0	1.1	1.3	-0.56	0.59	-0.55	-0.04	-0.16	-0.63	26.2	18.4	19.7	-11.87	10.93	-13.46	-1.47	-6.02	-19.38
DFIs	0.4	0.2	0.1	0.06	-0.40	-0.68	-1.15	-2.80	-1.60	-171.7	-3.2	-0.9	-1.06	-5.81	-5.97	-5.79	-13.88	-8.14
PCBs	1.6	2.1	1.6	0.92	0.95	0.99	1.00	1.03	0.68	21.0	20.9	15.7	10.17	9.76	10.26	10.75	11.09	7.50
FCBs	3.2	2.9	3.2	3.27	2.98	3.38	2.92	2.56	2.15	22.4	17.0	16.6	17.29	16.93	17.67	14.59	13.08	10.81
Total	1.4	1.8	1.5	0.64	0.90	0.64	0.77	0.68	0.34	21.7	21.0	17.0	8.20	11.10	8.09	10.51	9.42	4.66

Source: Bangladesh Bank.

Chart 5.8 Aggregate profitability-all banks



*Up to 30 June 2017

Source: Bangladesh Bank.

Table 5.9 Trends of Net interest income by type of bank

(billion BDT)

Bank types	2009	2010	2011	2012	2013	2014	2015	2016	2017 June
SCBs	12.1	19.8	34.3	14.9	-5.4	39.7	40.4	49.5	24.9
DFIs	1.9	6.2	4.9	4.7	3.8	2.1	1.7	0.9	3.9
PCBs	56.7	82.8	91.4	114.7	118.2	205.8	222.6	254.1	125.5
FCBs	10.7	13.0	16.1	19.6	15.8	26.6	28.2	24.2	11.1
Total	81.5	121.9	146.7	153.8	132.3	274.2	292.9	328.7	165.4

Source: Bangladesh Bank.

included as well. Under this rating system, banking companies are assigned two sets of ratings- (i) performance ratings, based on six individual ratings that address six components of CAMELS (capital, assets, management earnings, liquidity and sensitivity to market risk) and (ii) an overall composite rating based on a comprehensive assessment of the overall condition of the banking company. Both ratings are expressed by using a numerical scale of “1” to “5” in ascending order of supervisory concern, “1” representing the best rating, while “5” indicating the worst. Any bank rated 4 or 5, i.e., ‘Marginal’ or ‘Unsatisfactory’ under the composite CAMELS rating is generally identified as a problem bank, and the activities of these banks are closely monitored by BB. At present, there are two problem banks, which are under intensive monitoring of BB.

5.30 Bangladesh Bank has introduced the Early Warning System (EWS) since March 2005 to address the difficulties faced by the banks in any of the areas of CAMELS. Any bank found to have difficulty in any areas of operation, is brought under the Early Warning category and monitored very closely to help improve its performance. Presently, there is no bank under EWS.

5.31 According to June 2017 based CAMELS rating, no bank was rated '1' or 'Strong'; the rating of 41 banks was '2' or 'Satisfactory'; rating of 7 banks was '3' or 'Fair'; 6 banks were rated '4' or 'Marginal', 2 banks were rated '5' or 'Unsatisfactory' and the rest 1 bank was not rated due to inadequate duration of its operation.

Operations of Banks in Urban and Rural Areas

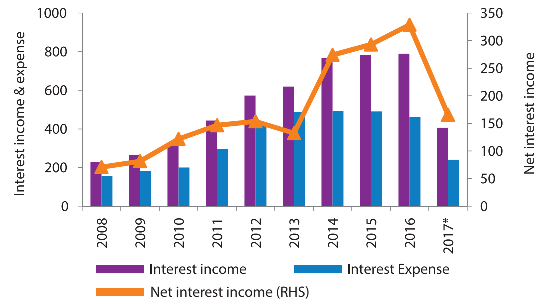
5.32 As on 30 June 2017, 57 scheduled banks are operating with their 9720 number of branches throughout Bangladesh. The number of rural branches stood at 5501 (56.60 percent of total branches) at the end of June 2017 (Appendix 4, Table XIII) and the number of branches in urban areas increased to 4219 (43.40 percent of total branches) during the same period. The number of branches of SCBs are 2341 (63.05 percent) in rural areas and 1372 (36.95 percent) in urban areas. DFIs have 1297 (92.2 percent) branches in rural areas and 110 (7.8 percent) in urban areas. Private commercial banks have 1863 (41.13 percent) branches in rural areas and 2666 (58.87 percent) in urban areas. Foreign commercial banks are operating through 71 urban branches. The share of urban deposits to total deposits of the banking sector was 79.50 percent and the share of rural deposits to total deposits was 20.50 percent at the end of December 2016. On the other hand, the amount of advances given in urban areas constituted 89.83 percent of total advances of the banking industry and the amount of advances disbursed in rural areas represent 10.17 percent of total advances of the banking industry at the end of December 2016.

Islamic Banking

5.33 Islamic banking system has been operating in Bangladesh since 1983. In FY17, out of 57 banks in Bangladesh, eight PCBs operated as full-fledged Islamic banks and 16 conventional banks (including three FCBs) were involved in Islamic banking through Islamic banking branches and windows. The Islamic banks have continued to show strong growth since its inception, as reflected by the increasing market share of the Islamic banking sector in terms of assets, financing and deposits compared to the total banking system. A brief analysis on the performance of Islamic banks is given in Table 5.11. It is evident from the Table-5.11 that, total deposits of the Islamic banks and Islamic banking branches and windows of the conventional banks stood at BDT 1857.3 billion at the end of December 2016 which accounted for 20.79 percent of total deposits (BDT 8933.92 billion). Total credit of the Islamic banks and the Islamic banking branches and windows of the conventional banks stood at BDT 1647.0 billion at the end of December 2016 which accounted for 24.44 percent of total credit (BDT 6739.3 billion) of the banking system of the country.

Chart 5.9 Aggregate NII of the industry

Billion BDT



*Up to 30 June 2017
Source: Bangladesh Bank.

Table 5.10 Tends of Liquidity ratio by types of banks

(billion BDT)

Bank types	2009	2010	2011	2012	2013	2014	2015	2016	2017 June
SCBs	12.1	19.8	34.3	14.9	-5.4	39.7	40.4	40.0	38.4
DFIs	1.9	6.2	4.9	4.7	3.8	2.1	1.7	0.0	0.0
PCBs	56.7	82.8	91.4	114.7	118.2	205.8	222.6	17.8	16.5
FCBs	10.7	13.0	16.1	19.6	15.8	26.6	28.2	48.2	40.9
Total	81.5	121.9	146.7	153.8	132.3	274.2	292.9	24.9	23.1

Source: Department of Off-site Supervision (DOS), BB.

Legal Framework and Prudential Regulations

Risk Based Capital Adequacy (RBCA) for Banks

5.34 To comply with international best practices and to improve financial stability, Bangladesh Bank (BB) has commenced implementation of Basel III capital adequacy framework since January 2015 after successful completion of Basel-II in December 2014. According to Pillar-1 of Basel-III, RWA of banks is calculated against credit risk, market risk, and operational risk. BB announced the Roadmap for

Table 5.11 Comparative position of the Islamic banking sector (as of end December 2016)

(billion BDT)

Particulars	Islamic banks		Conventional banks*		Islamic banking sector		All bank	
	2016	2015	2016	2015	2016	2015	2016	2015
1	2		3		4=2+3		5	
Number of banks	8	8	16	16	24	24	57	56
Deposits	1770.7	1552.2	86.6	89.4	1857.3	1641.6	8933.9	8033.5
Credits	1565.0	1305.5	82.0	81.7	1647.0	1387.2	6739.271	5952.9
Investment deposit ratio (IDR in %)	86.3	83.2	84.2	75.6	86.7	82.7	71.85	70.98
Liquidity: excess(+)/shortfall(-)**	113.6	133.4	3.0	3.1	116.6	136.5	1259.5	1234.1

*Conventional banks having Islamic Banking Branches and windows.
**Conventional banks which have Islamic banking branches and windows do not maintain SLR individually, but their head offices of the respective banks maintain a combined SLR and liquidity position.
Source: BRPD and DOS, BB.

implementing Basel III in Bangladesh and issued Guidelines on Risk Based Capital Adequacy (Revised Regulatory Capital Framework for banks in line with Basel III) in 2014.

5.35 Banks were instructed to submit their Capital Adequacy Statements/Reports to BB following new Basel-III accord from the quarter ended in March 2015. At the end of March 2016, CRAR of the banking industry stood at 10.6 percent while CET1 was 8.2 percent which fulfilled Basel-III capital adequacy requirements. However, at individual level, seven banks out of 56 scheduled banks failed to maintain CET1 and CRAR requirements as per Basel-III.

5.36 Banks are required to maintain a total capital conservation buffer (CCB) of 2.5 percent (Following the phase-in-arrangements), comprised of Common Equity Tier 1 capital, above the regulatory minimum capital requirement of 10 percent which has already come into effect since 2016. In 2017, CCB requirement is 1.25 percent. Bank should not distribute profit in case capital level falls below this range. CCB of the banking industry stood at 0.68 percent at the end March 2017, which did not fulfil CCB requirements. Besides, at individual level, 13 (thirteen) banks out of 57 scheduled banks failed to maintain CCB requirement during the period.

5.37 In order to avoid building-up excessive on and off-balance sheet leverage in the banking system, a simple, transparent, non-risk based leverage ratio has been introduced since 2015. In Bangladesh, the minimum requirement of leverage ratio is 3 percent. Based on the results of the year 2015 and 2016, final adjustments to the definition and calibration of the leverage ratio may be made by BB at the end of 2017. Leverage ratio of the banking industry stood at 4.93 percent at the end March 2017, which fulfilled the minimum requirement. However, at individual level, 8 (eight) banks out of 57 scheduled banks failed to maintain leverage ratio requirement during the period. Instructions mentioned in the guidelines will be adopted phase by phase, with full implementation of capital ratios by December 2019. Phase-in-arrangement of minimum capital requirements is depicted in Table 5.12. Under the new capital adequacy framework, all banks will be required to maintain the following ratios on an ongoing basis:

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

ii. Tier-1 capital will be at least 6.0 percent of the total RWA.

iii. Additional Tier-1 capital can be admitted maximum up to 1.5 percent of the total RWA or 33.33 percent of CET-1, whichever is higher.

iv. Minimum Capital to risk-weighted Asset Ratio (CRAR) of 10 percent of the total RWA.

v. Tier-2 capital can be admitted maximum up to 4.0 percent of the total RWA or 88.89 percent of CET-1, whichever is higher.

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

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

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

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

Source: Bangladesh Bank.

Loan Classification and Loan-Loss Provisions

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

Loan Restructuring

5.40 Loan restructuring policy for large borrowers having multiple bank exposures was revised. Considering the contribution of the large borrowers to the socio-economic development and employment generation of the country, and to support the loan recovery efforts of the banks, the Board of Directors of Bangladesh Bank recommended necessary policy support in line with international best practices for the affected large borrowers. Accordingly, large loan restructuring policy has been issued through and was valid till 30

June 2015. According to the policy, loans of a particular borrower or group in a bank, singly or in clubbed together form, shall be eligible for restructuring. Borrower having exposure in multiple banks may also be eligible for loan restructuring by forming a consortium. Minimum outstanding loan amount for restructuring shall be BDT 5.0 billion or above in aggregate. Under this policy, banks can provide restructuring facility to a particular loan account only once and the restructured loan shall have a maximum tenure of twelve years for term loan(s); in case of demand and/or continuous loan(s), the tenure shall be maximum six years. However, borrowers indulging in frauds and forgeries will not be eligible for loan restructuring. Under the large loan restructuring policy, BDT 145.7 billion has been restructured with the approval of Bangladesh Bank. Respective banks have recovered BDT 1.9 billion as down payment and BDT 11.83 billion as instalment from various borrowers up to June 2017. As most of the borrowers are enjoying moratorium period, the recovery of instalment from all borrowers have not yet been fully started.

Corporate Governance in Banks

5.41 BB has undertaken several measures in the recent years to establish good corporate governance in the banking sector. These include 'formation of Risk Management Committee at the Board of the banks', 'the constitution of audit committee of the Board, "fit and proper" test for appointment of chief executive officers of PCBs, enhanced disclosure requirements, etc. In continuation of the above reforms, the roles and functions of the board and management have been redefined and clarified with a view to specifying the function and powers of the management of the bank. In this connection, related clauses of the Bank Company Act 1991 have already been amended.

Supervision of Banks

5.42 With a view to promoting and maintaining soundness, solvency and systematic stability of the financial sector as well as protecting the interest of depositors, Bangladesh Bank (BB) carries out two types of supervision namely (i) off-site supervision and (ii) on-site supervision. Department of Off-site Supervision (DOS) of BB is responsible for conducting off-site supervision on banks.

Off-site Monitoring of Banks

5.43 Off-site monitoring continued as a necessary complement to on-site inspection in FY 2016-17, with its various tools and procedures for intensive and rapid analysis of the financial health of the banking sector. Recently, Department of Off-site Supervision (DOS) has undertaken some innovative initiatives to strengthen banking supervision.

Banking Supervision Specialists (BSSs)

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

5.45 BSSs monitor the progress of memorandum of understanding (MoU) with the SCBs and specialized banks and report the findings/progress of those banks immediately to the concerned senior management. To improve the standard of credit management and internal control system, BB is monitoring the compliance status of the implementation of Internal Control and Compliance Policy of four largest state-owned commercial banks (Sonali Bank Ltd., Janata Bank Ltd., Agrani Bank Ltd. and Rupali Bank Ltd.). The ICC policy is formulated by those SCBs with the approval of the respective BoD. Meanwhile, the government has injected BDT 10.0 billion to BASIC Bank Ltd., BDT 3.0 billion to Sonali Bank Ltd. and BDT 1.0 billion to Ruapli Bank Ltd in June 2017 as recapitalization. On the other hand, BKB and RAKUB are also being monitored and reviewed under the MoUs of FY17. Preparation of MoUs for BKB and RAKUB for FY18 is currently under process.

Risk Management Activities of Banks

5.46 BB has revised six core risk management guidelines to ensure robustness, efficiency and effectiveness of risk management systems for the banking sector. Besides, the review of the guideline namely ‘Risk Management Guideline for Banks’ issued in 2012 is now in process to facilitate banks in adopting contemporary methods to identify, measure, monitor and control the risks existing in their institutions.

5.47 Recently, to bring greater expertise and harmonization to risk management activities of all banks and exercise international best practices, the reporting format of risk management activities of banks has been revised and banks submit the report on half yearly basis according to the revised reporting format titled "Comprehensive Risk Management Report (CRMR)" instead of previous one. Various contemporary issues have been incorporated in the CRMR for the quantification of risk management process along with a questionnaire for some qualitative checking of the risk management activities of the banks. Moreover, to monitor the risk management activities more closely, a short reporting format named "Monthly Risk Management Report (MRMR)" has been introduced and banks are submitting those reports to DOS on monthly basis. Based on the CRMR and MRMR submitted by the banks, DOS regularly evaluates the risk management activities of each bank and provides constructive recommendations to improve their conditions. Banks have to execute all the recommendations and submit their compliance reports within a specified period. BB also instructed the banks to determine their risk appetite on a yearly basis for all possible measurable risk areas in line with the strategic planning of their bank and to submit the statement to DOS by the end of first quarter of every year after taking board approval. BB analyzes the statements and monitors its implementation status on regular basis.

5.48 BB determines the comprehensive risk management rating of each bank on half yearly basis based on available information in the CRMR, minutes of enterprise risk management committee (ERMC) and board risk management committee (BRMC) meetings, compliance status of BB instructions submitted by banks and other sources. This risk rating carries 15 percent weight in the management component of CAMELS rating. Therefore, a bank's risk management practices will have a significant effect on its CAMELS rating. Besides, a high and critical score of this rating is considered as a negative indicator, along with others, while giving approval/NOC for branch expansion, AD license, dividend declaration, etc. for banks. In 2016, BB has revised the process for determining comprehensive risk management rating. According to the rating of June 2017, out of 57 scheduled banks, 14 banks were rated as low risk, 32 as moderate, 8 as high, 2 as critical and the rest 1 was not rated due its inadequate duration of operation.

5.49 BB revised Self- Assessment reporting format in FY 2016-17 which was introduced in 2012 to keep the operational risk at a minimum level by strengthening the internal control and compliance system of a bank. The report is to be signed by MD/CEO and counter signed by the chairman of the audit committee of the board. This report comprises a questionnaire divided into five (05) sections - Internal Control and Compliance (ICC), General Banking and Operation, Loans and Advances, Foreign Exchange Operation, and Information and Communications Technology (ICT) and two statements containing detailed information regarding fraud-forgeries that have been detected within a specific reporting period as well as fraud-forgeries detected and unsettled up to the previous reporting period since the inception of the bank along with the action taken against those incidences. BB has revised the reporting format to make the questions more specific/effective and to ensure accountability of the management regarding their internal control system and instructed. The banks submit the report on half-yearly basis. BB analyzes these reports and provides proper instructions to the banks based on the findings. The information provided in the report is also sent to the on-site supervision departments for verification during on-site inspection.

On-site Inspection of Banks

5.50 As part of bank’s statutory function, currently seven departments of BB namely Department of Banking Inspection-1 (DBI-1), Department of Banking Inspection-2 (DBI-2), Department of Banking Inspection-3 (DBI-3), Department of Banking Inspection-4 (DBI-4), Department of Foreign Exchange Inspection (DFEI), Financial Integrity and Customer Services Department and Bangladesh Financial Intelligence Unit (BFIU) are conducting inspection activities. These seven departments conduct on-site inspection on SCBs, DFIs, PCBs (including banks under Islamic Shariah), FCBs and other institutions including Investment Corporation of Bangladesh (ICB) and money changers. These departments conduct different types of inspection which may be summarized in three major categories like (i) comprehensive/ regular/ traditional inspection, (ii) risk based system check inspection and (iii) special/surprise inspection.

5.51 The overall performance of the banks (such as capital adequacy, asset quality, liquidity, earnings, management competence, etc.) is evaluated in a comprehensive inspection. Based on their performance, banks are rated from “1” to “5” grades in ascending order. The on-site inspection departments also monitor implementation of the suggestions or recommendations made in the inspection reports. Risk based inspection is conducted to examine the compliance of the core risk management guidelines on Asset Liability Management, Credit/Investment Risk

Management, Internal Control & Compliance, and Information Systems Security issued by Bangladesh Bank. Special/surprise inspections are conducted to investigate complaints received from the depositors, public or institutions.

5.52 The supervision of banks is based on the internationally accepted standards for bank supervision set out by the Basel Committee for Banking Supervision. Under the continuous supervision/surveillance system, the overall financial condition of the banks operating in Bangladesh is monitored throughout the year on the basis of periodic on-site inspections conducted by the concerned departments of BB.

5.53 During FY17, DBI-1 conducted a total number of 1381 inspections, among which 835 comprehensive inspections and 224 core risk inspections were conducted on 28 banks to review the progress of implementation of the core risk guidelines issued by Bangladesh Bank. Head/country offices of the bank as well as one branch of each bank have been taken under the purview of the core risk inspection. Besides this, DBI-1 also conducts on-site inspection and off-site surveillance on risk areas of banks as determined from Integrated Supervision System (ISS) Software. DBI-1 attends in the special board meeting of the concerned banks in order to exchange views on the compliance of the inspection report of head offices. The department also arranges meeting of Supervision Committee bi-monthly basis, presided over by the Deputy Governor, in-charge of supervision, where different policy and operational issues covering supervision are discussed. Under the jurisdiction of DBI-1, the concerned banks are directed to sit in a tri-partite meeting with their Management Committee (MANCOM), inspection team of Bangladesh Bank and external auditors before finalization of the annual financial statements.

5.54 During FY17, DBI-2 conducted a total number of 937 comprehensive inspections on 06 head offices, 143 big branches and 788 small branches of 06 state-owned commercial banks. At the same time, a total number of 73 special inspections and 22 core risk based inspections were conducted on SCBs. The department conducted comprehensive inspection on 04 branches and the head office of ICB. DBI-2 also conducted one special inspection on 01 branch of ICB during the period.

5.55 DBI-3 has to conduct comprehensive inspection on specialized banks, namely Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnoyan Bank (RAKUB), Ansar-VDP Unnoyan Bank, Karma-Sangsthan Bank, Grameen Bank, Probashi Kallyan Bank and SME activities of all banks and NFIs. During FY17, DBI-3 conducted a total number of 763 comprehensive inspections on banks including 06 head offices, 757 branch offices including SME/agriculture. In addition, this department also conducted 06 risk-based inspections, 08 special inspections and 01 surprised inspection during the period.

5.56 DBI-4 is entrusted with the responsibility of supervising the performance of domestic 08 Islamic banks, 03 NRB banks (established by non-resident Bangladeshis) and 09 foreign private commercial banks that are operating in the country with special emphasis on regulatory and supervisory compliances. During FY17, DBI-4 conducted a total number of 238 inspections on banks' head/country offices and branches. During the period, DBI-4 conducted comprehensive inspections on 128 branches and on 20 head/country offices to evaluate their overall soundness and regulatory compliance status. Within this period, the department carried out core risk inspections on 20 branches and on 20 head/country offices. To review the accuracy of the statement of Internal Capital Adequacy Assessment Process (ICAAP) of banks, the department carried out Supervisory Review Evaluation Process (SREP) inspections on 20 branches and on 20 head/country offices.

5.57 Besides these, DBI-4 conducted Anti Money Laundering (AML) inspections on 10 branches of different banks under its jurisdiction. DBI-4 conducted quick summary inspection on 87 branches and on 11 head offices (08 Islami banks and 03 NRB banks). DBI-4 examined asset quality of the banks on the basis of 31st December, 2016 and ensured reflection of observation of this inspection in the annual financial statements of the banks. This is ensured through exchanging views in a tri-partite meeting among the concerned bank’s management, external auditors and inspection team before finalization of financial statements. This department also regularly monitors implementation progress of the recommendations made in the inspection reports of bank branches and head /country offices.

5.58 Department of Foreign Exchange Inspection (DFEI) conducts inspection on foreign trade financing, treasury functions and foreign exchange risk management of banks, foreign exchange transactions of banks and money changers. In FY17, the department conducted a total of 127 comprehensive inspections on authorized dealer branches of banks, 10 comprehensive inspections on head office and 56 inspections on foreign exchange risk management of banks. The department also conducted 48 inspections on new authorized dealer branches of banks, a good number of special inspections on foreign trade and foreign exchange related irregularities and 31 inspections on money changers.

5.59 BB has always striven hard to ensure highest standards for fair banking practices, moral codes and corporate governance in the banking sector. With a view to achieving this objective, Financial Integrity and Customer Services Department (FICSD) of BB has continued its efforts to settle disputes/complaints received from customers successfully. As a part of customer/public awareness initiatives, the department has aimed to increase publicity in the print and electronic media. FICSD has also taken initiatives to settle issues related to frauds in ATM Card, MICR cheque and Mobile banking. FICSD has conducted special inspections on general banking, credit and foreign exchange transaction in various banks throughout the year and several actions were taken accordingly. During FY2016-17, a total number of 3359 complaints were received by the department through the dedicated hot-line numbers, e-mails and traditional letters and among them 3357 complaints were resolved. Resolution rate is 99.94 percent. Besides, a total number of 86 special inspections were carried out on different commercial and specialized banks by this department during the period.

5.60 FICSD has issued "Guideline on customer services and complaint management" in 2014 and banks were instructed to implement that guideline accordingly. FICSD monitors the implementation status by the banks regularly. In order to protect banking customer's rights, recently this department has amended the existing guideline and banks were advised to inform customers in case of changing interest rate on term loan before one month and to allow customers to exit bank without deducting any early settlement fee. No early settlement fee will be deducted in case of adjustment of continuous or demand loan before maturity. Charging of penalty will be considered on rational basis in case of overdue installments to be paid by the borrowers and the rate of penalty should not exceed 2 percent over existing rate. Banks were also advised not to receive blank cheque as collateral security against loans.

5.61 Bangladesh Financial Intelligence Unit

(BFIU) is the central agency of Bangladesh responsible for analyzing Suspicious Transaction Reports (STR), Cash Transaction Reports (CTR) and information related to money laundering (ML) and terrorist financing (TF) received from reporting agencies and other sources and disseminating information/ intelligence thereon to relevant law enforcement agencies. BFIU is also entrusted with the responsibility of exchanging information related to ML and TF with its foreign counterparts. The main objective of BFIU is to establish an effective system for prevention of money laundering, combating financing of terrorism and proliferation of weapons of mass destruction.

5.62 The BFIU has adopted risk-based approach to supervise the banks more effectively and to comply with FATF recommendation-1. Therefore, in FY17 supervisory activities were focused on banking sector and branches that are most vulnerable to money laundering or terrorist financing and are at highest risk of being non-compliant with legislative and regulatory requirements. While implementing risk based approach, BFIU took account of a number of risk factors faced by the branches including sectoral, client, geographic, delivery channel or services/product risks. In order to identify the important risks faced by banks and to mitigate those risks by choosing the appropriate response, BFIU considered the following four (4) types of risk assessments, namely (i) national risk assessment, (ii) sectoral risk assessment, (iii) risk assessment of the banks by the supervisory body (i.e. BFIU) and (iv) risk assessment prepared by the banks (about its customers, products/ services, countries and geographic areas, and distribution channels). AML/CFT system check inspections for branches are conducted on a 6 months cycle to oversee and ensure compliance. During the inspection, AML/CFT risk management procedures of the banks are also been examined. Branch inspections include review of capacity of compliance officers, CDD procedures, KYC procedures related to customers, Politically Exposed Persons (PEPs) and influential persons, record keeping, United Nations Security Council Resolution (UNSCR) sanctions monitoring process, STR identification, monitoring and reporting process, KYC procedure of beneficial owner(s) of a account(s), CTR monitoring, KYC for occasional/walk-in or one off customers transactions, transaction monitoring process, self-assessment and Independent Testing Procedures, Quarterly AML/CFT meeting, training records. BFIU has conducted system check inspection on 56 head offices as well as 114 branches of those banks during FY 2016-17. The rating awarded through AML/CFT system check inspection of the FY17 reveal that no branch of any bank got ‘Strong’ rating, whereas the majority of them got ‘Fair’ and ‘Marginal’. In the FY 2016-17, 3 banks were rated ‘Satisfactory’, 28 banks were rated ‘Fair’, 24 banks were rated ‘Marginal’ and one bank was rated ‘Unsatisfactory’.

5.63 BFIU continues its effort to create awareness among the officials of different reporting organizations and thus encourages the reporting organizations to conduct a number of training programmes for their officials. Besides, it has arranged workshops for other law enforcing agencies. Apart from these, BFIU has been maintaining continued engagement with all concerned international bodies such as APG, Egmont Group, FATF and BIMSTEC to boost international efforts in this arena.

Financial Stability and Macro Prudential Supervision

5.64 Financial Stability Department (FSD) is working relentlessly to build up a stable macro prudential framework that would shield the financial system from any adverse development in the downturn phases of the economic and financial cycles. The department has been publishing 'Financial Stability Report (FSR)'on yearly basis to evaluate the strength of banks and financial institutions (FIs) as a whole and contribute to enhance risk awareness among the stakeholders of the financial system. Another report called 'Quarterly Financial Stability Assessment Reports (QFSAR)' is also published by FSD to provide the stakeholders with more frequent updates on major trends in banking, FIs and capital market indicators. Besides, FSD conducts stress tests on quarterly basis to monitor the strength of the banks to withstand financial shocks and aggregate stress test results are published regularly in FSR and QFSAR.

5.65 FSD also use a number of macro prudential supervisory tools as early warning indicators. Financial Projection Model (FPM), a forecasting tool developed under the technical assistance from the World Bank, is used for projecting fluctuations in the financial markets by assuming hypothetical scenarios in the model. It helps improve BB's risk assessment capacity for individual bank. FPM report is generated on half-yearly basis. Another tool named 'Interbank Transaction Matrix (ITM)' is used by the department for monitoring liquidity management of banks and FIs to find any potential liquidity crisis in the market. ITM report is prepared on quarterly basis. Besides, the department has been preparing Bank Health Index (BHI) and Heat Map on a half-yearly basis to perform a dynamic analysis of the health of the banks from liquidity, solvency and earning perspectives.

5.66 The department has developed a framework for identifying and dealing with the Domestic Systemically Important Banks (DSIB) in its jurisdiction due to the underlying assumption that the impact of the failure of DSIBs will be significantly greater than that of a non-systemic bank. A new oversight framework titled 'Central Database for Large Credit (CDLC)' has been introduced by FSD to enhance financial discipline through monitoring the large exposures of banks and FIs in a more structured way. This will help to identify and manage the low quality assets well ahead of time before they appear as a cause to financial distress. Reports based on the analysis of CDLC are generated quarterly.

5.67 Bangladesh Systemic Risk Dashboard (BSRD) has been developed which is intended to serve as an early warning system capturing probable build-up of any systemic risk in the financial system. It contains a set of relevant qualitative and quantitative indicators of systemic risk. A tool named 'Composite Financial Stability Index (CFSI)' has been developed in order to measure financial stability. Taking into account the interconnectedness among different sectors of the economy, the index integrates the major soundness indicators of banking sector, financial sector, real sector and external sector to form a single composite indicator which will indicate the stability condition of the financial system as well as any build up of systemic stress. Under the framework titled 'Coordinated Supervision framework for Bangladesh Financial System', a Coordination Council Technical Group (CCTG) has been formed to assist the Coordination Council in decision-making. The CCTG met three times during 2016-17 with a view to exchanging ideas and information, and promoting cooperation among various regulators of the financial system.

Banking Sector Infrastructure for Financial Stability and Risk Management

Deposit Insurance Systems in Bangladesh

5.68 The Deposit Insurance Systems (DIS) is designed to minimize the risk of loss that the depositors may suffer due to keeping funds with a bank. The purpose of DIS is to help increase market discipline, reduce moral hazard in the financial sector and provide safety nets at the minimum cost to the public in the event of a bank failure. The direct rationale for deposit insurance is customer protection while the indirect rationale for deposit insurance is to reduce the risk of a systemic crisis; for example, panicked withdrawals of deposits from sound banks and thus breaking down of the payments system. From a global point of view, deposit insurance provides many benefits and, over the long term, appears to be an essential component of a viable modern banking system.

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

5.70 In accordance with the "The Bank Deposit Insurance Act 2000", the main functions of DITF are collecting premium from all scheduled banks on a half-yearly basis (end of June/end of December) and investing the proceeds in the Government Securities and REPO. The income derived from such investments is also credited to the DITF account for further investment. In case of winding up of an insured bank, as per the said act, BB will pay to every depositor of that bank an amount equal to his/her deposits not exceeding BDT100,000.

Table 5.13 The recent position of DITF

Particulars	Unaudited figure (as on as on 30 June 2017)	Premium rate*
Total fund	58.81 billion BDT	---
Total investment	58.81 billion BDT	---
Insurable deposit to total demand and time liabilities	83.47%	---
Covered deposit of total insurable deposit	24.86%	---
Fully insured deposit	88.91%	---
Sound bank categories	---	0.08%
Early warning bank categories	---	0.09%
Problem bank categories	---	0.10%

* Effective from 2013
Source: Bangladesh Bank.

5.71 To enhance the effectiveness of market discipline, BB has adopted a system of risk based deposit insurance premium rates applicable for all banks effective from 2007. From 2013, the premium rate has been increased. Moreover, proposal for the amendment of the current Act i.e. 'Deposit Protection Act' has already been sent to Ministry of Finance, which is now under consideration. There is a plan to bring depositors of NBFIs under the umbrella of DIS and increase the coverage limit in the amended act. At present, a software named 'Information for Deposit Insurance Premium Assessment (IDIPA)' has been introduced for assessing and calculating deposit insurance premium.

5.72 The effectiveness of DIS in reducing systemic risk would be increased if the public is well aware of its existence and scope. Therefore, BB has already issued a circular regarding public awareness and more information are available in the Bangladesh Bank website so that the public can be informed about the benefits and limitations of DIS on an ongoing basis.

Activities of Credit Information Bureau

5.73 Credit Information Bureau (CIB) was set up in Bangladesh Bank (BB) on August 18, 1992 with the objective of minimizing the extent of default loans. CIB has been providing its online services since 19 July, 2011. The online system of CIB is playing an important role to maintain a risk free lending procedure in the banking industry. At present, CIB is providing its online services through new CIB online solution, which was developed by BB's internal resources and started its operation on October 01, 2015. It has eliminated vendor dependency as well as reduced huge cost incurred by maintaining the previous online system. With the adoption of highly sophisticated ICT facilities, the performance of the CIB services has been improved significantly in terms of efficiency and quality. It has also appreciably reduced the time and physical movement for the banks/NBFIs in submission of credit information and CIB report generation process. Consequently, online services of CIB have made the loan processing activity faster.

5.74 The CIB database consists of detailed credit information in respect of borrowers, co-borrowers and guarantors. CIB database includes credit information of borrowers having outstanding amount of BDT 50,000 and above and defaulted credit card information having outstanding amount of BDT 10,000 and above. At the end of June 2017, the total number of borrowers was 13,17,664 while it was 11,01,046 during the same period of the previous year. This number recorded an increase of around 20 percent compared to the same of the previous year. The total number of classified borrowers in banks/FIs was 2,16,647 at the end of June, 2017 which is about 5 percent higher compared to the same period of the last year. In June, 2016 the number was 2,06,639.

5.75 The total outstanding amount of loans and advances of the banking and non-banking financial institutions stood at BDT 8612.67 billion (including BLW amount) in June, 2017 which recorded an increase of around 26 percent compared to the same period of the last year. In June 2016, the amount was BDT 6852.64 billion. Furthermore, total classified outstanding amount recorded an increase of around 24 percent in June 2017 over the same period of last year. The classified amount was BDT 1152.57 billion at the end of June, 2017 while it was BDT 929.55 billion in June, 2016.

Besides, Credit Information Bureau of Bangladesh Bank has undertaken several initiatives with a view to increasing the score of 'Depth of Credit Information Index', which is a part of 'Getting Credit' of Doing Business Report prepared by World Bank. The initiatives are described below:

i) Strengthening and making the existing CIB of Bangladesh Bank more informative through-

a) Fine tuning the newly developed CIB online system;

b) Increasing the coverage of credit information stored in CIB database submitted by banks/FIs. i.e resetting the threshold of outstanding loans and advance at BDT1 of a borrower;

c) Increasing credit history showed in CIB report of a borrower to 24 months from 12 months.

ii) Developing collateral/security information system to prepare a collateral/security database of immovable assets.