Off-site Supervision of Bangladesh Bank
Recent Initiatives
(2009-2013)

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Speech of Governor

Bangladesh Bank is continuing and progressing its close and intense monitoring activities to protect depositors' interests, together with preserving soundness, solvency and overall stability of the banking sector. One of the major reasons behind the global economic downturn, which began in 2007, is a lack of effective supervision in the financial sector. That's why, in order to strengthen continuous supervision, along with on-site supervision, the importance of off-site supervision has increased to a great extent. At present, diversity in customer service, instability of the financial market, and a gradual increase of competition make the banks confront more risks and challenges. To improve the supervision activities in the banking sector in facing these challenges, Bangladesh Bank, as a central bank, has long endeavor to adopt and follow international best practices, while making them workable in a local context.

Bangladesh Bank has emphasized strategic change in monitoring the banking sector, and has started continuous supervision and monitoring of the overall banking sector through innovative measures, while keeping the principal focus on current and emerging risks. Bangladesh Bank has been working for more intense monitoring both in off-site and on-site supervision. As a part of this, Town Hall meetings were arranged nationally and regionally to strengthen supervision activities further by formulating necessary policies in the light of real experience of field level supervisors. The central bank continues to increase its capability and stringency in monitoring to maintain stability of the financial sector. The highest priority has been given to the increased effectiveness of supervision. Effective ways are innovated and operated competently for the identification of credit risk, liquidity risk, market risk, operational risk, and other risks, and mitigation of these risks by measuring, monitoring, and controlling them effectively. Necessary steps have been taken to make prudential regulations consistent with international best practices and implement the basic principles of the Basel Committee completely.

The Department of Off-site Supervision, an indispensable department of Bangladesh Bank, is entrusted with the duties and responsibilities of off-site monitoring. Recently this department has taken a number of initiatives for implementation of strategic changes in supervision. The necessity to make these initiatives, taken for the public welfare, known to all is self-evident. This publication is intended to fulfill this purpose. The recent initiatives taken by the Department of Off-site Supervision have been accumulated and compiled in this report.

I hope that this department will keep on taking such new and timely initiatives in future also. My cordial felicitation for everyone associated with the publication of the report.

আতিউর রহমান

Atiur Rahman
Governor

Speech of Deputy Governor

Banking sector regulatory authorities in every country-developed, developing, emerging-market, post-conflict, and frontier economies-are having to grapple with ever more complex risks and challenges, as they try to prevent avoidable failures at individual institutions that are not only costly in themselves, but could also threaten the stability of the entire financial sector. And it seems that just as one risk is being tamed, another one looms over the horizon. The level of risk in the banking sector like credit risk, liquidity risk, operational risk, foreign exchange risk, money laundering risk, fraud-forgery risk, etc. has increased at a large extent due to globalization, open market economy, continuing global financial crisis, dependence on information-technology and many others. These risk matters have awakened the central banks and regulators to think on effective monitoring process to ensure the stability of global economy.

For all of these reasons, regulatory authorities have to be especially alert and resourceful to deal with rapidly-emerging challenges and situations. Bangladesh Bank is also getting prepared to face those. The Department of Off-site supervision plays a crucial role in this rapid-reaction process. Filling in the gap between on-site examinations, off-site monitoring has its finger on the pulse of the banking sector on a daily basis, analyzing the levels and trends of a large variety of indicators to spot potential problems before they become too great. Additionally, off-site monitoring checks regularly for compliance with such risk-focused indicators as minimum liquidity and regulatory capital ratios and promote liquidity and solvency at individual institutions.

The improvements and upgrades that the Department of Off-site Supervision of Bangladesh Bank has been able to make in the last few years are summarized in this publication. I sincerely hope that these enhancements and innovations will continue and be summarized in an exciting and dynamic report every year. My good wishes for all concerned in the publication related jobs.

Abu Hena Mohd. Razee Hassan
Deputy Governor

Speech of Executive Director

Banking sector plays an important role in building the economy of the country. Bank deals with the depositors money. Now the banks are providing lot of services to their clients in home & abroad. Moreover, due to the application of technology in banks, risks are increasing day by day. As a central bank, our role is to monitor them and minimize the risks. Off-site Supervision Department has taken a number of steps to address the risks and enhance the capabilities. More IT based monitoring softwares are introduced. Some of these initiatives are focused in this publication. I hope this will inspire us to go forward in performing our duties. Thanks to all associated to this task. I hope such activities will be in force in future too.

Mohammad Naushad Ali Chowdhury
Executive Director

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Introduction

Bangladesh Bank conducts supervision activities in order to maintain the efficiency, solvency and overall stability in the financial sector and develop the sector as well, to serve and protect the interests of the depositors. Under article 7A(f) of Bangladesh Bank Order 1972 and section 44 of Bank Companies Act, 1991, Bangladesh Bank has been given responsibility to regulate and supervise the banks operating in Bangladesh. The primary objectives of bank supervision are to ensure the safety, stability and discipline of the banking sector and banks' compliance with banking rules and regulations; to identify weaknesses and take corrective measures for strengthening the financial bases of banks; to evaluate financial ability and operational efficiency of banks together with the abilities and performances of their Board of Directors and management and to take initiatives for improving their performances up to an international-standard level, etc. In fact, supervision activities are of two types, namely On-site or field level inspection and Off-site or reporting based monitoring. Currently seven departments of Bangladesh Bank namely Department of Banking Inspection-1 (DBI-1), Department of Banking Inspection-2 (DBI-2), Department of Banking Inspection-3 (DBI-3), Department of Banking Inspection-4 (DBI-4), Department of Foreign Exchange Inspection (DFEI), Financial Integrity and Customer Services Department (FICSD) and Bangladesh Financial Intelligence Unit (BFIU) conduct on-site inspection. Basically, three types of inspections are conducted by these departments - (i) comprehensive inspection (ii) risk based inspection/system check inspection and (iii) special inspection.

On the other hand, Department of Off-site Supervision (DOS) and Foreign Exchange Operation Department (FEOD) conduct off-site supervision activities. DOS is endowed with the responsibility of continuous monitoring and assessment of Key Performance Indicators of banks on the basis of various returns & statements. In addition, DOS helps to promote soundness and stability of the banking system through CAMELS rating, liquidity and capital adequacy monitoring, etc. along with other key tools. Since inception, DOS has been conducting supervision activities by following international best practices. Recently, Bangladesh Bank has started bringing strategic changes in its existing supervision procedures. In the last five years (2009-2013), it has taken on a number of policy-related, structural, and regulatory reform programs; DOS is playing an anchor role in implementing most of them.

The supervision strategy adopted and followed by Department of Off-site Supervision under policy reforms

1) Revision of CAMELS Rating Guidelines and its up-gradation

As a part of off-site supervision, the CAMELS rating is determined on a quarterly basis for State-owned Commercial Banks and half yearly basis for Private Commercial Banks, Foreign Commercial Banks and Specialized Banks. A comprehensive view of the overall financial condition and performance of banks is determined by means of this CAMELS rating. All types of financial indicators, core risks, overall risk management, information related to irregularities, errors and omissions detected through on-site inspection, financing in prioritized sectors such as Agriculture, SME, Women Entrepreneurs, Environment-friendly projects, etc., participation of the banks in Corporate Social Responsibility (CSR) activities, and rules and regulations related to payment of accepted bills are considered for determining the CAMELS rating. The previous CAMELS rating guideline has been reviewed by the department of Off-site Supervision with a view to adapting international best practices, upgrading with modern banking activities and assessing the banks' soundness more accurately. The updated CAMELS Rating guideline has been followed since December, 2013.

The revised CAMELS rating guideline has brought not only major changes in ratios or indicators but also modifications in the qualitative evaluation questionnaire. Basel-III principles related to capital adequacy have been considered, and some related issues have been included while reviewing the guideline. Along with emphasizing best quality capital, investments in the capital market, the amount of off-balance sheet items in comparison to the capital of the banks, large loan exposures to capital, etc., are considered to calculate capital adequacy. HHI (Herfindahl-Hirschman Index) has been incorporated in the updated CAMELS rating guideline to analyze loan portfolio concentration, as a complement to percentages of classified loans and provisioning in the evaluation of asset quality. The disbursed loan amount to risk-associated different sectors has been included as well. Core Risk Assessments, Risk Management Performance Rating, SME and Agriculture Financing Performance, and Corporate Social Responsibility, etc. are taken into account for the management component rating. Apart from the existing tools such as Return on Assets (ROA), Return on Equity (ROE), and Net Interest Margin (NIM), measures focusing on the quality of earnings such as interest earning assets to total assets, core income to total assets, etc. are incorporated in the CAMELS rating guideline for measuring earnings capacity. For calculating liquidity, in light of Basel-III, two ratios are integrated which are the liquidity coverage ratio and net stable funding ratio. Beside these, deposit volatility, small deposit, large deposit and liquid assets to short term liabilities are also considered for computing liquidity components. Post-shock core income and required excess provision due to decreasing share prices (the mark-to-market loss in capital market investments) to operating profit are also considered for calculating the sensitivity to market risks component analysis.

2) Strong Monitoring over Liquidity Management

Banks face reputational risk when they fall into liquidity crises and in such condition they need to borrow money from the market at a higher rate which ultimately decreases profit and affects customer service. It is the responsibility of banks themselves to manage liquidity. Bangladesh Bank, as a regulator, has undertaken the following initiatives to enrich the supervision in this regard:

a) Structural Liquidity Profile (SLP) for the Commercial Banks

Due to the abrupt changes in market liquidity and its consequence in the market in December 2010, a circular was issued regarding the Structural Liquidity Profile (SLP) in March 2011. The implementation of the instruction of the circular has resulted in a significant improvement in asset-liability management of the banks.

b) Implementation of Liquidity Ratio under Basel-III

The two new tools for measuring liquidity under BASEL-III namely Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) have already been customized. Relevant information from the banks is being collected and analyzed for this purpose. These two ratios have been included in determining CAMELS rating since December 2013. According to the announced roadmap these will be mandatory from September 2015.

3) Constant Review of the Financial Statements of Banks

The Department of Off-site Supervision follows two types of strategies to review the financial condition of the banks regularly:

a) Introduction of Diagnostic Review Report (DRR)

The Diagnostic Review Report (DRR) is prepared quarterly by reviewing the financial statements to evaluate the overall condition and ensure mandatory disclosures of banks. One of the major objectives of such report is to assist banks in improving their financial condition, by acting as a distant signal calling for close monitoring of their activities considering the gravity of the weaknesses and irregularities mentioned in the report. Recently, a new format has been introduced to prepare DRR. In this format, trends are analyzed, along with incorporating asset-liability and profit and loss account data to get an indication about the source, use and division-wise increase/decrease of funds; and key financial indicators (Capital Adequacy, Asset Quality, Earnings, Liquidity etc.) are arranged sequentially in table format following the CAMELS rating guidelines to evaluate the financial condition of banks easily. As a consequence of integrating risk management activities of banks in the DRR, the current implementation status of core risk management guidelines and individual risk management standards of banks can be assessed.

In addition to analyzing audited financial reports of banks, the major irregularities found by other departments of Bangladesh Bank are also incorporated. It is expected that the newly formatted DRR will contribute significantly to evaluate financial soundness of the banks.

b) Introduction of Quick Review Report (QRR)

The Quick Review Report (QRR) is prepared quarterly in a short form for quick identification of the existing risks of banks especially in the area of capital, asset quality, management, earnings capacity, liquidity, sensitivity to market risk, etc. The QRR contains noteworthy information for the last few quarters. As a result, it is possible to know about a bank's condition easily and quickly and give necessary recommendations to mitigate any kind of major risk, if observed; top management gets informed about any unusual change and movement of the financial indicators of a bank.

4) Introducing Marking to Market based Revaluation System

a) Introduction of Marking-to-Market Based Revaluation System for Treasury Bills and Bonds Held by the Banks

Scheduled banks use Government Securities as high liquid asset for maintaining Statutory Liquidity Ratio (SLR) which is monitored by this department very closely. In order to maintain the liquid nature of these securities after their issuance and to promote an efficient secondary market for trading activities of those, a mark-to market revaluation policy was formulated in 2008. A comprehensive policy was also issued in 2009 for accounting treatment including marking to market based revaluation techniques of such securities.

B) Introduction and Implementation of Uniform Accounting Procedure for REPO Transaction:

In 2010, this department issued a guideline for uniform REPO transactions of government securities to ensure transactional transparency. Risk mitigation and uniformity regarding REPO transaction are ensured through the implementation of the aforesaid policy.

5) Risk Management of Banks

Department of Off-site Supervision has taken several initiatives for continuous monitoring and surveillance with the aim of overall risk management in banks:

a) Issuance of Guidelines

In 2012, a comprehensive guideline was issued with a view to creating an international-standard risk management environment, enhancing risk management practices for mitigating overall risks as well as balancing individual risk management activities in our banking system. This guideline describes the process of determining credit risk, market risk, operational risk, strategic risk, liquidity risk, compliance risk, reputation risk, etc. In addition, it also emphasizes the roles and responsibilities of board and management, suggests a risk management structure, and describes the setting of risk appetite and reporting methods, etc. As per Bank Company Ain, 1991 (amended upto 2013), banks have been instructed to form a separate Risk Management Committee (RMC) of the Board, which has geared up the risk management activities of the banks. Moreover, an initiative has been taken in 2013 to streamline the six core management guidelines originally introduced in the early 2000s.

b) Introduction of Risk Management Paper (RMP)

In order to speed up risk management activities, harmonize risk management activities with banking activities, strike a balance among the various risk management activities, ensure identification and analysis of various risks prevalent in banks and adopt the proper measures toward determining and controlling these risks, a RMP system has been introduced. Under this system, banks must submit their RMPs on quarterly basis for review and analysis by DOS staff.

c) Introduction of Risk Rating System

A risk rating system has been implemented in order to measure accurately the risks prevailing in banking businesses. For this, a risk rating guideline has been introduced. As per this guideline, the risk ratings of banks were determined for the first time in January-March quarter 2013. This system allows banks to evaluate their true conditions regarding credit risk, market risk and liquidity risk, taking into account their risk management structure and risk management compliance. In the updated CAMELS rating guideline, additional weight has been allocated to the management rating in order to emphasize risk management activities.

6) Guidelines Regarding Investment in Capital Market

A guideline was prepared and implemented for the commercial banks in 2010-2011 when there were abrupt ups and downs in capital market, and it saved the banks from immense losses. Later on, steps were taken to amend the clauses of Bank Company Ain, 1991 regarding banks' capital market investment with a view to managing risk in a better way. A new guideline has already been implemented in the light of Bank Company Ain, 1991 (amended up to 2013) and capital market activities of banks are being monitored closely.

7) Establishing Islami Interbank Fund Market (IIFM)

The Islami Interbank Fund Market (IIFM) has been established to facilitate short term liquidity management for Shariah based scheduled banks and financial institutions and Islamic branches of conventional banks in Bangladesh. They can transfer their excess funds to the Islami Bond Fund (IBF) on a daily basis. IBF management allocates profit acquired from investment among the fund providers according to a provisional profit sharing ratio (PSR). This provisional PSR is adjusted with the final PSR at year end. The establishment of IIFM is considered as a milestone for the rapidly growing Shariah-based banking in Bangladesh.

A CEO of a Shariah-based bank hands over his bank's donation to the Governor for investing in the Islami Interbank Fund Market

8) Introduction of Self-Assessment Report

In the global post-recession period, different risks such as credit risk, liquidity risk, operational risk, foreign exchange risk, money laundering risk, and fraud and forgery risk (a very important, and disturbing, subset of operational risk) have persisted as threats to the banking sector and, indeed, for the overall financial sector as well. One of the main reasons for the recent financial frauds and forgeries in the banking sector of Bangladesh is a poor internal audit and internal control system. A "Self-Assessment of Anti-Fraud Internal Controls" report has been introduced to keep close monitoring with a view to avoiding fraud-forgery and unwanted events committed in the banks. A circular was issued on 07 November 2012 mandating banks to submit the report to Bangladesh Bank signed by the CEO and counter-signed by the chairman of the Audit Committee on a quarterly basis. A questionnaire is the main component, where more than 50 determinants on Internal Control and Compliance (ICC), General Banking and Operation, Loans and Advances, and Information and Communication Technology (ICT) have been set. To increase the accountability of Boards of Directors, Chairmen of the Board, and Chief Executives, and to diminish the propensity to conduct deceptive activities, Bangladesh Bank analyzes the self-assessment reports, instructs them accordingly, and conducts on-site inspection on a sample basis to ensure the accuracy of the information. As a result, joint accountability of Boards of Directors and Management has been easier to ensure; the banks have become active in pinpointing their weaknesses and preventing fraud and forgery.

9) Introduction of Stress Testing Management and Guideline

To assess the risk absorption capacity of banks and FIs, a stress testing system has been introduced. Through quarterly stress testing, credit, market and liquidity risk management is improving due to measurement of the risk-absorbing capacity of banking system against plausible shocks. This regime is helping the banks to take necessary and corrective actions for risk mitigation as cautionary measures. Banks are also slowly paying attention to possible risks and taking preparations accordingly. The Stress Testing guidelines, although originally designed and prepared by the Department of Off-site Supervision, are now carried out by the recently-formed Financial Stability Department.

Supervision Techniques Carried out under Institutional Structure Reform

1) Formation of Risk Management Unit

In the context of a free market economy and alignment with international practices, for increasing resilience capacity, for preventing the emergence of probable future risks and, above all, for achieving expected growth by maintaining sustainable growth, five Core Risk Management Guidelines - Asset Liability Management, Credit Risk Management, Anti Money Laundering, Foreign Exchange Risk, and Internal Control and Compliance - were introduced in 2003.

Later, to ensure the secure use of augmented information technology, another core guideline namely Information and Communication Technology, was introduced in 2007. Besides, a Credit Risk Grading Manual was issued to mitigate credit risk in 2005, and a Risk Based Capital Adequacy Guideline was issued to implement Basel-II in 2008. Banks have been instructed to form a separate Risk Management Unit/Division /Department to identify, analyze and mitigate credit risks, market risk, liquidity risk, operational risk, etc. and take early cautions. The newly established unit or division must be headed by an experienced Chief Risk Officer ranked at least Deputy Managing Director (DMD). The process includes making sure that all risks have been identified, measured, and monitored, combined with taking precautionary measures to limit any type of risk, lessen the possibility of a crisis, and briefing all of these key issues and activities to the Chief Executive Officer of the bank. A Risk Management Monitoring Section has been formed in the Department of Off-site Supervision of Bangladesh Bank to oversee the risk management activities of banks. Banks send their Risk Management Papers (RMP) on a quarterly basis to this section. This section analyzes associated risks from the RMPs and advises the banks accordingly.

2) Implementation of Large Loan Monitoring Software

Various steps have been taken to ensure improved risk management and avoid credit concentration in large loan disbursement. Recently Large Loan Monitoring Software has been introduced to review the current CIB report, preserve Credit Risk Grading (CRG) report and borrowers' information, analyze them from time to time, and at the same time define the trend of the banking industry as a whole. Necessary directives are provided to the banks through analyzing different reports prepared from this software.

Deputy Governor S.K. Sur Chowdhury addresses the inaugural ceremony of "Large Loan Software" in presence of high officials of Bangladesh Bank

At Present establishment of a link between "Credit Information Bureau (CIB)" and "Large Loan Monitoring Software" is under process. Consequently, analyzing CIB reports of large loan borrowers will be more dynamic.

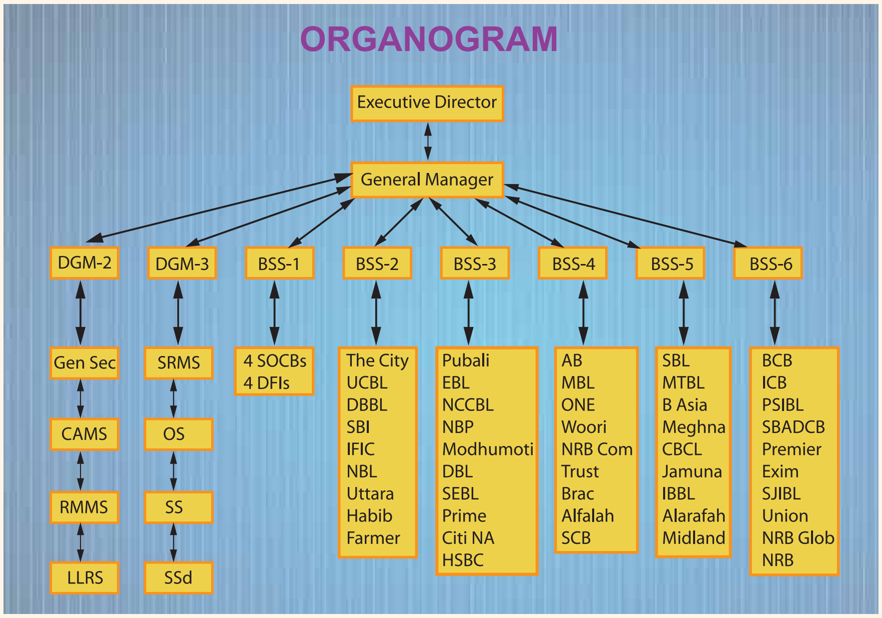
General Manager S.M. Rabiul Hassan addresses the inaugural ceremony of "Large Loan Software" in presence of high officials of Bangladesh Bank

Establishment of Bank Supervision Specialist Structure

In order to bring all the banks under intensive surveillance and to create specialist supervisors regarding banking affairs, a position denoted as Bank Supervision Specialist (BSS) has been initiated. In this framework, employees, at the level of Deputy General Manager, will be regarded as Bank Supervision Specialists. The proposal was to create 10 sections each guided by 10 BSSs. To facilitate the BSS, one Joint Director will be assigned as a Junior Bank Supervision Specialist for each bank and 4 to 5 Deputy Directors/Assistant Directors will be attached with each section.

In the previous framework of the Department of Off-site Supervision, each officer was responsible for each bank individually. There was no detailed database for a specific bank; corrective measures were taken in a scattered way. In BSS system, a Bank Supervision Specialist will act as a mentor to give precautionary signals to all of those banks which are assigned to him/her. While scrutinizing the activities of the banks, BSS will bring all the irregularities and loopholes to the notice of top management of concerned banks immediately. BSS, receiving information from different sources as per the necessary format, will preserve the data on overall conditions, efficiency, various risk conditions, corporate governance infrastructure etc. of the banks under his/her jurisdiction. BSS will also collect recent data of the banks from other related departments of Bangladesh Bank, take necessary steps accordingly, maintain continuous communications with the higher authorities of the banks and arrange meetings with them if required. The Junior Bank Supervision Specialist (JBSS) will observe the treasury activities, capital adequacy, advance-deposit ratio, credit growth, off-balance sheet exposures, call money borrowings and such other sensitive financial indicators of the banks and bring these into the consideration of higher authorities if any alarming condition arises. The JBSS will also prepare the regular QRRs and DRRs and will examine and observe the minutes of the meeting of board/audit committee/executive committee and risk management committee.

Up to the present, six (06) BSSs have started their operations experimentally. Two (02) Junior Bank Supervision Specialists and 2/3 Deputy Directors/Assistant Directors are working under the guidance of one BSS. Fifty six banks are distributed under six (06) BSSs as per the following diagram:



3) Establishment of Corporate Memory Management System

Preserving the incidents of breaches of banking laws, regulations and best practices by officers and directors of banks and financial institutions, and in order to take necessary steps by scrutinizing those preserved data, a web-based Corporate Memory Management System has been implemented. In the current financial situation of the country, data preservation has already started through this system by identifying the irregularities done by different level officers and directors of the banks.

Awareness Program

Arranging a Workshop about Risk Management

A five-day workshop was organized successfully for the officers who are involved in risk management. The objective of this workshop was to provide detailed ideas and concepts about the risk management guidelines, to synchronize the bank's RMPs, and to encourage discussion to identify the primary risks in the banking sector. The overarching objective of the workshop was to increase the ability of the officers for taking steps to mitigate those risks and handle risk management. The workshop was held in December 2012.

Deputy Governor Abu Hena Mohd. Razee Hassan addresses the Risk Management Workshop in 15th November 2012

Executive Director Mohammad Naushad Ali Chowdhury and General Manager S.M. Rabiul Hassan at the inaugural program of 'Risk Management Workshop'

Supervision-Related Town Hall Meeting

In order to formulate required policies for bringing coordination among Bangladesh Bank's supervision-related activities, several "Town Hall Meetings," with the participation of the concerned officials, have been arranged nationally and regionally to gain understanding of the reality from the field level supervisors, explain new initiatives from the head office, and further strengthen supervision activities.

Governor Dr. Atiur Rahman addresses the first Town Hall Meeting in Dhaka

Deputy Governor Md. Abul Quasem delivers his speech in the first Town Hall Meeting

As the head offices of all the banks are situated in Dhaka; discussions and decisions on all government/non-government issues on the national level take place in Dhaka. Still, a significant portion of the country's economic activities are extended outside Dhaka. Therefore, supervision has a role to protect the interest of the customers outside Dhaka and improve the reliance and service standard in branch level. In response, more attention is now being given to the branch offices. The branch offices are playing an important role in implementing the financial inclusion programs, especially loan disbursement and collection in agriculture, SME, women entrepreneurs and environmentally-friendly sectors, and the activities of the Customers' Interest Protection Centre for improving standards of customer service. Taking these into consideration, a number of Town Hall Meetings have been arranged in last two years.

Governor Dr. Atiur Rahman, Change Management Advisor Allah Malik Kazemi, Supervision Advisor Glenn Tasky (right), Executive Director Mohammad Naushad Ali Chowdhury and General Manager of Chittagong office Mohammad Masum Kamal Bhuiyan (left) at the regional Town Hall Meeting in Chittagong

In these meetings, necessary instructions were given to field level supervisors. They were instructed to use their prudence to verify whether borrowers of a bank branch really exist, or if banks are concealing the true relations. If head offices are giving less attention to a branch that has a comparatively lesser volume of transactions or a greater distance from the head office, then sometimes fewer face-to-face meetings are arranged with the executives, and there are possibilities of internal and external fraud due to some other reasons. Moreover, the primary ideas obtained from these town hall meetings played a supportive role to formulate and effectively implement the proper policy and guidelines for maintaining stability in the financial sector in future. In these town hall meetings, the Banking Supervision Advisor Glenn Tasky delivered various presentations highlighting challenges regarding supervision and proposing new tools and methods.

Governor Dr. Atiur Rahman, Executive Directors Md. Ebtadul Islam, Dasgupta Asim Kumar (right), Mohammad Naushad Ali Chowdhury and General Manager of Barisal office Nurul Alam Kazi (left) at the regional Town Hall Meeting in Barisal

Governor Dr. Atiur Rahman at the Bank's Town Hall Meeting of Khulna region

Town Hall Meetings

17th September 2011	Dhaka	Head office, Dhaka	Contemporary Challenges in the Banking Sector and Supervisory Stance
18th March 2012	Chittagong	Chittagong and Sylhet	Promoting Banking Excellence and Integrity at the Branch Level
12th April 2012	Barisal	Barisal	Free Talks about Supervision
15th July 2012	Rajshahi	Rajshahi, Bogra and Rangpur	Stronger Branches, Stronger Banks: Controlling Risks and Enhancing Returns at the Branch Level
11th November 2012	Khulna	Khulna and Barisal	Financial Integrity: Managing Operational Risk and Avoiding Serious Losses at the Branch Level

Emphasis in Executive Retreat on strengthening Supervision System

The Executive Retreat--2013 was held during 5-6 July 2013, attended by the Governor, the Deputy Governors, Executive Directors and all General Managers of Bangladesh Bank. The core focus of this program was "Strengthening the Supervision System of BB". On the second day, Dr. Mohammed Farashuddin, former governor of Bangladesh Bank, conducted a session on 'Banking Supervision: Emerging Challenges and Evolving Tools'. ABB Chairman Md. Nurul Amin, former Managing Director of Sonali Bank, Mohammad Hossain, and Banking Supervision Advisor of BB Glenn Tasky also spoke at the session. There were also power point presentations, case studies, and team-building exercises, highlighting challenges ahead to keep stability in the financial sector and fight against irregularities in the banking sector.

General Managers' Conference

With a view to enhancing the financial sector supervision regime's effectiveness, a conference consisting of senior BB Executives and General Managers was held on September 22, 2012 in BB Head Office premises. The activities of the departments involved in bank and NBFI supervision, including inspection, have been reorganized and restructured in the light of the recommendations made in this conference. In the General Managers' conference, Senior Executives were divided into four groups to discuss and exchange ideas on : Evaluation of the banks' own supervision and controlling system in identifying and preventing fraud and forgeries; probable assessment of identifying banks' activities on deception/fraud/major non compliance of rules and regulations from the statements and financial reports used for Off-site Supervision; probable strategies to upgrade supervisory capability of the inspection teams of BB for identifying major weaknesses/irregularities of the inspected branches/offices; and building up of the capacity and pro-activeness of BB inspection groups in identification and remedy of foreign currency dealing beyond rules/regulations along with capital trafficking activities.

Governor Dr. Atiur Rahman, Deputy Governors Md. Abul Quasem, Abu Hena Mohd. Razee Hassan, Nazneen Sultana, Executive Directors Md. Ebtadul Islam, S. M. Moniruzzaman at the plenary session of 'GM Conference 2012' in Dhaka

Subsequently the groups presented their recommendations appearing in the plenary. The discussion sessions were interesting and worthy, and included the participation of two Supervision Advisors of BB sponsored by the International Monetary Fund (IMF). In the concluding part of the program, some specific recommendations were drawn up by reaping the experiences of the senior executives regarding BB's instant and long-term responsibilities, on the basis of which the work of implementing the recommendations in a more effective manner and developing the ideas is going on. It is now being emphasized to supervise and inspect those banking activities which are contributing most to the aggregate amount of risks. The bank branches are being physically inspected on the basis of probable weak factors being found out by analyzing the statements and data collected under the off-site supervision system.

Deputy Governor Nazneen Sultana delivers her speach in the plenary session of 'GM Conference 2012' in Dhaka

Initiatives of Analyzing and Uploading "Financial Soundness Indicators (FSIs)" of Overall Financial System of Bangladesh in the Website of IMF

To keep investors, different stakeholder countries, other multilateral agencies and their associated organizations informed, and to facilitate relative analysis, IMF has advised its country members to upload Financial Soundness Indicators (FSIs) on its website. In this context, "financial sector" means scheduled and non-scheduled banking organizations, microfinance institutions, insurance companies, cooperative banks, and other financial and non financial companies. By the year 2013, eighty eight (88) member countries of IMF have been able to upload FSIs to the website of IMF. However, Bangladesh has not been able to do the same yet. To attract foreign investment and represent the position of Bangladesh to the other countries, the Department of Off-site Supervision with the technical assistance of IMF has taken initiative to compile the FSIs and upload those to the official website of IMF. In the meantime, technical assistance team of IMF has provided required training to the employees of Bangladesh Bank in this regard. As a result of this effort, Bangladesh Bank will be able to compile and upload its required FSIs of 2013 including banks and non bank financial institutions to the assigned website. Later microfinance institutions, insurance companies, non-scheduled banks, cooperative banks and other financial and non-financial institutions will be brought under this project. When it is completed, financial information of Bangladesh will get placed in the financial index book of IMF published on a half-yearly basis, and thus, potential investors will remain aware of and will be willing to invest in Bangladesh. After all, Bangladesh will be considered a compliant country by IMF.

Deputy Governor Abu Hena Mohd. Razee Hassan speaks at the training session conducted by IMF technical assistance team

Supervision Tools Established under Policies Issued by Other Departments of BB and Structural Reformation

Capital Adequacy Monitoring

Capital Adequacy is the main indicator for determining the financial soundness and stability of the bank and the main tool for depositors' protection from the shock of probable loss. It is used as shock absorber to safeguard against core financial risks. Risk-based Capital Adequacy was introduced in Bangladesh Bank in 2010. The international Basel-II standard regarding capital adequacy for banks has already been implemented in Bangladesh. BB has fixed the minimum Capital Adequacy Ratio (CAR) of the banks at 10% of total Risk-Weighted Assets (RWA).

After the global recession, initiatives have been taken for the implementation of Basel-III standards in various countries by considering amendments and changes of international best practices regarding capital adequacy. For the implementation of Basel-III, a roadmap has already been formulated in Bangladesh as well. Steps to implement Basel-III have also been taken to move forward following that roadmap. DOS has been involved with the policy formulation and implementation of Basel-II from the very beginning. One of the sections of this department has been working for the monitoring of CAR of the banks. Another section of this department has been working relentlessly for the determination and implementation of the liquidity-related significant ratios (LCR and NSFR) under Basel-III.

Initiation of Enterprise Data Warehouse (EDW)

Modernization and automation of the banking sector is very important for proper administration of the broader financial sector of the country. Bangladesh Bank has taken multiple steps for that. The Enterprise Data Warehouse (EDW) is an effective initiative in support of full automation. A data warehouse has been established as the central data storage in BB including a full-fledged data center. Now all kinds of macroeconomic and banking sector data are being preserved and processed centrally in this data center. Various report generations, forecasting, time series analysis, and other research related activities are accomplished through this database after data analysis, data mining and data modeling have been done using various analytical tools. Users can search and collect data online according to their needs from this data storage. A departmental dashboard has been created under EDW where a summary of all significant information is displayed. It is designed in such a way that it becomes possible to get real picture of the banking sector of Bangladesh. Various kinds of data are being preserved in the data warehouse, such as the monetary policy of central bank, monetary management, and bank supervision. Fast and effective policy formulation has become possible due to EDW. DOS has successfully accomplished all necessary tasks to connect to the Central Data warehouse.

Launching the Integrated Supervision System (ISS) Software

The Integrated Supervision System (ISS) is an online reporting-based supervision software which enables monthly viewing of the major activities and current and emerging risks at each bank's head office and branches. Activities such as movements in balance sheet and profit-loss statement items, loan disbursements, trade finance, and cash management can be observed closely for early identification of unusual and potentially fraudulent activity. Many important ratios can already be observed, and in the future the inventory of indicators will be enhanced, enabling more comprehensive trend analysis and peer group comparisons.

Coordination between Off-site and On-site Supervision

The activities of both on-site and off-site supervision are well coordinated. Off-site supervision complements the activities of on-site examination (i.e. comprehensive and in-depth analysis of the financial soundness, compliance, risk management, internal control and corporate governance of the supervised banks) with "more frequent but limited scope" analysis of quantitative parameters to ensure continuous supervision. Off-site analysis is used as an input for on-site examination planning. The irregularities revealed by off-site supervision through analyzing the various returns and statements, reports submitted by the banks are sent to on-site supervision departments for verification of data accuracy and getting updated status during onsite inspection. On-site examination ensures that the off-site returns submitted are compiled accurately and submitted in time. Conducting on-site inspection, the supervision departments provide the summery reports to off-site supervision department which are incorporated in CAMELS rating and used for preparing Diagnostic Review Report. On-site supervision departments also supply the core risks rating which is a part of management rating under CAMELS. On the other hand, off-site analysis underscores some early warning signals prompting an on-site review. Beside these, on-site and off-site supervision co-operate each other on policy issues. Moreover, on-site and off-site supervision departments are operated under the supervision of same Executive Director and Deputy Governor.

Risk Management Committee of the Board of Directors

An instruction has been given to the banks to constitute a Risk Management Committee consisting of members of the Board of Directors, to monitor and control the probable risks associated with the implementation of the strategy and action plan formulated by the Board of Directors (BoD) as well as the other duties performed by the BoD. The Risk Management Committee will oversee whether the credit risk, foreign currency transaction risk, internal controls and compliance risk, money laundering risk, information and communication technology risk, management risk, interest risk, liquidity risk and others risks are identified and measured, and proper risk reduction approaches and methods are being applied properly by the management together with maintaining the required capital and provision against the risks. The Company Secretary will be the Secretary of the Risk Management Committee.

Outcomes of the Initiatives taken in the Last Five Years

Substantial progress has been made in achieving off-site supervision goals of Bangladesh Bank due to the aforesaid initiatives taken by DOS in the last five years. The capital base of the whole banking system has become deeper because of close monitoring by Bangladesh Bank. The amount of capital maintained by Banks was Tk. 205.78 billion in December 2008 and stood at Tk. 651.91 billion in December 2013, amounting to a 217 percent capital growth. Transfer of large portions of income into capital as well as new capital injections by banks is accounted for this growth. As a result, the base of the whole banking system in our country has been strengthened. From a capital adequacy perspective, now Bangladesh is in a stronger position than many other countries. The CAR for the whole banking industry was 11.31 percent in June 2012, as against a minimum of 10 percent, and increased to 11.52 percent by December 2013. Non-performing loans (NPLs) dropped to 7.17 percent in June 2012 from 10.79 percent in December 2008. This ratio soared throughout 2013 because of political instability and its adverse effects on businesses, but Bangladesh Bank brought some relaxation to its provisioning policies and banks have took some proper actions as the end of 2013 approached, so NPLs decreased to 8.93 percent in December 2013. The decline in NPLs leads to a decline in required provisions on the balance sheet, resulting in a decline in provision expense on the profit-and-loss statement, which ultimately helps banks to improve their CARs.

In order to estimate systemic risk, a stress testing technique was introduced and strengthened, which encouraged banks improve their shock absorbing capacity by giving more emphasis in maintaining capital and provisions. As seen in stress testing, most of the banks have a moderate level of resilience. At this moment, liquidity management in banking system remains stable, with the call money rate hovering at satisfactory level. Banks have already set up their own risk management units and also taken steps to control and, in some cases, reduce various risks by identifying them. With a view to preventing fraud and fraudulent activities the "Self-Assessment of Anti-Fraud Internal Controls", commonly known as Assessment Sheet and signed by the Chief Executive Officer and Chairman of the Audit Committee of the bank, is being prepared and reported on quarterly basis. This reporting has made banks' internal control systems stronger. As a result, the amount of fraud and fraudulent activities has been reduced. The "Diagnostic Review Report" is being regularly prepared, and disclosures in banks annual reports have become more transparent than previously. Because of preparation of "Quick Review Report," it has been possible to give necessary directives to banks by identifying core risks associated with banking activities in the shortest possible time. For instance, several banks, that had excess Advance-Deposit Ratios (ADR), were brought down within the predetermined limit. Now their ADR condition is at reasonable level. The implementation of EDW, among other attributes, has made it possible to move forward swiftly toward paperless banking or green banking. The number of unadjusted debit and credit entries regarding inter-branch transactions has reduced significantly because of giving more emphasis to bank supervision and monitoring.

It has been possible to bring back transparency and discipline in banking activities because of increased corporate governance accountabilities and responsibilities of those, from the Board level down to the branch, who are involved in loan sanctioning and disbursement processes. Separate software has been installed; so overall and individual bank-wise data on different indicators such as the number and amount of large loans, classified large loans, sector-wise concentration, etc., is being easily traced out. With better use of this software and having a proper monitoring system, it is becoming possible to do more close monitoring of large loans than ever before. In case of providing large loans, an advanced risk management system has been adopted. As a result, on industry average there was only 5.08 percent of large loans that were classified against 11.9 percent of overall loans.

Due to continuous monitoring of the implementation status of capital market exposure-related polices and regulations, investment in capital market by the banks (on both a solo and consolidated basis) has come down within the prescribed limit. In fact, risks associated with capital market exposure have reduced a lot. The Islamic inter-bank fund market is now playing a pivotal role in solving the short term liquidity crisis of the Islamic banks and also allows Islamic banks having excess liquidity to earn profit. It has also been possible to strengthen the supervision process with proper actions taken against various irregularities because of amendments to the Bank Companies Act. DOS has been reformed through formulation of new sections named BSS (Banking Supervision Specialist), each looking after a particular group of banks. As a result, obtaining complete information and taking corrective actions, if needed, for an individual bank would be easier for each BSS.

Due in part to the successes of these BB initiatives, Bangladesh achieves a satisfactory sovereign ratings as rated independently by two international credit rating agencies - Standard and Poor's (S&P) and Moody's - in the year 2010, even amid a global crisis. The rating values were BB- and Ba3 respectively. This rating is an indicator of financial discipline and soundness of a country. Although credit ratings of many rich countries were downgraded, Bangladesh has been able to preserve these two ratings even in 2011 and 2012. A review report published by S&P on 31 May 2012 shows that Bangladesh stands in the 2nd position in credit rating among South Asian countries. Reports of these two rating agencies reflect a strong growth prospects and positive trend of Bangladesh economy for having ongoing donor support, substantial growth in foreign reserves, effective measures taken in infrastructure development, gradual increases in export, import and investment, etc.

Supervision of the banking sector is a complex, never-ending process. All of the supervision patterns are changing to keep up with changes in financial markets, and it is true in the case of off-site supervision as well. To ensure performance up to the mark in desired supervision standards, there must not only be reliable information but also efficient supervision specialists and cutting-edge information technology. With these factors incorporated, off-site supervision standards are improving day by day. In this case, significant outcomes are expected to be apparent very soon.

Banking Sector of Bangladesh at a Glance

Sl No.	Item	31 December 2013
01	Total No. of Banks	56
02	Total No. of Branches	8685
	A) Urban Branches	3723
	B) Rural Branches	4962
03	Total No. of Employees	168,845
		Amount in billion
04	Total Risk Weighted Assets	5659.69
05	Total Capital	651.91
06	Total Loans and Advances	4544.35
07	Total Classified Loan	405.83
08	Capital Adequacy Ratio (CAR)	11.52%
09	Percentage of Classified Loan	8.93%
10	Percentage of Provision Maintained	98.98%
11	Return on Assets (ROA)	0.90%
12	Return on Equity (ROE)	11.10%
13	Statutory Liquidity Ratio (SLR)	33.21%

Capital to Risk Weighted Assets Ratio by Type of Banks

(In Percentage)

Type of Banks	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
SCBs	4.1	- 0.4	1.1	7.9	6.9	9.0	8.9	11.7	8.1	10.8
DFIs	9.1	- 7.5	- 6.7	- 5.5	- 5.3	0.4	- 7.3	- 4.5	- 7.8	- 9.7
PCBs	10.3	9.1	9.8	10.6	11.4	12.1	10.1	11.5	11.4	12.5
FCBs	24.2	26.0	22.7	22.7	24.0	28.1	15.6	21.0	20.6	20.3
Total	8.7	5.6	6.7	9.6	10.1	11.6	9.3	11.4	10.5	11.5

* Capital means regulatory capital

** Banks are required to maintain 10% of their Risk Weighted Asset as minimum Capital

Ratio of Net NPLs to Total Loans by Type of Banks

(In Percentage)

Type of Banks	2005	2006	2007	2008	2009	2010	2011	2012	2013
SCBs	13.2	14.5	12.9	5.9	1.9	1.9	-0.34	12.82	1.72
DFIs	22.6	23.6	19.0	17.0	18.3	16.0	16.95	20.40	19.69
PCBs	1.8	1.8	1.4	0.9	0.5	0.0	0.20	0.92	0.60
FCBs	-2.2	-2.6	-1.9	-2.0	-2.3	-1.7	-1.81	-0.86	-0.37
Total	7.2	7.1	5.1	2.8	1.7	1.3	0.70	4.38	2.01

* Net NPL = NPL - Provision - Interest suspense

Required Provision and Provision Maintained - all Banks

(billion Taka)

All Banks	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Amount of NPLs	203.2	187.3	175.1	200.1	226.2	224.8	224.8	227.1	226.4	427.26	405.83
Required Provision	92.5	87.8	88.3	106.1	127.2	136.1	134.8	149.2	148.2	242.39	252.42
Provision Maintained	37.3	35.9	42.6	52.9	97.1	126.2	137.9	142.3	152.7	189.76	249.84
Excess(+)/ Shortfall(-)	-55.2	-51.9	-45.7	-53.2	-30.1	-9.9	3.1	-6.9	4.6	-52.62	-2.58
Provision Maintenance Ratio (%)	40.3	40.9	48.2	49.9	76.3	92.7	102.3	95.4	103.0	78.33	98.98

* Banks are required to maintain provision against all kinds of loans as per regulatory instruction

Comparative Position of Provision Adequacy

(billion Taka)

Year	Items	SCBs	DFIs	PCBs	FCBs
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
2010	Required provision	70.64	19.07	53.31	6.19
	Provision maintained	69.87	13.29	51.78	7.39
	Provision maintenance ratio (%)	98.9	69.7	97.1	119.4
2011	Required provision	60.8	21.7	58.3	7.4
	Provision maintained	69.0	13.9	61.2	8.5
	Provision maintenance ratio (%)	113.49	64.06	104.97	114.86
2012	Required provision	119.22	29.82	84.43	8.91
	Provision maintained	81.89	13.64	84.93	9.29
	Provision maintenance ratio (%)	68.69	45.74	100.60	104.26
2013	Required provision	107.79	38.25	94.79	11.59
	Provision maintained	122.33	17.41	97.80	12.29
	Provision maintenance ratio (%)	113.49	45.52	103.18	106.04

Profitability Ratios by Type of Banks

(in Percentage)

Type of Banks	ROA *											ROE **										
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
SCBs	0.1	-0.1	-0.1	0.0	0.0	0.7	1.0	1.1	1.3	-0.56	0.59	3.0	-5.3	-6.9	0.0	0.0	22.5	26.2	18.4	19.7	-11.87	10.93
DFIs	0.0	-0.2	-0.1	-0.2	-0.3	-0.6	0.4	0.2	0.1	0.06	-0.40	-0.6	-2.1	-2.0	-2.0	-3.4	-6.9	-171.7	-3.2	-0.9	-1.06	-5.80
PCBs	0.7	1.2	1.1	1.1	1.3	1.4	1.6	2.1	1.6	0.92	0.95	11.4	19.5	18.1	15.2	16.7	16.4	21.0	20.9	15.7	10.17	9.76
FCBs	2.6	3.2	3.1	2.2	3.1	2.9	3.2	2.9	3.2	3.27	2.98	20.4	22.5	18.4	21.5	20.4	17.8	22.4	17.0	16.6	17.29	16.93
Total	0.5	0.7	0.6	0.8	0.9	1.2	1.4	1.8	1.5	0.64	0.90	9.8	13.0	12.4	14.1	13.8	15.6	21.7	21.0	17.0	8.20	11.10

* ROA = Net Income after provision and taxes to Total Assets (Acceptable level 1.3 - 1.5)
** ROE = Net Income after provision and taxes to Capital (Acceptable level 13 - 15)

Liquidity Ratio by Type of Banks

(in Percentage)

Type of Banks	Liquid assets											Excess liquidity										
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
SCBs	24.4	22.8	20.0	20.1	24.9	32.9	25.1	27.2	31.30	29.23	44.27	8.4	6.8	2.0	2.1	6.9	14.9	17.6	8.2	12.30	10.24	25.29
DFIs	12.0	11.2	11.2	11.9	14.2	13.7	9.6	21.3	6.91	11.51	15.27	5.8	4.7	6.2	3.8	5.6	4.9	7.1	2.3	1.34	1.44	4.19
PCBs	24.4	23.1	21.0	21.4	22.2	20.7	18.2	21.5	23.45	26.29	27.95	9.8	8.8	5.1	5.6	6.4	4.7	5.3	4.6	6.57	9.49	11.18
FCBs	37.8	37.8	41.5	34.4	29.2	31.3	31.8	32.1	34.13	37.47	46.15	21.9	21.9	23.6	16.4	11.2	13.3	21.8	13.2	15.28	18.68	27.35
Total	24.7	23.4	21.7	21.5	23.2	24.8	20.6	23.0	25.41	27.05	32.54	9.9	8.7	5.3	5.1	6.9	8.4	9.0	6.0	8.39	9.88	15.38

* Required liquidity ratio for conventional banks is 19%
** Required liquidity ratio for DFIs is 6%