Banking Sector Performance, Regulation and Bank Supervision

5.1 Banking sector in Bangladesh demonstrated a moderate level of resilience in FY11, attributable to improvement in key financial indicators of the banking industry. With a view to maintaining soundness, solvency, efficiency and stability in the financial system, Bangladesh Bank (BB) initiated a number of policy measures including greater emphasis on risk managements in the banks, periodic review of stability of the banks and the banking industry through stress testing, strengthening financial inclusion of under-served/un-served productive economic sectors and population segments, encouraging enhanced CSR activities and Green Banking initiatives. Moreover, preparation of revised risk management guidelines is at final stage. The following paragraphs highlight the recent regulatory and supervisory measures initiated by BB for banks, industry statistics and performance trends of the banking sector.

A. Banking Sector Performance

5.2 The banking sector of Bangladesh comprises four categories of scheduled banks. These are state-owned commercial banks (SCBs), state-owned development financial institutions (DFIs), private commercial banks (PCBs) and foreign commercial banks (FCBs). The number of banks declined from 48 in 2009 to 47 in 2010. These banks had a total number of 7729 branches as of December 2010. The number of bank branches increased from 7095 in 2009 to 7729 in 2010 due mainly to opening of new branches by the PCBs during the year. At the end of FY11, the total number of bank branches increased to 8522, with total number of banks remained unchanged at 47 (Appendix-3, Table-I). Structure of the banking sector with breakdown by type of banks is shown in Table 5.1:

Table 5.1 Banking System Structure

(billion Taka)

Bank types	2009						2010					
	Number of Banks	Number of Branches	Total Assets	Percent of Industry assets	Deposits	Percent of Deposits	Number of Banks	Number of Branches	Total Assets	Percent of Industry assets	Deposits	Percent of Deposits
SCBs	4	3387	1135.6	28.6	869.1	28.6	4	3447	1384.3	28.5	1044.9	28.1
DFIs	5	1365	261.9	6.6	161.1	5.3	4	1382	295.4	6.1	183.4	4.9
PCBs	30	2285	2275.7	57.4	1792.4	59.0	30	2828	2854.6	58.8	2266.5	60.9
FCBs	9	58	292.6	7.4	215.0	7.0	9	72	320.8	6.6	227.1	6.1
Total	**48**	**7095**	**3965.8**	**100.0**	**3037.6**	**100.0**	**47**	**7729**	**4855.1**	**100.0**	**3721.9**	**100.0**

5.3 In 2010, the SCBs held 28.5 percent of the total industry assets as against 28.6 percent in 2009. PCBs' share rose to 58.8 percent in 2010 as against 57.4 percent in 2009. The FCBs held 6.6 percent of the industry assets in 2010, showing a declining trend of 0.8 percentage point over the previous year. The DFIs' share of assets was 6.1 percent in 2010 against 6.6 percent in 2009.

Chart 5.1

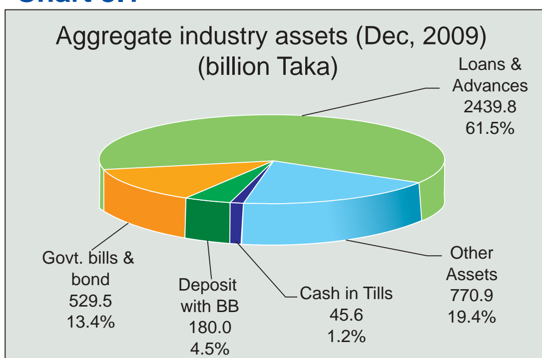
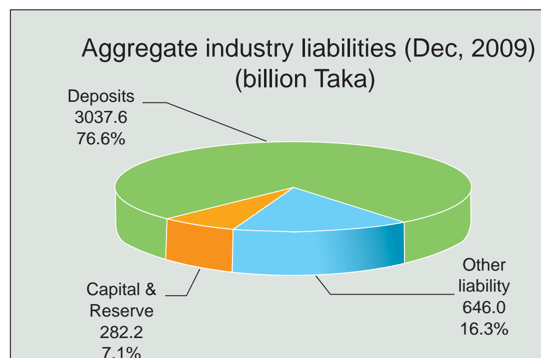
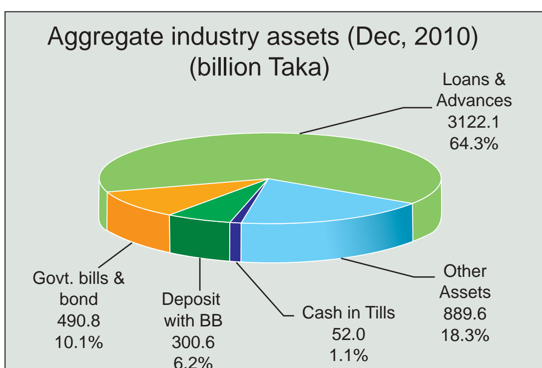
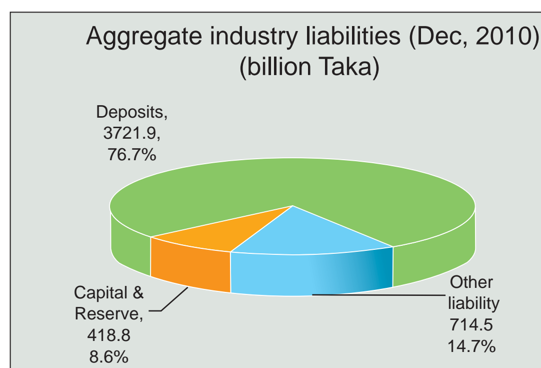


Chart 5.2







5.4 Total deposits of the banks in 2010 rose to Taka 3721.9 billion from Taka 3037.6 billion in 2009 showing an overall increase by 22.5 percent. The SCBs' (comprising the largest 4 banks) share in deposits decreased from 28.6 percent in 2009 to 28.1 percent in 2010. On the other hand, PCBs' deposits in 2010 amounted to Taka 2266.5 billion or 60.9 percent of the total industry deposit against Taka 1792.4 billion or 59.0 percent in 2009. FCBs' deposits in 2010 rose only by Taka 12.1 billion over the year. The DFIs' deposits in 2010 were Taka 183.4 billion against Taka 161.1 billion in 2009 showing an increase of 13.8 percent over the year.

Aggregate Balance Sheet

5.5 **Assets:** Aggregate industry assets in 2010 registered an overall increase by 22.4 percent over 2009. During this period, SCBs' assets increased by 21.9 percent and those of the PCBs' increased by 25.4 percent. Loans and advances played a major role on the uses of fund. Loans and advances amounting to Taka 3122.1 billion out of aggregate assets of Taka 4855.1 billion constituted the most significant portion of the asset (64.3 percent). Cash in tills were Taka 52.0 billion (1.1 percent); deposits with BB were Taka 300.6 billion (6.2 percent); other assets were Taka 889.6 billion (18.3 percent) and investment in government bills and bonds were Taka 490.8 billion (10.1 percent).

5.6 **Liabilities:** The aggregate liability portfolio (including equities) of the banking industry in 2010 was Taka 4855.1 billion of which deposits constituted Taka 3721.9 billion (76.7 percent). Deposits continued to be the main sources of fund of the banking industry. Capital and reserves of the banks were Taka

418.8 billion (8.6 percent) in 2010, as against Taka 282.2 billion (7.1 percent) in 2009. Capital and reserves of the banks increased further and stood at Taka 461.2 billion at end June 2011.

Performance and Rating of Banks

5.7 Performance and financial conditions of the scheduled banks are evaluated through CAMELS rating system, which involves analysis and evaluation of the six crucial dimensions of banking operations. The six indicators used in the rating system are (i) capital adequacy, (ii) asset quality, (iii) management efficiency (including implementation status of Core Risk Management Guidelines), (iv) earnings, (v) liquidity, and (vi) sensitivity to market risk.

Capital Adequacy

5.8 Capital Adequacy focuses on the total position of banks' capital and protection of depositors and other creditors from the potential shocks of losses that a bank might incur. It helps absorbing all possible financial risks like credit risk and other core risks, market risk, operational risk, residual risk, credit concentration risk, interest rate risk, liquidity risk, reputation risk, settlement risk, strategic risk, environmental & climate change risk etc. Under Basel-II, banks in Bangladesh are instructed to maintain minimum capital requirement (MCR) at 10.0 percent of the risk weighted assets (RWA) or Taka 4.0 billion as capital, whichever is higher, with effect from July-September 2011 quarter. It may be mentioned that in the fourth quarter of 2010 banks were required to maintain MCR at 9.0 percent of RWA or Taka 2.0 billion, whichever was higher.

Under Supervisory Review Process, banks are asked to determine their adequate level of capital which would be enough to compensate all possible risks in their business and that would be more than the minimum required capital. Adequate capital for the banks would be finalised through SRP-SREP[1] dialogue.

[1]SRP-SREP- Supervisory Review Process-Supervisory Review Evaluation Process

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

(Percent)

Bank types	2002	2003	2004	2005	2006	2007	2008	2009	2010
SCBs	4.1	4.3	4.1	-0.4	1.1	7.9	6.9	9.0	8.9
DFIs	6.9	7.7	9.1	-7.5	-6.7	-5.5	-5.3	0.4	-7.3
PCBs	9.7	10.5	10.3	9.1	9.8	10.6	11.4	12.1	10.1
FCBs	21.4	22.9	24.2	26.0	22.7	22.7	24.0	28.1	15.6
Total	**7.5**	**8.4**	**8.7**	**5.6**	**6.7**	**9.6**	**10.1**	**11.6**	**9.3**

Chart 5.3

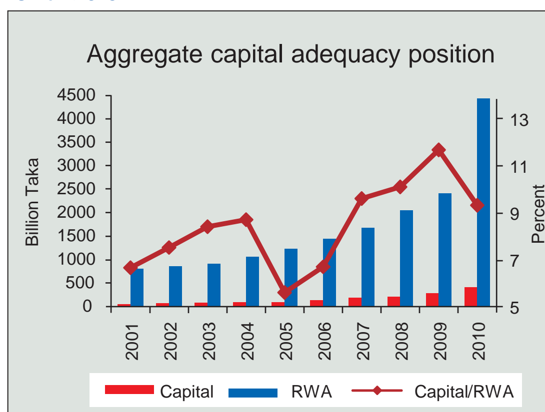


Table 5.3: NPLs to total loans ratios by type of banks

(Percent)

Bank types	2002	2003	2004	2005	2006	2007	2008	2009	2010
SCBs	33.7	29.0	25.3	21.4	22.9	29.9	25.4	21.4	15.7
DFIs	56.1	47.4	42.9	34.9	33.7	28.6	25.5	25.9	24.2
PCBs	16.4	12.4	8.5	5.6	5.5	5.0	4.4	3.9	3.2
FCBs	2.6	2.7	1.5	1.3	0.8	1.4	1.9	2.3	3.0
Total	**28.0**	**22.1**	**17.6**	**13.6**	**13.2**	**13.2**	**10.8**	**9.2**	**7.3**

5.9 Table 5.2 shows that as on 31 December 2010 the SCBs, DFIs, PCBs and FCBs maintained CAR of 8.9, -7.3, 10.1 and 15.6 percent respectively. 2 SCBs, 2 DFIs and 4 PCBs could not maintain minimum required CAR. The CAR of the banking industry was 9.3 percent at end 2010 as against 11.6 percent at end 2009. All foreign banks maintained minimum required capital. Noteworthy that industry CAR stood at 9.7 percent at end June 2011 (Appendix-3, Table-II).

Asset Quality

5.10 The asset composition of all commercial banks shows the concentration of loans and advances (65.9 percent). The high concentration of loans and advances indicates vulnerability of assets to credit risk, specially because of having significant portion of non-performing assets. A huge non-performing loan portfolio has been the major predicament of banks particularly of the SCBs and DFIs. However, investment of banks in bills, bonds, shares etc. also demonstrates somewhat concentration, which is 12.1 percent of total assets.

5.11 The most important indicator intended to identify problems with asset quality in the loan portfolio is the ratio of gross non-performing loans (NPLs) to total loans and net NPLs to net total loans. In 2010, FCBs have the lowest and DFIs have the highest ratio of gross NPLs to total loans. SCBs had gross NPLs to total loans ratio of 15.7 percent whereas in case of PCBs, FCBs and DFIs, the ratios were 3.2, 3.0 and 24.2 percent respectively at end December 2010. The gross NPLs to total loans ratios for the SCBs, PCBs, FCBs and DFIs were 14.1, 3.5, 3.1 and 21.8 percent respectively at end FY11 (Appendix-3, Table-III).

5.12 The ratio of NPL to total loans of all the banks shows an encouraging trend since its decline from the peak (34.9 percent) in 2000, although the aggregate ratio was still as high as 7.3 percent in December 2010. The reason is being high NPL of the SCBs and the DFIs. The ratio ended up 7.1 percent at end FY11 (Appendix-3, Table-III).

5.13 The SCBs and DFIs continue to experience high level of NPLs mainly due to substantial loans provided by them on considerations other than commercial and under directed credit programmes during the

Chart 5.4

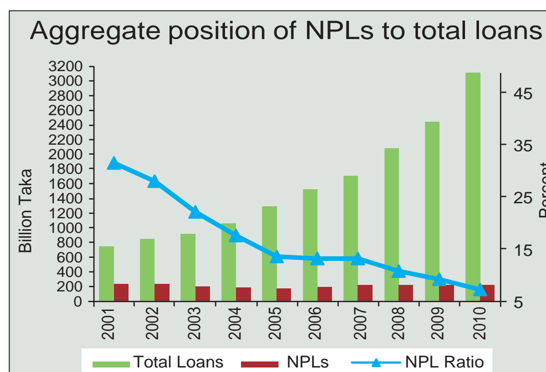


Table 5.3(a) Ratio of net NPL to total loans by type of banks

(Percent)

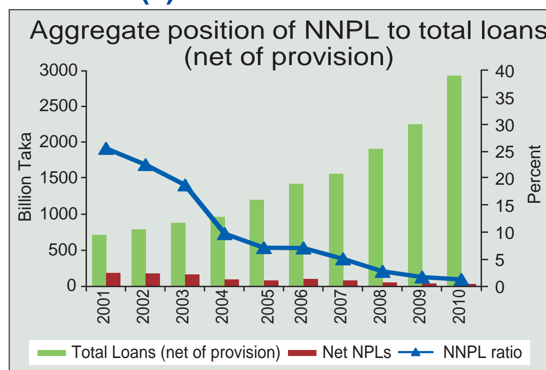
Bank	2002	2003	2004	2005	2006	2007	2008	2009	2010
SCBs	30.1	28.3	17.6	13.2	14.5	12.9	5.9	1.9	1.9
DFIs	48.0	38.3	23.0	22.6	23.6	19.0	17.0	18.3	16.0
PCBs	10.5	8.3	3.4	1.8	1.8	1.4	0.9	0.5	0.0
FCBs	-0.4	0.1	-1.5	-2.2	-2.6	-1.9	-2.0	-2.3	-1.7
Total	**22.6**	**18.8**	**9.8**	**7.2**	**7.1**	**5.1**	**2.8**	**1.7**	**1.3**

Table 5.4 Required provision and provision maintained - all banks

(billion Taka)

All banks	2003	2004	2005	2006	2007	2008	2009	2010	2011 (30 June)
Amount of NPLs	203.2	187.3	175.1	200.1	226.2	224.8	224.8	227.1	243.8
Required Provision	92.5	87.8	88.3	106.1	127.2	136.1	134.8	149.2	158.0
Provision maintained	37.3	35.9	42.6	52.9	97.1	126.2	137.9	142.3	152.3
Excess(+)/ shortfall(-)	-55.2	-51.9	-45.7	-53.2	-30.1	-9.9	3.1	-6.9	-5.6
Provision maintenance ratio (%)	40.3	40.9	48.2	49.9	76.3	92.7	102.3	95.4	96.4

Chart 5.4 (a)



70s and 80s. Poor appraisal and inadequate follow-up and supervision of the loans disbursed by the SCBs and DFIs in the past eventually resulted in massive booking of poor quality assets remained significant in the portfolio of these banks. Furthermore, these banks were reluctant to write-off the historically accumulated bad loans because of poor quality of underlying collaterals. Recovery of NPLs, however, witnessed some signs of improvement mainly because of the steps taken with regard to internal restructuring of these banks to strengthen their loan recovery mechanism and recovery drive and write-off measures initiated in recent years.

5.14 It is shown in the Table 5.3(a) and chart 5.4(a) that the ratio of net NPLs (net of provisions and interest suspense) to net total loans (net of provisions and interest suspense) stood at 1.9 percent (SCBs), 16.0 percent (DFIs) and 1.3 percent (banking sector) in 2010. It is evident from the table that DFIs' non-performing portfolios was still high after adjustment of actual provision and interest suspense, whereas FCBs and PCBs had excess provision against their NPLs. The net NPLs to net total loans ratios were 2.0, 13.5, 0.2, -1.5 and 1.3 percent for the SCBs, DFIs, PCBs, FCBs and all banks respectively at end FY11 (Appendix-3, Table-IV).

5.15 Chart 5.5 displays the amounts in NPLs of the four types of banks since 1999 through 2010. Amount of NPLs of the SCBs decreased from Taka 117.3 billion in 2000 to Taka 107.6 billion in 2010. The PCBs recorded a total increase of Taka 18.1 billion in their NPL accounts, which stood at Taka 64.3 billion in 2010 as against Taka 46.2 billion in 2000. The amount of NPLs of the DFIs decreased to Taka 49.7 billion in 2010 from Taka 63.7 billion in 2000. It appears from

Chart 5.5

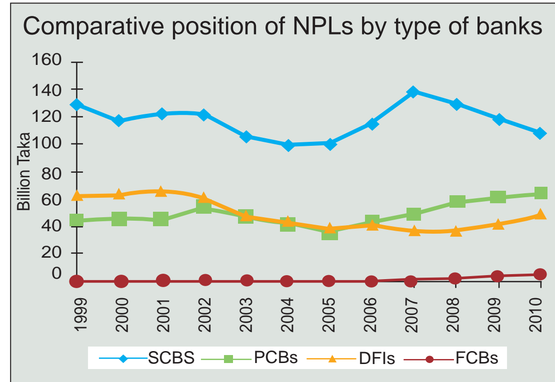


Chart 5.6

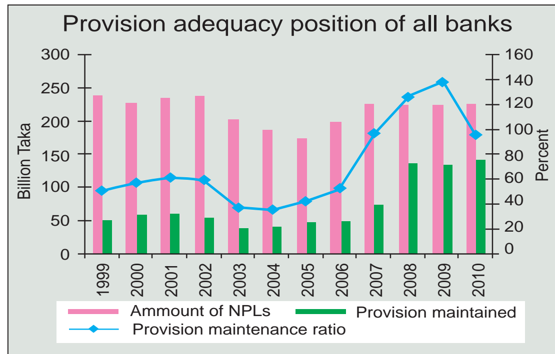
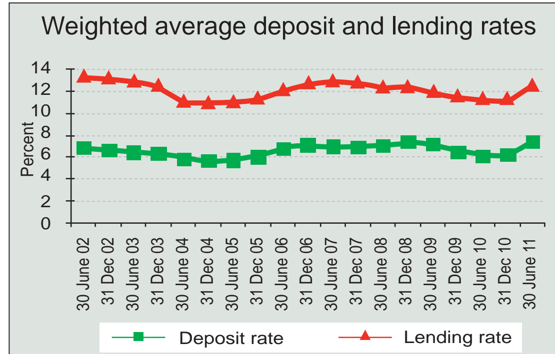


Table 5.5 Comparative position of provision adequacy

(billon Taka)

Year	Items	SCBs	SBs	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
30 June 2011	Required provision	69.8	20.6	60.0	7.5
	Provision maintained	69.8	14.3	60.0	8.2
	Provision maintenance ratio (%)	100.0	69.4	100.0	109.3

Chart 5.7



the Chart 5.4(a) that the decline in NPLs to total loans ratio in the recent years can be attributed partly to some progress in recovery of long outstanding loans and partly to write-off of loans classified as 'bad' or 'loss'.

Loan Loss Provisioning of the Banks

5.16 Table 5.4 shows the aggregate amounts of NPLs, required loan loss provision and actual provision maintained by the banks from 2003 to June 2011.

5.17 Table 5.4 and Chart 5.6 depict that in aggregate, the banks are failed continuously to maintain the required level of provisions against their NPLs from 2003 through 2010 except in the year 2009. Table 5.4 shows that in 2009 the banking sector had been able to maintain 100 percent or more provision for the first time. Banks maintained 40.3 percent of the required provision in 2003; which increased thereafter to 95.4 percent in 2010. The main reasons for the shortfall in provision adequacy from 2000 through 2010 was the inability of some SCBs, DFIs and PCBs including those in problem bank category to make sufficient provisions due to inadequate profits and transferred provision for write-off. Notably the FCBs showed better performance as they have been able to make adequate provisions in the recent years. A comparative position of loan loss provision as of end 2009, 2010 and FY11 is shown in Table 5.5.

5.18 At end December 2010 twenty eight PCBs out of thirty maintained required provision, the remaining 2 failed due to their poor asset portfolios and earning level.

Weighted Average Deposit and Lending Rates

5.19 Banks' weighted average deposit rate increased from 6.07 percent to 7.27 percent and weighted average lending rate increased from 11.19 percent to 12.42 percent during the

Table 5.6 Weighted average deposit and lending rates 30/06/02-30/06/11)

(Percent)

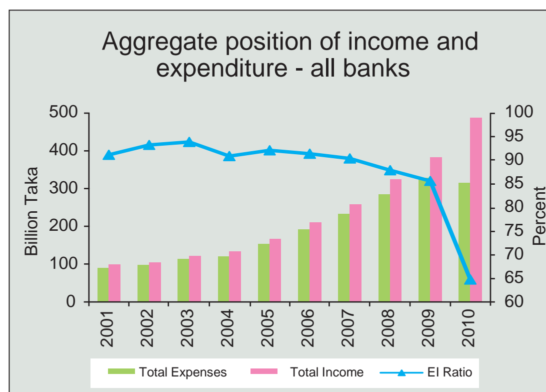
Date	Weighted average		Spread
	Deposit rate	Lending rate	
30/06/02	6.74	13.16	6.42
31/12/02	6.49	13.09	6.60
30/06/03	6.30	12.78	6.48
31/12/03	6.25	12.36	6.11
30/06/04	5.65	11.01	5.36
31/12/04	5.56	10.83	5.27
30/06/05	5.62	10.91	5.31
31/12/05	5.90	11.25	5.35
30/06/06	6.68	12.06	5.38
31/12/06	6.99	12.60	5.61
30/06/07	6.85	12.77	5.92
31/12/07	6.77	12.75	5.98
30/06/08	6.94	12.29	5.39
31/12/08	7.31	12.31	5.00
30/06/09	7.01	11.87	4.56
31/12/09	6.33	11.44	5.11
30/06/10	6.01	11.31	5.30
31/12/10	6.07	11.19	5.12
30/06/11	7.27	12.42	5.15

Table 5.7 Writing-off bad debts in different bank categories (From 30 June 2006 to 30 June 2011)

(billion Taka)

Bank Types	30/06/06	30/06/07	30/06/08	30/06/09	30/06/10	30/06/11
SCBs	35.7	42.8	48.4	64.5	70.5	82.4
DFIs	28.6	30.4	31.0	31.8	31.8	32.0
PCBs	40.7	45.5	49.4	54.7	69.6	77.1
FCBs	1.5	1.6	1.7	2.0	2.1	2.4
Total	**106.5**	**120.3**	**130.5**	**153.0**	**174.0**	**193.9**

Chart 5.8



second half of FY11 (01/01/2011 to 30/06/2011). The spread between lending and deposit rates remained more or less stable at 5.15 percent during the same period. Weighted average deposit and lending rates along with the spread during 30/06/2002 to 30/06/2011 are shown in table 5.6 and chart 5.7.

Writing-off Bad Debts

5.20 To wipe out unnecessarily and artificially inflated size of balance sheet, uniform guidelines of write-off have been introduced in 2003. According to the policy, banks may, at any time classified write-off loans as bad/loss. Those loans, which have been classified as bad/loss for last 5 years and above and loans for which 100 percent provisions have been kept, should be written-off immediately. The total amount of written-off bad debts from June 2006 to June 2011 in different bank categories is given in Table 5.7.

Management Efficiency

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

5.22 As evident from Table 5.8 and chart 5.8, in 2010, expenditure-income (EI) ratio of the DFIs was the highest among the shown bank clusters due to huge operating loss incurred by BKB and RAKUB. The EI ratio of the SCBs was 80.7 which could mainly attributable to high administrative and overhead expenses and suspension of income against NPLs. EI ratio of PCBs was also substantially high due to deduction of loan loss provision, other assets and corporate tax from current income.

Table 5.8 Expenditure-income ratio by type of banks.

(Percent)

Bank Types	2003	2004	2005	2006	2007	2008	2009	2010
SCBs	98.8	102.3	101.9	100.0	100.0	89.6	75.6	80.7
DFIs	101.1	104.0	103.9	103.5	107.7	103.7	112.1	87.8
PCBs	93.1	87.1	89.3	90.2	88.8	88.4	72.6	67.6
FCBs	80.3	76.3	70.8	71.1	72.9	75.8	59.0	64.7
Total	**93.9**	**90.9**	**92.1**	**91.4**	**90.4**	**87.9**	**72.6**	**70.8**

Earnings and Profitability

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

5.24 Earnings as measured by return on assets (ROA) and return on equity (ROE) differ largely within the industry. Table 5.9 shows ROA and ROE by type of banks and Chart 5.9 shows the aggregate position of these two indicators for all banks. Analysis of these indicators reveals that the ROA of the SCBs was less than industry average considering huge provision shortfall and that of the DFIs even worse. PCBs' ROA shows consistently strong position during last five years. FCBs' ROA has been consistently strong during the last couple of years.

5.25 SCBs' ROE was -6.9 percent in 2005 and rose to 26.2 percent in 2009, but dropped down to 18.4 percent in 2010 as owners' equity had increased comparatively at higher rate than after tax profit. In case of DFIs, the ROE was still negative in 2010. The ROE of PCBs was robust for last five years. The ROE of FCBs was 22.4 percent in 2009, but decreased to 17.0 percent as two FCBs incurred net loss in 2010.

Net Interest Income

5.26 Aggregate net interest income (NII) of the industry has consistently increased from Taka 16.6 billion in 2003 to Taka 121.9 billion in 2010. However, the NII of the SCBs was a negative amount of Taka 0.3 billion in 2003 and had become positive (Taka 7.7 billion) in 2005. The positive trend continued till 2010. In 2010, the NII of SCBs was Taka 19.8 billion. The DFIs had a positive trend since 2002 and it was Taka 6.2 billion in 2010.

5.27 Since 2005, SCBs have been able to increase their net interest income (NII) by reducing their cost of fund. The NII of the PCBs has been incredibly high over the period from 2003 through 2010. Overall industry NII shows a consistently upward trend. The trend of NII indicates that the interest spread of PCBs and FCBs is higher than that of SCBs and DFIs.

Liquidity

5.28 Commercial banks' demand and time liabilities are at present subject to a statutory liquidity requirement (SLR) of 19.0 percent inclusive of average 6.0 percent (at least 5.5 percent in any day) cash reserve ratio (CRR) on bi-weekly basis. The CRR is to be kept with the BB and the remainder as qualifying secured assets under the SLR, either in cash or in Government securities. SLR for the banks operating under the Islamic Shariah is 11.5 percent. The specialised banks (except Basic Bank Ltd.) are exempted from maintaining the SLR. Liquidity indicators measured as percentage of demand and time liabilities (excluding inter-bank items) of the banks indicate that although all the banks had excess liquidity but the amount was lower than the previous two years.

5.29 Table 5.11 and Chart 5.11 show that the FCBs are having the highest liquidity ratios followed by the SCBs. This situation of lower surplus of liquidity made the money market volatile.

CAMELS Rating

5.30 CAMELS rating is a supervisory tool to identify those banking companies that are having problems and require increased supervision. 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 the 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 composite CAMELS rating is generally identified as a problem bank, activities of which are closely monitored by the BB.

5.31 BB had introduced Early Warning System (EWS) of supervision from March 2005 to address the difficulties faced by the banks in any of the areas of CAMELS. Any bank found to have faced difficulty in any areas of operation, is brought under early warning category and monitored very closely to help improve its performance. Presently 2 banks are monitored under EWS.

Table 5.9 Profitability ratios by type of banks

(Percent)

Bank types	Return on assets (ROA)									Return on equity (ROE)								
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2002	2003	2004	2005	2006	2007	2008	2009	2010
SCBs	0.1	0.1	-0.1	-0.1	0.0	0.0	0.7	1.0	1.1	4.2	3.0	-5.3	-6.9	0.0	0.0	22.5	26.2	18.4
DFIs	0.3	0.0	-0.2	-0.1	-0.2	-0.3	-0.6	0.4	0.2	5.8	-0.6	-2.1	-2.0	-2.0	-3.4	-6.9	-171.7	-3.2
PCBs	0.8	0.7	1.2	1.1	1.1	1.3	1.4	1.6	2.1	13.6	11.4	19.5	18.1	15.2	16.7	16.4	21.0	20.9
FCBs	2.4	2.6	3.2	3.1	2.2	3.1	2.9	3.2	2.9	21.5	20.4	22.5	18.4	21.5	20.4	17.8	22.4	17.0
Total	**0.5**	**0.5**	**0.7**	**0.6**	**0.8**	**0.9**	**1.2**	**1.4**	**1.8**	**11.6**	**9.8**	**13.0**	**12.4**	**14.1**	**13.8**	**15.6**	**21.7**	**21.0**

5.32 As of end 2010, CAMELS rating of 5 banks was 1 or "Strong"; 32 banks were rated 2 or "Satisfactory"; rating of 7 banks was 3 or "Fair"; 2 were rated 4 or "Marginal" and 1 bank got 5 or "unsatisfactory" rating.

Islamic Banking

5.33 Alongside the conventional interest based banking system, Bangladesh entered into an Islamic banking system in 1983. In FY11 out of 47 banks in Bangladesh, 7 PCBs operated as full-fledged Islamic banks and 16 conventional banks were involved in Islamic banking. The Islamic banking industry continued to show strong growth since its inception in 1983 to December 2010 in tandem with the growth in the economy, as reflected by the increased market share of the Islamic banking industry in terms of assets, financing and deposits of the total banking system. A brief picture is given in Table 5.12. Total deposits of the Islamic banks and Islamic banking branches of the conventional banks stood at Taka 675.8 billion at end December 2010. This was 17.5 percent of deposits of the total banking system at the end of December 2010. Total credit of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 628.7 billion at end December 2010. This was 19.1 percent of the credit of the total banking system of the country.

Chart 5.9

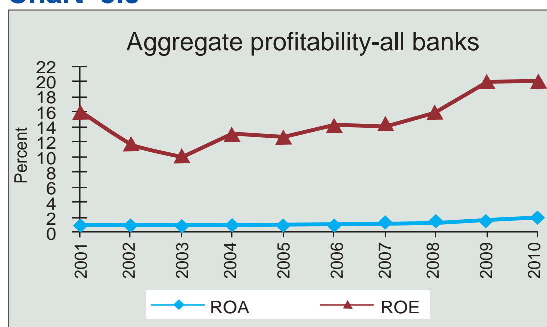


Chart 5.10

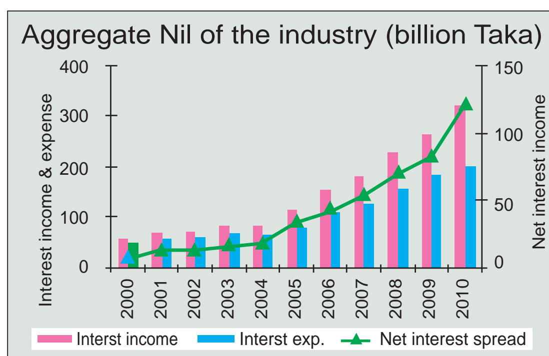


Table 5.10 Net interest income by type of banks

(billion Taka)

Bank Types	2003	2004	2005	2006	2007	2008	2009	2010
SCBs	-0.3	-1.1	7.7	9.0	7.4	7.9	12.1	19.8
DFIs	1.3	1.8	1.0	1.7	1.4	1.9	1.9	6.2
PCBs	12.0	13.7	21.0	25.4	36.1	48.5	56.7	82.8
FCBs	3.6	4.2	5.6	8.2	9.9	12.6	10.7	13.0
Total	**16.6**	**18.3**	**35.3**	**44.3**	**54.8**	**70.9**	**81.5**	**121.9**

Table 5.11 Liquidity ratio by type of banks

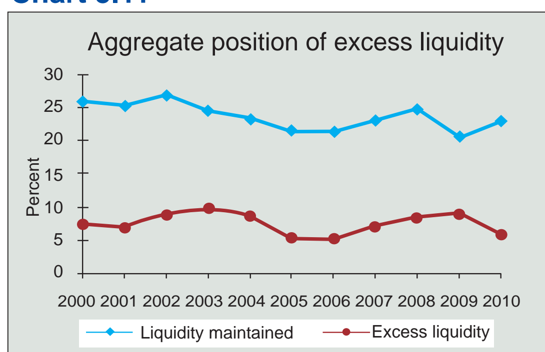
(Percent)

Bank types	Liquid assets									Excess liquidity								
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2002	2003	2004	2005	2006	2007	2008	2009	2010
SCBs	27.3	24.4	22.8	20.0	20.1	24.9	32.9	25.1	27.2	7.3	8.4	6.8	2.0	2.1	6.9	14.9	17.6	8.2
DFIs	13.7	12.0	11.2	11.2	11.9	14.2	13.7	9.6	21.3	6.9	5.8	4.7	6.2	3.8	5.6	4.9	7.1	2.3
PCBs	26.3	24.4	23.1	21.0	21.4	22.2	20.7	18.2	21.5	8.5	9.8	8.8	5.1	5.6	6.4	4.7	5.3	4.6
FCBs	41.6	37.8	37.8	41.5	34.4	29.2	31.3	31.8	32.1	21.8	21.9	21.9	23.6	16.4	11.2	13.3	21.8	13.2
Total	**27.2**	**24.7**	**23.4**	**21.7**	**21.5**	**23.2**	**24.8**	**20.6**	**23.0**	**8.7**	**9.9**	**8.7**	**5.3**	**5.1**	**6.9**	**8.4**	**9.0**	**6.0**

Deposit Insurance Scheme

5.34 Deposit Insurance Scheme was introduced in Bangladesh in August 1984 to act as a safety net. It aims at minimising or eliminating the risk of loss of depositors' fund with banks. Deposit insurance in Bangladesh is now being governed by the Bank Deposit Insurance Act 2000. A Deposit Insurance Trust Fund (DITF) has also been created for providing limited protection (not exceeding Taka 0.10 million) to a small depositor in case of winding up of any bank. The Board of Directors of BB is the Trustee Board for the DITF. The DITF is now being administered and managed under the guidance of the Trustee Board. BB is now a member of International Association of Deposit Insurers (IADI). At the end of June 2011, the total assets of the DITF stood at Taka 17.9 billion of which Taka 17.7 billion were invested in Government securities. Revised risk based premium rate was introduced in January 2007. As per new schedule, the banks under problem bank category will have to pay 0.09 percent whereas other banks will pay 0.07 percent as premium on their deposits. To inform the public and for stabilising the payment system in the banking sector, the information regarding deposit insurance scheme, its nature, operating procedures, level of coverage, premium rates etc. and last audited balance sheet (as on 30-6-2010) has been disclosed in BB website. It is mentionable that Board of Directors of BB as the Trustee of the DITF has approved new risk based premium rate and amount of coverage which will come into force after Government approval.

Chart 5.11



B. Legal Reforms and Prudential Regulations

5.35 As part of the ongoing efforts to strengthen the banking system through the adoption of policies aimed at both improving the financial strength of banks as well as bringing about greater transparency in their operations, several policy measures were initiated in FY11.

Risk Based Capital Adequacy (RBCA) for Banks

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

Table 5.12: Comparative position of the Islamic banking sector (as of end December 2010)

(billion Taka)

Particulars	Islamic banks		Islamic banking branches		Islamic banking sector		All banking sector	
	2010	2009	2010	2009	2010	2009	2010	2009
1	2		3		4=2+3		5	
Number of Banks	7	7	16	9	23	16	47	47
Deposits	627.6	470.2	48.0	62.4	675.6	532.6	3858.9	3037.8
Credits	587.2	456.0	41.6	36.9	628.7	492.9	3297.5	2439.8
Credit Deposit Ratio	93.6	96.98	86.7	59.1	93.1	92.5	85.5	80.3
Liquidity: Excess(+)/Shortfall(-)@	25.5	33.8	0.5	--	26.0	--	211.8	335.0

Notes: @=Conventional banks which have islamic banking branches do not maintain SLR individually. The head offices of the respective banks maintain combindly SLR and liquidity position.

with their risk profile. Pertinently, banks have been instructed to raise their capital to Taka 4.0 billion of which paid up capital shall be minimum Taka 2.0 billion with effect from 11 August 2011. Moreover, BB has reviewed the minimum regulatory Capital Adequacy Ratio (CAR) and Minimum Capital Requirement (MCR) of the banks in 2010 through revising the existing RBCA policy and banks' past capital adequacy reporting. Banks are required to maintain CAR at greater than or equal to 10 percent of Risk Weighted Assets (RWA) from July 2011. According to Pillar-1 of Basel-II, RWA of banks are calculated against Credit Risk, Market Risk and Operational Risk. Banks are instructed to submit their Capital Adequacy Statement at the end of each quarter to BB.

BB is now on its way to implement the Pillar-2 (Supervisory Review Process) of RBCA framework. The key principle of the supervisory review process (SRP) is that "banks have a process for assessing overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital at an adequate level". Banks are now instructed to form a SRP team, where risk management unit is an integral part, and to develop a process document called Internal Capital Adequacy Assessment Process (ICAAP) for assessing their overall risk profile. Adequate capital means enough capital to compensate all the risks in their business. Basel-II has linked capital to the level of risk management. Therefore, banks should have best practiced risk management techniques in monitoring and mitigating their risks. Supervisory Review Evaluation Process (SREP) of BB includes dialogue between BB and the bank's SRP team followed by findings/evaluation of the bank's ICAAP. During SRP-SREP dialogue (box-5.1), BB will review and determine additional capital to MCR of banks. To facilitate the dialogue, a process document has been developed from the end of BB, which can be accessible at BB website. Under the process document, BB has instructed the banks to calculate adequate capital in addition to MCR against residual risk, evaluation of core risk management, credit concentration risk, interest rate risk, liquidity risk, reputation risk, settlement risk, strategic risk, environmental risk and other material risks in specified format and submit the return to BB. In this process, information of banks' ICAAP would be counterchecked with the information available to the On-site Inspection Departments of BB. During the SRP-SREP dialogue (Box-5.1), if banks would not be able to produce information backed by proper evidence and real review regarding risk management, the information of Inspection Department would be prepared for determining adequate capital.

Box 5.1

Eligible Regulatory Capital for Banking Company

Banks and Non-bank Financial Institutions (NBFIs) are highly leveraged institutions. They have every possibility of making losses that exceed their capital, as they hold significantly more deposits and other debt than capital. Banks and NBFIs have to maintain an adequate level of capital to protect depositors' interest and to ensure the survival of business enterprises incurring losses. They have to maintain "specific provisions" or loan loss provisions (LLP) against Non Performing Loans (NPLs) or Loan Loss Provisions (LLP). This is a "shock absorber" fund created to offset future expected losses arising from classified loans and advances. Expected loss is measured according to regulations on loan classifications and provisioning. This fund is charged on income not recognised as part of regulatory capital. The Basel Committee on Banking Supervision (BCBS) in their publication "International Convergence of Capital Measurement and Capital Standard" stated that the regulatory capital of banks and NBFIs would be the minimum as well as adequate to meet comprehensive risks.

Eligible Regulatory Capital is comprised of core (Tier-1) and supplementary (Tier-2&3) capital. In Bangladesh, Tier-1 capital consists of paid up capital, non-repayable share premium accounts, statutory reserves, general reserves, retained earnings, minority interest in subsidiaries, non-cumulative irredeemable preference shares, and the dividend equalisation account. Tier- 2 capital of a bank consists of general provisions, 50% of revaluation reserves for fixed assets, 50% of revaluation reserves for securities, 10% of revaluation reserves for equity instruments, other preference shares (do not fall under Tier-1 capital) and long term subordinated debt. Tier- 3 or additional supplementary capital consists of short-term subordinated debt with original maturity of less than or equal to five years but not less than two years. This is solely for the purpose of meeting a portion of the capital requirements for market risk.

Banks in Bangladesh are obliged to maintain eligible regulatory capital at minimum as well as at adequate level. The minimum requirement is 10% of Risk Weighted Assets (RWA) or Taka 400 crore whichever is higher. Banks are not allowed to commence or operate their businesses unless they have the minimum capital requirement (MCR). Banks also have to maintain adequate capital in order to protect depositors' interests. Adequate capital means MCR plus some additional capital for all other risks which are not captured during calculation of RWA. BB has identified the following risks which are not included in the RWA calculation process: residual risk, core risks, credit concentration risk, interest rate risk, liquidity risk, reputation risk, settlement risk, strategic risk, environmental & climate change risk etc. Thus, Basel-II linked capital to a comprehensive risk management system.

Banks in Bangladesh are required to maintain a Capital Adequacy Ratio (CAR) ≥ 10%. CAR is derived by dividing Eligible Regulatory Capital by the RWA of a Bank. The RWA is determined according to regulations provided in the Risk Based Capital Adequacy (RBCA) guideline. In line with Basel-II, RWA is calculated using a standardised approach for credit risk, a standardised measurement method for market risk and a basic indicator approach for operational risk.

In order to obtain the eligible regulatory capital for the purpose of calculating Capital Adequacy Ratio (CAR), banks in Bangladesh are required to make the following deductions from their Tier-1 capital - intangible assets e.g., book value of goodwill and value of any intangible assets shown in the banking book, shortfall in provisions required against classified assets, shortfall in provisions required against investment in shares, remaining deficit on account of revaluation of investments in securities after netting off from any other surplus on the securities, reciprocal holding of banks' capital/subordinated debt, holding of equity shares exceeding the approved limit under section 26(2) of Banking Company Act, 1991; and investments in subsidiaries which are not consolidated.

Box 5.1

Eligible Regulatory Capital for Banking Company

(Contd.)

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

World Bank, IMF and BCBS have suggested stress tests for use in the assessment of capital adequacy. These tests help in managing risk within a financial institution to ensure optimum allocation of capital across its risk profile. BCBS recently developed and approved Basel-III of the international regulatory framework for banks. The regulations target greater resilience at the individual bank level and reduce the risk of system wide shocks by strengthening micro prudential regulation and supervision, and add a macro prudential cover that includes capital buffers. A capital conservation buffer comprising of common equity of 2.5% of risk-weighted assets will be imposed when banks fall into the buffer range which includes leverage ratio, liquidity coverage ratio and countercyclical position.

Rationalisation of Schedule of Charges

5.37 BB has rationalised the charges of some services to ensure the interest of depositors/investors/customers and advised all scheduled banks to display the complete schedule of charges in suitable visible places in their branches and head offices for the information of their customer and upload the same in their respective websites for the convenience of the customers. Considering the interest of the small depositors it has been decided that no charge can be imposed as account maintenance fee for average deposit balance up to Taka 5000. It has also been decided that Taka 100 at maximum may be imposed as account maintenance fee for average deposit balance up to Taka 25000 on six monthly basis.

Rationalisation of Rate of Interest

5.38 Banks in general are free to charge/fix their deposit and lending rate. However, the maximum cap of 7.0 percent interest rate on export credit has been fixed by BB since 10 January 2004 to facilitate export earnings. Besides, the maximum cap on rate of interest on agriculture and term loans to industrial sector has been fixed at 13.0 percent. Also, with a view to ensuring adequate supply of essential commodities and keeping the price of these commodities within a reasonable limit the maximum rate of interest on import financing of rice, wheat, edible oil (crude and refined), pulse, gram, onions, dates and sugar (refined & raw sugar/raw cane sugar) has been fixed at 12.0 percent. Banks are allowed to differentiate interest rate up to a maximum of 3.0 percent considering comparative risk elements involved among borrowers in same lending category. With progressive deregulation of interest rates, banks have been advised to announce the mid-rate of the limit (if any) for different sectors and they may change interest by 1.5 percent more or less than the announced mid-rate on the basis of the comparative credit risk. In cases where the maximum interest rate has been fixed by BB, banks shall report their own maximum cap. Banks have also been advised to upload their deposit and lending interest rate on their respective website.

Policy Guidelines for Green Banking

5.39 Bangladesh is one of the most climate change vulnerable countries. Financial institutions of Bangladesh can play an important role to protect environmental degradation. A comprehensive Policy Guidelines for Green Banking has been issued with a view to developing a strong and environment friendly banking system (Box-5.2).

Box 5.2

Green Banking in Bangladesh

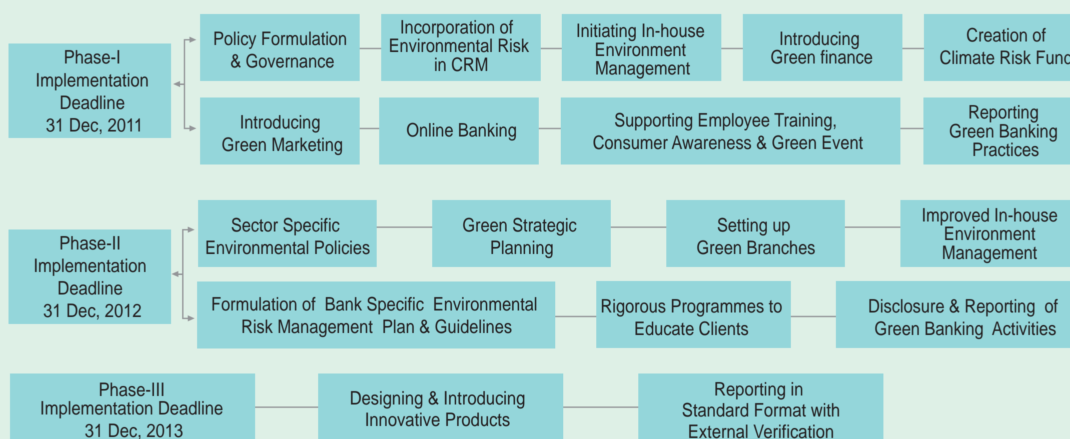
The state of the environment in Bangladesh is rapidly deteriorating. In order to protect environmental degradation and ensure sustainable banking practices in Bangladesh, an indicative Green Banking Policy and Strategy framework for banks has been developed by Bangladesh Bank (BB).

A Green Bank is an ethical bank, a socially responsible bank or a sustainable bank efficient in using water, light, air, energy and resources. Green Banking means providing innovative green products by the green banks that cover financial services to support the activities that are not hazardous to environment and help conserve the environment. Green finance contributes to the transition to resource-efficient and low carbon industries i.e. green industry and green economy in general. Green banking products are those that help create a favourable impact on environment. The banking sector can play a significant role in protecting the environment by financing support to high impact environmentally sensitive sectors. Banks, by using their commercial lending and securities underwriting, are in a position to catalyse the necessary transition to an economy that minimises air pollution, relies on energy efficiency and low/no carbon energy sources.

BB previously advised banks to provide their clients with utmost assistance when opening Letters of Credit (L/C) for the installation of Effluent Treatment Plants (ETP) in industrial units; financing solar energy, bio-gas and ETP; complying with the guidelines on Corporate Social Responsibility (CSR) (banks have been asked to concentrate on linking CSR at their highest corporate level for ingraining environmentally and socially responsible practices) and engaging with borrowers in scrutinising environmental and social impacts. Banks have been brought under the purview of e-commerce with a view to providing the customers with online-banking facilities including payments of utility bills; money transfers and transactions in local currency through the internet. BB has launched a refinance programme of Taka 2.00 billion for bio-gas plant, solar power plant, ETP and Hybrid Hoffman Kiln (HHK) in brick fields.

Considering the adverse effects of climate change, banks have been advised to be cautious about the impacts of natural disasters and encourage farmers to cultivate salinity resistant crops in salty areas, water resistant crops in the waterlogged and flood-prone areas, drought resistant crops in drought-prone areas. They should also be encouraged to use surface water instead of underground water for irrigation, organic fertiliser and natural insecticides instead of chemical fertiliser and pesticides.

Banks in Bangladesh are required to implement Green Banking activities through the following three phases:



Box 5.2

Green Banking in Bangladesh

(Contd.)

Banks have been advised to submit the first ever quarterly report of their green banking initiatives/activities under the Phase-I programme on 30 June 2011 basis within 15 July 2011 and reports of the subsequent quarters within 15 days of the respective quarter's end. Banks shall report on the initiatives/practices to BB and disclose information on their websites as well.

Preferential treatments for Compliant Banks have been taken into consideration. BB will award points to banks on the criteria of "management" while computing CAMELS rating where there will ultimately be a positive impact on overall rating of a bank. BB will declare the names of the top ten banks for their overall performance in green banking activities on the BB website. BB will actively consider green banking activities/practices of a bank while according permission for opening new bank branches. SME/Agriculture bank branches to be established/ opened after 20 June 2011 will be required to be eco-friendly ensuring that a solar panel is installed at the branch.

Guidelines on Environmental Risk Management (ERM)

5.40 A detailed guideline on Environmental Risk Management (ERM) has been introduced to assess environmental risk along with the credit risk for an overall credit rating prior to disbursement of loan/credit facility.

Bank Account for Farmers

5.41 A farmer can open an account by depositing Taka 10 (ten) only at any state owned commercial and specialised banks against National ID Card/Birth Registration Card and Agricultural Equipment Assistance Card issued by the Department of Agricultural Extension. There will be no bindings for maintaining minimum balance on the said account and banks shall not impose any charges/fees on these accounts. Due to close monitoring of BB, the number of farmers' accounts has gone up to 9,472,894 as of 30 June 2011.

Bank Account for Unemployed Youth

5.42 An unemployed youth can open a bank account by depositing Taka 50 at any scheduled bank under National Services Programme.

Bank Account for Hardcore Poor

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

Bank Account for Freedom Fighters

5.44 A freedom fighter can open bank account by depositing Taka 10 (ten) only at any state owned commercial and specialised banks against national ID card and Payment Receipt Book for freedom fighter's allowance. There are no bindings for maintaining minimum balance on the said account and banks shall not impose any charges/fees on these accounts.

Bank Account for Beneficiaries under Social Security Programme

5.45 Beneficiaries under Social Security Programme can open bank account by depositing Taka 10 (ten) only at any state owned commercial and specialised bank against National ID card and Payment Receipt

Book containing Pension Payment Order (PPO) for the beneficiaries. There are no bindings for maintaining minimum balance on the said accounts and banks shall not impose any charges/fees on these accounts. Transactions may also be carried on through vouchers in case of insufficiency of check books.

Banking Services for Physically Handicapped People

5.46 Banks have been advised to designate an official at 'Focal Point' of each branch of their bank with a view to making the banking services beneficial and easily accessible to the physically handicapped people.

SCBs Monitoring Cell

5.47 The Government of the People's Republic of Bangladesh (GOB) has already corporatised 3 SCBs (Sonali, Janata and Agrani) for improving financial soundness and operational efficiency of the banking sector. Rupali Bank has been converted into public limited company on 14 December 1986. After restructuring, the performance of Sonali Bank Limited, Janata Bank Limited and Agrani Bank Limited is comparatively better than the previous years. Positive impact is observed from the financial indicators of these four banks. Meanwhile, cumulative loss of Rupali Bank Limited has been transformed into Intangible Assets (Goodwill) as per the instruction of Ministry of Finance dated 18 August 2010. Furthermore, the overall progress of these four banks are being monitored and reviewed under the Memorandum of Understanding (MoU) signed by the respective bank at the beginning of 2011. On the other hand, Bangladesh Krishi Bank (BKB) and Rajshahi Krishi Unnayan Bank (RAKUB) are being monitored and reviewed under the MoU of FY11. Preparation of MoU for BKB and RAKUB for FY12 is under process.

Progress of Basel-II implementation in Bangladesh

5.48 BB has commenced the implementation of Basel-II from January 2010 as regulatory compliance and has provided banks with a guideline on 'Risk Based Capital Adequacy for Banks (Revised regulatory capital framework in line with Basel-II)' vide BRPD circular no. 35/2010. The framework is based on three mutually reinforcing pillars: (i) new and considerably more sophisticated minimum capital requirements, (ii) banks' own assessments of their capital adequacy and enhanced supervision of capital management, and (iii) materially increased disclosure requirements. Besides, BB has issued "Process Document for SRP-SREP Dialogue on ICAAP" in February 2010. All scheduled banks have been instructed to submit their reports on risk based capital adequacy according to Basel-II guideline on quarterly basis, which would be verified by the Inspection Departments of BB. With reference to the information, adequate capital of banks will be finalised through SRP-SREP dialogue.

Corporate Governance in Banks

5.49 Liquidity and solvency problems caused by poor governance in banks can have harmful systematic consequences in the broader economy reliant on banks for credit and payment services. High priority is, therefore, accorded to give corporate governance in banks, putting in place check and balance comprising a mix of legal, regulatory and institutional provisions specifying the roles and accountabilities of the board, the executive management, external and internal audit, disclosure and transparency prescriptions. Good corporate governance can contribute substantially to a shared working environment between banks and its' supervisors. It supports not only a well-managed banking system but also

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

Corporate Social Responsibility

5.50 Corporate social responsibility (CSR) is mainly about the awareness of and actions in support of environmentally sustainable societal development. CSR actions aim at mitigating the diverse environmental impacts of the activities of the business and at reducing inequalities and alleviating deprivation and poverty in the communities across the country. Out of 47 scheduled banks in Bangladesh, 46 had engagement in CSR practices in some form or other in 2010. In terms of direct monetary expenditure as shown in Table 5.13, engagements of banks in CSR initiatives are sharply increasing, particularly in response to the BB guidance circular (DOS Circular No.1 Dated 1 June 2008).

CSR expenditures of banks have far largely been in the form of passive grants and donations. Banks were particularly responsive to emergency support needs of population groups affected in natural and man-made disasters. Apart from one-off grants and giveaways, some banks have engagements in longer-term continuing support commitments, in areas of education and healthcare. In addition to the passive engagements by way of grants/donations, banks are now getting actively engaged in socially responsible business

Table 5.13 CSR Expenditures of banks during 2007 to 2010

(millon Taka)

Year	2007	2008	2009	2010
CSR Expenditure	226.4	410.7	553.8	2329.8

operations by way of increased lending to under-served economic sectors like agriculture and SMEs, towards broad based financial inclusion and faster poverty eradication. Some banks have shown commitment for environmental sustainability in own and client businesses. Their actions have not, however, gone beyond compliance with relevant government laws and regulations. Proactive initiatives of helping arrest environmental degradation like adoption of more energy efficient and harmful emission/effluence reducing internal practices and processes have been largely absent in the CSR initiatives, even of branches of foreign banks with such practices in their home offices. In addition, banks are yet to adopt practices of prior stakeholder consultations (an important element indicated in BB's guidance circular) in drawing up their CSR programmes and to adopt separate reporting of their CSR activities in comprehensive formats such as the global reporting initiative (GRI).

Activities of Credit Information Bureau

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

5.52 The workload of the bureau kept on increasing unabated in terms of number of requests, number of borrowers and owners, number of reporting banks/financial institutions. CIB database consists of detailed information in respect of individual borrowers, owners and guarantors; the total number of which was (29,65,902 at end June, 2011 active & inactive) recorded an increase by 19.6 percent over the previous year (24,80,511 at end June, 2010). The number of CIB reports supplied during FY11 (end June 2011) stood at 11,84,132 compared to 10,02,674 in the FY10 (end June 2010). As per existing service standard, the credit reports are supplied within 5 working days of receiving the request, the volume of which was around 5500 per day during FY11.

5.53 As per reporting of scheduled banks/ financial institutions, the classified loan decreased during FY11. The classified loan decreased to 10.8 percent at the end of June 2011 compared to 13.1 percent in the preceding year. The percentage of such classified loan was 34.9 in December 2000. It may be mentioned that with effect from June 2004 quarter the amount of "written-off" loan was excluded from both classified and outstanding loans, and after exclusion, the percentage of classified loan stood at 10.8 as on 30 June 2011.

5.54 In order to ensure prompt collection of credit data from the sources as well as instantaneous delivery of credit report to the users by applying latest computer technology, the CIB started diagnostic analysis of the customer and the central bank with effect from 13 July 2007 under DFID financial assistance programme aimed at implementing on-line services between the Bureau and the lending institutions. The selected vendor CRIF (Italy) of CIB online project has started project work since 3 May 2009. CIB online services have been opened up at the inaugural ceremony of CIB online services by the honourable Governor, BB on 19 July 2011. It has brought huge advantage to the banking sector of Bangladesh. Physical presence is no longer needed for collection of CIB reports and submission of credit information to the CIB database.

C. Supervision of Banks

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

On-site Inspection of Banks

5.56 As part of Bank's statutory function, currently five 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), Foreign Exchange Inspection and Vigilance Department (FEIVD) and Anti-Money Laundering Department (AMLD) are conducting the inspection activities. These five departments conduct on-site inspection on SCBs, DFIs, PCBs (including banks under Islamic Shariah), FCBs and other institutions including Investment Corporation of Bangladesh (ICB) and Money Changers.

Basically, three types of inspections are conducted namely (i) comprehensive inspection, (ii) risk based inspection/system check inspection, and (iii) special inspection. The broad objectives of on-site inspection are

as follows:

- To promote soundness, solvency and systemic stability of the financial sector as well as to protect depositors' interests;
- To ensure safety, stability and discipline in the banking sector;
- To ensure compliance of banking laws, rules and regulations;
- To combat money laundering and terrorist financing activities;
- To evaluate quality and performance of bank management and Board of Directors;
- To identify weaknesses which are to be addressed to strengthen the banks; and
- To evaluate financial soundness and operational efficiency of the banks.

In comprehensive inspection, overall performance/conditions of the banks such as capital adequacy, asset quality, liquidity, earnings, management competence etc. are evaluated. Based on their performance banks are rated between 1-5 grades in ascending order. Inspection is done according to the Annual Inspection Programme chalked out by the respective departments well ahead of the beginning of each calendar year. 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 issued by BB as well as to evaluate and monitor risk management systems and control environment of the banks. The frequency of the inspection is annual and areas covered are risks associated with credit, internal control and compliance, asset liability management and information system. Special inspections are conducted on the banks on specific/particular issue(s) as well as to investigate complaints received from the depositors, general public or institutions.

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

5.58 In FY11, DBI-1 conducted a total of 725 comprehensive inspections including 35 Head Offices and 690 branches, core risk inspections on 39 banks and special inspection on 134 bank branches.

DBI-2 conducted a total of 1149 comprehensive inspection including 5 Head Offices and 1149 bank branches. The Department also conducted 76 comprehensive inspections on financial institutions (FIs) including 24 head offices & 52 branches and 10 inspections on ICB including its head office and 9 branches. Besides, the Department conducted 22 risk-based inspections on banks. Moreover, the Department also conducted 224 special inspections on banks, 8 special inspections on FIs and 1 on ICB.

DBI-3 conducted a total of 445 comprehensive inspections on banks including 5 head offices and 440 branches. The Department conducted 4 risk based and 40 special inspections on banks.

5.59 FEIVD conducts inspection on foreign trade financing, treasury functions and foreign exchange risk management of banks, foreign exchange transactions of banks and money changers. In FY11, the Department conducted a total of 251 comprehensive inspections on banks including 45 head offices and 206 authorised dealer branches. The Department also conducted 393 special inspections on various banking irregularities, 46 special inspections on foreign exchange risk management and 380 inspections on money changers.

5.60 In FY11, AMLD conducted system check inspection in 47 head offices and 365 bank branches under core risk programme. The Department also conducted special inspection on 131 branches and head offices of 10 banks. In the reporting year, 5 banks have been fined for non-compliance of the Money Laundering Prevention Act, 2009.