Banking Sector Performance, Regulation and Bank Supervision

5.1 The banking sector of Bangladesh demonstrated considerable progress in reinforcing the resilience during FY14 amid political turbulence. Bangladesh Bank (BB) continued to focus on strengthening the financial system of the country. A number of policy measures continued during the year emphasising risk management, corporate governance, stress testing, enhanced CSR and Green Banking activities in the banks as well as monitoring of fraud-forgeries through self assessment of Anti-Fraud Internal Controls. A revised guideline for CAMELS rating has been put into effect in order to make it more suitable with international standard. Monitoring of investment in shares by the scheduled banks has been stringent in light of the amendments made in the Bank Company Act in 2013. Risk Management Committee at the board level has been made mandatory to ensure proper risk management practice in the banks. Presently the banks are being rated for their overall risk management performance. The following paragraphs highlight the performance of the banking sector including the recent regulatory and supervisory measures initiated by BB.

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). Nine (9) newly licensed private commercial banks have started functioning in this year. So the number of banks increased from 47 in 2012 to 56 in 2013. These banks had a total number of 8685 branches as of December 2013. The number of bank branches increased from 8322 of 2012 to 8685 due to opening of new branches mainly by the PCBs, DFIs and SCBs during the year. At the end of June 2014, the total number of bank branches increased

Table 5.1 Banking systems structure

(billion Taka)

Bank types	2012						2013					
	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	3478	1831.9	26.1	1377.9	25.5	4	3520	2108.5	26.4	1631.2	26.0
DFIs	4	1440	385.5	5.5	260.4	4.8	4	1494	454.8	5.7	343.0	5.5
PCBs	30	3339	4371.5	62.2	3430.7	63.6	39	3602	4948.2	61.9	3939.3	62.8
FCBs	9	65	441.8	6.3	327.0	6.1	9	69	488.7	6.1	359.5	5.7
Total	**47**	**8322**	**7030.7**	**100**	**5396.0**	**100**	**56**	**8685**	**8000.2**	**100**	**6273.0**	**100**

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

Chart 5.1 Aggregate industry assets (Dec, 2012) (billion Taka)

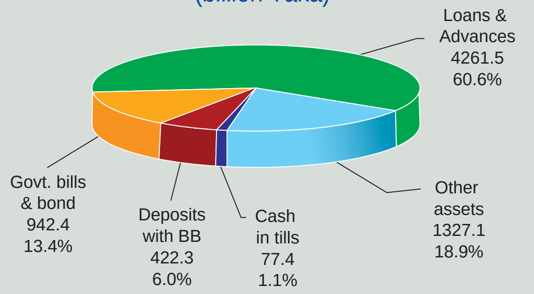
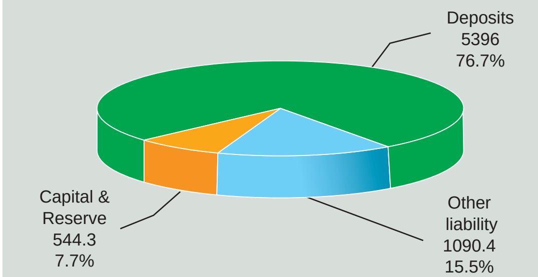
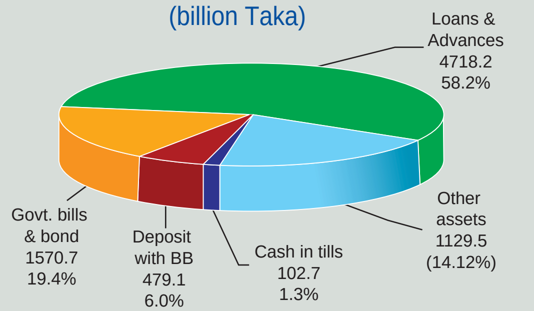


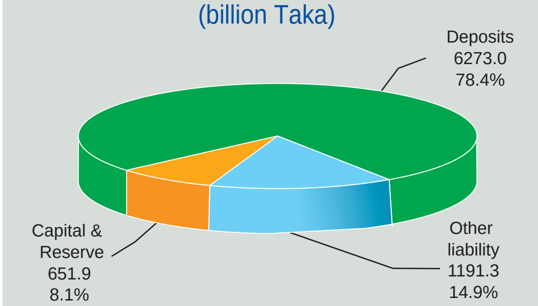
Chart 5.2 Aggregate industry liabilities (Dec, 2012) (billion Taka)



Aggregate industry assets (Dec, 2013) (billion Taka)



Aggregate industry liabilities (Dec, 2013) (billion Taka)



further to 8794, with total number of banks remained unchanged at 56 (Appendix 4, Table I). Structure of the banking sector with breakdown by type of banks is shown in Table 5.1.

5.3 In 2013, the SCBs held 26.4 percent of the total industry assets as against 26.1 percent in 2012. PCBs' share in total assets is showing persistent trend and it slightly decreased from 62.2 percent in 2012 to 61.9 percent in 2013. The FCBs held 6.1 percent of the industry assets in 2013, showing a decline by 0.2 percentage point over the previous year. The DFIs' share of assets was 5.7 percent in 2013 as compared to 5.5 percent in 2012.

5.4 Total deposits of the banks in 2013 rose to Taka 6273.0 billion from Taka 5396.0 billion in 2012 showing an overall increase by 16.3 percent compared to a 19.7 percent growth in 2012. The SCBs' share in deposits slightly increased from 25.5 percent in 2012 to 26.0 percent in 2013. PCBs' deposits in 2013 amounted to Taka 3939.3 billion or 62.8 percent of the total industry deposit compared to Taka 3430.7 billion or 63.6 percent in 2012. FCBs' deposits in 2013 slightly increased by Taka 32.5 billion over the year 2012. The DFIs' deposits in 2013 were Taka 343.0 billion compared with Taka 260.4 billion in 2012 showing an increase of 31.7 percent over the year. The total deposits growth rate declined during the year despite inclusion of 9 new banks and a large decline in interbank borrowings.

A.1. Aggregate Balance Sheet

5.5 **Assets:** Aggregate industry assets in 2013 showed an overall increase of 13.8

percent over 2012. During this period, the SCBs' assets increased by 15.1 percent and those of the PCBs' increased by 13.2 percent. Loans and advances of Taka 4718.2 billion constituted the most significant portion (58.2 percent) of the sector's aggregate assets of Taka 8000.2 billion. Cash in hand including foreign currencies was Taka 102.7 billion; deposits with BB were Taka 479.1 billion; other assets were Taka 1129.5 billion and investment in government securities were Taka 1570.7 billion (Chart 5.1).

5.6 **Liabilities and capital:** Deposits continued to be the main sources of funds of the banking industry and constituted 78.4 percent (Taka 6273.0 billion) of its aggregate liability and capital portfolio in 2013. Capital and reserves of the banks were Taka 651.9 billion (8.1 percent) in 2013, compared with Taka 544.3 billion (7.7 percent) in 2012 (Chart 5.2).

A.2. Capital adequacy

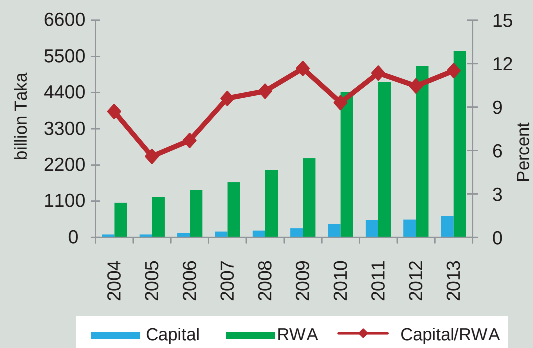
5.7 Capital adequacy focuses on the total position of banks' capital and the protection of depositors and other creditors from the potential shocks of losses that a bank might incur. It helps absorbing all possible financial risks like credit risk, market risk, operational risk, residual risk, core risks, 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 the Minimum Capital Requirement (MCR) at 10.0 percent of the Risk Weighted Assets (RWA) or Taka 4.0 billion as capital, whichever is higher. Under the Supervisory Review Process (SRP),

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

(percent)

Bank types	2006	2007	2008	2009	2010	2011	2012	2013	End June 2014
SCBs	1.1	7.9	6.9	9.0	8.9	11.7	8.1	10.8	8.7
DFIs	-6.7	-5.5	-5.3	0.4	-7.3	-4.5	-7.8	-9.7	-13.7
PCBs	9.8	10.6	11.4	12.1	10.1	11.5	11.4	12.6	12.1
FCBs	22.7	22.7	24.0	28.1	15.6	21.0	20.6	20.2	20.6
Total	**6.7**	**9.6**	**10.1**	**11.6**	**9.3**	**11.4**	**10.5**	**11.5**	**10.7**

Chart 5.3 Aggregate capital adequacy position



banks are directed to maintain a level of "adequate" capital which is higher than the minimum required capital and sufficient to cover for all possible risks in their business. This higher level of capital for the banks is usually determined and finalised through SRP-SREP (Supervisory Review Evaluation Process, the central bank's assessment) dialogue. The amount of capital was Taka 205.8 billion as on 31 December 2008 and increased to Taka 651.9 billion at the end of December 2013, showing capital growth of 216.8 percent.

5.8 Table 5.2 shows that on 31 December 2013, in aggregate, the SCBs, DFIs, PCBs and FCBs maintained CAR of 10.8, -9.7, 12.6, and 20.2 percent respectively. But individually, 2 SCBs, 2 PCBs, 1 FCB and 3

DFIs did not maintain the minimum required CAR. The CAR of the banking industry as a whole was 11.5 percent at end of December 2013 as against 10.5 percent at the end of 2012. Implementation of new revised policy on loan rescheduling (BRPD Circular no. 15/2013) was the main reason of increase in CAR in 2013. On the other hand, increase of classified loans resulted in rise of deficit of capital of 2 SCBs (Sonali, Rupali), 3 DFIs (BKB, BASIC, RAKUB), 2 PCBs (BCBL, ICB Islamic) and 1 FCB (NBP). The CAR of the industry was 10.7 percent at end of June 2014.

A.3. Asset Quality

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

5.10 The most important indicator intended to identify the asset quality in the loan portfolio is the ratio of gross non-performing loans (NPLs) to total loans and net NPLs to net total loans. At the end of December 2013, PCBs had the lowest and DFIs had the highest ratio of gross NPLs to total loans. PCBs' gross NPLs to total loans ratio was 4.5 percent, whereas that of SCBs, FCBs and DFIs were 19.8, 5.5 and 26.8 percent respectively at the end of December 2013 (Table 5.3). The gross NPL ratios to total loans for the SCBs, PCBs, FCBs and DFIs were recorded as 23.2, 5.7, 6.2 and 33.1 percent respectively at end June 2014.

5.11 The ratio of NPL to total loans of all the banks had shown an overall declining trend from its peak (34.9 percent) in 2000 up to 2011 (6.1 percent). But the ratio increased in 2012 (10.0 percent), decreased again in 2013 (8.9 percent), then increased (10.8 percent) at end June 2014. It can be seen from Table 5.3 that the decline in NPLs to total loans ratio in recent years till 2011 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'.

Chart 5.4 Aggregate position of NPLs to total loans

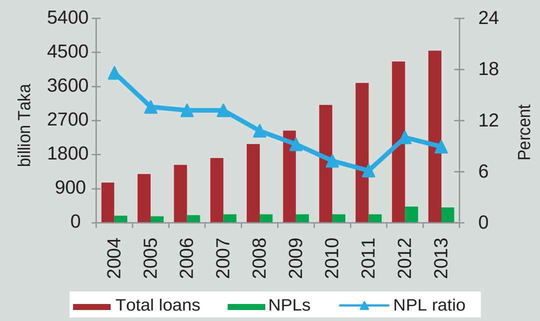


Table 5.3 NPL ratios by type of banks

(percent)

Bank types	2006	2007	2008	2009	2010	2011	2012	2013	End June 2014
SCBs	22.9	29.9	25.4	21.4	15.7	11.3	23.9	19.8	23.2
DFIs	33.7	28.6	25.5	25.9	24.2	24.6	26.8	26.8	33.1
PCBs	5.5	5.0	4.4	3.9	3.2	2.9	4.6	4.5	5.7
FCBs	0.8	1.4	1.9	2.3	3.0	3.0	3.5	5.5	6.2
Total	**13.2**	**13.2**	**10.8**	**9.2**	**7.3**	**6.1**	**10.0**	**8.9**	**10.8**

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

(percent)

Bank	2006	2007	2008	2009	2010	2011	2012	2013	End June 2014
SCBs	14.5	12.9	5.9	1.9	1.9	-0.3	12.8	1.7	7.4
DFIs	23.6	19.0	17.0	18.3	16.0	17.0	20.4	19.7	26.4
PCBs	1.8	1.4	0.9	0.5	0.0	0.2	0.9	0.6	1.2
FCBs	-2.6	-1.9	-2.0	-2.3	-1.7	-1.8	-0.9	-0.4	-0.2
Total	**7.1**	**5.1**	**2.8**	**1.7**	**1.3**	**0.7**	**4.4**	**2.0**	**3.9**

But it went up again in 2012 & 2014 (end June) due to the reasons of issuance of the circular regarding new classification and rescheduling of loans and a few notable scams in the banking industry.

5.12 The SCBs and DFIs continue to have high level of NPLs mainly due to substantial loans provided by them on considerations other than commercial criteria. Furthermore, these banks were reluctant to write-off the historically accumulated bad loans because of poor quality of underlying collaterals. Recovery of NPLs, however, has showed some signs of improvement, mainly because of the steps taken with regard to internal restructuring of these banks to strengthen their loan recovery mechanism and write-off measures initiated in recent years.

5.13 Table 5.3 (a) and Chart 5.4 show that in 2013, the ratio of net NPLs (net of provisions and interest suspense) to net total loans (net of provisions and interest suspense) was 2.0 percent for the banking sector and 19.7 percent for DFIs. It is revealed in the table that DFIs' nonperforming portfolios were still high after adjustment of actual provision and interest suspense, whereas SCBs, FCBs and PCBs had excess provision against their NPLs. The net NPLs to net total loan ratios were 1.7, 0.6, and -0.4 percent for the SCBs, PCBs and FCBs respectively at the end of December 2013. The ratios were 7.4, 26.4, 1.2 and -0.2 percent for SCBs, DFIs, PCBs and FCBs at the end June 2014.

5.14. Table 5.3(b) displays the amount of NPLs of the 4 type of banks since 2006 to 2014 (end June). The amount of NPLs of the SCBs increased from Taka 115.0 billion in 2006 to Taka 166.1 billion in 2013. The PCBs recorded a total increase of Taka 99.4 billion in their NPL accounts, which stood at Taka 143.1 billion in 2013 as against Taka 43.7 billion in 2006. The amount of NPLs of the DFIs increased to Taka 83.6 billion in 2013 from Taka 41.5 billion in 2006. The amount of

Table 5.3 (b) Amount of NPLs

(billion Taka)

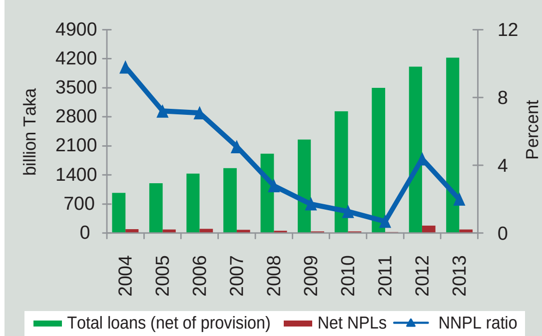
Bank	2006	2007	2008	2009	2010	2011	2012	2013	End June 2014
SCBs	115.0	137.9	127.6	117.5	107.6	91.7	215.2	166.1	197.2
DFIs	41.5	37.2	37.3	42.1	49.7	56.5	73.3	83.6	110.5
PCBs	43.7	49.2	57.0	61.7	64.3	72.0	130.4	143.1	191.5
FCBs	0.8	1.9	2.9	3.5	5.5	6.3	8.5	13.0	14.2
Total	**201.0**	**226.2**	**224.8**	**224.8**	**227.1**	**226.4**	**427.3**	**405.8**	**513.4**

Table 5.4 Required provision and provision maintained-all banks

(billion Taka)

All banks	2006	2007	2008	2009	2010	2011	2012	2013	End June 2014
Amount of NPLs	201.0	226.2	224.8	224.8	227.1	226.4	427.3	405.8	503.5
Required Provision	106.1	127.2	136.1	134.8	149.2	148.2	242.4	252.4	300.4
Provision maintained	52.9	97.1	126.2	137.9	142.3	152.7	189.8	249.8	260.4
Excess(+)/ shortfall(-)	-53.2	-30.1	-9.9	3.1	-6.9	4.6	-52.6	-2.6	40.0
Provision maintenance ratio (%)	49.9	76.3	92.7	102.3	95.4	103.0	78.3	99.0	86.7

Chart 5.4 (a) Aggregate position of NNPL to total loans (net of provision)



NPLs of the FCBs increased from Taka 0.8 billion in 2006 to Taka 13.0 billion in 2013. The amount of NPLs of SCBs, DFIs, PCBs and FCBs stood at Taka 197.2, 110.5, 191.5 and 14.2 billion respectively at the end of June 2014.

5.15 Table 5.4 shows the aggregate amount of NPLs, the required loan loss provision and the actual provision maintained by the banks from 2006 to end June 2014. Table 5.4 and Chart 5.6 depict that in aggregate, the banks have been continuously failing to maintain the required level of provisions against their NPLs from 2006 to 2013 except the year 2009 and 2011. Table 5.4 shows that in 2009 and 2011, the banking sector was able to maintain 100 percent or more of the required provisions. Banks maintained 49.9 percent of the required provision in 2006; which increased thereafter to 103.0 percent in 2011, then declined to 99.0 percent in 2013 and to 86.7 percent at end of June 2014.

The main reason for the shortfall in provision adequacy from 2000 to 2013 was the inability of some SCBs, DFIs and PCBs, including those in the problem bank category to make sufficient provisions due to inadequate profits and provision transfer for write-offs. Notably, the FCBs are in a much better position; as they have been able to make adequate provisions during the period under consideration. A comparative position of loan loss provisions as of end 2012, 2013 and 2014 (end June) is shown in Table 5.5.

5.16 Thirty seven out of thirty nine PCBs were able to maintain the required provision at the end of December 2013, but the remaining two failed due to their poor asset portfolios and earning levels.

Chart 5.5 Comparative position of NPLs by type of banks

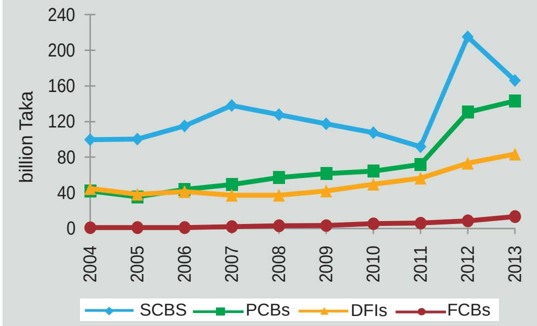


Chart 5.6 Provision adequacy position of all banks

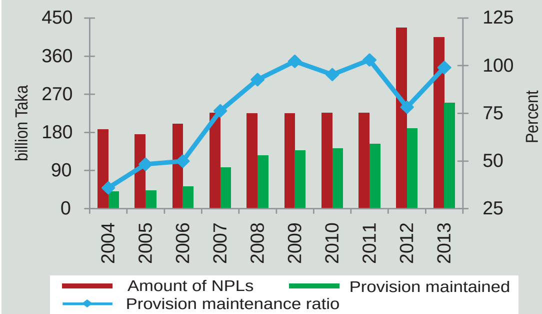


Table 5.5 Comparative position of provision adequacy

(billon Taka)

Year	Items	SCBs	SBs	PCBs	FCBs
2012	Required provision	119.2	29.8	84.4	8.9
	Provision maintained	81.9	13.6	84.9	9.3
	Provision maintenance ratio (%)	68.7	45.7	100.6	104.3
2013	Required provision	107.8	38.3	94.8	11.6
	Provision maintained	122.3	17.4	97.8	12.3
	Provision maintenance ratio (%)	113.5	45.5	103.2	106.0
2014 June	Required provision	124.2	49.3	114.4	12.5
	Provision maintained	110.7	19.3	117.9	12.5
	Provision maintenance ratio (%)	89.1	39.2	103.1	100.1

5.17 To correct an unnecessarily and artificially inflated size of the balance sheet, uniform guidelines for write-offs were introduced in 2003. According to the policy, banks may, at any time, classify write-off loans as bad/loss. Those loans, which have been classified as bad/loss for the 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 2007 to June 2014 in different bank categories is given in Table 5.6.

Table 5.6 Writing-off bad debts in different bank categories

(billion Taka)

Bank types	30 June 07	30 June 08	30 June 09	30 June 10	30 June 11	30 June 12	30 June 13	30 June 14
SCBs	42.8	48.4	64.5	70.5	82.4	72.9	107.2	154.8
DFIs	30.4	31.0	31.8	31.8	32.0	24.5	32.6	34.2
PCBs	45.5	49.4	54.7	69.6	77.1	64.9	109.7	127.7
FCBs	1.6	1.7	2.0	2.1	2.4	2.6	3.7	4.4
Total	**120.3**	**130.5**	**153.0**	**174.0**	**193.9**	**164.9**	**253.3**	**321.1**

A.4. Management Soundness

5.18 Sound management is the most important and inescapable pre-requisite for the strength and concrete growth of any financial institution. It is difficult to draw any conclusion regarding management soundness based on quantitative 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 portray management soundness. Technical competence & leadership of mid and senior-level management, compliance to plan and respond to changing circumstances, etc., are also taken into consideration in evaluating the quality of management.

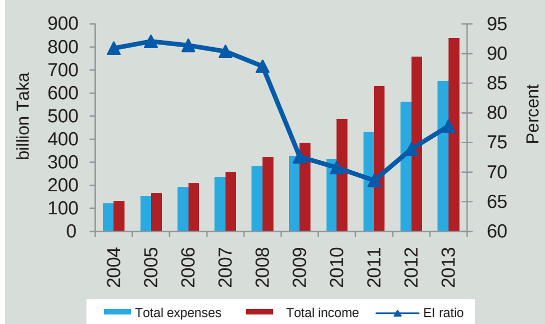
Table 5.7 Expenditure-income ratio by type of banks

(percent)

Bank types	2006	2007	2008	2009	2010	2011	2012	2013	2014 June
SCBs	100.0	100.0	89.6	75.6	80.7	62.7	73.2	84.1	83.3
DFIs	103.5	107.7	103.7	112.1	87.8	88.6	91.2	94.8	112.0
PCBs	90.2	88.8	88.4	72.6	67.6	71.7	76.0	77.9	75.8
FCBs	71.1	72.9	75.8	59.0	64.7	47.3	49.6	50.4	46.5
Total	**91.4**	**90.4**	**87.9**	**72.6**	**70.8**	**68.6**	**74.0**	**77.8**	**77.8**

5.19 As evident from Table 5.7, in 2013, the expenditure-income (EI) ratio of the DFIs was the highest among the displayed bank clusters. The EI ratio of the SCBs was 84.1 in 2013, the second highest, which could mainly be attributable to high administrative and operating expenses. The EI ratio of SCBs increased from 73.2 percent in 2012 to 84.1 percent in 2013. The EI ratio of SCBs, PCBs, FCBs declined to 83.3, 75.8, 46.5 percent respectively and rose to 112.0 percent for DFIs at end June 2014.

Chart 5.7 Aggregate position of income and expenditure - all banks



A.5. Earnings and Profitability

5.20 There are various indicators of earnings and profitability but the most representative and widely used one is Return on Assets (ROA), which is supplemented by Return on Equity (ROE) and Net Interest Margin (NIM).

5.21 Earnings as measured by Return on Assets (ROA) and Return on Equity (ROE) differ greatly within the industry. Table 5.8 shows ROA and ROE by type of banks.

Table 5.8 Profitability ratios by type of banks

(percent)

Bank types	Return on assets (ROA)									Return on equity (ROE)								
	2006	2007	2008	2009	2010	2011	2012	2013	2014 June	2006	2007	2008	2009	2010	2011	2012	2013	2014 June
SCBs	0.0	0.0	0.7	1.0	1.1	1.3	-0.6	0.6	-0.1	0.0	0.0	22.5	26.2	18.4	19.7	-11.9	10.9	-2.4
DFIs	-0.2	-0.3	-0.6	0.4	0.2	0.1	0.1	-0.4	-0.9	-2.0	-3.4	-6.9	-171.7	-3.2	-0.9	-1.1	5.8	-9.5
PCBs	1.1	1.3	1.4	1.6	2.1	1.6	0.9	1.0	0.8	15.2	16.7	16.4	21.0	20.9	15.7	10.2	9.8	8.4
FCBs	2.2	3.1	2.9	3.2	2.9	3.2	3.3	3.0	3.5	21.5	20.4	17.8	22.4	17.0	16.6	17.3	16.9	20.1
Total	**0.8**	**0.9**	**1.2**	**1.4**	**1.8**	**1.5**	**0.6**	**0.9**	**0.6**	**14.1**	**13.8**	**15.6**	**21.7**	**21.0**	**17.0**	**8.2**	**11.0**	**8.4**

Analysis of these indicators reveals that the ROA of the SCBs was less than the industry average. The ROA of SCBs was gradually increasing up to 2011, but it dropped down to negative (0.6 percent) in 2012 due to a huge net loss in the year. In 2013, it increased and became positive. The DFIs' situation is not getting better due to persistent operating losses incurred by BKB and RAKUB. The ROA of DFIs' deteriorated more scoring negative (0.4 percent) in 2013. PCBs' ROA showed a consistently strong position up to 2010, but it was in a decreasing trend during 2011 and 2012 due to decrease of net profit. In 2013, it didn't drop from the previous year. Though FCBs' ROA had been consistently strong during the last couple of years, it decreased slightly in 2013 and again increased in June 2014.

5.22 SCBs' ROE shows a sign of positive indication in 2013 through an increased rate of 10.9 percent whereas it dropped to 11.9 percent (negative) in 2012 due to an increased amount of provisioning required against an increased amount of NPLs. In case of DFIs, the ROE was positive in 2013 which was negative for the last couple of years. The ROE of PCBs was robust upto 2010. It was on decreasing trend for previous couple of years; it was 9.8 percent in 2013 against 15.7 percent in 2011. It declined to 8.4 percent at end June 2014. The ROE of FCBs shows steady fluctuation through out some of the previous years. The ROE of FCBs in 2010 stood at 17.0 percent, which fell to 16.9 percent in 2013 and rose to 20.1 percent at end June 2014.

Chart 5.8 Aggregate profitability-all banks

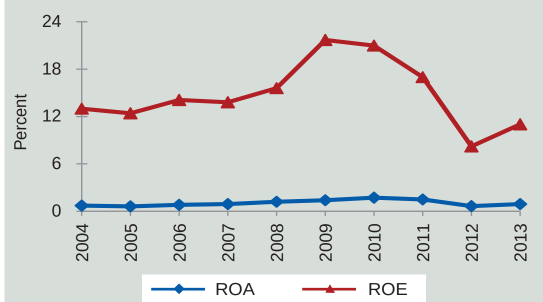


Table 5.9 Net interest income by type of bank

(billion Taka)

Bank types	2006	2007	2008	2009	2010	2011	2012	2013	2014 June
SCBs	9.0	7.4	7.9	12.1	19.8	34.3	14.9	-5.4	-9.3
DFIs	1.7	1.4	1.9	1.9	6.2	4.9	4.7	3.8	1.9
PCBs	25.4	36.1	48.5	56.7	82.8	91.4	114.7	118.2	63.8
FCBs	8.2	9.9	12.6	10.7	13.0	16.1	19.6	15.8	6.7
Total	**44.3**	**54.8**	**70.9**	**81.5**	**121.9**	**146.7**	**153.8**	**132.3**	**63.1**

5.23 Aggregate net interest income (NII) of the industry had consistently increased from Taka 44.3 billion in 2006 to Taka 153.8 billion in 2012. But in 2013, aggregate NII of the

Table 5.10 Liquidity ratio by type of banks

(percent)

Bank types	Liquid assets									Excess liquidity								
	2006	2007	2008	2009	2010	2011	2012	2013	2014 June	2006	2007	2008	2009	2010	2011	2012	2013	2014 June
SCBs	20.1	24.9	32.9	25.1	27.2	31.3	29.2	44.3	41.2	2.1	6.9	14.9	17.6	8.2	12.3	10.2	25.3	28.2
DFIs	11.9	14.2	13.7	9.6	21.3	6.9	12.0	15.3	10.0	3.8	5.6	4.9	7.1	2.3	1.3	1.0	4.2	1.2
PCBs	21.4	22.2	20.7	18.2	21.5	23.5	26.3	28.0	21.7	5.6	6.4	4.7	5.3	4.6	6.6	9.5	11.3	12.8
FCBs	34.4	29.2	31.3	31.8	32.1	34.1	37.5	46.2	47.1	16.4	11.2	13.3	21.8	13.2	15.3	18.7	27.4	34.9
Total	**21.5**	**23.2**	**24.8**	**20.6**	**23.0**	**25.4**	**27.1**	**32.5**	**27.4**	**5.1**	**6.9**	**8.4**	**9.0**	**6.0**	**8.4**	**9.9**	**15.4**	**17.3**

industry fell down to Taka 132.3 billion reflected mainly in the negative NII of Taka 5.4 billion by the SCBs. The NII of the PCBs showed gradual increasing trend from 2006 to 2013 whereas NII of DFIs and FCBs were fluctuating in stable condition. The decline in net interest income during the year is attributed to the shifting of investment funds from loans and advances to investments in liquid assets.

5.24 Since 2006, SCBs have been able to increase their net interest income (NII) by reducing their cost of funds up to 2011. In 2012, the NII of SCBs dropped and alarming situation occurred in 2013 due to higher interest expenses which grew faster than interest earnings. The NII of the PCBs had been significantly high during the span of time from 2006 to 2013. Overall industry NII showed a consistently upward trend from 2006 to 2012 though it went reverse in 2013 due to the lackluster performance of SCBs. The trend of NII indicates that the interest spreads of PCBs and FCBs were higher than that of SCBs and DFIs. The NIl of different categories of bank declined at the end of June 2014.

Chart 5.9 Aggregate NII of the industry (billionTaka)

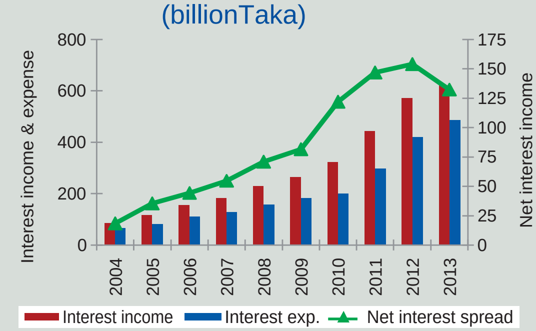
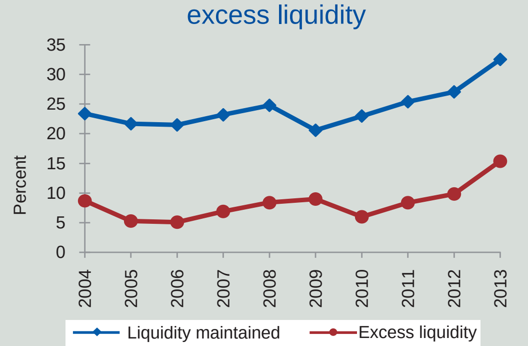


Chart 5.10 Aggregate position of excess liquidity



A.6. Liquidity

5.25 Currently the scheduled commercial banks have to maintain a CRR (Cash Reserve Ratio) averaging 6.5 percent daily on bi-weekly basis against Average Total Demand and Time Liabilities (ATDTL) of the preceding 2nd of the month, with an obligation to maintain daily minimum 6 percent cash against the same ATDTL held by the bank. The current rate of SLR (Statutory Liquidity Reserve) for conventional banks is 13 percent of time and demand liabilities. In case of

Islamic shariah-based commercial banks, the rate of SLR is 5.5 percent of their total time and demand liabilities. The specialised banks (except Basic Bank Ltd.) are exempted from maintenance of SLR, but they have to maintain the CRR at the stated rate. The banks maintain CRR in cash with Bangladesh Bank. However, they are allowed to hold Government approved securities (unencumbered portion) for maintenance of the SLR.

5.26 Table 5.10 shows that the FCBs had the highest liquidity ratios followed by the SCBs. There was an increasing trend in the percentage of liquid assets in total assets of the banks during the last four years.

A.7. CAMELS Rating

5.27 CAMELS rating is a supervisory tool to identify banks which require increased supervision. 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 other related issues have been included while reviewing the guideline. Along with emphasising 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 analyse 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. 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 the composite CAMELS rating is generally identified as a problem bank, the activities of which are closely monitored by the BB.

5.28 BB introduced the 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 difficulty in any areas of operation, is brought under the Early Warning category and monitored very closely to help improve its performance. Presently, no banks are monitored under EWS.

Table 5.11 Comparative position of the Islamic banking sector (as of end December 2013)

(billion Taka)

Particulars	Islamic banks		Dual banking (Conventional+ Islamic)		Islamic banking sector		All banking sector	
	2013	2012	2013	2012	2013	2012	2013	2012
1	2		3		4=2+3		5	
Number of banks	8	7	16	16	24	23	56	47
Deposits	1117.9	961.2	61.0	56.7	1178.9	1017.9	6273.0	5396.0
Credits	951.3	858.9	52.5	51.2	1003.7	910.1	4638.7	4318.6
Credit eeposit ratio	85.1	89.4	68.1	90.3	85.2	89.4	73.9	80.0
Liquidity: excess(+)/shortfall(-) @	91.2	51.0	3.1	0.8	94.3	51.9	955.8	505.4

@ Conventional banks which have Islamic banking branches do not maintain SLR individually.
The head offices of the respective bank maintain combinedly SLR and liquidity position.

5.29 In December 2013, CAMELS rating accomplished under the revised guidelines, no banks have been rated 1 or Strong; the rating of 28 banks were 2 or satisfactory; rating of 12 banks were 3 or fair; 6 banks were rated 4 or marginal and 1 bank received 5 or unsatisfactory rating.

A.8. Operations of Banks in Urban and Rural Areas

5.30 The number of branches and outstanding deposits and advances in the banking system classified by rural and urban areas are displayed in Appendix 4, (Table-XIII). The number of rural branches stood at 4962 (57.1 percent of total branches) at the end of December 2013. The number of branches in urban areas increased to 3723 (42.9 percent of total branches) during the same period. The number of rural branches increased at a lower rate compared with the number of urban branches. Total deposits of rural branches increased to Taka 1117.1 billion (18.3 percent of total deposits) at the end of December 2013 and the amount of urban deposits increased to Taka 4988.2 billion (81.7 percent of total deposits) at the end of December 2013. The amount of advances in rural and urban areas increased to Taka 450.6 billion (10.2 percent of total advances) and Taka 3987.8 billion (89.9 percent of total advances) respectively as on 30 December 2013.

A.9. Islamic Banking

5.31 Islamic banking systems have been operating in Bangladesh since 1983 alongside with the conventional interest based banks. In FY14 out of 56 banks in Bangladesh, 8 PCBs operated as full-fledged Islamic banks, and 16 conventional banks (including 3 FCBs) were involved in Islamic banking through Islamic banking branches. The Islamic banking industry continued to show strong growth since its inception in 1983 to December 2012, as reflected by the increased market share of the Islamic banking industry in terms of assets, financing and deposits of the total banking system. However, the performances of Islamic banks were quite subdued in 2013 which might be attributed to vulnerable business environment in 2013. A brief picture is given in Table 5.11. Total deposits of the Islamic banks and Islamic banking branches of the conventional banks stood at Taka 1178.9 billion at the end of December 2013 which was 18.8 percent of deposits of the total banking system, lower than that of in 2012. Total credit of the Islamic banks and the Islamic banking branches of the conventional banks stood at Taka 1003.8 billion at the end of December 2013 which was 21.6 percent of credit of the total banking system of the country.

B. Legal Framework and Prudential Regulations

B.1. Risk Based Capital Adequacy (RBCA) for Banks

5.32 BB introduced the Risk Based Capital Adequacy (RBCA) framework for banks from January 2010 as regulatory compliance, moreover, BB reviewed the minimum regulatory CAR and MCR of the banks in the year 2010 through revising the existing RBCA policy and banks' past capital adequacy reporting. Banks are required to maintain the 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 is 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 the move to implement the Supervisory Review Process (SRP) of RBCA framework. The key principle of the 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 required to form an SRP team, where the 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. Basel II has linked capital to the level of risk management. Therefore, banks should have "best practice" risk management techniques in monitoring and managing their risks.

Now, BB has declared the roadmap and action plan of the phase-in arrangements for Basel III implementation. These instructions will be adopted in a phased manner starting from July 2014, with full implementation of capital ratios by January 2019. Under the new capital adequacy framework, all banks will be required to maintain the following ratios on an ongoing basis:

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

ii. Tier-1 capital will be at least 6.0 percent of the total RWA which means that additional Tier-1 capital can be admitted maximum up to 1.5 percent of the total RWA.

iii. Minimum Capital to risk-weighted Asset Ratio (CRAR) of 10 percent of the total RWA i.e. Tier-2 capital can be admitted maximum up to 4.0 percent of the total RWA.

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

5.33 The Supervisory Review Evaluation Process (SREP) of BB includes dialogue between BB and the bank's SRP team, followed by findings/evaluation of the bank's

ICAAP. During the SRP-SREP dialogue, BB reviews and determines any additional capital that would be required for banks on the basis of quantitative as well as qualitative judgement. The first SREP dialogue was initiated in 2011. Afterwards, to facilitate the dialogue, a revised evaluation process document was prepared by BB in May 2013. Under the process document, BB provided guidance to calculate required capital against residual risk, credit concentration risk, interest rate risk, liquidity risk, reputational risk, settlement risk, strategic risk, appraisal of core risk management practice, environmental & climate change risk and other material risks in a specified format and submit the same to BB. Information of banks' ICAAP is counter checked with the information available from both on-site inspection and off-site supervisory departments of BB. During the SRP-SREP dialogue, if the bank fails to produce their own ICAAP backed by proper evidence and rigorous review regarding risk management, the SREP team of BB applies their prudence and also uses the available information from the inspection departments in determining the adequate capital. The process document has been further revised in May 2014. On the basis of the revised process document and return format, all 56 banks (including nine new banks) submitted their ICAAP report based on 31 December 2013.

B.2. Loan Classification and Loan-Loss Provisions

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

B.3. Corporate Governance in Banks

5.35 BB has taken several measures in the recent past to put in place good corporate governance in banks. These included a "fit and proper" test for appointment of chief executive officers of PCBs, specifying the constitution of audit committee of the Board, 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. In this connection, related clauses of Bank Company Act, 1991 have already been amended.

C. Supervision of Banks

5.36 With a view to promoting and maintaining soundness, solvency and systematic stability of the financial sector as well as protecting the 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. Recently DOS has made an innovation regarding banking supervision.

C.1. Banking Supervision Specialists (BSS)

5.37 In order to strengthen and intensify current banking supervision, Bangladesh Bank has recently formed 6 (six) Banking

Supervision Specialist Sections in the Department of Off-site Supervision. Each section is headed by a Banking Supervision Specialist (BSS), at the Deputy General Manager Level. Banking Supervision Specialist emphasises more on analytical works than extensive figure works of innumerable data. Banking Supervision Specialists act as early signal providers of the banks they are assigned to. They maintain extensive familiarity with condition, performance, risks, corporate governance and corporate structure of portfolio banks. They collect executive summary reports of comprehensive inspections carried out by Departments of Banking Inspection and take actions accordingly. They maintain regular co-ordination with Inspection Departments to get update on recent supervisory developments. Junior Banking Supervision Specialists monitor treasury functions, capital adequacy, ADR, etc. of portfolio banks. They prepare Diagnostic Review Report (DRR) on audited financial statements and Quick Review Report (QRR) at the required frequency. They also examine the meeting minutes of the Board of Directors, Executive/Audit Committee of the banks; monitor the progress of MOU with the SCBs and report immediately to the concern senior management.

The details of on-site supervision are given below.

C.2.On-site Inspection of Banks

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

5.39 The overall performance/ condition of the banks (such as capital adequacy, asset quality, liquidity, earnings, management competence etc.) is evaluated in a comprehensive inspection. Based on their performance banks are rated from 1 to 5 grades in ascending order. The on-site inspection departments also monitor implementation of the suggestions or recommendations made in the inspection reports. Risk based inspection is conducted to examine the compliance of the Core Risk Management Guidelines. Special inspections are conducted to investigate complaints received from the depositors, public or institutions.

5.40 Commercial banks having CAMELS rating between 3 and 5 are inspected every year. Banks rated 1 or 2 are inspected once in every two years. Based on the findings about provisions, income and expenditure entries, banks will be asked to correct their final account. This system has been adopted to enhance the effectiveness of on-site inspection and reduce the time gap between on-site and off-site supervision.

5.41 During FY14, DBI-1 conducted inspection on 884 branches of 28 banks including head offices. At the same time Core Risk Inspections were conducted on 8 banks that are under the jurisdiction of DBI-1 to review the progress of implementation of the core risk guidelines (Asset-Liability Management, Credit Risk Management, Information System Security and Internal Control & Compliance) issued by Bangladesh Bank. Head/Country offices of the bank as well as one branch of each bank have been taken under the purview of the core risk inspection. On the basis of 30 June 2013, a total of 200 branches including head office of 1 bank were inspected. 23 head offices and 196 branches were inspected on the basis of 31 December 2013. The banks were directed to sit in a tri-partite meeting with their Management Committee (MANCOM), inspectors of Bangladesh Bank and external auditors before finalisation of annual financial statements of the banks. DBI-1 has arranged 35 in house training sessions in 9 working days.

5.42 DBI-2 conducted comprehensive inspection on 855 bank branches including 7 head offices, 152 big branches and 696 small branches. At the same time a total number of 71 special inspections were conducted on state owned commercial banks and specialised banks. 29 risk based inspections on 6 banks were conducted. The department also conducted comprehensive inspections on 97 branches, 29 head offices and 27 special inspections on the 31 financial institutions.

5.43 DBI-3 conducted a total of 740 comprehensive inspections on banks including 5 head offices, 95 big branches, 640 small branches and 143 SME service centres, SME/agriculture branches (including inspection on some of the branches of different banks involved in SME activities). At the same time, a total number of 103 special inspections were conducted on 4 banks (including SME) and 11 risk based inspections on 2 banks.

5.44 During FY14, DBI-4 conducted 248 inspections on banks' head offices and branches. Within this timeline, the department conducted Core Risk Inspections in 19 branches and 17 head offices of a total 20 banks that are under the jurisdiction of DBI-4 to review the implementation advancements of Core Risk Management Guidelines (Asset-Liability Management, Credit Risk Management, Information System Security and Internal Control & Compliance) issued by Bangladesh Bank as well as to evaluate and monitor risk management systems and to control environment of the banks. During the period, DBI-4 also carried out comprehensive inspection in 130 branches and 19 head offices of a total 20 banks. DBI-4 conducted special inspections on 62 branches and 1 head office. During the financial year all banks listed in the local stock exchange were inspected and besides this, 1 NRB bank and 5 foreign banks were inspected before finalisation of annual financial statements. Pre-opening inspections were conducted on the newly opened 9 banks, and on the basis of these inspection reports, banks were permitted to start their operational activities.

5.45 DFEI conducts inspection on foreign trade financing, treasury functions and foreign exchange risk management of banks, foreign exchange transactions of banks and money changers. In FY14, the department conducted a total of 395 comprehensive inspections on banks, including 8 head offices and 387 authorised dealer branches. The department also conducted 45 inspections on foreign exchange risk management, 62 special inspections, 21 inspections on money changers and a good number of special inspections on foreign trade and foreign exchange related irregularities.

5.46 Customers' Interests Protection Centre (CIPC) was reconstituted as a department named Financial Integrity and Customer Services Department (FICSD) on 26 July 2012. FICSD is acting as a watchdog for spotting the early warning signs of internal and external fraud at banks and NBFIs, investigating frauds and making criminal referrals when necessary. This department is also continuing its efforts to promote security, efficiency, effectiveness, transparency and risk management of the information and communication technology (ICT) structures of banks and NBFIs.

5.47 During FY14, the department received a total of 4477 complaints through the dedicated hot line number, email and traditional letter. The department conducted 126 special inspections on banks and financial institutions operating in Bangladesh. Apart from the Customer Service Division of Head Office, the CIPCs established in 10 branch offices of Bangladesh Bank to deal with the complaints received from the bank customers of their respective areas.

In FY14, Bangladesh Financial Intelligence Unit (BFIU) has conducted system check inspections in 22 head offices and 67 bank branches under the core risk programme. The department also conducted special inspections on 4 branches of 4 banks. Besides, some other special inspections are conducted for further analysis of some STRs (Suspicious Transaction Reports). During FY14, 12 head offices, 18 branches of 19 banks have been inspected for this purpose. In addition, on the basis of allegations/ complaints received from different medias, persons, organisations, some special inspections are also conducted to look into the matter. BFIU has conducted special inspections in 8 head offices, 21 branches of 25 banks during FY14.

5.48 A number of activities on AML/CFT for the banking sector have been taken during FY14. The Anti-Terrorism Rules, 2013 and Money Laundering Prevention Rules, 2013 were enacted in FY14. For the optimum supervision, submission of Cash Transaction Report (CTR) and Suspicious Transaction Report (STR) is a major obligation for all reporting agencies including banks. The online reporting system has been introduced in FY14 by implementing the goAML software. BFIU has been receiving CTR and STR from all scheduled banks through goAML web since January 2014. 7 local workshop/training programmes and 7 regional conferences for the banking sector had been conducted in FY14 to create awareness among the bank officials. Training of Trainers (TOT) programmes have been conducted during the

Box 5.1

Strategic Changes in Supervision

BB has initiated strategic changes in bank supervision techniques and approaches to promote the institutional and systemic soundness of the banking sector of the country. The principle focus of these changes is to minimise the risk and uncertainty in order to maintain stability in the financial sector and protect the interest of the depositors. In particular, BB is shifting its strategy from compliance based approach to forward looking risk based approach aiming at matching with international best practices.

In this regard, Basel-II standard regarding capital adequacy for banks has been implemented and measures have been taken to move forward to adopt Basel-III within the shortest possible time. Two new tools for measuring liquidity under BASEL-III namely Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) have been introduced. New master circulars were issued to improve the loan classification, provisioning and rescheduling policy in line with international standard as a part of a close monitoring process. The Bank Company Act, 1991 has been amended; CAMELS Rating Guideline has been reviewed and a comprehensive guideline was issued. Banks were instructed to form a separate Risk Management Department and a Risk Management Committee consisting of members of the Board of Directors. A Risk Management Monitoring Section was formed in Bangladesh Bank, a Risk Rating System has been implemented and risk rating is introduced for CAMELS rating.

To assess the risk absorption capacity of banks and NBFIs, stress testing system has been introduced; QRR and DRR to identify the existing risks of banks and evaluate the overall condition with mandatory disclosures have been introduced. Banks have been instructed to prepare a "Self-Assessment of Anti-Fraud Internal Controls" report in order to prevent moral hazard problem and financial scam. This report is supposed to be signed by the CEO and counter-signed by the chairman of the Audit Committee. Purchase of inland bills has been banned without prior verification and approval from their head offices. An Electronic Dashboard has been set up in BB to identify the irregularities and fraudulent activities from the data collected from banks' financial statements and different departments of BB as early as possible. Web-based corporate memory management process has been launched for keeping record of various activities to prevent possible violation of banking discipline by the officials and directors of banks and NBFIs.

'Financial Stability Department (FSD)' has been established in 2012 in BB for in-depth analysis of factors underlying financial stability of the country, forecasting risks that may impair stability and recommending preventive and remedial measures. 'Financial Integrity and Customer Services Department (FICSD)' has been established reforming earlier 'Customers' Interest Protection Center (CIPC)' to address the grievances of customers within the shortest possible time. 'Integrated Supervision System (ISS) Software' has been launched to monitor the major activities at each bank's head office and branches on monthly basis. A number of local and foreign trainings had been arranged to build up a group of able inspectors to use these new technology and approaches. In order to bring all the banks under intensive surveillance, a position named as Bank Supervision Specialist (BSS) has been initiated and implemented in Department of Off-site Supervision.

Several town hall meetings were arranged nationally and regionally with BB supervisory staff to understand the ground reality and strengthen supervision activities accordingly by forming new supervision framework as per the need. In addition, the recommendations of GM conferences were implemented to sharpen the effectiveness of financial sector monitoring. A taskforce led by an executive director and consisting of general managers of bank supervision related departments was formed to enhance the coordination and cooperation among different departments for strengthening regulation of banking sector and corporate governance.

year to help organise in-house AML training programmes by the banks.

C.3. Off-site Monitoring of Banks

5.49 Off-site monitoring continued as a necessary complement to on-site inspection in FY14, with the introduction of new tools and procedures for more intensive and rapid analysis.

Quick Review Report

5.50 Bangladesh Bank started determining the financial positions of the banks' quarterly through Quick Review Report (QRR) with the existing supervisory tools like CAMELS Rating, Stress Testing, Financial Projection Model etc. The report focuses on major risks existing in the bank and provides possible solutions to problems.

Reviewing Minutes

5.51 During 2013, on reviewing of 1798 minutes (including Board, Executive and Audit meetings) from local scheduled banks, various gross irregularities and violations of banking laws, circulars etc. were detected. Accordingly, banks have been advised to regularise the same so that major financial indicators as well as the internal control system of the banks become regular and can achieve shock-resilient capacity.

Monitoring of the State-owned Commercial Banks (SCBs)

5.52 After restructuring the SCBs, positive impact in the financial indicators of these four banks was observed and their performances showed comparatively better position than that of the previous years. However, Bangladesh Bank is monitoring the SCBs closely under Memorandum of Understanding (MoU) since 2003. Some important rules and policies regarding loan and accounts, implementation of credit policy and core risk management guidelines are incorporated in the MoU. Moreover, in order to ensure the financial soundness, the SCBs have already prepared Credit Policy, Liquidity Risk Management Policy and Internal Control and Compliance Policy with the direction of central bank. The SCBs are advised to follow these polices meticulously. On the other hand, Bangladesh Krishi Bank (BKB) and Rajshahi Krishi Unnayan Bank (RAKUB) are also being monitored and reviewed under the MoUs of FY13. Preparation of MoUs for BKB and RAKUB for 2014 is currently under process.

C.4. Risk Management Activities of Banks

5.53 BB issued six core risk management guidelines, risk based capital adequacy guideline, and stress testing guideline to ensure robustness, efficiency and effectiveness of risk management systems for the banking sector. On 15 February 2012, BB issued another guideline called Risk Management Guideline for banks. This guideline promotes an integrated, bank-wide approach to risk management which will facilitate banks in adopting contemporary methods to identify, measure, monitor and control risks throughout their institutions

5.54 Each scheduled bank was instructed to establish an independent Risk Management Unit (RMU) in June 2009 for better risk management practices. Banks were also instructed to prepare a Risk Management Paper (RMP) containing the analysis of all types of existing and probable risks that might occur in future, place the same in their regular monthly meeting of the RMU and submit the RMP along with the decisions of the meetings to the Department of Off-site Supervision.

5.55 Banks were instructed to establish Risk Management Division (RMD) in place of Risk Management Unit and to appoint a Chief Risk Officer (CRO) from a senior management position (at least from the Deputy Managing Director level) to give more emphasis on risk management practices. BB instructed the banks to form a risk management committee whose members will be nominated by the board of directors from themselves and the company secretary of the bank will be the secretary of the Risk Management Committee. Based on the RMP, DOS regularly evaluates the risk management activities of each bank and provides constructive recommendations to improve their conditions. Banks have to execute all the recommendations and submit their compliance reports within a specified time frame.

5.56 A Risk Rating procedure has been developed to quantify all possible risks based on the RMP and other sources. This risk rating carries 15 percent weight in the management component of CAMELS rating. According to the rating of December 2013, among 47 (other than 9 new banks) scheduled banks 11 banks were rated as low risk, 27 were as moderate and the rest 9 were rated as high risk category bank.

5.57 All the banks have been obliged to submit a self-assessment report on internal control systems. The objective of this self-assessment process is to keep the operational risk at a minimum level by strengthening the internal control and compliance system of a bank. In this regard, BB has formulated a reporting format with 53 questionnaires on anti-fraud internal controls and a statement of fraud and forgeries that have taken place during a period along with the action taken against those incidences. BB is analysing these reports on quarterly basis and providing proper instructions to the banks.

C.5. Financial Stability and Macro-prudential Supervision

5.58 The Financial Stability Department (FSD) has been working actively to strengthen the macro prudential framework of the country. Since inception, this department has published Financial Stability Report (annual and quarterly) to evaluate overall financial stability which will give comprehensive analysis of the major trends.

5.59 The Department primarily designed macro stress tests to quantify the impact of possible changes in economic environment on the financial system. The Financial Projection Model (FPM) has been implemented with the technical assistance of the World Bank. Inter-bank Transaction Matrix (ITM) tool has been introduced and is used to observe liquidity management of banks and NBFIs. This matrix will help to find out the institutions which are in face of the crisis and give early warning signals for safeguarding financial institutions.

5.60 The department has developed the framework for identifying and dealing with the Domestic Systemically Important Banks (D-SIB) in its jurisdiction due to the underlying assumption that the impact of the failure of D-SIBs will be significantly greater than that of a non-systemic institution. The formulation and implementation plan of Counter-cyclical Capital Buffer (CCB) in the time of crisis is under process to resist the pro-cyclicality of financial system. The department prepared the bank intervention and resolution framework, comprising a Bank Intervention Resolution Plan (BIRP) and a contingency plan to have more effective tools, information in order to enable the orderly resolution of banks without any resort to taxpayers' fund.

5.61 The Department prepared the Lender of Last Resort (LOLR) framework documents and corporate 'watch list'. Development of a "Coordinated Supervision Framework" is under process.

D. Banking Sector Infrastructure for Financial Stability and Risk Management

D.1. Deposit Insurance Scheme

5.62 The Deposit Insurance Scheme (DIS) is introduced to minimise or eliminate the risk of loss of depositors' funds with banks that subsequently fail. The direct rationale for deposit insurance is customer protection. The indirect rationale for deposit insurance is that it reduces the risk of a systemic crisis involving, for example, panic withdrawals of deposits from sound banks and breakdown of the payments system. From a global point of view, deposit insurance provides many benefits and over the long term, appears to be an essential component of a viable modern banking system.

Table 5.12 The recent position of DITF

Particulars	Unaudited figure (as on 30 June 2013)	Premium rate*	Coverage amount
Total fund	33.54 (billion Taka)	-	
Total investment	-	-	
Covered deposit of total insurable deposit	36.82%	-	Up to BDT 100 thousand (per Bank per Depositor)
Insurable deposit to total D&T liabilities	82.04%		
Fully insured depositors	79.51%	-	
Sound bank categories	-	0.08%	
Early warning bank categories	-	0.09%	
Problem bank categories	-	0.10%	

* Effective from 2013

5.63 In Bangladesh, DIS was first introduced in August 1984, in terms of "The Bank Deposit Insurance Ordinance 1984", which was repealed by "The Bank Deposit Insurance Act 2000" in July 2000. DIS in Bangladesh is now being administered by the said Act. In accordance with the Act, Bangladesh Bank (BB) is authorised to administer a fund called the Deposit Insurance Trust Fund (DITF) for providing limited protection (Taka 0.10 million) to a small depositor in case of winding up of any bank. The Board of Directors of BB acts as the Trustee Board for DITF. The DITF is now being administered and managed under the guidance of the Trustee Board. In addition, Bangladesh Bank is a member of the International Association of Deposit Insurers (IADI).

5.64 In accordance with "The Bank Deposit Insurance Act 2000," the main function of DITF is collecting premium from all scheduled banks on a half yearly basis (30 June/31 December) and investing the proceeds in Government securities. The income derived from such investments is also credited to the DITF account for further investment.

Box 5.2

Performance of Credit Rating Agencies in Bangladesh

A Credit Rating Agency (CRA) also known as External Credit Assessment Institution (ECAI) rates the securities like stock or bond issued by different business entities based on their credit worthiness. Banks and Financial Institutions (FIs) are allowed to rate their borrowers by the external assessors, i.e. ECAIs. According to Basel framework, credit ratings of banks/FIs' clients are mapped with corresponding risk weights. Following this process, banks/FIs can assess total Risk Weighted Asset (RWA) against their total credit exposures. If any borrower is unrated, banks/FIs may require to give higher weight. Assessing total RWA against rated and unrated credit exposures, banks/NBFIs calculate and maintain their capital adequacies in accordance with section-13 of Bank Company Act 1991.

In this regard, Bangladesh Bank (BB) has recognised 8 ECAIs after having license from Bangladesh Securities and Exchange Commission (BSEC). They are Credit Rating Information and Services Ltd. (CRISL), Credit Rating Agency of Bangladesh (CRAB), National Credit Rating Ltd. (NCRL), Emerging Credit Rating Ltd. (ECRL), Argus Credit Rating Services Ltd. (ACRSL), Alpha Credit Rating Ltd. (ACRL), WASO Credit Rating Company (BD) Ltd. and Bangladesh Rating Agency Ltd. (BDRAL). Among them, BDRAL is licensed and recognised only for SME rating. According to BB's recognition criteria, all ECAIs' performances are reviewed annually. In order to assessing entity's credit worthiness, each ECAI has developed their own rating methodology consisting of qualitative and quantitative factors and complying with both BSEC rules and BB's recognition criteria.

At present, CRAs of Bangladesh are conducting different rating activities like entity rating, corporate debt rating, equity rating etc. Most of the CRAs have no long experience even some are very new in the industry. They have rated total 6936 clients (mostly corporate clients) during April'13-March'14. However, the number of CRAs is reasonably satisfactory considering the size of Bangladesh economy. In addition, CRAs have further opportunity to manage bigger participation in the market facilitating Basel regulation and financial globalisation.

CRAs have become important participants in financial market of Bangladesh. They play greater role in reducing information asymmetry between lenders and investors. Moreover, strong and well defined credit rating can minimise lending cost and can influence availability of credit flows as well.

5.65 To enhance the effectiveness of market discipline, BB has adopted a system of risk based deposit insurance premium rates applicable for all the banks effective from January-June 2007. Very recently the premium rate has been increased, with effect from January-June 2013. Along with the scheduled banks, BB has also taken the initiative to bring the NBFIs under the coverage of DIS, an initiative which is now under the consideration of the Ministry of Finance (MoF).

5.66 The effectiveness of DIS in reducing systemic risk will surely increase if the public become well aware of its existence and scope. With this end in mind, BB has already issued a circular regarding public awareness about DIS and more information and updates are available in the Bangladesh Bank website so that the general public can be informed on an ongoing basis about the benefits and capabilities of the DIS.

D.2. Activities of Credit Information Bureau

5.67 The Credit Information Bureau (CIB) was set up in BB on 18 August 1992 with the objective of minimising the extent of potential default loans. The CIB has been providing its online services since 19 July 2011. The CIB online system is playing an important role to maintain a risk free lending procedure in banking industry. The system has gone through a major change over the past few years. With the adoption of highly sophisticated ICT facilities the performance of the CIB services has been improved significantly in terms of efficiency and quality. It has also appreciably reduced the time and physical movement for the banks/NBFIs in report generation process which ultimately leads the fast loan processing activity.

5.68 The CIB database consists of detailed credit information in respect of borrowers, owners and guarantors. CIB database covers the borrowers having outstanding amount of Taka 50000 & above. The total number of borrowers was 853,851 at the end of June 2014 recording an increase of 1.1 percent over the same month of the previous year. The classified borrowers in banks and NBFIs decreased by 2.4 percent during FY14 (end June 2014) over the previous year (end June 2013).