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The Banking Sector of Bangladesh: A General Discussion on Ten Years' Achievement.

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Abstract: *This paper examines the extent of achievements accomplished by the banking sector of Bangladesh during the past ten years (2003 onwards) in terms of profitability, earnings efficiency, cost efficiency etc. One important indicator of financial stability and soundness is the share of non-performing loans (NPL). In addition to these indicators, the paper adopts relevant indicators to estimate the overall soundness of the banking sector. The banking sector of Bangladesh has witnessed significant changes over the last decade, particularly in the areas of financial inclusion and e-banking. The study finds that, after deregulation and libaralisation the concentration has declined which resulted in enhancing competition. The share of private and foreign banks in banking asset, deposit and credit has gone up. The profitability of all groups of banks except DFIs recorded uptrend. However, foreign banks are outperforming all other banks in maintaining profitability. Diversification of banking operation has reduced the weight on the traditional sources of income of the banking sector, from reliance on interest income to emphasis on fee based income. The paper concludes that creating an enabling environment for a rational spread rate, introducing tailored products on both asset and liability front and ensuring proper management of NPLs alongwith accuracy in risk management devices may further improve the current financial stability of the banking system.*

JEL Classification: *E52, G21*

Keywords: *Banking sector, reforms, non-performing loans, profitability.*

1. Introduction

In economies where capital and debt markets are as yet undeveloped, the principal conduit for economy-wide investment and saving is the banking system. The efficiency of banks is an indicator of the efficiency of financial intermediation. A

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well-functioning banking system efficiently mobilizes resources and allocates capital for productive investment projects. Voluminous studies have established that financial instruments, markets, and institutions together lessen the effects of information problems on lending and transaction costs. Additionally, "information asymmetry" problem remains severe in developing economies and this information asymmetry problem reduces the depth of the capital market (Allen et al., 2000). Developing economies also suffer from a shortage of supporting institutions such as venture capitalists, security houses, rating companies, and asset management bodies which are in fact preconditions for accepting the Anglo-Saxon system (King & Levine, 1993; Rajan and Zingles, 1998).

Just after the liberation war, the whole banking system of Bangladesh (excepting 3 foreign banks with 14 branches) was restructured and nationalized. "The logic of bank nationalization lay in the need to build a democratic banking system built on principles of social justice. The system was designed to serve a much broader constituency of borrowers, small farmers, rural and small entrepreneurs, new medium sized entrepreneurs as well as the nationalized industries largely based on the major private industries abandoned by their non-Bangali owners" (Sobhan 2000)

The evolution of Bangladesh banking sector in the post liberation period till today can be divided into four distinct phases. The first phase[1] 1982-1989 initiated privatisation, which allowed banks to operate in a competitive environment. The second phase[2] of reforms was launched in 1990 and ended in 1995. This phase worked on imposing financial discipline in the shortrun and making the financial institutions operate increasingly on the basis of market forces and achieving operational efficiency and financial deepening in the long run. The third phase[3] during the

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[1] **Phase I: Ownership Reform:** Period 1982- 89. This phase was dedicated to Restructuring for denationalization of nationalized banks and allowing the operation of the private commercial banks with the purpose of bringing competition and operational efficiency of the banks.

[2] **Phase II:** Financial Sector Reform Project (FSRP 1990-95): The reform measures under this project were freedom in fixing deposit and lending rates and making them flexible according to market forces, strengthening of criteria/procedure for loan classification and provisioning, greater autonomy or self regulation by banks and non bank financial institutions, improvement of capital positions of NCBs and PCBs, replacement of refinance facilities with a single discount window, rationalization of branch network, strengthening of Bangladesh Bank's role in the field of supervision of banks, protection of banks from shouldering the cost of subsidized loan and transferring the cost to the government, adoption of indirect and market oriented monetary policy instruments, strengthening the operation of NCBs and PCBs ensuring enabling legal environment by enacting the Bank Companies Act, 1991, opening of current account, making taka convertible and computerization of bank etc. These reform measures aimed at imposing financial discipline in the shortrun and making the financial institutions operate increasingly on the basis of market forces and achieving operational efficiency and financial deepening in the long run (Choudhuri et al., 1995)

[3] **Phase III:** BRC/CBRP 1996-2002: The reform measures in this phase broadly included supervisory and regulatory restructuring, reforms of Bangladesh Bank, reforms of NCBs and restructuring the legal framework related to finance and banking.

period 1996-2002 covered supervisory and regulatory restructuring. Finally, in the 4th phase (2002 onward) the reform initiatives were made to improve legal aspects, corporate governance, corporatization of nationalised commercial banks (NCBs), risk management, financial inclusion, e-banking etc.

The various banking reform programmes resulted in significant improvements in quantitative as well as qualitative dimensions of Bangladesh financial system. A significant number of banks and other financial institutions with variegated types of financial instruments emerged. The institutional network and volume of operations of the financial system expanded and were diversified, with the number of scheduled banks going up from 11 in 1980 to 56 in 2013.

Underscoring the importance of the banking sector, several banking sector specific reforms as a part of financial reforms were introduced to improve the performance of the banking sector of Bangladesh and to make the banks more competent and efficient. Against this backdrop, the present paper intends to study the achievements accomplished by the banking sector of Bangladesh during the past ten years (2003 onwards) in terms of profitability, earnings efficiency, cost efficiency, etc. In addition to these indicators, the paper adopts relevant indicators to estimate the overall soundness of the banking sector. Keeping this background in mind, this paper aims at addressing the following research questions:

1. *To view different aspects of reforms undertaken in the 4th phase (2002 onwards) and*
2. *To find out the achievements of the reforms on the performance of banking sector of Bangladesh during the past ten years (2003 onwards).*

In order to answer these questions the study proceeds as follows. Section 2 describes research methodologies. Section 3 discusses reform measures undertaken in the 4th phase of reforms. Section 4 records past ten years' achievements of reforms. Section 5 concludes.

2. Research Methodology

The study uses secondary information. Publications of both printed and electronic sources of different banks, Bangladesh Bank, Ministry of Finance, different organs of the Govt., International agencies like IMF, World Bank, BIS, and Asian Development Bank have been used as data sources.

The achievements accomplished by the banking sector of Bangladesh during the past ten years (2003 onwards) in terms of profitability, earnings efficiency, cost efficiency, etc. have been assessed. In this regard, simple accounting techniques, descriptive statistics and relevant parametric tests have been used.

3. Reform measures undertaken in the 4th phase of reforms (2002 and beyond)

The 4th phase, which began at 2002, was a multifaceted one. In terms of several indicators like financial deepening, accounting and auditing standards, risk management, compliance of Basel II, e-banking, modernization and automation, The banking sector of Bangladesh is still lagging behind in comparison with many emerging economies. In a globalized and competitive environment, The banking sector of Bangladesh must follow more effectively the accepted international norms and standards. With these views in mind, the focus in the fourth phase (2000 and beyond) was on further strengthening the prudential norms in line with international best practices, improving credit delivery, strengthening corporate governance practices, promoting financial inclusion, rapid technology adoption and improving the customer service. The experience of banks facing asset-liability mismatches in the South East Asian countries during 1997 underlined the need for putting in place sound asset liability management (ALM) practices. The ALM framework was, therefore, complemented with guidelines on risk management. One of the significant achievements of this phase was the introduction of comprehensive policy framework of ownership and governance in private sector banks to ensure that (i) ultimate ownership and control was well diversified; (ii) directors and CEO and the important shareholders were ‘fit and proper’ and observed sound corporate governance principles; (iii) (iv) policy and processes were transparent and fair. The current phase also attempted to improve legal aspects, corporate governance, loan recovery, exchange and interest rates management, corporatization of nationalized commercial banks (NCBs), risk management and efficiency of the Bangladesh Bank with the objectives to strengthen the legal framework of the financial sector, bring dynamism therein, extend autonomy to the central bank, combat money-laundering offences and obtain decrees and executions against defaulters of loans. Better disclosure and transparency standards have been introduced; fit and proper tests have been prescribed for bank directors, chief executives and advisors; restrictions have been imposed on the composition of the membership of the board of directors; the roles and functions of the board and management were clarified and redefined. The capacities of the Bangladesh Bank (BB) to supervise and regulate banks effectively, monitor non-performing loans, and enforce actions against banks violating regulations and laws have been strengthened. Audit Committees were mandated for all banks with clear guidelines and terms of references (TOR) and Early Warning System (EWS) was introduced. To strengthen the banking operation, minimum capital requirement was raised from Tk. 400 million to Tk. 1000 million and the requirement on risk-weighted basis was also increased.

In order to reform and build up a banking system of international standard and to strengthen, fortify and reinforce the overall banking system of the country, following reform initiatives have been taken during the past ten years (See Box 1).

Box 1: Selected Current Reforms in the Banking Sector

- Central Bank Strengthening Project (CBSP) with the financial assistance of the International Development Agency (IDA).(Strengthening the Legal Framework, Reorganization and Modernization, Capacity Building)
- Formation of Audit Committee by individual banks to assist the Board in fulfilling its oversight responsibilities.
- Provision for appointing two independent directors representing the depositors' interest.
- Measures to strengthen risk management through recognition of different components of risk, assignment of risk-weights to various asset classes.
- Several provisions of the three important Acts relating to Banking, viz. the Bangladesh Bank Order, 1972, the Bank Company Act, 1991 and the Banks Nationalization Order, 1972 were amended during the period 2003-2013 with a view to further strengthening the activities of the banking sector, bringing dynamism and extending greater autonomy to the central bank.
- Enactment of the Artha Rin Adalat Ain 2003 to provide mainly for speedy procedures for obtaining decrees and execution. Provision was also made for Alternative Dispute Resolution to ensure early settlement of disputes through settlement conference and negotiations.
- Development of a basic risk management model for selected areas of banking operation.
- Promulgation of "Money Laundering Prevention Act, 2012 repealing Money Laundering Prevention Act, 2009 and Anti Terrorism (Amendment) Act, 2012".
- High priority is accorded to ensure Corporate Governance in Banks.
- Introduction to uniform account opening and KYC profile form for all banks. Besides, the National Payment System Council (NPSC) was reorganized to support the development of sound and efficient payment, clearing and settlement systems, and to serve as a forum for cooperation in domestic and international payment matters.
- Mapping of External Credit Assessment Institutions (ECAIs) rating with the Bangladesh Bank Rating Grade.
- Introduction of New Capital Accord (Basel II) and Risk Based Capital Adequacy (RBCA) for Banks, and preparation to introduce Basel III" .Now, Action plan for Implementation of Basel-III.
- Prudential Guidelines for Consumer Financing and Small Enterprise Financing were issued.
- Marking to Market Based Revaluation of Treasury Bills & Bonds Held by the Banks.
- Introduction of CAMELS supervisory rating system, move towards risk-based supervision, consolidated supervision of financial conglomerates, strengthening of off-site surveillance through control returns.
- Corporatization of nationalised commercial banks (NCBs)
- Stress Testing became mandatory for the Scheduled Banks.
- Single Borrower Exposure Limit.
- Introduction to Corporate Social Responsibility
- Safeguard Policy for the banks on capital market activities.
- Financial Inclusion.
- Green Banking- a new dimension.
- On-line CIB services.
- E-banking.
- Agent Banking Operation.
- Coordinated Supervision Framework.
- The Financial Projections Model (FPM)
- 'Interbank Transaction Matrix'(Liquidity Monitoring Tool)
- MOU was signed with SCBs & DFIs

Source: Banking Regulation & Policy Department, Department of Off-Site Supervision, Bangladesh Bank.

3.1. Strengthening the Regulatory Framework

Banks are exposed to unique risks and challenges. Therefore, the more immediate motivations for banking regulation are the protection of the depositors' interest and maintaining public confidence in the banking system. Banking regulations also aim at building efficiency and resilience of the banking system on the one hand and address the concerns that arise from the functioning of the financial system on the other. Contagion and systemic risk, moral hazard, too big to fail phenomenon, public bailouts of banks are some of the issues that came under sharp scrutiny following the global financial crisis that gyrated in 2008. As such banking regulation assumes critical significance to retain the resilience and soundness of the banking entities and the macro-prudential stability of the financial system as a whole and thereby also prevents volatility and disruptions in the real sector and the overall economy.

Banking regulation can take the form of formalized legislation and statutory provisions, regulatory directions and guidelines, moral suasion, etc. Evolutions in different stages in the banking sector in response to unfolding financial and banking crises influenced substantive regulatory reforms from time to time. As the effectiveness of traditional control based rules diminishes with increasing competition, liberalization, globalization and innovation, ongoing regulatory reform assumes great significance. The recent global financial crisis called for banking sector reforms through new regulatory measures to ensure safety and stability by drawing lessons from other countries. They ought to be consistent with the goals of capital deepening and financial inclusion to spur economic development.

In light of the above, several provisions of the three important Acts relating to banking, viz. the Bangladesh Bank Order 1972, the Bank Company Act 1991 and the Banks (Nationalization) Order 1972 were amended during 2002-2013 with a view to further strengthening the activities of the banking sector, bringing dynamism and extending greater autonomy to the central bank.

Besides, The Artha Rin Adalat Ain 2003 (Money Loan Court Act, 2003) was enacted in March 2003 with a view to streamlining the process of realization of overdue loans and advances by the banks and financial institutions. In order to strengthen the process of recovering defaulted loans, banks, under this Act are now empowered to sell the collaterals without prior approval of the court. Effective application of this Act has started yielding encouraging results.

In recognition of the fact that financial institutions may be particularly vulnerable to being used by money launderers, the Prevention of Money Laundering Act & Anti Terrorism Act, was enacted and amended during the period of 2002-2013. Bangladesh Bank as part of its supervisory process will assess the adequacy of procedures adopted to counter money laundering and the degree of compliance with such procedures.

3.2. Prudential Regulations

In order to reform and build up a banking system of international standards and to strengthen, fortify and reinforce the overall banking system of the country, several initiatives were taken in 2002 beyond.

3.2.1. Credit Ratings of the Banks: Earlier, it was made mandatory only for the banks to have themselves credit rated to raise capital from capital market through IPO. With a view to safeguarding the interest of the prospective investors, depositors and creditors and also the bank management as a whole for their overall performances it was made mandatory from January, 2007 for all banks to have themselves credit rated by a Credit Rating Agency. Banks will disclose their credit rating prominently in their published annual and half yearly financial statements.

3.2.2. Merger/Amalgamation of Banks/Financial Institutions: A detailed guideline for merger/amalgamation of banks and financial institutions has been issued by the Bangladesh Bank. Under the policies, a bank may be merged with another bank or a financial institution with other financial institutions/banks.

3.2.3. Issue and Purchase of Banking Instruments: Banks have been advised to introduce more effective, transparent and effective internal controlling system to ensure that proper banking norms are meticulously followed by the banks in course of banking transactions related to issues and purchases of the banking Instruments (pay order, TT, DD etc.).

3.2.4. Corporate Governance in Banks: 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 ensure corporate governance in banks, putting in place checks and balances comprising a mix of legal, regulatory and institutional provisions specifying the roles and accountabilities of the board, the executive management, external and internal audit, disclosure and transparency prescriptions.

Corporate governance is a sine-qua-non for a sound financial system in private commercial banks. 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 it is also necessary to protect depositors' interest. BB has taken several measures in recent times to put in place good corporate governance in banks. These include regulation limiting the tenure of directors not more than six years at a stretch; reduction in the size of bank boards to a maximum of thirteen directors; appointment of two independent directors by BB; fit and proper test for appointment of board members and 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.

3.2.5. Capital Adequacy for Banks

3.2.5.1. Implementation of Basel- II

In order to strengthen the capital base of banks as required by Basel-II accord, guidelines for risk-based capital adequacy for banks have been issued, and as per the guidelines, commercial banks will calculate their Minimum Capital Requirement (MCR) against Credit Risk, Market Risk and Operational Risk. Apart from these three risks, banks will determine their adequate capital against comprehensive risk under their Supervisory Review Process (SRP). In addition to guaranteeing adequate capital through SRP, necessary action has been taken to ensure public disclosure of information about banks' capital structure through market disclosure. In Bangladesh, full implementation of Basel II started from the beginning of 2010 (BB).

3.2.5.2. Stress Testing

Under the new Basel Accords on Banks' Capital Adequacy, the presence of sound stress testing methodologies is a prerequisite for the adoption of the advanced methods for the qualification of minimum capital requirements. In Bangladesh, as a part of pillar-2 adoption, all banks are doing this stress-testing and are reporting their results to Bangladesh Bank regularly. Stress test is a general term covering the techniques and methodologies which financial institutions can employ to measure their vulnerability or exposure to the impacts of exceptional, rare but potentially occurring events. Such events can be interest rate changes, exchange rate fluctuations, changes in credit rating, events which influence liquidity, etc. (BB).

3.2.5.3. Implementation of Basel Accord III

In response to the 2007-2009 global financial crises, the Basel Committee for Banking Supervision (BCBS) provides Basel III (A Global Regulatory Framework for More Resilient Banks and Banking Systems) with the goal of improving the banking sector's ability to absorb shocks arising from financial and economic stress. Basel III is expected to be implemented during 2013-2019 (BCBS, 2010). Basel III introduces several new or enhanced rules, including the introduction of a new and stricter definition of capital designed to increase quality, consistency and transparency of the capital base and the introduction of a global liquidity standard. Basel III also imposes a new leverage ratio, a supplement to the Basel II framework. Study (QIS) to assess the preparedness of banks for implementing Basel III in Bangladesh.

Following this framework, the Bangladesh Bank has conducted Quantitative Impact

Based on the findings of the last QIS, an Action Plan/Roadmap is finalized for implementing Basel III. Deadline for Basel III implementing process was July, 2014 and initiation of full implementation in January, 2019 (detailed action plan/roadmap is shown in Appendix -5). Under Basel III too in Bangladesh, the minimum capital requirement has been retained at 10% of Risk Weighted Assets as against Basel III requirement of 8%. Leverage Ratio requirement is proposed to be at par with Basel III proposal of 3%. In Bangladesh, the real sector is predominantly dependent on the banking sector for credit needs. Any disruption in provision of credit supply from banks may be catastrophic for the economy. In view of the foregoing, it is desirable to reduce the probability of bank failures by having additional capital. The Basel Committee for Banking Supervision (BCBS) provides flexibility to national regulators to prescribe higher minimum capital requirements. Several other jurisdictions (e.g., Singapore, China, South Africa, Brazil, Australia, etc.) have also prescribed higher capital requirements than 8% of the risk weighted assets. Bangladesh Bank had prescribed higher capital requirements even under Basle II.

However, capital ratio prescription at levels higher than the global standards and additional ‘buffer’ concept and leverage ratio prescriptions can have constraining effect on the supply of adequate credit from banks to the productive sectors which, in turn, can adversely impact growth to some extent raising questions of trade-off between growth and banking stability. Further, questions have been raised about requiring banks to mobilize additional capital, given the huge capital needs and a lackluster capital market. This compels to take a balanced view about continuing with the additional requirements to ensure banking resilience by having adequate cushion towards identified weaknesses and the practical difficulties the banks face.

3.2.6. Exposure norms

In Bangladesh, our efforts have been to harmonize our guidelines with the international best practices to conform to the same global prudential standards. Stricter group exposure limits would also leave surplus lendable resources with banks which may result in adverse selection. At the same time, high exposures to specific businesses or business groups impair stability and results in excessive concentration of credit. Thus, while we are aware of the need to reduce the group borrower limit, we have to take a considered view as to what extent and how smoothly this can be brought down going forward without adversely impacting the growth prospects of the economy. BCBS in the Standards published on Supervisory framework for measuring and controlling large exposures' (the BCBS Standards) in April 2014 stipulated that the sum of all the exposure values of a bank to a single counterparty or to a group of connected counterparties must, at all times, not be higher than 25% of the bank's available eligible capital base. As per the Standards, the eligible capital base is also revised to the effective amount of Tier 1 capital only.

3.2.6.1. Single borrower exposure

Individual loans amounting to 15 percent of a bank's capital and reserves is defined as a large loan for that particular bank. The total amount of large loans of a bank is to be kept within a limit prescribed by the central bank depending upon the percentage of the bank's net classified loans. A bank with 0-5 percent classified loans can lend up to 56 percent of total loans in the large loan category. Single borrower exposure has been restricted to 50 percent of bank's capital and reserves subject to a maximum funded loan of 15 percent of capital. Considering power sector development as a government priority, the present guidelines also allow banks to exceed the norm with respect to a single borrower and group borrower, for extension of credit to produce and distribute electricity against the award provided by the Electricity Department or the institutions controlled by the Electricity Department (BB).

3.2.7. Liquidity Standards

During the early "liquidity phase" of the financial crisis that began in 2007, globally many banks faced unprecedented difficulties despite adequate capital levels. The Basel Committee on Banking Supervision (BCBS) recognized that such difficulties were due to lapses in basic principles of liquidity risk management. In response, as the foundation of its liquidity framework, the BCBS in 2008 published Principles for Sound Liquidity Risk Management and Supervision ("Sound Principles"), which provide detailed guidance on the risk management and supervision of funding liquidity risk. To complement these principles, the BCBS further strengthened its liquidity framework by developing two minimum standards for funding liquidity, viz., the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) to achieve two separate but complementary objectives. While the LCR's objective is to promote short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high-quality liquid assets to survive a significant stress scenario lasting for one month, the NSFR is aimed at promoting resilience over a relatively longer time horizon (one year) by creating additional incentives for banks to fund their activities with more stable sources of funding on an ongoing basis.

3.2.7.1. Treatment of the SLR holdings

Following the issue of final standards by BCBS, the BB in its phase-in arrangements for implementing Basel III proposed 'Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards. The balance sheets of our banks have adequate liquid assets due to the CRR and SLR requirements of 6% and 19%, respectively.

The Statutory Liquidity Ratio (SLR) for the scheduled banks, except banks operating under the Islamic Shariah and the specialized banks, is 19% of their demand and time liabilities, excluding interbank items since December 15, 2010 The SLR for the Islamic banks is 11.5%. The specialized banks excepting erstwhile BASIC bank are exempted from maintaining SLR. The Cash Reserve Requirement (CRR) for the scheduled banks with the Bangladesh Bank is 6.5% of their total demand and time liabilities. It may be noted that banks are required to maintain CRR daily at the rate of 6% on average on bi-weekly basis provided that the CRR would not be less than 5.5% in any day with effect from December 15, 2010 (BB).

3.2.8. Countercyclical Capital Buffer

In the aftermath of the financial crisis in 2008, BCBS *published Guidance for national authorities operating countercyclical capital buffer* (CCCB) to propose a framework for dampening excess cyclicality of minimum regulatory capital requirements with the aim of maintaining the flow of credit from banks to the real sector in economic downturns with the capital accumulated in good times. Moreover, in good times, while the banks will be required to shore up capital, they may be restrained from extending indiscriminate credit. In Bangladesh context, its implementation may have to be well calibrated by recognizing structural changes in the banking system due to financial deepening and the need for separating the structural factors from cyclical factors. Accordingly, it has been envisaged that while the credit-to-GDP gap shall be used for empirical analysis to facilitate CCCB decision, other indicators like Gross Non-Performing Assets' (GNPA) growth, Industrial Outlook Survey, Credit to Deposit Ratio, etc., will also be considered in Bangladesh. CCCB regime will be effective from January, 2016.

3.2.9. Accounting Norms and International Financial Reporting Standards (IFRS) implementation

The bank companies required to disclose more information in their financial statements as per the International Accounting Standards (IAS) from 2003. It is aimed at providing investors, depositors and other stakeholders with transparent and adequate information about the bank, especially the capital deficit/surplus, steps for recovery of defaulted loans, written off loans, contingent liabilities, etc. Financial statements shall have to be published in the national dailies and disclosed on the banks' websites.

At their summit in London in 2009, the G- 20 leaders called on “the accounting standard setters to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards”. The International Accounting Standards Board (IASB) has now replaced IAS 39 with IFRS 9 with a view to reducing complexity and improving convergence. In order to address implementation issues and facilitate a smoother transition, the BB has set up a Working Group comprising professionals with experience in IFRS implementation, bankers and BB staff engaged in regulation and supervision.

3.2.10. Know Your Customer (KYC), Anti Money Laundering (AML) and Combating Financing of Terrorism (CFT) Standards

The international standards for KYC/AML/ CFT are set by the Financial Action Task Force (FATF) and the Bangladesh Bank issues KYC/AML/CFT guidelines mainly on the lines of FATF recommendations. However, irrespective of the FATF recommendations covering many areas, the Bangladesh Bank issues instructions to banks only if there are enabling provisions in Prevention of Money Laundering Act. Thus, for example, Recommendation 17 of FATF provides for third party verification of KYC, subject to certain conditions.

3.2.11. Corporate Social Responsibility

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. All banks had undertaken CSR practices which focused on i) financial inclusion of less privileged population segments and underserved economic sectors; ii) emergency relief in humanitarian distresses; iii) promotion of health, education and cultural/recreational activities for advancement and well-being of underprivileged population segments; iv) promotion of environmentally-friendly projects; and v) adoption of energy efficient, carbon footprint-reducing internal processes and practices in own offices and establishments.

Besides CSR initiatives involving direct expenditure, all banks participated actively in promoting SMEs and agricultural financing. PCBs were particularly active in these areas. Banks proceeded ahead on multiple fronts including the presence of increased rural bank branches for broader, deeper financial inclusion, mobile phone banking, and opening of bank accounts with Taka 10 as initial deposit for farmers/poor/ultra poor and thereby increasing transactions in these bank accounts. BB also directed the banks to include their CSR activities in their Annual Report as a part of fair disclosures. (BB Annual Report-13)

3.2.12. Deposit Insurance Scheme

The Deposit Insurance Scheme (DIS) is designed to minimize or eliminate the risk of loss of funds that the depositors may incur by placing funds with a bank that subsequently fails. 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. In Bangladesh, DIS was first introduced in August 1984, in terms of "The Bank Deposit Insurance Ordinance 1984". In July 2000, the ordinance was repealed by an Act of parliament called "The Bank Deposit Insurance Act 2000". DIS in Bangladesh is now being administered by the said Act. In accordance with the Act, Bangladesh Bank (BB) is authorized to administer a fund called the Deposit Insurance Trust Fund (DITF). 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).

In accordance with "The Bank Deposit Insurance Act 2000," the main functions of DITF are: 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. In case of winding up of an insured bank, as per the said Act, BB will pay to every depositor of that bank an amount equal to his/her deposits not exceeding Taka one hundred thousand. 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, effective from January-June, 2013. Along with the scheduled banks, BB has also taken the initiative to bring the FIs under the umbrella of DIS, an initiative which is now under the consideration of the MOF. The effectiveness of DIS in reducing systematic risk would surely increase if the public became 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 (BB Annual Report-13).

3.2.13. Managing Core Risk in Banking

Deregulated regimes along with globalization of business have opened new frontiers that have made risk management an even greater priority. Therefore, managing these risks must be one of the fundamental concerns of the management and the boards of the Banks. This is an attempt of the Bangladesh Bank for risk management.

A concept paper was prepared for the project which identified five core risks areas of banking. The concept paper outlines the various steps/ processes to bring it to successful conclusion. These core risks are:

- Credit risks
- Asset and liability/ Balance sheet Risks
- Foreign Exchange Risks
- Internal control and compliance Risks
- Money Laundering Risks.

3.2.14. Prudential Guidelines for Consumer Financing and Small Enterprise Financing

With a view to facilitating more credit towards consumers and better customer service a guideline named "Prudential Guidelines for Consumer Financing" was issued in 2006. Since small and medium industries can make important contributions to growth, employment and poverty alleviation, for establishing such type of industries, a guideline named "Prudential Guidelines for Small Enterprise Financing" was also issued by the Bangladesh Bank in the reporting year. To encourage (i) Housing Finance and (ii) Loans for Professionals to set up business, provisioning for these two sub-sectors under Consumer Financing was lowered from 5 percent to 2 percent in 2006. And in case of Small Enterprise Financing also, banks were advised to maintain 2 percent general provision instead of 5 percent against unclassified loan amount.

3.2.15. Marking to Market Based Revaluation of Treasury Bills & Bonds Held by the Banks

With a view to widening the application of fair value accounting of Government Securities and encourage secondary trading of these securities after issuance, some changes were made in the note no. 4 (kha) of the first schedule of section 38 of the Bank Companies Act, 1991. As per the instructions stipulated, the securities held for the fulfillment of Statutory Liquidity Requirement (SLR) by a banking company, would be treated as Held to Maturity (HTM). The gain/loss due to the revaluation would be taken to Capital Account and disclosed in the 'Statement of Changes in Capital'. And Government treasury bills and bonds held in excess of SLR would be treated as Held for Trading (HFT). The portion of securities Held for Trading should be revaluated at least on weekly basis based on marking to market or at current market prices.

The banking company would show the gain/loss due to this revaluation in the Profit and Loss Account of the concerned period. The weekly revaluation based on marking to market for the portion of securities held for trading by the banks was made compulsory since 1 February, 2006.

3.2.16. Financial Inclusion

Financial Inclusion is defined as the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low-income groups in particular at an affordable cost in a fair and transparent manner by mainstream institutional players.

Financial Inclusion is at the centre stage of international policy discourse under the G-20 umbrella. More than fifty countries have set formal targets and goals of Financial Inclusion.

Bangladesh has accorded high priority to Financial Inclusion. Furthering the pace of financial inclusion is a mission through a combination of strategies ranging from relaxation of regulatory guidelines, provision of new products and supportive measures to achieve sustainable and scalable financial inclusion.

Although financial services are available to poor people, they are compelled to pay four times the price usually paid for them because they are not linked to formal financial system and have to rely on unreliable informal sector providers. Bangla-deshBank has since the last decade addressed these asymmetries through macro policy interventions:

3.2.16.1. Opening of Account by Depositing Tk. 10-50. Bank account can be opened by depositing Tk. 10/ to Tk.50/ by farmers, unemployed youth, hardcore poor, physically handicapped people, Freedom Fighters, beneficiaries under Social Security Program, and distressed people, etc.

3.2.16.2. School banking

To build the habit of saving among the youngsters, the Bangladesh Bank (BB) introduced the 'school banking' program for financial inclusion in November, 2010 and issued a guideline in 2013 to provide students with necessary banking services.

3.2.16.3 Mobile banking facilitates

Bangladesh has been gradually moving towards branchless banking, referred to as 'mobile financial services' (MFS), which, since 2011, has been providing easy access to formal financial services.

3.2.16.4. Relaxed Know Your Customer (KYC) requirements

To facilitate easy access to bank accounts, Know Your Customer (KYC) requirements have been simplified to such an extent that small accounts can be opened with self-certification in the presence of bank officials.

3.2.16.5. Agent Banking

Agent Banking Guidelines have been framed by the Bangladesh Bank to permit banks to be engaged in agent banking.

Agent banking means providing limited scale banking and financial services to the underserved population through engaged agents under a valid agency agreement, rather than a teller/ cashier. It is the owner of an outlet that conducts banking transactions on behalf of a bank. Globally, these retailers are being increasingly utilized as important distribution channels for financial inclusion. The Bangladesh Bank has also decided to promote this complementary channel to reach the poor segment of the society as well as existing bank customer with a range of financial services specially to geographically dispersed locations. Banks will accord much emphasis on the rural area to cover a lion share of the target group. At the same time, they will not ignore the rest of the target group by limiting concentrating on the urban area. Thus, the opening of outlets by agent banking in service areas has to be designed by the following criteria:

The ratio of the number of sub-agents/outlets of a bank will be 2:1 for rural and urban areas. This means a bank must have at least 2 rural agent banking outlets to have 1 urban agent banking outlet.

3.2.16.6. Financial inclusion plan and its performance evaluation

A large number of small bank accounts have been opened (Table-1). However, it has been observed that the accounts opened have not seen substantial operations in terms of transactions. In order to continue with the process of ensuring meaningful access to banking services to the excluded, the focus should now be more on the volume of transactions in the large number of accounts opened. A brief of the performance of banks under FIP up to December-2013 appears in Table 1.

Table-1: Financial Inclusion plan and its performance evaluation. (up to December-2013)

Name of the Account	Total No.of A/Cs	Amount
a) Bank Account for Farmers (with initial deposit of Tk.10/- at any SCBS & SPBS)	96,75,313	
b) Bank account for Beneficiaries under social security program (with initial deposit of Tk.10/- at any SCBS & SPBS)	30,07,346	
c) Bank account for Freedom fighter's (with initial deposit of Tk.10/- at any SCBS & SPBS)	1,38,998	
d) Bank account for small life insurance policy holders (with initial deposit of Tk.10/- at any SCBS & SPBS)	12,945	
e) Bank account for hardcore poor women, labor & Aila affected people (with initial deposit of Tk.10/- at any SCBS & SPBS)	10,10,532	
Total:	1,38,45,134 A/Cs	
f) School Banking (46 banks already initiated school banking program)	2,86,544	Deposit balance: 304.65 core
g) Mobile Financial Service (No. of Banks permitted-28)	(1).Registered Customers:1,31,80,000 (2). Agent: 1,88,647	Transaction: 6.64 Billion Taka
h) Green Banking a new dimension (26 Banks & NBFIS participation contact with BB)	Refinance Scheme	Refinance Facility: 74.83 core

Source: i) Economic Review, Chapter-5, MOF-2014. ii) Bangladesh Bank [Compilation]

3.2.16.7. Financial Literacy

Financial Literacy is an important adjunct for promoting financial inclusion, consumer protection and ultimately financial stability. In this direction, the Bangladesh Bank has initiated 'Financial Literacy Project' with the help of 'Department for International Development (DFID)'of UK to elevate financial literacy through awareness drives to make people understand the benefits of linking with the formal banking system.

3.2.17. Technological Advancement

Technology has brought a complete paradigm shift in the functioning of banks and delivery of banking services. Over the last three decades, the role of banking in the process of financial intermediation has been undergoing a profound transformation owing to changes in the global financial system. The banking system of Bangladesh has seen some major financial innovations in the past decade as well as steps to promote financial inclusion. The various innovations in banking sector are Automated Clearing House System (ACHS), Electronic Fund Transfer (EFT), Real Time Gross Settlement (RTGS) for ensuring the fastest payment and settlement system, On-line, SWIFT, ATM and POST Network, Online CIB, Call Center, Retail Banking, Debit & Credit Cards, payments of utility bills, fund transfers, internet banking, telephone banking, mobile banking, introducing MICR cheques, traveler's cheques and many more value-added services. The major impetus for financial innovation has been globalization of financial systems, deregulation, and great advances in technologies. In increasingly integrated financial systems facing higher volatilities, more competition and wide varieties of risks, financial innovation has become an essence to provide new products and strategies to better suit different circumstances of time and market and to meet different requirements of participants in financial system. Banks boost technology investment spending strongly to address revenue, cost and competitiveness concerns.

3.2.17.1. Guideline on ICT for Scheduled Banks

In recent years, the banking industry has undergone massive changes in providing service to their customers by using information technology. So, it is important to ensure security in IT setup as well as in IT operations, and banks must take adequate measures to prevent the information from unauthorized access, modification, disclosure and destruction so that customers' interest is fully protected. To address this sensitive issue, the Bangladesh Bank issued guidelines for banks for establishing an effective IT security framework. Banks are had been advised to follow the Guideline in their IT area and implement all the security standards by 15th May, 2006.

Besides, the Bangladesh Bank introduced the Integrated Supervision System (ISS) through launching software in October 2013, aiming to facilitate quicker financial analysis of all aspects of banking activity, but especially to lower the risk of fraud and forgery in the country's banking sector.

3.2.18. Other Developments in the Financial System during 2013

The following initiatives were taken in the financial system of Bangladesh during 2013:

3.2.18.1. Coordinated Supervision Framework

The Bangladesh Bank took an initiative to develop a 'Coordinated Supervision Framework' for maintaining financial stability, considering the individual roles of regulators without creating any conflicts over polices adopted by the individual regulators . A high-powered coordination council was formed under a memorandum of understanding (MOU) with the institutions mandated for financial sector regulation in Bangladesh in 2012, under the stewardship of the Governor of the Bangladesh Bank. In this regard, a working committee, comprising the officials from Bangladesh Bank, Bangladesh Securities and Exchange Commission, Insurance Development and Regulatory Authority, Microcredit Regulatory Authority and Registrar of Joint Stock Companies and Firms, was formed. The working committee was obliged to finalize a concept paper with the approval of the coordination council by 2014 and subsequent consideration of the Ministry of Finance for adoption of the framework by the financial system. Officials of the aforementioned regulatory bodies would be members of the coordination committee and a fresh memorandum of understanding on formation of the committee would be signed by the five regulators (Financial Stability Report 2013, BB).

3.2.18.2. Financial Projections Model

The Financial Projections Model (FPM) is a multi-purpose analytical tool which has been developed in collaboration with the World Bank and is directed to the banks to identify potential/contingent risks inherent in the financial system as well as to ensure the soundness of the entire system.

The FPM is fully customized to reflect the existing prudential, regulatory and accounting practices in the financial sector of Bangladesh. It is, therefore, ready for integration into the supervisory process of the Bangladesh Bank as a tool and was introduced in the banking system from early 2014 to: (i) assess the strengths and weaknesses of individual banks in the system based on hypothetical scenarios; (ii) perform comprehensive scenario analyses to identify risks; and (iii) improve BB's risk assessment capacity for individual banks. (Financial Stability Report 2013, BB)

3.2.18.3. Interbank Transaction Matrix

With a view to assessing the risk arising from the liquidity interdependence and placements among the institutions in the banking system, the Bangladesh Bank introduced a liquidity monitoring tool known as the 'Interbank Transaction Matrix' covering all the banks and NBFIs. It is helping to analyze and review the interbank transactions regularly to detect the risks arising from the interconnectedness among banks and non-bank financial institutions. Identifying highly interconnected institutions has since become one of the key objectives of systemic risk assessment and a necessary prerequisite for developing a well-organized macro prudential supervision framework.

This matrix, indeed, will help in finding such institutions and give early warning signals for safeguarding the financial institutions as well as the system from liquidity stresses arising from other financial institutions and the interbank market, by applying techniques from network economics. The ultimate goal of this matrix is to focus on the liquidity management of the whole banking sector. Thus, this matrix will help the Bangladesh Bank to focus its liquidity monitoring attention on both the individual financial institutions and the system as a whole towards establishing a more stable and resilient financial system in Bangladesh. (Financial Stability Report 2013, BB)

4. Ten Years' Achievements of Reforms

4.1 Banking Sector Performance

The banking sector of Bangladesh comprises four categories of scheduled banks. Table-2 shows that as of 2013 (June) there were 4 (four) state-owned commercial banks (SCBs), 4 (four) state-owned development financial institutions (DFIs), 38 (thirty eight) private commercial banks (PCBs) and 9 (nine) foreign commercial banks (FCBs). (Group wise Banks and Bank Branches Expansion over the period 2003-2013 can be seen in table-2).The number of banks remained unchanged at 47 during the period from 2010-2012. At the end- June 2013, the total number of banks increased to 55 due to opening of new PCBs during the year. The number of bank branches increased from 6253 to 8427 during the period from 2003- 2013 mainly owing to opening of new branches by the PCBs during the year.

4.1.1. Banking system structure

The structure of the banking sector with breakdown by type of banks is shown in table-2 .In 2013, the SCBs held 26.75 percent of the total industry assets as against 41.7 percent in 2003. PCBs' remarkably share rose to 61.49 percent in 2013 as against 40.8 percent in 2003. The FCBs held 6.13 percent of the industry assets in 2013, which was 7.3 percent in2003. The DFIs' share of assets declined from 10.2 percent to 5.63 percent during the stated period.

Total deposits of the banks in 2013 rose to Taka 5692.84 billion from Taka 1140.3 billion in 2003. The SCBs' (comprising the largest 4 banks) share in deposits declined from 46.0 percent in 2003 to 26.75 percent in 2013. On the other hand, PCBs' deposits sharply increased in 2013 amounted to Taka 3551.17 billion or 62.38 percent of the total industry deposit against Taka 468.2 billion or 41.1 percent in 2003. FCBs' deposits in 2013 rose to Taka 316.95 billion or 5.57 percent of the total industry deposit against Taka 84.5billion or 7.4 percent in 2003. The

DFIs' deposits in 2013 were Taka 301.84 billion or 5.30 percent of the total industry deposit against Taka 62.6 billion or 5.5 percent of the total industry deposit in 2003.

The sector-wise classification of advances over the years 2003-2013 is shown in Appendix-1. As observed, advances by the private banking sector increased over the years. The public/private ratio over the years revealed a declining trend, which indicates positive development in the private banking sector.

Table-2: Movement of Banking Variables: Branch Expansion, Asset Position and Deposit Mobilization

(Billion Taka)

Bank types	2003						2004					
	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits
SCBs	4	3397	631.6	41.7	525.0	46.0	4	3388	683.7	39.6	567.5	42.8
DFIs	5	1314	154.5	10.2	62.6	5.5	5	1328	167.9	9.7	75.1	5.7
PCBs	30	1510	617.8	40.8	468.2	41.1	30	1550	749.3	43.5	588.0	44.3
FCBs	10	32	110.1	7.3	84.5	7.4	10	37	124.6	7.2	95.5	7.2
Total	**49**	**6253**	**1514.0**	**100.0**	**1140.3**	**100.0**	**49**	**6303**	**1725.5**	**100.0**	**1326.1**	**100.0**

Contd. Table-2

Bank types	2005						2006					
	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits
SCBs	4	3386	763.1	37.4	621.3	40.0	4	3384	786.7	32.7	654.1	35.2
DFIs	5	1340	197.2	9.7	89.5	5.8	5	1354	187.2	7.8	100.2	5.4
PCBs	30	1635	934.3	45.6	731.3	47.0	30	1776	1147.8	47.7	955.5	51.3
FCBs	09	41	148.2	7.3	112.6	7.2	09	48	284.9	11.8	150.87	8.1
Total	**48**	**6402**	**204.28**	**100.0**	**1554.7**	**100.0**	**48**	**6562**	**2406.7**	**100.0**	**1860.6**	**100.0**

Contd. Table-2

Bank types	2007						2008					
	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits
SCBs	4	3383	917.9	33.1	699.7	32.6	4	3386	1030.9	31.1	758.8	29.6
DFIs	5	1359	201.7	7.3	115.6	5.4	5	1362	222.3	6.7	137.8	5.4
PCBs	30	1922	1426.6	51.4	1150.2	53.5	30	2082	1794.5	54.2	1450.7	56.6
FCBs	09	53	227.7	8.2	183.4	8.5	09	56	265.8	8.0	214.1	8.4
Total	**48**	**6717**	**2773.9**	**100.0**	**2148.9**	**100.0**	**48**	**6886**	**3313.5**	**100.0**	**2561.4**	**100.0**

Contd. Table-2

Bank types	2009						2010					
	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits
SCBs	4	3387	1135.6	28.6	869.1	28.6	4	3404	1384.3	28.5	1044.9	28.1
DFIs	5	1365	261.69	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	2810	2854.6	58.8	2266.5	60.9
FCBs	09	58	292.6	7.4	215.0	7.0	09	62	320.8	6.6	227.1	6.1
Total	**48**	**7095**	**3965.8**	**100.0**	**3037.6**	**100.0**	**47**	**7658**	**4855.1**	**100**	**3721.9**	**100**

Contd. Table-2

Bank types	2011						2012					
	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits
SCBs	4	3437	1629.2	27.8	1235.6	27.4	4	3478	1831.9	26.0	1377.9	25.5
DFIs	4	1406	328.8	5.6	214.4	4.8	4	1440	385.5	5.5	260.4	4.8
PCBs	30	3055	3524.2	60.0	2787.5	61.8	30	3339	4371.5	62.2	3430.7	63.6
FCBs	9	63	385.4	6.6	272.2	6.0	9	65	441.8	6.3	327.0	6.1
Total	**47**	**7961**	**5867.6**	**100**	**4509.7**	**100**	**47**	**8322**	**7030.7**	**100**	**5396.0**	**100**

Contd. Table-2

Bank types	2013 (June)					
	No. of banks	No. of branches	Total Assets	% of industry assets	Deposits	% of Deposits
SCBs	4	3499	2013.15	26.75	1522.88	26.75
DFIs	4	1476	424.02	5.63	301.84	5.30
PCBs	38	3386	4628.21	61.49	3551.17	62.38
FCBs	9	66	461.26	6.13	316.95	5.57
Total	**55**	**8427**	**7526.51**	**100**	**5692.84**	**100**

Source: Compiled from various issues of Bangladesh Bank Annual Report of different years

The number of branches and outstanding deposits and advances in the banking system classified by rural and urban areas are showr in Appendix-2. In 2003, the number of rural branches was 3694 (59.38 percent of total branches), which increased to 4827 (57.3 percent of total branches) at end of June, 2013. The number of branches in urban areas increased from 2526 (40.61 percent of total branches) as of 2003 to 3600 (42.7 percent of total branches) at end- June 2013. 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 1030.9 billion (17.76 percent of total deposits) at end- June 2013. The amount of advances in rural areas increased from Taka 102.5 billion as of end June 2003 to Taka 434.3 billion at end- June 2013. However, the share of rural advances decreased to 10.2 percent as of end- June 2013 from 17.76 percent of the same period in 2003. The amount of urban advances increased from Taka 744.8 billion (87.90 percent of total advances) at end June 2003 to Taka 3813.8 billion (89.8 percent of total advances) as on 30th June, 2013.

4.2. Earnings and Profitability

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). Return on Assets (ROA) indicates the productivity of the assets i.e. how much income is earned from per unit of assets. According to Basel-__ accord, ROA should be more than 1 percent. On the other hand, Return on Equity (ROE) is another important measure of earning and profitability determination which indicates net income after tax to total equity.

Table-3 shows ROA and ROE by types of banks the aggregate position of these two indicators for all banks. SCBs have achieved negative and nearly zero percent of return on assets (ROA) over the period of 2004 to 2007. In case of the DFIs, the ROA were even worse (negative) over the period of 2003 to 2008. PCBs had an inconsistent trend but satisfactory and FCBs' return on assets ratio has been consistently strong during the last 10 years. In 2010, overall ROA in the banking sector peaked at 1.8 percent whereas it was 0.6 percent in 2013.

Similar trends are observed in ROE during the same period. Overall ROE in banking sector was 21.7 percent in 2009, which reduced to 8.2 percent in 2012 and 2013. Fall in ROE ratio in the banking sector indicates that profits of shareholders declined gradually. SCBs return on equity was 3.0 percent in 2003, but it suddenly spiked to 22.5 percent and 26.2 percent in 2008 and 2009, respectively. In case of DFIs, the ROE position remained worse (-171.7 percent) in 2009 due to huge losses. Difference of ROE between PCBs and FCBs reduced substantially since 2005, but, again, it increased since 2012. The ROE of PCBs and FCBs were strong (21.0 percent & 22.4 percent, respectively) in 2009.This tendency signals growing competition between FCBs and PCBs. Past superior performance of foreign banks might be due to their technological advantage and product differentiation capabilities, though it might have subdued to some extent in the local private banks in recent years.

Table- 3: Profitability Ratios by Type of Banks

(In Percent)

Type of Banks	**Return on Assets (ROA)**						**Return on Equity (ROE)**					
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
SCBs	0.08	-0.14	-0.10	0.00	0.00	0.7	3.00	-5.75	-6.90	0.00	0.00	22.5
DFIs	-0.04	-0.13	-0.13	-0.2	-0.3	-0.6	-0.61	-2.14	-2.14	-2.00	-3.4	-6.9
PCBs	0.69	1.24	1.06	1.1	1.3	1.4	11.37	19.53	18.10	15.2	16.7	16.4
FCBs	2.55	3.15	3.09	2.2	3.1	2.9	20.39	22.47	18.40	21.5	20.4	17.8
All Banks	**0.49**	**0.69**	**0.60**	**0.8**	**0.9**	**1.2**	**9.75**	**12.97**	**12.40**	**14.1**	**13.8**	**15.60**

Contd. Table-3

Type of Banks	Return on Assets (ROA)					Return on Equity (ROE)				
	2009	2010	2011	2012	2013 June	2009	2010	2011	2012	2013 June
SCBs	1.0	1.1	1.3	-0.6	0.6	26.2	18.4	19.7	-11.9	11.7
DFIs	0.4	0.2	0.1	0.1	-0.5	-171.7	-3.2	-0.9	-1.1	-28.9
PCBs	1.6	2.1	1.6	0.9	0.4	21.0	20.9	15.7	10.2	5.5
FCBs	3.2	2.9	3.2	3.3	3.4	22.4	17.0	16.6	17.3	19.7
All Banks	**1.4**	**1.8**	**1.5**	**0.6**	**0.6**	**21.7**	**21.0**	**17.0**	**8.2**	**8.2**

Source: Bangladesh Bank Quarterly, Annual Reports of different years.

4.2.2. Interest Rate Spread

It is to mention here, the government liberalized interest rate fully in 1999 to make the banking system market-driven and competitive. In such a market-driven system, one of the important indicators of competitiveness in the financial markets is the interest rate spread (the difference between lending and deposit rates). The higher the level of competitiveness, the lower the interest rate spread. However, in the wake of the deregulation of interest rates it has been observed that the spread has increased over the years in Bangladesh — the spread in the banking sector decreased from 6.49% in 2002-2003 to 5.31% in 2013-2014 (Appendix-3.). In 2013-14, the spread declined to 5.31%, but in terms of competitiveness, this remained very high for the banking system. In other words, the high nominal spread indicates that previous reforms are yet to bring about the expected degree of competitiveness in the banking system, rather, market distortions have increased. Arguably, the presence of higher NPLs is one of the factors responsible for those market distortions, but government-led distortions (for example, high interest rates on government savings certificates) and misconceived price strategies of the bank management are also responsible for these unusually high spreads. Fortunately, the real interest spread was found negative in most of the years during the period of 2002-03 to 2013-14, indicating that the financial liberalization policies provided incentives for banks to expand their bank branches as well as financial intermediation.

4.2.3: Net Interest Income

Table-4. shows that aggregate net interest income (NII) of the banking sector has been positive and consistently increased from Taka 16.6 billion in 2003 to Taka 153.8 billion in 2012. However, the NII of the SCBs was negative in the amount of Taka 1.1 billion in 2004 and had turned positive in the amount of Taka 7.7 billion in 2005. In 2009, the NII of SCBs was Taka 34.3 billion and, again, it slid into negative territory in June, 2013. The DFIs had a positive trend since 2003 and it was Taka 2.7 billion in June2013. Since 2005, SCBs have been able to increase their net interest income (NII) by reducing their cost of fund. The NII of the PCBs has shown positive trend since 2003 and incredibly high trends over the period from 2005 through 2012. The trend of NII indicates that the PCBs and the FCBs are charging higher lending rates in contrast to deposit rates.

Table-4: Net interest income by type of banks

(Billion Taka)

Bank types	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 June
SCBs	-0.3	-1.1	7.7	9.0	7.4	7.9	12.1	19.8	34.3	14.9	-0.03
DFIs	1.3	1.8	1.0	1.7	1.4	1.9	1.9	6.2	4.9	4.7	2.7
PCBs	12.0	13.7	21.0	25.4	36.1	48.5	56.7	82.8	91.4	114.7	53.7
FCBs	3.6	4.2	5.6	8.2	69.9	12.6	10.7	13.0	16.1	19.6	8.0
Total	**16.6**	**18.3**	**35.3**	**44.3**	**54.8**	**70.9**	**81.5**	**121.9**	**146.7**	**153.8**	**64.4**

Source: Bangladesh Bank Quarterly, & Annual Reports of different years.

4.2.4 Liquidity

Table-5. shows that the FCBs are having the highest liquidity ratios followed by the SCBs. This situation of constant surplus of liquidity warrants creation of effective demand for credit at lower costs. Lastly, all banks have maintained a sufficient liquidity position in terms of cash and balances with the BB in conjunction with investment in government securities. They thus suggest that banks, in general, are poised to cope with unforeseen adverse circumstances at least in the near term.

Table-4.2.4: Liquidity ratio by type of banks

(In Percent)

	Liquid assets						**Excess Liquidity**					
Bank types	2003	2004	2005	2006	2007	2008	2003	2004	2005	2006	2007	2008
SCBs	24.4	22.8	20.0	20.1	24.9	32.69	8.4	5.8	2.0	2.1	5.9	14.9
DFIs	12.0	11.2	11.2	11.9	14.2	13.7	5.8	4.7	6.2	3.8	5.5	4.9
PCBs	24.4	23.1	21.0	21.4	22.2	20.7	9.8	8.8	5.1	5.8	5.4	4.7
FCBs	37.5	37.8	41.5	34.4	29.2	31.3	21.9	21.9	23.5	16.4	11.2	13.3
Total	**24.7**	**23.4**	**21.7**	**21.5**	**23.2**	**24.8**	**9.9**	**8.7**	**5.3**	**5.1**	**8.9**	**8.4**

Contd. Table-5

	Liquid assets					**Excess Liquidity**				
Bank types	2009	2010	2011	2012	2013 June	2009	2010	2011	2012	2013 June
SCBs	25.1	27.2	31.3	29.2	37.9	17.5	8.2	12.3	10.2	18.9
DFIs	9.6	21.3	6.9	11.5	16.4	7.1	2.3	1.3	1.4	5.7
PCBs	18.2	21.5	23.5	26.3	27.4	5.3	4.6	6.6	9.5	10.6
FCBs	31.8	32.1	34.1	37.5	43.5	21.8	13.2	15.3	18.7	24.7
Total	**20.6**	**23.0**	**25.4**	**27.1**	**30.5**	**9.0**	**6.0**	**8.4**	**9.9**	**13.3**

Source: Bangladesh Bank Annual Reports of different years.

4.2.4.1. Advance to deposit Ratio

ADR is one of the useful indicators of adequacy of a bank's liquidity. BB is currently measuring the advance to deposit ratio (ADR) as a gross measure to calculate the liquidity condition prevailing in the economy. There is no international guideline regarding the benchmark of ADR or upper limit on ADR. Banks were instructed in February, 2011 to cut down their ADR within a prescribed level (for conventional banks it is up to 85 percent and for Shari'ah banks it is up to 90 percent) by June, 2011.

The ADR of banking industry from the beginning of 2012 started declining from 80.0 percent in January, 2012 to 71.2 percent in December, 2013 (Appendix-4). This decline of ADR was attributable to higher growth in deposits than growth in credit in 2013. Banking sector deposit and credit growths was 16.26 percent and 7.41 percent, respectively, in 2013 (Financial Stability Report, BB).

4.3: Management Soundness

Since indicators of management quality are primarily specific to individual institutions, 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.

It transpires from Table-6 that expenditure-income (EI) ratio of the DFIs was very high with 112.1 percent in 2009. This was mainly because of huge operating loss incurred by DFIs. The position however improved after 2009 and the ratio came down to 87.8 percent and 88.6 percent in 2010 and 2011, respectively. However, it rose again to 107.6 percent in 2013. The EI ratio of the SCBs exceeded 102.3 percent in 2004, situation improved to 62.7 percent in 2011. It again rose to 84.2 percent in 2013. Very high EI ratio of SCBs was mainly attributable to high administrative and overhead expenses; suspension of income against NPLs. EI ratio of PCBs is substantially high due to deduction of loan loss provision, other assets and corporate tax from current income.

Table-6: Expenditure-income ratio by type of banks

(Percent)

Bank types	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 June
SCBs	98.8	102.3	101.9	100.0	100.0	89.6	75.6	80.7	62.7	73.2	84.2
DFIs	101.1	104.0	103.9	103.5	107.7	103.7	112.1	87.8	88.6	91.2	107.6
PCBs	93.1	87.1	89.3	90.2	88.8	88.4	72.6	67.6	71.7	76.0	78.0
FCBs	80.3	76.3	70.8	71.1	72.9	75.8	59.0	64.7	47.3	49.6	51.6
Total	93.9	90.9	92.1	91.4	90.4	87.9	72.6	70.8	68.6	74.0	79.2

Source: Bangladesh Bank Annual Report of different years

4.3.2: Capital Adequacy

Table 7 provides risk- weighted capital asset ratios by type of banks over the period 2003-2013. It shows that DFIs and SCBs were not able to meet the required capital over the period except SCBs in 2011. On the other hand, PCBs and FCBs acquired 20.3 percent and 11.4 percent capital, respectively, to its risk- weighted assets in the year of 2013. This indicates that SCBs and DFIs were yet to comply the required 10% CAR. It is noted here that at the end-December 2012, the capital adequacy of the banking industry was 10.5 percent; the same stood at 11.5 percent at end December 2013. (Financial Stability Report-201)

Table: 7: Risk Weighted Capital Asset Ratios by Type of Banks

(In Percent)

Type of Banks	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 June
SCBs	4.3	4.1	-0.4	1.1	7.9	6.9	9.0	8.9	11.7	8.1	1.2
DFIs	7.7	9.1	-7.5	-6.7	-5.5	-5.3	0.4	-7.3	-4.5	-7.8	-9.0
PCBs	10.5	10.3	9.1	9.8	10.6	11.4	12.1	10.1	11.5	11.4	11.4
FCBs	22.9	24.2	26.0	22.7	22.7	24.0	28.1	15.6	21.0	20.6	20.3
All Bank	**8.4**	**8.7**	**5.6**	**6.7**	**9.6**	**10.01**	**11.6**	**9.3**	**11.4**	**10.5**	**9.1**

Source: Bangladesh Bank, Annual Report of different years

4.3.3 Asset Quality

4.3.3.1: Gross Non-performing Loans

It appears from the Table-8 that non-performing loans of the banking sector from 6.1 percent in 2011 to 11.9 percent in June 2013. Table 9 shows that. Net Non-Performing Loans to total loans are higher in SCBs and DFIs. In 2011, net-NPLs were - 0.3 and 17.0 percent in SCBs and DFIs, respectively, whereas in 2012, the percentages stood much high at 12.8 and 20.4, respectively. Overall net NPLs was 0.70 percent in 2011 but increased to 4.4 percent in 2012. The classified loans increased due to tightening of the guideline. Besides, sluggish business during the political uncertainty and lack of gas and electricity pushed the classified loans up.

Table-8: Trend of Classified Loans (Gross) by Category of Banks.

(In Percentage)

Bank types	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 June
SCBs	29.0	25.3	21.4	22.9	29.9	25.4	21.4	15.7	11.3	23.9	26.4
DFIs	47.4	42.9	34.9	33.7	28.5	25.5	25.9	24.2	24.6	26.8	26.2
PCBs	12.4	8.5	5.6	5.5	5.0	4.4	3.9	3.2	2.9	4.6	6.6
FCBs	2.7	1.5	1.3	0.8	1.4	1.9	2.3	3.0	3.0	3.5	4.7
Total	**22.1**	**17.6**	**13.6**	**13.2**	**13.2**	**10.8**	**9.2**	**7.3**	**6.1**	**10.0**	**11.9**

Source: Compiled from various issues of Bangladesh Bank Annual Report of different years

4.3.3.2: Net Non-performing Loans

It appears from the Table-9 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), 18.3 percent (DFIs), 0.5 percent (PCBs) and 1.7 percent (banking sector) in 2009. It is seen in the Table that DFIs' non-performing portfolios were still high after adjustment of actual provision and interest suspense, whereas FCBs had excess provision against their NPLs.

Table- 9. Ratio of Net NPL to total loans by type of Banks

(Percent)

Bank types	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 June
SCBs	28.3	17.6	13.2	14.5	12.9	5.9	1.9	1.9	-0.3	12.8	8.1
DFIs	38.3	23.0	22.6	23.5	19.0	17.0	18.3	16.0	17.0	20.4	19.5
PCBs	8.3	3.4	1.8	1.8	1.4	0.9	0.5	0.0	0.2	0.9	2.4
FCBs	0.1	-1.5	-2.2	-2.5	-1.9	-2.0	-2.3	-1.7	-1.8	-0.9	0.1
Total	**18.8**	**9.8**	**7.2**	**7.1**	**5.1**	**2.8**	**1.7**	**1.3**	**0.7**	**4.4**	**4.4**

Source: Compiled from various issues of Bangladesh Bank Annual Report of different years

4.3.3.3 Status of Classified Loans

Among the classified loans, bad/loss loans constitute about 78.7 percent in 2013 which was 80.97 percent in 2003. The total classified loan ratio declined markedly from 22.1 percent in 2003 to 8.9 percent in 2013 (Table-10). In 2013, the sub-standard category of loans out of total classified loans declined to 11.2 percent, but doubtful loans increased from 8.75 percent in 2003 to 10.1 percent in 2013.

Table- 10. Status of classified loans: sub-standard, doubtful and bad/loss loans of all banks (2003-2013)

(Taka in Billion)

Year	Total loans	Total classified loans	Classified loans as % of total loans	Sub-standard loan as % of TCL	Doubtful loans as % of TCL	Bad/loss loans as % of TCL
2003	914.90	203.2	22.1	10.24	8.75	80.97
2004	1079.71	190.03	17.6	7.2	6.6	86.19
2005	1292.51	175.14	13.6	8.66	6.96	84.37
2006	1515.90	200.1	13.2	13.13	7.15	79.72
2007	1713.63	226.2	13.2	9.75	7.51	82.74
2008	2081.48	224.8	10.8	9.43	9.42	81.14
2009	2493.20	229.37	9.2	12.2	8.4	79.4
2010	3198.60	227.10	7.1	13.4	8.4	78.2
2011	3792.50	235.13	6.2	14.8	11.5	73.7
2012	4386.70	438.67	10.0	19.1	14.2	66.7
2013	4720.06	420.08	8.9	11.2	10.1	78.7

Source: Financial Stability Report, BB.

4.3.3.4. Default Risks: Loan Loss Provisions

Table- 11 shows the aggregate amount of NPLs, required loan loss provision and actual provision maintained there against by the banks from 2003 to 2013. It depicts that in aggregate, the banks have been continuously unable to maintain the required level of provisions against their NPLs from 2003 through 2009. It also shows that in 2009 the banking sector was able to maintain 100% or more provision for the first time. During the years from 2003 through 2009, the banks maintained 40.3 percent of the required provision in 2003; which increased thereafter to 103.0 percent in 2011 and again it dropped to 78.3 percent in 2012.The main reasons for the shortfall in provision adequacy from 2003 through 2008 was the inability of some SCBs, DFIs and PCBs including those in problem bank category to make sufficient provisions due to inadequate profits and transferred provision for write-offs. Notably, the FCBs have been in much better shape in meeting adequate provisions in the recent years.

Table- 11: Required provision and provision maintained -all banks

(Billion Taka)

Bank types	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 June
Amount of NPLs	203.2	187.3	175.1	200.1	226.2	224.8	224.8	227.1	226.4	427.3	523.1
Required provision	92.5	87.8	88.3	106.1	127.2	136.1	134.8	149.2	148.2	242.4	299.0
Provision maintained	37.3	35.9	42.6	52.9	97.1	126.2	137.9	142.3	152.7	189.8	274.4
(Excess(+)/ Shortfall(-)	-55.2	-51.9	-45.7	-53.2	-30.1	-9.9	3.1	-6.9	4.6	-52.6	-24.6
Provision maintenance ratio (%)	40.3	40.9	48.2	49.9	78.3	92.7	102.3	95.4	103.0	78.3	91.8

Source: Compiled from various issues of Bangladesh Bank Annual Report of different years

A comparative position of loan loss provision by category of banks is shown in table-12

In line with the long-existing trend, the data show that actual provision fell short of required provision for all excepting FCBs during 2003- 2008 indicating lack of efficiency in fund management especially in disbursing and recovering loans, sustained pressure of non-performing loans (NPLs) in all commercial banks (excepting FCBs) including state-owned DFIs. After 2008, actual provisioning scenario for SCBs has reversed. The actual provision remained higher than required provision for SCBs in 2009 mainly because of intensified recovery drive and rescheduling of overdue loans under the new management of the state-owned banks. This was supported by the Election Commission's requirement of non-defaulter status of potential candidates in national and local elections. For FCBs, the amount of actual provision remained higher than required provision throughout the whole period. It is noteworthy that the shortfall in the provisions for all PCBs is improving and the shortfall for DFIs remained high during the entire period.

Table-12: Comparative position of provision adequacy by Category of Banks

(Billion Taka)

Year	Items	SCBs	DFIs	PCBs	FCBs
2003	Required provision	53.3	14.7	23.1	1.4
	Provision maintained	3.5	14.6	17.5	1.7
	Provision maintenance ratio (%)	6.6	99.2	75.4	125.2
2004	Required provision	50.7	13.5	22.3	1.3
	Provision maintained	3.4	12.4	18.5	1.6
	Provision maintenance ratio (%)	6.7	91.9	83.0	123.1

2005	Required provision	52.8	13.4	20.5	1.6
	Provision maintained	13.2	9.3	17.8	2.2
	Provision maintenance ratio (%)	25.0	89.4	85.8	137.5
2006	Required provision	61.6	14.8	27.5	2.2
	Provision maintained	18.2	9.1	22.6	3.1
	Provision maintenance ratio (%)	229.5	61.5	82.2	140.9
2007	Required provision	71.4	17.3	34.9	3.5
	Provision maintained	56.5	8.7	28.2	3.8
	Provision maintenance ratio (%)	79.1	50.3	80.5	108.6
2008	Required provision	73.1	17.0	41.3	4.6
	Provision maintained	75.6	8.6	37.0	5.0
	Provision maintenance ratio (%)	103.4	50.6	89.6	108.7
2009	Required provision	66.0	17.5	48.5	4.6
	Provision maintained	79.5	8.9	43.5	5.9
	Provision maintenance ratio (%)	120.5	50.9	93.8	128.3
2010	Required provision	70.6	19.1	53.3	6.2
	Provision maintained	69.9	13.3	51.8	7.4
	Provision maintenance ratio (%)	98.9	69.7	97.1	119.4
2011	Required provision	60.8	21.7	58.3	7.4
	Provision maintained	69.0	13.9	61.2	8.5
	Provision maintenance ratio (%)	113.5	64.1	105.0	114.9
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 June	Required provision	149.7	34.8	104.9	9.6
	Provision maintained	145.7	15.4	103.8	9.5
	Provision maintenance ratio (%)	97.4	44.3	98.9	98.2

Source: Bangladesh Bank Annual Report of different years

4.3.4. Writing off Bad Debts

To wipe out the unnecessarily and artificially inflated size of balance sheet, uniform guidelines of write-off were introduced in 2003. According to the policy, banks may, at any time, write-off loans classified as bad/loss. Those loans, which have been classified as bad/loss for last 5 years and above and loans for which 100 percent provisions have been kept, should be written-off immediately. The total amount of written-off bad debts from June, 2004 to June, 2013 in different bank categories is given in Table-13. It is revealed from the Table that banks were able to write-off an amount of Taka 65.8 billion as on 30-06-2004 and an amount of Taka 253.3 billion as on 30-06-2013. It also shows that as on 30-06- 2013 the SCBs, DFIs, PCBs and FCBs were able to write-off an amount of Taka 107.2, 32.6, 109.7 and 3.7 billion, respectively.

Table-13: Writing off bad debts in different bank categories (From June, 2004 to June, 2013)

(Billion Taka)

Bank types	30/6/04	30/6/05	30/6/06	30/6/07	30/6/08	30/6/09	30/6/10	30/6/11	30/6/12	30/6/13
SCBs	26.3	29.7	36.7	42.8	48.4	64.5	70.5	82.4	72.9	107.2
DFIs	17.4	27.6	28.6	30.4	31.0	31.8	31.8	32.0	24.5	32.6
PCBs	21.2	32.9	40.7	45.5	49.4	54.7	69.6	77.1	64.9	109.7
FCBs	0.9	1.1	1.5	1.6	1.7	2.0	2.1	2.4	2.6	3.7
Total	65.8	91.3	106.5	120.3	130.5	153.0	174.0	193.9	164.9	253.3

Source: Bangladesh Bank Annual Report of different years

4.3.5. CAMELS Rating

Bangladesh Bank also undertakes a yearly performance evaluation of all banks through conducting CAMELS rating which involves analysis and evaluation of the six crucial dimensions of banking operations. The six indicators used in the rating system are (i) Capital Adequacy, (ii) Asset quality, (iii) Management Soundness (including implementation status of Core Risk Management Guidelines),(iv) Earnings, (v) Liquidity, and (vi) Sensitivity to market risk. Performance indicators of the banking industry depict a trend similar to that of the state-owned banks, which is understandable due to their predominant market share. CAMELS ratings indicate that financial performance of the PCBs and FCBs, in general, has been better than that of the industry average. Any bank rated 4 or 5 i.e., 'Marginal' or 'Unsatisfactory' under composite CAMELS rating is generally identified as a Problem Bank.

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, no banks are monitored under EWS. As at end of 2012, the

CAMELS rating of 3 banks were 1 or Strong; 29 banks were rated 2 or Satisfactory; rating of 6 banks were 3 or Fair; 6 banks were rated 4 or Marginal and 3 banks received 5 or Unsatisfactory rating (BB Annual Report).

4.3.6 Activities of Credit Information Bureau

CIB online services were opened up on 19th July, 2011. The CIB database consists of detailed information on borrowers, owners and guarantors. It has brought huge advantages in CIB related operations over the previous system. The total number of borrowers was 844,404 at the end-June 2013, recording an increase of 18.9 percent over the previous period (710,020 as of end- June, 2012). (BB Annual Report)

4.3.7: Corporate Social Responsibility

All banks had undertaken CSR practices in different forms in 2012. As shown in Table 14, the CSR expenditure in 2012 was higher than that in 2011 and around six times higher than 2009. As in preceding years, CSR initiatives of banks continued.

In terms of direct monetary expenditure, engagements of banks in CSR initiatives are increasing, particularly following issuance of BB guidance. Table-14 shows an increasing trend in CSR expenditure in the country's banking over the period 2007 through 2012.

Table-14. Corporate Social Responsibility

Year	2007	2008	2009	2010	2011	2012
CSR Expenditure (million Taka)	226.4	410.7	553.8	2329.8	2188.3	3046.7

Source: Bangladesh Bank Annual Report of different years.

4.4. The Deposit Insurance Scheme (DIS)

The deposit insurance system aims at minimizing the risk of loss of depositors' funds with banks. The present coverage of the deposits is Tk.1.00 lac per depositor per bank. A proposal to enhance the ceiling of coverage to 2.00 lac per depositor per bank is under process of approval (BB).The percentage of depositors (in number) who are fully insured increased from 84.4 percent in 2012 to 87.72 percent in 2013. This factor indicates a comparatively higher effective deposit safety net in that year compared with the previous year. Table-15 shows Deposit Insurance Trust Fund Position. As of 2013, the Deposit Insurance Trust Fund reached around Tk. 30 billion, which is around 2.5 times that of 2009.

Table: 15. Deposit Insurance Trust Fund and its Composition

(Amount in Billion BDT)

Particulars	2009	2010	2011	2012	2013
Insurable Deposits	2,439.84	3,238.58	3,857.33	4,229.77	5,322.93
Insurance Premium	1.34	1.65	1.92	2.31	3.34
i. Investment	12.50	16.10	19.46	23.99	29.76
ii. Cash	0.06	0.01	0.32	0.15	0.07
Deposit Insurance Trust Fund Balance	12.56	16.11	19.78	24.14	29.83

Source: BB Financial Stability Report.

Table-16 shows the recent premium rate as per new schedule. Banks under problem bank category have to pay 0.09 percent whereas other banks have to pay 0.07 percent as premium on their deposits. As per new schedule effective from 2013, sound bank categories will have to pay 0.08 percent, Early Warning Bank Categories will pay 0.09 percent and Problem bank Categories will pay 0.10 percent.

Table: 16. The Recent Premium Rate

Particulars	Premium Rate before 2013	Premium Rate 2013
Sound bank categories	0.07	0.08%
Early Warning Bank Categories	0.07	0.09%
Problem bank Categories	0.09%	0.10%

Source: Bangladesh Bank Annual Report.

4.5: Status of ICT in the Banking Sector

Table-17 provides the overall picture of computerization in the banking sector of Bangladesh during 2003-2013. In 2003, only 31.10 percent branches (SCBs 11.89%; DFIs 4.20%; PCBs 97.76%; and FCBs 100%) were computerized. SCBs are also progressing in computerization of their branches. They have already computerized almost 96% of their branches till 2013. By 2013, a significant improvement in computerization can be observed especially by the PCBs. In 2013, a total of 88.32% branches (SCBs 96.49%; DFIs 27.03%; PCBs 100%; and FCBs 100%) were computerized. The performance of DFIs in computerization is unsatisfactory with only 27.03 percent of the branches computerized by 2013 (BIBM survey).

Table-17: Computerization of Bank Branches by Categories, (In Percentage).

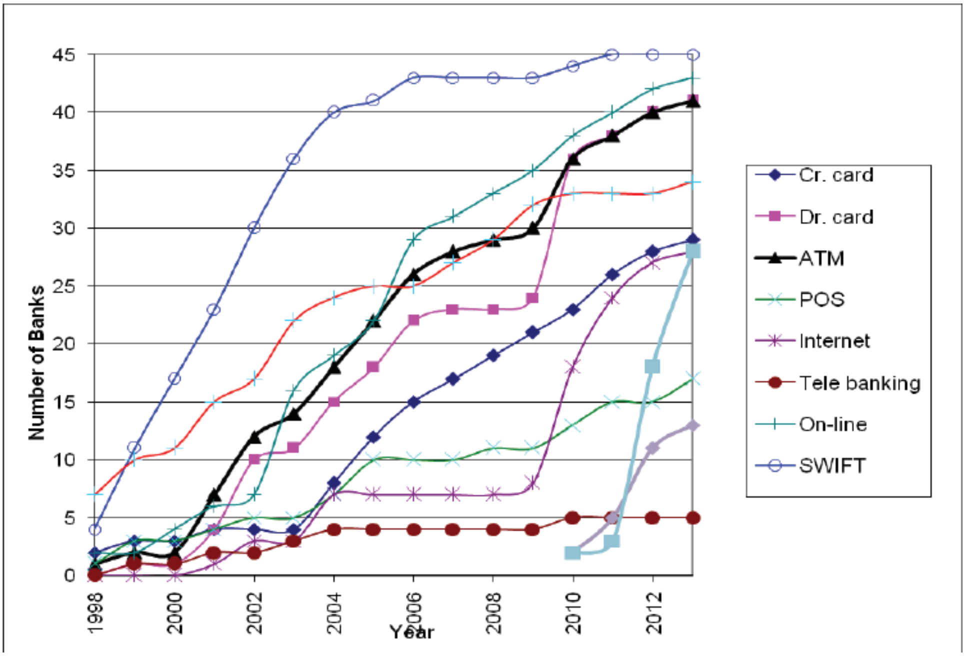
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
SCBs	11.89	14.43	16.12	16.38	19.4	21.7	23.59	40.15	64.92	71.16	96.49
DFIs	4.20	4.39	4.35	4.38	8.51	12.57	15.22	15.93	16.23	19.21	27.03
PCBs	97.76	98.45	98.90	98.92	98.97	99.0	99.01	99.11	99.15	100	100
FCBs	100	100	100	100	100	100	100	100	100	100	100
Total	**31.10**	**33.50**	**35.42**	**36.95**	**37.2**	**37.5**	**47.49**	**55.22**	**69.17**	**76.21**	**88.32**

Source: BB, BIBM survey

4.5.1: Modern and Innovative Products and Services: Present Status

The existing modern and innovative banking products and services in Bangladesh are: (i) modern and innovative banking products - Debit Card and Credit Card, (ii) services- Automated Teller Machine (ATM), Point of Sales (POS), and e-services-Internet, Tele banking, On-line banking, Society for Worldwide Inter-Bank Financial Telecommunication (SWIFT), and Reuter. It is evident from the following figure that during the last couple of years the trends in technology adoption in the country's banking sector have been increasing rapidly.

Figure-1: Trends in Technology Adoption



Source: BIBM Survey Information

4.5.2. Electronic Banking

Tables 18 (A) & (B) provide electronic banking features during 2011-2013. Out of 56 scheduled banks, 52 banks provide full or partial online banking services. Plastic cards (debit/credit cards) are becoming more popular and banks are offering these to attract new customers and retain their customer base. Table 18 demonstrates an increasing trend in the adoption of electronic banking features during 2011-2013. Although the number of banks introducing credit cards became stagnant, there was a significant increase in online banking operations in 2013. Moreover, during the last couple of years, the uses of ATM as smart payments and services have been increasing rapidly. The numbers of ATM being used in the banking sector as of 2013 were 5349 which were 1733 in 2010 (Financial Stability Report) The table also describes an increasing trend in the monetary volume of electronic banking transactions during 2011-2013. The volume of transactions using debit cards increased faster in 2013 than previous years. Besides, the increasing trend in the transaction volume using ATMs shows a significant growth in electronic banking. But the volume of transactions using credit cards experienced a slower increase in 2013 compared with previous years, for the reason that banks have been very careful about giving credit cards to people who do not have repayment capacity. Moreover, transactions through internet banking rose to Taka 90.5 billion in 2013.

Table 18: Number of Banks Providing Electronic Banking Services

Year	Online Banking	Internet Banking	Credit Card	ATM/Debit Card
2011	40	24	26	38
2012	42	27	28	40
2013	52	27	28	41

Source: BB Financial Stability Report.

Table: 18 (B) Volume of Electronic Banking Transactions

(Figures in Billion Taka)

Year	Using ATM	Using Debit Card	Using Credit Card	Internet Banking
2011	374.9	454.2	39.6	41.6
2012	565.8	585.0	57.0	48.7
2013	654.3	775.7	62.7	90.5

Source: BB Financial Stability Report.

4.5.4 Mobile Banking

In order to ensure the access of unbanked people by taking advantage of country-wide mobile network coverage, Mobile Financial Services (MFS) have been introduced in Bangladesh. Only banks are allowed to lead the mobile financial services. This model offers an alternative to conventional branch-based banking to the customers through appointed agents being facilitated by the Mobile Network Operator (MNO)/Solution Providers instead of bank branches or through bank employees. In so doing, BB allows a customer's account, recognized as 'Mobile Account' to be attached with the bank and be accessible through the customer's mobile device. The mobile account should be a non-checking account classified separately from a standard banking account. BB has fixed the transaction limit for the account holders of MFS at a maximum of Tk. 10,000 daily and a total of Tk. 25,000 on monthly basis. Table-19 shows the MFS status as of March, 2014.

As of March 2014, only 20 banks started offering the services. Consequently, the number of mobile accounts reached 1.5 crore and number of agents went up to 2, 40,000. In March of 2014, a total amount of Tk. 7,849 crore was transacted disclosing a high monthly growth in this sector.

Table-19: Mobile Banking Growth

	March 2012	**April 2013**	**July 2013**	**November 2013**	**January 2014**	**March 2014**
No. of Banks Permitted	10	27	27	27	28	28
Live Deployment	5	18	18	19	19	20
No. of Agents	9093	82638	107760	172265	200000	240000
No. of Customers (Crore)	0.04	0.53	0.72	1.15	1.32	1.5
No. of Transaction Per Month (Crore)	0.12	1.51	2.12	2.34	3.01	3.33
Volume of Transaction Per Month (Crore Tk.)	17.2	3634	5350	5533	6630	7849

Source: Bangladesh Bank

4.5.5 Bangladesh Automated Clearing House (BACH)

The Bangladesh Automated Clearing House (BACH) started automated cheque clearing from 7th October, 2010 by replacing the earliest manual clearing system with automation, which allows inter-bank cheques and similar type of instruments to be settled instantly. All the 7 clearing regions in major cities (Chittagong, Rajshahi, Khulna, Bogra, Rangpur, Barisal and Sylhet) have been connected with the Dhaka Clearing House from 25th October, 2011. Almost 90 percent of all the clearing instruments are now being processed through the automated clearing house.The BACH integrates two components:

1. The Automated Cheque Processing System; and
2. The Electronic Funds Transfer (EFT).

Under this automated clearing system, two types of transactions take place: a) High-Value Cheque Clearing (Cheques amounting to Tk. 5.00 lacs or more) and b) Regular Value Cheque Clearing. The figure in Table 20 illustrate the trend in high value and regular value transactions over the last 3 (three) years. The volume of high value cheque processing during 2011-2013 showed considerable growth, whereas regular value cheque processing fluctuated over the years.

Table: 20. Automated Cheque Clearing Operations

(Amount in Billion Tk)

Category	2011		2012		2013	
	Number (in thousands)	Amount	Number (in thousands)	Amount	Number (in thousands)	Amount
High Value (HV)	3,123	4,177.8	1,263	5,977.42	1,365	6,877.9
Regular Value (RV)	17,954	5,093.9	18,824	4,827.44	20,695	5,165.5

Source: BB Financial Stability Report.

4.5.6. Electronic Fund Transfer (EFT)

This facility ensures the transmission of payments between the banks electronically, which makes it a faster and efficient means of inter-bank clearing over the existing paper-based system, i.e. Bangladesh Automated Cheque Processing System (BACPS). This network introduced credit and debit transactions from 15th September, 2011. It is able to manage a wide-variety of credit transfers such as payroll, foreign and domestic remittances, bill payments, dividend payments, tax payments, as well as debit transfers such as mortgage payments, membership dues, loan payments, insurance premiums, utility bill payments, government tax payments, and government licenses and fees. On average, approximately 21,072 EFT transactions were processed in a day in 2013. Total monetary amount of EFT transactions under Bangladesh Electronic Fund Transfer Network (BEFTN) in 2013 was Tk. 396.1 billion, which was 44 percent higher than that in 2012 transactions (BB Financial Stability Report).

5. Concluding Remarks

The analyses lead to the conclusion that timely financial reform initiatives since 2002 drawing gainful lessons from global financial crisis and consequent steps taken by major international financial institutions produced significant positive changes in the banking sector in Bangladesh. Being primarily a bank-based financial system, good banking performance augurs good economic performance. The Great Recession beginning in 2008 in the USA transmitted into global recession and many important countries are going through a healing process toward recovery with some trouble spots. The success of the Bangladesh banking sector lies in its ability to cope with the recent global financial stormy weather. Surprisingly, Bangladesh has been able to maintain average 6% growth over the last decade. However, the decennial record of banking performance has been mixed with significant successes and some failures. In brief, the decade ended on a positive note.

To sum up some of the major facts, private banks with some exceptions fared much better than public sector banks in terms of asset, deposit and credit shares. In fact, the former had positive trends amid some fluctuations while the latter had declining trend. This implies shrinking market concentration and increasing market competition in the overall banking sector. The indicators of profitability demonstrate that all bank groups except DFIs recorded an increase in the rate of profit and the foreign banks were found more profitable in comparison with the domestic private banks and the public sector banks. Furthermore, these reforms have changed the technology used and the products offered by the banking sector. The changes in market structure have intensified competition not only in the banking industry but also in the overall financial services sector. Diversification of operational activities of banking firms has changed the relative importance of the traditional sources of income of the banking sector, from reliance on interest earning to greater emphasis on income from fees. Lending rate is still exorbitantly high (above 15 percent). This is not conducive to investment and productive business activities. In addition, the target of financial inclusion has not been achieved as expected. Therefore, strengthening of enabling environment by instituting rational interest rate spread, introducing tailored products on both asset and liability fronts and ensuring proper management of NPLs along with accuracy in risk management devices may further enhance current financial stability of the banking system in Bangladesh.

In closing remarks, both public sector and local private sector banks should draw lessons from foreign-owned private banks operating in Bangladesh. All public and private banks must be held accountable to the same performance standards as they compete in the same deposit and credit markets.

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Appendix

Appendix-1: Sector-Wise Classifications of Advances by Scheduled Banks

(Taka in crore)

Year	Public Sector		Total	Private Sector	Total Advances (Pub. +Pri.)	Ratio (Pub. /Pri.)
	Government	Other than Government				
2003	973.46	4456.54	5430.00	84106.70	89536.70	0.06
2004	482.22	3327.58	3809.80	98627.01	102436.81	0.04
2005	384.93	7372.45	7757.38	112490.28	120247.66	0.07
2006	329.54	6629.45	6958.99	132500.92	139459.91	0.05
2007	332.86	5984.74	6317.60	153701.08	160018.68	0.04
2008	1892.81	7141.57	9034.38	187351.11	196385.49	0.05
2009	2140.81	7581.94	9722.75	223756.75	233479.50	0.04
2010	1421.19	10588.37	12009.56	283871.62	295881.18	0.04
2011	2337.82	9995.71	12333.53	338188.91	350522.44	0.04
2012	3968.06	7909.05	11877.11	398747.99	410625.10	0.03
2013	1613.62	6884.54	8498.16	435346.25	443844.41	0.02

Sources: Bangladesh Bank, Scheduled Banks Statistics various issues

Appendix-2: Total Branch, Deposit and Advance Distributed by Urban & Rural Areas

(billion Taka)

Year	Number of Branch			Deposit			Advance		
	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban	Total
2003	3694	2526	6220	190.8	883.3	1074.1	102.5	744.8	847.3
2004	3724	2579	6303	192.0	1023.8	1215.8	103.4	847.9	951.3
2005	3764	2638	6402	218.3	1197.6	1415.9	117.6	999.7	1117.3
2006	3834	2728	6562	241.5	1445.8	1687.3	128.4	1163.3	1291.7
2007	3894	2823	6717	263.0	1689.1	1952.1	130.1	1335.6	1465.7
2008	3981	2905	6886	306.2	2009.8	2316.0	148.5	1667.0	1815.5
2009	4136	3051	7187	369.9	2424.0	2793.9	169.6	1920.9	2090.5
2010	4393	3265	7658	436.9	2942.3	3379.2	206.9	2367.5	2574.4
2011	4551	3410	7961	536.0	3579.9	4115.9	254.5	2958.3	3212.8
2012	4760	3562	8322	853.1	4011.0	4864.1	405.6	3453.7	3859.3
2013 June	4827	3600	8427	1030.9	4690.2	5721.1	434.3	3813.8	4248.0

Source: Bangladesh Bank Annual Report.

Appendix-3: Interest Rates, Spread and Inflation Rates (All Banks)

Year	Deposit Rate	Lending Rate	Spread	Inflation	Real Spread
2002-2003	6.29	12.78	6.49	4.38	2.11
2003-2004	5.65	11.01	5.36	5.83	-0.47
2004-2005	5.62	10.93	5.31	6.48	-1.17
2005-2006	6.68	12.06	5.38	7.16	-1.78
2006-2007	6.85	12.78	5.93	7.20	-1.27
2007-2008	6.95	12.29	5.34	9.94	-4.6
2008-2009	7.01	11.87	4.86	6.66	-1.8
2009-2010	6.01	11.31	5.30	7.31	-2.01
2010-2011	7.27	12.42	5.15	8.88	-3.73
2011-2012	8.15	13.75	5.60	10.62	-5.02
2012-2013	8.54	13.67	5.13	7.70	-2.57
2013-2014	7.79	3.10	5.31	7.35	-2.04

Note: Rate of interest on scheduled banks (weighted average);
Source: Bangladesh Bank, Economic Trends Various issues.

Appendix-4: Banking Sector Year-wise ADR

(Amount in Billion BDT)

Year	Deposits (Excluding Inter- Bank)	Advance (Excluding Inter- Bank)	Advance-Deposit Ratio
2006	1,829.3	1,394.6	76.2%
2007	2,116.1	1,600.2	75.6%
2008	2,527.6	1,963.9	77.7%
2009	3,042.8	2,334.8	76.7%
2010	3,689.2	2,958.8	80.2%
2011	4,509.8	3,792.5	84.1%
2012	5396.0	4318.7	80.0%
2013	6,363.5	4,529.3	71.2%

Source: BB Financial Stability Report-13.

Appendix-5: Action Plan/Roadmap of Basel III Implementation

Action	Deadline
Issuance of Guidelines	June 2014
Capacity Building of Banks	June-Dec 2014
Commencement of Basel III Implementation process	July 2014
Initiation of Full Implementation of Basel III	January 2019

Phase-in Arrangements

The phase-in arrangements for Basel III implementation will be as follows:

	July 2014	2015	2016	2017	2018	2019
Minimum Common Equity Tier-1 (CET-1) Capital Ratio	4.00%	4.50%	4.50%	4.50%	4.50%	4.50%
Capital Conservation Buffer	-	-	0.625%	1.25%	1.875%	2.50%
Minimum CET-1 plus Capital Conservation Buffer	4.00%	4.5%	5.125%	5.75%	6.375%	7.00%
Minimum T-1 Capital Ratio	5.00%	5.50%	5.50%	6.00%	6.00%	6.00%
Minimum Total Capital Ratio	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%
Minimum Total Capital plus Capital Conservation Buffer	10.00%	0.00%	10.625%	11.25%	11.875%	12.50%
Phase-in of deductions from CET1	Not Applicable					
Phase-in of deductions from Tier 2 Revaluation Reserve (RR)						
RR for Fixed Assets	*20%*	*40%*	*60%*	*80%*	*100%*	*100%*
RR for Securities	*20%*	*40%*	*60%*	*80%*	*100%*	*100%*
RR for Equity Securities	-	*50%*	*100%*	*100%*	*100%*	*100%*
Leverage Ratio	3%	3%	3%	3%	3% Readjust ment	Migration toPillar 1
Liquidity Coverage Ratio	June 2014 to June 2015 on test basis	≥100% (FromSep.)	≥100%	≥100%	≥100%	≥100%
Net Stable Funding Ratio		≥100% (FromSep.)	≥100%	≥100%	≥100%	≥100%
CountercyclicalCapital Buffer	-	-	Countercyclical capital buffer regime will be effective from Jan 2016			

Source: BRPD,BB