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Bangladesh Bank and Management of Financial Sector

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Bangladesh Bank is the Central Bank of Bangladesh. It was established on the 16th December 1971 under Bangladesh bank (Temporary) Order 1972 (Subsequently substituted by the Presidential order No. 127 of 1972). The powers and functions of Bangladesh Bank are governed by the Bangladesh Bank Order 1972 and Banking Companies Act. 1991 (Act 14 of 1991) to make provisions for streamlining the affairs of banking companies to suit the present day socioeconomic needs of the country.

The general superintendence and direction of affairs and business of the Bank are entrusted to a nine member Board of Directors, which consists of the Governor as chairman.

Functions of Bangladesh Bank as mentioned in Bangladesh Bank Order 1972:

- To formulate and implement monetary policy.
- To formulate and implement intervention policies in the foreign exchange market.
- To manage the official foreign exchange reserves.
- To promote, regulate and ensure a secure and efficient payment system, including the issue of bank notes.
- To regulate and supervise banking companies and financial institutions.
- To play the role of advisor to the government on the impact of various policy measures on the economy

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1. The author is an Executive Director of Bangladesh Bank. For the opinion which are expressd in the paper, the author alone in responsible.

VISION

To develop continually as a forward looking central bank with competent and committed professionals of high ethical standards, conducting monetary management and financial sector supervision to maintain price stability and financial system robustness, supporting rapid broad based inclusive economic growth, employment generation and poverty eradication in Bangladesh.

Core Central Banking Functions

1. Formulation of Monetary Policy

- Bangladesh Bank formulates monetary and credit policies for attaining macro economic objectives. These monetary and credit policies are primarily implemented through the banking system. At present monetary policy is declared by the Governor on half yearly basis.
- Growth rate of broad money (total of currency, demand and time deposits) is programmed considering the projected GDP growth, inflation and income velocity of money [GDP to broad money supply (M2) ratio].
- In line with this, annual levels of foreign assets and domestic credit to public and private sector are also programmed.

2. Implementation of Monetary Policy

- To keep broad money supply on desired growth path, Money and Credit Program is implemented by different ways:
- Changes in the broad money supply is effected by increasing/ decreasing reserve money [total of currency issued both by government (2% of the total) and the BB, and balances of banks with the BB].
- Auctions of government treasury bills and bonds and auctions of Repo and reverse Repo are used.
- Supply of broad money can be influenced through changing cash reserve ratio (CRR) and effecting market interest rates by varying repo and reverse repo rates.

3. **Credit Control**

Bangladesh Bank controls the credit to achieve the financial growth. It exercises credit control through various traditional and non-traditional methods. It also enjoys comprehensive powers of Selective Credit Control. It can regulate polices in respect of advances made by the commercial banks in general or by any specific bank or banks in particular. The main instrument of selective credit control are **(a)** minimum margins for lending against selected commodities **(b)** ceilings on the levels of credit and **(c)** charging of minimum rate of interest on advances against specified commodities. While the first two instruments control the quantum of credit, the third instrument works as leverage on the cost of credit. In some cases BB introduces refinance scheme for the priority sectors.

Apart from the selective credit control by Bangladesh Bank, it also controls volume of credit in the following way:

a) Bank Rate

The Bank Rate is the rate of interest at which Bangladesh Bank rediscounts the first class bills of exchange from commercial banks. Whenever Bangladesh Bank wants to reduce credit, the bank rate is raised and whenever the volume of bank credits is to be expanded the bank rate is lowered. This is because by change in the bank rate, Bangladesh Bank seeks to influence the cost of bank credit. Since 2003, Bangladesh employs repo and reverse – the two policy interest rates – in stead of the bank rate to achieve the desired monetary policy objectives.

b) **Open Market Operation**

Bangladesh Bank’s most useful tool is open market operation. Bangladesh Bank can influence resources of commercial banks by buying or selling Government Securities in open market. If Bangladesh Bank buys Government Securities in the market from commercial banks, there is a transfer of cash from Bangladesh Bank to commercial banks and this increases the cash base of the commercial banks enabling them to expand credit and conversely sells securities to the commercial banks to contract credit. Auctions of government reserve repo are used for managing liquidity on daily basis.

c) Reserve Requirements Policies

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 except BASIC bank are exempted from maintaining SLR. The Cash Reserve Requirement (CRR) for the scheduled banks with the Bangladesh Bank is 6% 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.

d) Open Mouth Method

Besides selective credit control, open mouth method or moral persuasion is also used to influence credit operations of the banks.

4. **Maintaining the value of currency**

Being responsible for maintaining the external value of taka**,** Bangladesh Bank also administers exchange control in the country. This task is two-fold. On the one hand, it ensures that all foreign exchange receipts are accounted for, and surrendered to the Authorized Dealers, and on the other, it allocates and rations foreign exchange in line with set priorities. Bangladesh Bank issues license to a number of bank branches as Authorized Dealers to deal in foreign exchange at authorized rates subject to its directions. Besides, Bangladesh Bank authorizes certain establishments like hotels, selected shops and other organizations visited by foreign tourists to change their foreign money. These establishments known as money changers are authorized only to buy and sell convertible foreign currency notes and other currency instruments and conduct no other transactions. Foreign exchange transactions made by authorized dealers and money changers are monitored by BB regularly.

5. Exchange rate, Intervention in the Foreign Exchange Market

- Successful and stable introduction of market based floating exchange rate of Bangladesh Taka from 31 May 2003.
- Bangladesh Bank, from time to time, buys and sells US dollar in the local market in the interest of keeping exchange rate stable and competitive and raising the level of foreign exchange reserve.

6. **Foreign Exchange Reserve Management**

- In the interest of investment liquidity and security, Bangladesh Bank, like other central banks, carefully invests its reserves only in major convertible currencies with important central banks and some international commercial banks with high credit ratings.
- Like other central banks, Bangladesh Bank avoids earning profit through

risky currency trading from exchange fluctuations of different currencies.

7. **Management of Clearing System of Check/Bill etc.**
BB has introduced a fully automated clearing house. The arrangement of electronic fund transfer has also been introduced for the corporate clients.

8. Regulatory Functions

- **Corporate Governance:** Financial disclosure, Audit Committee, Limiting the directorship to 6 years or two terms. Fit and proper tests for CEOs and bank directors, Independent director, Maximum number of directors.
- **Supervise and regulates banks effectively:** Fine for violation, EWS and problem bank introduced.
- **Monitoring of non-performing loans:** Stringent loan rescheduling, limitation on dividend pay out, loan loss provisioning, CIB, large loans linked to banks NPL ratio.
- **Enforce actions against banks found violating regulations and laws:** Removal of MD, Chairman and directors.
- **Risk Management:** Risk management guidelines on major risk areas.

9. Collection and Furnishing of Credit Information
Bangladesh Bank may collect in such manner as it may think fit, credit information from every banking company and furnish such information to any banking company in accordance with the provisions of Bangladesh Bank Order. Commercial banks can collect CIB report of their clients on line basis from Bangladesh Bank.

Legal Reforms and Prudential Regulations

a. Policy of Capital Adequacy of Banks
To adopt the international best practices and to make the banks' capital more risk-absorbent as well as to build the banking industry more shock resistant and stable, all scheduled banks are obligated to comply with "Guidelines on Risk Based Capital Adequacy (RBCA) for Banks Revised Regulatory Framework in line with BASEL-II" from January 01, 2010.

b. **Minimum Capital Requirement (MCR)**

Minimum Capital Requirement (MCR) for each scheduled bank in Bangladesh will be at least 9% of total Risk Weighted Assets (RWA) from July 2010 to June 2011 and 10% of total RWA from July 2011 onwards or the amount determined by BB from time to time. Moreover, banks have to maintain at least 50% of required capital as Tier 1 capital. Banks have to maintain minimum CAR on ‘Solo’ basis as well as on ‘Consolidated’ basis as per instruction(s) given by BB from time to time.

c. **Policy on Loan Classification and Provisioning**

Bangladesh Bank introduced new accounting policies with respect to loan classification, provisioning and interest suspense in 1989 with a view to attaining the relevant international standards over a period of time. A revised policy for loan classification and provisioning was introduced from 1st January 1999. The revised policy calls for an independent assessment of each loan on the basis of qualitative factors and objective criteria. The NPL are classified as SMA, SS, DF and BL and the respective provision requirements for these loans are 1%, 20%, 50% and 100%. The classified loan can be rescheduled as per BB guidelines.

d. **Credit Rating**

In terms of the BRPD Circular Letter No. 05 dated May 29, 2004 it was made mandatory for the banks to have themselves credit rated to raise capital from capital market through IPO. The issue was reviewed and with a view to protecting the interest of the prospective investors, depositors and creditors and also the bank management as a whole for their overall performances in each relevant areas including core risks of the bank, it was decided to make it mandatory from January 2007 for all banks to have themselves credit rated by a Credit Rating agency. Banks had been advised to take necessary measures from that time so that they could have their credit ratings in all relevant areas as well as the bank management.

e. **Camels Rating**

Bangladesh Bank (BB), as central bank, has the statutory task of regulating and supervising the banking system of Bangladesh. To help in this endeavor, there is a uniform rating system, which provides meaningful and concise information about the condition of the banking system, as well as identify those banking companies that require closer supervision by BB. By assigning individual numerical ratings to the key areas of Capital, Assets, Management, Earnings, Liquidity and **S**ensitivity to market risk, as well as assigning an overall composite rating to each banking company, BB categorizes the banking companies into groups based on their overall strength, quality and operating soundness. The rating system, commonly referred to as the CAMELS, serves as a supervisory tool to help identify those banking companies that are having problems and require increased supervision.

f. **Marking to Market based Revaluation of Treasury Bills & Bonds held by the Banks**

With a view to widening application of fair value accounting of Government Securities and encourage secondary trading of these securities after issuance, some changes have been 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 will be treated as Held to Maturity (HTM). The gain/loss due to the revaluation will 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 will 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 will 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.

g. **Bank Charges**

Banks in general are free to fix the fees and commissions relating to the services offered by them to their customers. In applying the fees there should be no discrimination among customers for similar services. In other words, all customers are required to be treated at par for similar services. Bangladesh Bank has issued master circular incorporating necessary instructions for rationalization of different service charges received by banks. Banks have also been advised to upload the schedule of charges in their respective websites and display the same in all of their head offices and branches, for ready reference of the c1ients.

h. **Disclosure requirements for Banks**

The forms of Financial statements of banks and directives for preparation thereof have been amended in line with International Accounting Standards with a view to providing the investors, depositors and stakeholders with transparent and adequate idea about the bank.

i. **Prohibition on Bank Loan for Purchasing Land**

The value of land has increased abnormally due to increasing trend of purchasing and demand for land. There has been a negative impact over the economy because of increasing flow of credit from banks to this unproductive sector. In this context, it has now been decided that banks shall not provide any loan/credit facility for purchasing land.

j. **Operation of Merchant Banking by Banking Companies**

Banks are advised to operate merchant banking constituting separate legal entity i.e. subsidiary company to protect the interest of the depositors·

k. **Green Banking**

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

l. **Inclusion of Solar Energy System for Establishment of New SME/ Agricultural Branch**

SME/Agriculture branches to be established/opened will be required to be environment friendly where there will be the availability of using natural light, renewable energy, power and energy saving bulbs, other equipments, efficient use of water and refined water. These branches will be required to ensure that the solar system is in place in the branch and the same must be ensured in the application for obtaining license for the branches having permission in principle.

m. **Policy and Guidelines**

Bangladesh Bank has introduced different guidelines in different aspects. Some of these are -

i. Credit Risk Grading Manual

ii. Prudential Guidelines for Consumer Financing and Small Enterprise Financing
iii. Guidelines on Managing core risk in Banking
iv. Guidelines on Information & Communication Technology
v. Guideline on ICT Security for Banks and Financial Institutions, 2010
vi Guidelines on Environmental risk Management(ERM)
vii. Revised Policy of Rescheduling
viii. Guidelines Regarding Appointment of Chief Executive Officer of Banks
ix. Policy for Maintaining Adequate security of Lockers
x. Guidelines on Islamic Banking
xi. Guide lines on Agriculture credit
xii. Guidelines on Small Medium Enterprise.

Financial Inclusion

Up until the later decades of the last century, the state owned banks provided credit flows to underserved sectors like smallholder agriculture, micro and small businesses, in Bangladesh. BB's financial inclusion drive has substituted directed lending with Corporate Social Responsibility (CSR) driven financing of productive undertakings of the underserved population segments, supporting inclusive socioeconomic growth equitably opening up advancement opportunities for all. Back in June 2008 BB issued a guidance circular urging and encouraging all banks to embrace and mainstream CSR obligations in their corporate goals, objectives and ethos, interalia making financial inclusion their consciously and spontaneously adopted approach of socially and environmentally responsible lending. Experience with this approach thus far has been encouraging, with all banks enthusiastically taking up multifaceted initiatives, widening and deepening financial inclusion such as extending branch and ATM networks into rural areas, mass scale opening of no-frills bank accounts with nominal deposits for poorer people (more than nine million such new accounts opened by now), adopting new cost saving remote delivery modes for financial services like mobile phone/smart card based banking, financing schemes for renewable energy generation projects, and so forth.

BB has supported these initiatives by putting in place necessary enabling infrastructure, including a fully automated interbank clearing and settlement platform for paper based and electronic payment instruments, an upgraded online credit information bureau, and some refinance lines for banks against their SME and environment focused lending. The refinance lines are modest, consistent with BB's announced monetary policy stance.

While promoting financial inclusion with appropriately designed initiatives, the banks and the supervision authorities will of course need to keep eye on proper risk management in the newer areas of lending expansion, to protect financial stability by preserving the desired standards of asset quality. Transparency and fairness in pricing of financial services for micro and small enterprises are also important issues from consumer rights protection viewpoints. For this, a Consumer Interest Protection Center (CIPC) has already been activated, with a hotline (16236) and other electronic connectivity to address consumer grievances and to monitor their satisfaction levels. Together, these diverse initiatives of the banks and BB are enhancing the image of our financial sector as humane and socially responsible.

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