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A brief study over the 'Liquidity Crisis' of the banking sector of Bangladesh

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Abstract

This is an exploratory paper with the aim of determining the nature of the liquid asset like cash, its reservation, management system as well as the steps which should be taken when cash reservation is not available in banks. Liquidity crisis or cash crisis has created disasters in banking sector of Bangladesh. As in many developing countries banks play a vital role in Bangladesh economy, as the dominant financier for the industrial and commercial activities. But now a day's banks are struggling to get rid of this cash crisis. To solve the problem immediately banks raise their interest rate on deposit, some banks borrow money from Bangladesh bank through repos (Repurchase Agreement) after pledging the liquid assets like treasury bills and bonds. Again some banks rent money from call money market. Their cost of deposit is increasing as they collecting deposit at high rate, as a result some banks also increasing their lending rate to cope up their additional cost. As the interest rate on bank financing is rising, the cost of investment of the entrepreneurs is also increasing, as well as cost of production is rising and entrepreneurs are avoiding bank financing. The total scenario of banking sector is not good and it shows a strong sign that if this situation is not handling properly then in recent future the total banking sector will be collapsed. Today business faces a high rate of interest. In this study has tried to findout the major challenges of the 'Liquidity Crisis' of the banking sector of Bangladesh.

Introduction

As in many developing countries banks play a vital role in Bangladesh economy, as the dominant financier for the industrial and commercial activities. Since the independence in 1971, the government until 1982, when the 'ownership reform' measures started in the financial sector, had carried out the regulation and ownership of all financial institution. During the reform period two out of six National Commercial Banks (NCBs) were denationalized and private commercial banks were allowed to operate in the country's economy. In 2003, out of the 49 banks operating in Bangladesh, 9 belong to the public sector,

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30 are local private and 10 are foreign owned banks (Bangladesh Bank 2003). Despite the expansion, the operational efficiency of the banking institutions has continued to be dismal. The sector witnessed decreasing profitability, increasing non-performing assets and provision and capital shortfalls eroded credit discipline, rampant corruption patronized by political quarters, low recovery rate, inferior asset quality, managerial weaknesses, excessive interference from government and owners, weak regulatory and supervisory role etc.

Internal control system along with accounting and audit qualities are believed to have been a sub standered. Many of the problems have been attributed to lake of sound corporate governance into the banks. The report by Banking Reforms Commission (1999) and BEI (2003) raises serious concerns on the banking sector and criticize the quality of governance and prevails in the banking sector in Bangladesh, which provides an impetus to explore the governance issues in detail in this proposal.

Objectives of the study

The Global Financial Crisis has brought into focus the need for better supervision and governance in banks internationally. Liquidity crisis, inflation and currency devaluation are matters of intense concern in the financial and economic circles of Bangladesh since the last few months. Knowledge about bank's liquidity crisis is important in less developed countries like Bangladesh because economic development and growth is dependent to a large extent on well functioning, stable and soundly managed banking system.

In the recent year, our country has experienced a decline in the value of Tk against US currency which has created has huge liquidity crisis in the banking sector. For this reason our county has failed to collect maximum amount of US dollar required to open letter of credit (LC) for local businessmen to import essential commodities for the country. As a result the importer is facing as ever crisis in their business.

Increased percentage of CRR and SLR the commercial bank is facing liquidity problem and for this reason to get rid of the problem this banks are concentrated to generate more deposits. To generate more deposits they have to increase the deposit rate which has a adverse effect in the society.

Government credit from banking sector that would create extra burden to the country's banking sector and it creates more liquidity crisis in that sector. the government has already borrowed Tk 110billion from the country's banking sector to met the existing budget deficit during last 10 months (July 2010 to April 2011), while last year it repaid Tk 8The liquidity crisis of the banking sector has been accelerated by the increased amount of inflation; thus increasing the price of overall commodities for the general people. To keep peace with this inflationary effect, the people withdraw their savings from the banks and use this fund for their transaction expenditure. As a result the bank faces liquidity crisis.7.92 billion loans. In the recent future the commercial banks will be unable to provide loan to the private sector.

The purpose of this study is to focus on liquidity or cash crisis in the banking sector with its direct impacts on the whole country's economy. Banks have become beleaguered, desperately trying to get rid of this liquidity crisis. To find an immediate solution to this crisis, banks are increasing their interest rates on deposits. Their deposit management cost is increasing as they are collecting deposits at a higher rate for an immediate solution.

Methodology of the study

This study is descriptive in nature. Both qualitative and quantitative research methods adopting participatory data collection processes were applied to explore information from different sources. Secondary data are used to analysis the findings in qualitative manner. For relevant secondary data from reputed journals, books, annual reports, government policies, Publication from Statistics Department, Bangladesh Bank and World Bank, publications and study papers was collected. Qualitative measures also have been taken with relevant to the research objectives.

Scope of the study

There are 48 commercial banks in Bangladesh including commercial and foreign banks. The prospect of corporate government practice is bright in banking industry in the country. Bangladesh Bank is working to establish teams of expert s whose primary responsibility will be monitor the performance of the banking sector for good risk management like liquidity crisis. It has been found that performance of bank is good at credit rating. The study has been conducted on 25 banks; both foreign and nationalized commercial bank. Maximum bank credit rating was 'A', that means high efficiency in management.

Merchant banks are new concept in financial system of Bangladesh, which significantly differs with traditional banking. There are a lot of scopes to explore and develop the industry. At the same time for financing larger investment, investors need to know the functions and usefulness of merchant banking. General investors can also be benefited by investing through merchant banking service like portfolio management. Although merchant banks are not providing all range of service that they can do, but day by day they are enlarging their service area in the capital market of Bangladesh and opening a new prospects in Corporate Governance.

The concept of Liquidity Crisis

For the economy as a whole, a liquidity crisis means that the two main sources of liquidity in the economy, banks and the commercial paper market, severely reduce the number of loans they make or stop making loans altogether. Because so many companies rely on these loans to meet their short-term obligations, this lack of lending has a ripple effect throughout the economy, causing liquidity crises at a plethora of individual companies, which in turn affects individuals.

A negative financial situation characterized by a lack of cash flow. For a single business, a liquidity crisis occurs when the otherwise solvent business does not have the liquid assets (i.e., cash) necessary to meet its short-term obligations, such as repaying its loans, paying its bills and paying its employees. If the liquidity crisis is not solved, the company must declare bankruptcy. An insolvent business can also have a liquidity crisis, but in this case, restoring cash flow will not prevent the business's ultimate bankruptcy.

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Bank should finance in productive sector

It is also a major responsibility of bank to finance a productive sector of Bangladesh; like power sector, agriculture sector, so that the nation would be beneficial in near future. But the picture is completely different. FBCCI Chairman A.K. Azad said that after the lending cap on the financing in the productive sector was removed on 9 March the banks were almost competing with each other in increasing the lending rate. Before 9th March maximum lending rent of business loan was 13%, but after 9th March bank imposes lending rate 15 to 18% on business. Some of the banks even take it up to 20%. Banks provide loan based upon the high rate of interest rather based on business criteria. Because of this, the cost of business is increasing. The FBCCI chairman believes that this will further ignite the inflation. The investment will not grow. No new employment will be generated. As a result the rate of unemployment will rise further. Under such condition, he expected that the central bank will take initiatives to determine the interest rate that will be beneficial to the economy.

Bangladesh Bank Deputy Governor Nazrul Huda has said that the businessmen have requested to predetermine the maximum lending rate. The Bangladesh Bank has informed the businessmen that there is no scope for redetermination of the interest rate. Moreover, the central bank cannot take such measure in the market economy. However, the banks will be requested to keep the interest rate to a tolerable level.

However, the interest rate on bank financing is continuously increasing. Bankers are not paying heed to the protests of the businessmen. Thirty of the local and international banks have increased their lending rate in this April. Among them, some of the banks have increased their interest rate by three to three and half percent. In April 2011, the rate of interest in business loans has been 18 percent; whereas in March it was imposed maximum at a rate of 13 percent. Among the 30 private commercial banks 26 have increased their rate of interest in the current month. Among the other four there is a specialized bank and three foreign banks.

Businessmen have expressed their grievance at the interest rate increment of so many banks at a time. As per their opinion, the commodity price has already increased due to the rise of fuel price in the international market.

Fund Management of Bank

The fund management of banks is in high level of crisis. The total assets and liabilities are not equal of some banks. As a result bank is losing their capability of settlement of claims including returning the deposit of the depositors.

According to the law of Central bank the difference between the total assets and their claims to be settled of any bank in any particular month must not be greater than 20% of their total assets. The total pay off a bank is being calculated from ‘Returning the money of the depositors in the maturity of their deposits’, ‘The settlement of import payment’ and ‘Earlier committed credit’. And the total earning of a bank is the accumulated result of’ Adjustment of credit’, ‘Maturity of treasury bills and bonds’,’ Income from different commissions’ and’ Income from the deposits’, etc. The difference between the total pay off and total earning must not be greater than Taka 20.

This difference of Assets and Liabilities is acceptable to Bangladesh Bank. Bank may adjust this deficit of Taka 20 from call money market, or through Repos from Bangladesh Bank. But if the difference goes beyond Taka 20 then bank has to face lots of hazards. The most common scenario is the bank may face severe liquidity crisis. Because of this cash crisis bank loses its capability to settle any of its claims.

The bank also fail to keep the mandatory cash reserve with the central bank Cash Reserve Ratio (CRR). The Statutory Liquidity Reserve (SLR) becomes deficient. To get rid of this condition bank has to borrow money at a extremely high rate and at the same time fund management cost of that bank will increase and the overall system of that bank collapse. As per the fund management of the bank a bank has to estimate the probable liabilities in a month and also has to calculate the amount of total inward deposits at that particular month. The fund management of any bank is maintained on this calculation. But unfortunately many of the scheduled banks are not following this guideline now a day. They are trying to acquire grater amount of expenditure, not conforming their income. As a result these banks are being more dependent on Central bank and also on call money market They are also failure to maintain their day to day expenditure.

It is also observe that when any customer wants to cash a large amount of check, some banks are not able to pay the total money within that day because of the liquidity crisis. Rather these banks requested their customer to come on next day and the respected customer feeling embarrassed. The reputation of these banks becomes questionable. So to handle this situation these banks rush towards Bangladesh Bank or Call money market.

In a recent study it shows that everyday these banks are borrowing more than 90 billion as Repo (Borrowing for short term) and under special liquidity support. In some days the Bangladesh Bank is even lending Taka 100 billion.

Recent Condition some of the banks of Bangladesh

According to BB data from January 1 to January 23, state-owned Agrani Bank Limited borrowed from the call money market on an average over Tk. 300 crore every working day. It was the highest borrowing rate.

Another state-owned bank, Sonali Bank Limited, is on second position as it borrowed about Tk. 250 crore daily. Within this period, the aggregated amounts of borrowing by these two banks are Tk. 5,054 crore (Agrani) and Tk. 4,217 crore (Sonali).

However, two other state-owned banks — Janata Bank Ltd and Rupali Bank Ltd — have lent to the call money market on a regular basis. Within this period, Janata Bank lent Tk. 15,334 crore while Rupali Bank lent Tk. 1,698 crore.

Among private banks, big lenders were:

1. Basic Bank Ltd (lending amount Tk. 11,894 crore),
2. United Commercial Bank Ltd (Tk. 8,769 crore),
3. Pubali Bank Ltd (Tk. 6,825 crore),
4. Dutch Bangla Bank Ltd (Tk. 5,434 crore),

The Trust Bank Ltd, Bank Al-Falah, Premier Bank Ltd, One Bank Ltd and Bangladesh Development Bank are also the big borrower. Borrowing and lending are almost parallel for The City Bank Ltd (aggregated lending Tk. 2,391 crore and borrowing Tk. 2,955 crore) and Standard Bank Ltd (borrowing Tk. 1,060.50 crore and lending Tk. 1,133 crore).

Two foreign banks that went for regular borrowing from the call money market are Bank Asia Limited and National Bank of Pakistan.

Among foreign banks, Commercial Bank of Ceylon, Citibank NA, Habib Bank Limited, Honkong Shanghai Banking Corporation, Standard Chartered Bank, State Bank of India and Woori Bank have lent to the call money market.

Meanwhile, FIs, such as, International Leasing, Lanka Bangla, Peoples Leasing, Prime Finance, Union Capital, Reliance Finance Ltd, ICB Islamic Bank Ltd and BIFC, are facing acute liquidity crisis.

The Steps of Bangladesh Bank should be taken

The Bangladesh Bank (BB) should be more operational independence to exercise properly its regulatory powers over the country's financial sector, specially it's own operational building.

State-owned Sonali Bank Limited has, once again, highlighted the need on guaranteeing proper functional independence to the Bangladesh Bank (BB), without being overloaded by any unnecessary interference by any other authority or influenced by any powerful political quarters

The Bangladesh Bank is now new equipped infrastructure and has been computerized to supervise the financial sector but there is huge lacking of upgraded human recourses to proper use these facilities. So adequate training system should be provided to make stronger human personnel.

Of course in recent times, the BB, however, arranged some in-house training programs for some of its officials on modern banking supervision, monitoring and auditing system, along with both off-sight and on-sight inspection in different phases. Besides, some new departments that those of money laundering prevention unit and the financial intelligent unit, have been set up in the central bank to monitor various types of fraudulent financial practices and crimes. But to protect future crisis the bank has to recruit more efficient and qualified manpower with probity and integrity, the knowledgeable sources, the compensation packages of the BB officials should be delinked from the national pay scales and higher remuneration on market-driven considerations should be paid to better qualified and more efficient manpower of the central bank, the sources added.

The central bank should work as an autonomous body. But government's unwillingness and political influence does not give permission to work it independently. The central bank's capacity to regulate the financial sector has improved considerably. But the BB cannot work independently due to political influence. The government should not influence at all the decisions of the central bank in areas of its functional remit, as it discourages the BB to demonstrate its real capacity to supervise the banking sector. Non-performing loans (NPLs) in particular, if appropriate actions are not taken in right time to enforce discipline in matters of loan approval, disbursement and recovery. A careful scrutiny of all relevant loan cases and a critical examination of stuck-up, rescheduled or non-performing loan portfolios of different banks, will help ascertain things in the right perspectives.

The recent reforms of Bangladesh Bank that are taken are given below:

Regulatory Reforms:

- Banks have been advised to upload their deposit and lending interest rate on their respective website and display the same in suitable visible places in their Branches and Head Offices.
- Banks in general are free to charge/fix their deposit and lending rate. Cap on rate of interest on lending in all sectors other than pre-shipment export credit (7%) and agricultural loans (13%) have recently been withdrawn.
- Banks have been advised to limit the difference between lending rate and weighted average rate of interest on deposit or intermediation spread within five percent in different sectors other than high risk consumer credit (including credit card) and SME loans.
- With progressive deregulation of interest rates, banks has been advised to announce the mid-rate of the limit (if any) for different sectors and they may change interest by 1.5 percent more or less than the announced mid-rate on the basis of the comparative credit risk.
- BB has rationalized the charges of some services to ensure the interest of depositors/invertors/customers and advised all Scheduled Banks to display the complete schedule of charges in suitable visible places in their Branches and Head Offices' for the information of their customer and upload the same in their respective websites for the convenience of the customers.
- Considering the interest of the small depositors it has been decided that no charge can be imposed as account maintenance fee for average deposit balance up to BDT 5000 (USD 62.5). A maximum of BDT 100 (USD 1.25) may be imposed as account maintenance fee for average deposit balance up to BDT 25000 (USD 312.5) on six monthly basis.
- The value of land has increased abnormally due to increasing trend of purchasing of and demand for land. In this context, it has now been decided that banks shall not provide any loan/credit facility for purchasing land in order to channel credit towards productive areas.
- Considering power sector development as a government priority it has been decided that Single Borrower Exposure Limit as stipulated in the BRPD circular 09/2005 will not be applicable for the banks financing in order to produce and distribute electricity against the award provided by the Electricity Department or the institutions controlled by the Electricity Department.

Supervision of banks and financial institutions

- Promulgated Stress Testing Guidelines for the scheduled banks in April 2010 and in February 2011 to gauge the resilience of the banking sector against plausible shocks. The development of credit, market and liquidity risks is being analyzed through stress tests. This will continually address risks that the banking industry is exposed to and help the banks to take necessary corrective measures.
- Introduced Financial Stability Report (FSR) for the first time in October 2011. The FSR contains analysis on macroeconomic developments impacts on the banks and financial institutions and evaluation on current and future risk factors.

- With a view to developing a world class risk management environment in the banking sector of Bangladesh, an elaborate risk management guideline was introduced in 2012. This document promotes an integrated, bank-wide approach to risk management that will propel banks in Bangladesh to the forefront in the region in adopting contemporary methods to identify, measure, monitor, and control risks.
- Scheduled banks were instructed to establish a separate Risk Management Unit (RMU) to develop risk management capacity among them to manage the risks that can cause systemic threats and jeopardize the stability of the entire financial system. The RMU not only conducts Stress Testing for examining the banks' capacity of handling future shocks, and to deal with all potential risks that might occur in future.
- Conducted scenario analysis on banks' Capital Adequacy data for fixing Capital Adequacy Ratio (CAR) & Risk Weight which contributed to the formulation of Guidelines on Risk Based Capital Adequacy (Revised Regulatory Capital Framework for banks in line with Basel II) in December 2010.
- BB has implemented successfully the Basel II accord strengthening overall capital base of the banking sector. The capital of the banking sector increased by BDT 355.2 billion (USD 4.4 billion) during the last three years.
- Investment policies related to capital market activities for scheduled banks were formulated and implemented, which helped the banking sector to remain unaffected from the capital market price correction of 2010-2011.
- Repo transaction has become more transparent and accountable after the implementation of a uniform accounting guidelines for Repo transactions.

Financial Inclusion

- Banks were instructed, from FY 2011-2012, mandatorily to set the annual agri./rural credit disbursement target at a 2.5% of their total loans and advances which was largely achieved.
- A farmer can open an account by depositing BDT 10 (equivalent 12 cents only) at any state owned commercial and specialized bank against national ID card/birth registration card and 'agricultural equipment assistance card' issued by the Department of Agricul- tural Extension. More than 10 million accounts of farmers have been opened at State-owned Commercial Banks with an initial deposit of BDT 10 (equivalent 12 cents only).
- An unemployed youth can open a bank account by depositing BDT 50 (equivalent 60 cents only) at any scheduled bank under National Services Program.
- A hardcore poor can open bank account by depositing BDT 10 (equivalent 12 cents only) at any state owned commercial and specialized bank against national ID card and registration card issued by the Ministry of Food & Disaster Management. There will be no bindings for maintaining minimum balance on the said account and banks shall not impose any charges/fees on these accounts.
- Banks have been advised to designate an official as 'Focal Point' at each branch of their bank with a view to making the banking services beneficial and easily accessible to the physically handicapped people.

 A freedom fighter can open bank account by depositing BDT 10 (equivalent 12 cents only) at any state owned commercial and specialized bank against national ID card and Payment Receipt Book for freedom fighter's allowance. There are no bindings for maintain- ing minimum balance on the said account and banks shall not impose any charges/fees on these accounts. Total number of freedom fighters' accounts is 92,693 as of March 29, 2012.

 Beneficiaries under Social Security Program can open bank account by depositing BDT 10 (equivalent 12 cents only) at any state owned commercial and specialized bank against national ID card and Payment Receipt Book containing Pension Payment Order (PPO) for the beneficiaries. There are no bindings for maintaining minimum balance on the said accounts and banks shall not impose any charges/fees on these accounts. Total number of accounts for Beneficiaries under Social Security Program is 25,80,668 as of March 29, 2012.

 Beneficiaries under Hindu Religious Welfare Trust can open bank account by depositing BDT 10 (equivalent 12 cents only) at any state owned commercial and specialized bank against national ID card and Certificate issued by Hindu Religious Welfare Trust.

Foreign Exchange Policy and Reserve Management

 Exporters are required to submit Proceed Realization Certificates (PRCs) to different government agencies as evidence of export and realization of proceeds. This requirement of authentication by Bangladesh Bank has been withdrawn with effect from July 01, 2009.

 To facilitate export trade, Bangladesh Bank has enhanced the limit of advance payment from Exporter's Retention Quota account to USD 10,000 from USD 5,000 for bona fide business purposes.

 Bangladesh Bank has relaxed regulations in releasing foreign exchange for regular study abroad. Now Authorized Dealers may, without reference to Bangladesh Bank, release foreign exchange to the student while studying abroad, for change of educational institution, for change of subject and for studying new course after completion of a course.

 Bangladesh Bank has relaxed remittance on account of legal expenses for legal prosecution against banks in foreign countries.

 To encourage forward sales of foreign exchange by Authorized Dealers, BB has relaxed the requirement to cover at least 50% of the forward sales by forward purchases and remaining portion by interbank forward purchases and/or spot purchases of export bills.

 BB has enhanced travel quota limit of USD 1000 (by air) and USD 500 (by overland) to USD 1,500 for travel to SAARC member countries and Myanmar. For other countries, the limit has been increased from USD 3,000 from USD 5,000 in a calendar year.

 To facilitate IT/Software firms, Bangladesh Bank has allowed Autho- rized Dealers to remit up to USD 10,000 on behalf of IT/Software firms in a calendar year on account of international alliance/software registration fee, domain registration/hosting fee, server mainte- nance fee, account verification/remittance test fee, etc. without prior approval of Bangladesh Bank.

 To facilitate import transactions, Bangladesh Bank has allowed Authorized Dealers to discount/purchase accepted usance/ deferred bills against import from abroad on banker customer relationship applying due diligence.

- To facilitate outsourcing business, BB has instructed Authorized Dealers to accommodate the proceeds of the inward remittance to the accounts of individual service providers subject to observance of the specific terms and conditions. Moreover, Bangladesh Bank has recognized service exports such as business services, professional/ research and advisory services, etc. rendered from Bangladesh.

- BB has allowed International Credit Card (ICC) for online payment through internet of membership fees of foreign professional and scientific institutions and fees for application, registration,

Relevant Departments: i) Foreign Exchange Policy Department, ii) Foreign Exchange Operation Department, iii) Foreign Exchange Investment Department, iv) Forex Reserve and Treasury Management Department

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- BB has allowed International Credit Card (ICC) for online payment through internet of membership fees of foreign professional and scientific institutions and fees for application, registration, admission, examination (TOEFL, SAT etc.) in connection with admission into foreign educational institutions. This has also allowed that individuals not holding ICCs in their names may also make such online payment through internet using 'Virtual Card' for the required amount by an ICC issuing bank, for use through its designated bank branch

Anti Money Laundering and Combating Financing of Terrorism

Money Laundering Prevention Act (MLPA), 2012 has been promul- gated repealing the Money Laundering Prevention Act, 2009 and the Anti Terrorism (Amendment) Act, 2012 has been promulgated amending the Anti Terrorism Act, 2009 to meet the international standards and to make an effective AML/CFT regime in Bangladesh. The Bangladesh Financial Intelligence Unit (BFIU) has performed a major role in drafting both of the Acts.

BFIU performed significant role in drafting Mutual Legal Assistance Act on Criminal Matters (MLA Act), 2012 for better international cooperation.

BFIU has developed 'National Strategy for Anti Money Laundering and Combating Financing of Terrorism 2011-2013'. The strategy paper contains 12 (twelve) strategies against 12 (twelve) strategic objectives. The National Coordination Committee, headed by honor- able Finance Minister, has approved the strategy paper on 30 April, 2011.

BFIU has performed vital role with Anti Corruption Commission to conduct AML/CFT risk and vulnerabilities assessment on Bangladesh to identify the AML/CFT risks and vulnerabilities in Bangladesh, and drafted a report on it.

A National Coordination Committee (NCC), has been formed headed by honorable Finance Minister, comprising Attorney General, Chair- men of ACC, Principal Secretary and secretaries of all relevant minis- tries, to formulate top level policy on AML/CFT issues and to deter- mine the work procedure to implement the policies. Governor of Bangladesh Bank is one of the members and Deputy Governor (Head of BFIU) is the member secretary of the committee.

A Working Committee has been formed comprising 21 (twenty one) members to support the NCC and to implement the decisions of NCC. The convener of the committee is the Secretary of Bank and Financial Institution Division, Ministry of Finance.

'Primary Contact Point' has been established in the relevant 21 (twenty one) ministries/Division/Organization to ensure seamless flow of information on ML/TF issues.

BFIU has drafted a notification to share related/required information with it and accordingly the notification has been issued by the Bank and Financial Institutions Division, Ministry of Finance instructing all the related agencies.

Bangladesh Financial Intelligence Unit has already signed MoU with FIU of 11 countries among which 07 MoU have been signed during May 2009- May 2012 for sharing information and intelligence on ML/TF issues.

Suggestive Remedies:

Reform Bank Financing System

1. Banks by their nature are not well suited for long term lending. According to a report published by the World Bank in 2008, 69 per cent of lending has a maturity period of less than 3 years in metropolitan areas. The average term for bank loans in non-metropolitan areas was 17 months. After independence, state-owned Bangladesh Shilpa Bank and Bangladesh Shilpa Rin Sangstha were entrusted with the responsibility of providing industrial term loan to meet the long term financing needs of the economy. But, the attempt was not very successful as a significant percentage of credit given through those institutions became non-performing.

2. A major problem in the banking sector is the accumulation of huge amount of nonperforming loan (NPL). The NPL ratio stood at 13.2% as at end-December 2007(BB Annual Report, 2007-08) which is still very high by any standards, although a downward trend of NPLs is observed in the banking sector for the last couple of years. SCBs and DFIs suffer most from NPL problems as about 30% of loans disbursed by these categories of banks are non-performing. PCBs are doing better in this regard as 5% of their loan is non-performing. In developed countries, the tolerable range of NPL is up to 3%. The performance of the banking sector in the neighboring countries in this regard is also much better than the Bangladesh banking sector. NPL ratios in India, Sri Lanka and Pakistan are 1.9%, 5.6% and 7.7%, respectively. (1) The NPL problem has several damaging effects in the way of optimum utilization of resources. On the supply side, it is limiting the recycling of fund and forcing some banks to follow a very conservative policy which ultimately makes it difficult for a new firm to get required financial assistance.

3. Ideally, interest rate should reflect the risk of the borrower i.e. the more risky borrower should pay a higher interest rate and vice versa. But such a variation is not observed in the interest rate among the borrowers classified in the same sector. Banks' risk analysis of borrowers is mainly reflected in the decision of accepting or rejecting the loan proposal; not so in differentiating interest rate of the credit. The country also lacks an updated, adequate and reliable data base of the business enterprises. However, we might expect the increasing availability of company risk profile with the institutional development of the few number of credit rating agencies that are operating in the country.

4. In many cases, banks assign undue weight to collateral security rather than future cash flow in making credit decision. It becomes difficult, for some potential entrepreneurs to meet the banks' requirement (The World Bank Report, 2008). As a result, the idea of 'entrepreneurship development' by banks is not practiced or cultured in the Bangladesh banking system.

5. Sound credit management using professional standards is required for insider-loans. Bank management must ensure the same set of standards both for the insider loan and loans granted to others. The issue of loans, given to insider parties, emerged as a matter of concern in the mid 1980s after allowing the operation of private commercial banks in Bangladesh. Although, Bangladesh Bank has adopted various measures for ensuring prudent management of insider-loan, still the banking sector is burdened with a high amount of default loan, granted to the insiders.

6. Although there are wide branching networks of state-owned commercial banks in the country, lending is heavily concentrated in urban areas. Thus, inequitable transfer of funds from the rural areas to the urban areas is evident. Moreover, private commercial banks established since 1990 have very few rural activities. This pattern of urban-based credit portfolio makes the target of equitable development unachievable. Also, there is a disparity between the rural areas and the urban areas in the quality of the banking services offered. In recent years, a number of modern information and communication technology based banking products have been made available mainly in the urban areas. Clients of many non-urban areas do not have access to such products.

7. One of the major problems in the existing financial system is the absence of exit policy. In one way or another, banks are allowed to continue their operations even in the face of severe problems. A number of banks, in the past, continued their operations without meeting the minimum capital requirement and with a substantial amount of defaulted loans. It seems that depositors axe also not aware of varying levels of risk with different banks and do not take

their deposit decisions based on the insolvency risk of the bank. This is an example of moral hazard problem where weak banks are not pressurized by the stakeholders, especially, by the depositors to make their operations sounder and efficient which eventually keep Bangladesh banking sector away from having adequate market discipline.

8. One of the major objectives of the regulatory body is to ensure financial stability which, in turn, depends on the compliance with the existing prudent measures by the commercial banks. There are numerous instances of regulatory failures in the banking sector, such as, violations of the provisions relating to the members of the board of directors, amount of shareholding by the directors, etc. Inadequate regulatory compliance and lack of market discipline in the banking sector might be due to incompetence on the part of the regulatory body and/or lack of autonomy of the central bank. Like most other developing countries, there is a sharp difference between legal independence and de facto independence of the central bank in Bangladesh. Thus, it becomes difficult for the central bank to take punitive actions against the wrongdoers within the prevailing overall legal environment of the country.

Conclusion

Banks are formed to ensure smoother financial activities of the country's economy. From the beginning people trust on the banking activities as well as their rules and regulation and keep their money for safety and security. But today banking activities become corrupted and depend on some selective persons' decision. The regulation of bank affected abruptly and the faith of depositors and investors become lessen upon banking sector. The entire management system has been involved to lose their reputation. In this situation this is the duty of Bangladesh bank to handle strictly the commercial banking activities and immediately enforce the rules and regulation which are applicable to improve the condition of those banks and as well as the entire economy.

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