

Mitigating Risk and Addressing Challenges Ahead |

Shitangshu Kumar Sur Chowdhury
Deputy Governor
Bangladesh Bank

**Monetary Policy Workshop on Strengthening
Macroprudential Frameworks**
March 22-23, Tokyo.

Background

- During the first decade of the 21st century credit institutions in many parts of the world faced increasing competition, increased volatility in interest rates, exchange rates, and share prices, asset price bubbles, deep recessions, deteriorations in credit quality, and unpredictable changes in the legal and regulatory framework.
- Most financial institutions were able to cope with these challenges, but a great many, including some very large and well-known institutions, were not.
- The key difference between those institutions that survived and those that did not was risk management.

Central Bank's Initiatives

Bangladesh Bank, in alignment with international community, has taken various initiatives to mitigate risks faced by banks through incorporating different forward looking policy tools to address the challenges ahead:

- (i) Liquidity Risk Management**
- (ii) Maintaining Financial Stability**
- (iii) Separation of Capital Market Activities of Banks**
- (iv) Risk Management and Stress Testing in Banks**
- (v) Basel II implementation**
- (vi) Contingency Planning**
- (vii) Financial Safety Net and Bank Regulation**

Liquidity Risk Management

- ✱ Banks in Bangladesh did not experience acute liquidity crisis in the recent past;
- ✱ However, some banks faced liquidity constraints in 2010 mainly due to shortage of cash money, attributable to high credit growth in the banking sector.
- ✱ The industry average credit-deposit ratio (CDR) was around 85 percent as against ceiling of 85 per cent for conventional banks and 90 percent for Islamic ones.
- ✱ Within 6 months banks brought down the industry average CDR to around 80 percent.
- ✱ BB instructed the banks to align the credit growth with deposit growth in such a way that the growth of credit should not exceed the same of deposit.

Liquidity Risk Management

- ✱ Banks are providing long-term loan to the country's industrial sectors, which is creating an asset-liability maturity mismatch in the commercial banks' profiles.
- ✱ After 2010, Bangladesh Bank (BB) has taken several steps to reduce liquidity risk in the banks.
- ✱ BB has taken initiatives to implement two of the Basel III components e.g., liquidity coverage ratio (LCR) and net stable funding ratio (NSFR).
- ✱ BB is trying to develop customized "run off" factors for various components of LCR and NSFR.
- ✱ BB has decided to begin the implementation of Basel III liquidity standards from 2014.

Maintaining Financial Stability

- Realizing the importance of resilience of the banking system in sustainable economic growth of Bangladesh, BB has put special emphasis on maintaining stability in the banking sector and has already published its first financial stability report titled "Financial Stability Report, 2010".
- The Report discusses major trends in the banking industry and non-bank financial institutions (NBFIs) in Bangladesh with respect to their impact on financial stability.

Maintaining Financial Stability

Result of the Stress Test on banks at end-Dec 2011

- ◆ Negative shift in NPL categories causes 5 banks' CAR fall below 10 percent
- ◆ Increase in NPL causes 10 banks' CAR fall below 10 percent
- ◆ Change in interest rate causes 8 banks' CAR fall below 10 percent
- ◆ Change in equity price causes 4 banks' CAR fall below 10 percent
- ◆ Change in exchange rate causes 2 banks' CAR fall below 10 percent

Separation of Capital Market Activities

- ⊕ Banks were advised to establish separate subsidiary companies for capital market activities.
- ⊕ This will ensure that banks are engaged in core business rather than capital market operation.
- ⊕ Almost all the banks having engagement in capital market activities had already established separate subsidiaries.
- ⊕ BB has also imposed strict limitations on exposures to capital market activities according to Bank Company Act, 1991.

Risk Management and Stress Testing

- To harmonize the process of analyzing and mitigation of different risks in banking business towards ensuring financial stability, banks were instructed in June 2010 to establish an independent Risk Management Unit (RMU).
- **Main objectives of RMU:**
 - Overseeing Risk Management of banks in a prudent manner
 - Analyzing various risk and preparing Risk Management Paper of banks
 - Formulating overall risk assessment and management policies
 - Reviewing and updating all risk on a systematic basis
 - Setting portfolio objectives and tolerance limits for each type of the risk
- All the 47 banks have already established RMU.
- BB has created a new unit to monitor risk management functions of the banks and stress tests results done by them.

Risk Management and Stress Testing

- ✓ BB has introduced a revised 'Risk Management Guidelines' for banks in February 2012 to manage various risks in a prudent manner.
- ✓ This document promotes an integral, bank-wide approach to risk management.
- ✓ Most innovative parts of this document are Risk Management Organization and Governance, and Capital Management.
- ✓ In February 2011, BB launched revised Stress Testing Guidelines to understand the strength and vulnerabilities of the banks.
- ✓ BB has revisited its CAMELS rating framework, incorporated a few new indicators and restructured CAMELS questionnaire for better subjective judgment.

Basel II implementation

- ★ With a view to making the banks more shock absorbent and resilient, BB has begun implementation of Basel II for regulatory compliance since January 1, 2010.
- ★ All the banks have been implementing pillar I through pillar III of Basel II,
- ★ SRP-SREP dialogues with banks will commence soon.
- ★ 43 banks out of 47 maintained capital adequacy ratio (CAR) of more than 10 percent at the end-December 2011.

Contingency Planning

- Bangladesh undertaken a Contingency Planning Project in 2011.
- Under this Project, BB is planning to initiate several institutional reforms namely:
 - (a) Creating a Financial Stability Group (FSG)
 - (b) Creating a Technical Secretariat for the FSG
 - (c) Creating a Special Analytical Unit in BB
 - (d) Creating a Senior Bank Specialist for Banks
 - (e) Creating a Specialized Bank Restructuring Unit
- The Special Analytical Unit is at blooming stage. Major tasks of the Unit are:
 - Conducting macro-prudential surveillance
 - Conducting bank-by-bank stress testing and systemic stress tests to assess resilience
 - Contingency plans for resolution/restructuring/liquidation (“living wills”)
 - Conducting special occasional studies
 - Preparing position papers identifying options for resolution of systemic crises
 - Preparing financial stability reports

Financial Safety Net and Bank Regulation

- ❖ Bangladesh introduced **Deposit Insurance Scheme** in August 1984 as an attempt to reduce the risk of loss of depositors' fund with banks.
- ❖ A fund titled “**Deposit Insurance Trust Fund**” has been created with a view to providing protection, to some extent, to small depositors (not exceeding BDT 0.01 million).
- ❖ BB proposed to enhance the coverage to BDT 0.02 million.
- ❖ Currently around 85 percent depositors are under the coverage of the safety net program of BB.
- ❖ Premium rate for problem banks is 0.07 percent and for others 0.09 percent.

Financial Safety Net and Bank Regulation

- ✓ To align the premium with the international standard, new risk based premium rate of 0.10 percent for problem bank, 0.09 percent for EWS banks and 0.08 percent for standard/regular banks are under review of the government.
- ✓ BB is currently addressing the bank failure through resorting to various provisions of Bank Company Act, 1991 and guidelines for Merger/Amalgamation of banks/FIs.
- ✓ BB is planning to strengthen the problem bank resolution framework through developing and implementing bank restructuring policies in a more prudent manner.

Conclusion

- BB is in the process of effectively shifting from compliance-based to risk-based supervision of banks, and this trend toward “supervision by risk” will be continued.
- **Supervision by risk contains many elements, including :**
 - comprehensive ratings of banks;
 - effective enforcement regime to mandate timely and adequate corrective action;
 - consistent application of laws, regulations, and best banking practices;
 - thorough evaluation of corporate governance, including internal audit, internal controls, and compliance;
 - transparency and integrity of data, including high standards of performance for external auditors and the validation of data by on-site inspectors; and
 - use of these data in an early-warning system to spot potential problems before they become too great.

Conclusion

- Although these responsibilities of banking supervisors are many and varied, we also cannot forget that the primary responsibility of good performance rests with the bank managements themselves.
- For bankers, a high standard of corporate ethics and responsibility to the public, coupled with keen attention to risk management as we have already discussed, will keep our banking sectors safe, strong, and contributing to our national development.

Thank You!