State of Governance in the Banking Sector
Dealing with the Recent Shocks

By

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Acronyms

ATM	Automated Teller Machine
BCA	Banking Company Act
SCBS	Commercial Banks
CY	Calendar Year
CIB	Credit Information Bureau
CAMELS	Capital Adequacy, Asset Quality, Management Quality, Earnings, Liquidity and Sensitivity to Risks
CBSP	Central Bank Strengthening Project
CEO	Chief Executive Officer
DGM	Deputy General Manager
DMD	Deputy Managing Director
ECF	Extended Credit Facility
ITFD	Finance Division
FCMD	Foreign Currency Management Division
FSRP	Financial Sector Reform Programme
FSAC	Financial Sector Adjustment Credit
FCBs	Foreign Commercial Banks
GDP	Gross Domestic Product
GoB	Government of Bangladesh
GMs	General Managers
HR	Human Resource
IMF	International Monetary Fund
IAD	Inspection and Audit Division
IT	Information Technology
KPI	Key Performance Indicators
L/Cs	Letters of Credit
MCR	Minimum Capital Requirement
NBFI	Non-Bank Financial Institution
NCBs	Nationalized commercial banks
NPL	Non-performing loans
NPA	Non-Performing Assets
PAD	payment Against Documents
PSC	Pre-shipment Credits
PCBs	Private Commercial Banks
RWA	Risk Weighted Asset
SBL	Sonali Bank Limited
ToR	Terms of Reference

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Fahmida Khatun, PhD[1]

1. Introduction

Banking sector is one of the most important components of the financial system that mobilizes resources for productive investments in a country which in turn contributes to economic development. The relationship between financial sector development and economic growth has been explored in several studies in the recent past. Cross-country empirical evidence suggests a positive association between financial development and economic growth (Ahmed and Ansari 1998; CPD 2011; Monnin and Jokipii 2010; McKinnon, 1973; Shaw, 1973; Calderón and Liu, 1999; Rahman, 2004; Chakraborty, 2008; Khan 2011; Khan 2002; Khan and Senhadji 2000). On the other hand crisis, volatility and corruption in the banking sector have been found to have negative implications for the growth of the banking industry (Park 2012; Moshirian and Wu 2012; Lin and Huang 2012; Serwa 2010).

In Bangladesh, financial sector is dominated by banks. In terms of share in Gross Domestic Product (GDP), total asset of the banking sector was 65.5 percent of GDP in 2010 and of non-bank financial institutions (NBFI) 3.4 percent of GDP in June 2011; asset of the capital market was 33.7 percent of GDP in April 2012 (GoB 2012; Bangladesh Bank 2012). The banking sector has flourished during the last three decades or so as a result of increased demand of the growing economy. During this period the banking sector has also undergone several reforms and fallen under the jurisdiction of a number of acts in a bid to improve the efficiency of the sector. Nevertheless, the sector is yet to improve its performance in terms of trust and confidence of people as shocks hit the sector from time to time in a major way. Among these, the issue of governance in the banking sector has currently been under the spotlight in the context of the Hall Mark scam which has been the biggest financial crime in the history of Bangladesh's banking sector. Given the contribution of the banking sector in the overall development of the country, such processes of misappropriating public resources can have serious implications for economic growth of the country.

This paper will discuss some of the challenges confronting the banking industry of Bangladesh, particularly focusing on the state owned commercial banks (SCBs) in view of the Hall Mark case. Hence the major objective of the paper is to examine how far the exposed performance indicators of the SCBs are credible and whether the SCBs have been able to meet the emerging domestic and global demand in terms of better services and newer products. The paper also makes a number of recommendations for a healthy banking sector and to prepare for the emerging challenges.

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This paper is structured in the following manner. The introductory Section is followed by an overview of the performance of the banking sector in Section 2. This section also includes a brief discussion on the major reforms in the banking sector of the country since independence. Section 3 discussed the challenges of the sector in view of the recently exposed fraudulent practices of the Hall Mark group. The paper presents a set of key recommendations in Section 4 based on lessons learnt from the Hall Mark case. These suggestions are made with a view to ensuring a healthy and sustainable growth of the banking sector of the country. Finally, in Section 5 some concluding remarks have been made.

2. Overview of the Banking Sector

2.1 Performance and Progress

The pace of development for the banking industry has been significant over the past decades. In calendar year (CY) 2011 total asset of 47 commercial banks stood at Tk 5874.9 billion and deposit at Tk 4509.8 billion (Bangladesh Bank 2012). During the last ten years (2001-2011) total asset has grown by 324.2 percent while deposit has increased by 326.9 percent (Bangladesh Bank Annual Report 2010-11). Total deposit is currently 51 percent of GDP of the country. The ratios of money supply (M2) to GDP, total deposits to GDP and total domestic credit to GDP have shown steady increase over the years indicating an increased financial depth. In comparison to other South Asian countries Bangladesh stands behind India and Nepal (Table 1).

Table 1: Financial Depth in Asian Countries

Indicators	**Bangladesh**				**India**	**Pakistan**	**Nepal**	**Sri Lanka**
	2000	2005	2010	2011	2011	2011	2011	2011
M2/GDP	0.32	0.41	0.52	0.55	0.79	0.38	0.76	0.34
Deposit/GDP	0.29	0.38	0.49	0.51	0.57	0.36*	0.51	0.31
Credit/GDP	0.25	0.32	0.39	0.55	0.75	0.44	0.67	0.42

Note: * represents data of 2010.
Source: Annual report central bank of Bangladesh, India, Nepal, Sri Lanka and WDI.

Financial inclusion, though still low compared to developing countries[2], have increased significantly since independence. Population per bank branch has improved from 57,700 in 1972 to 17,660 in June 2011 indicating that a large number of people are under the coverage of banking services. However, there is still a large untapped market for the banking industry as a large number of people remain outside the banking services. Sharma (2008) developed an index of financial inclusion using data on 3 dimensions of financial inclusion and compared it among 55 countries. Bangladesh ranked 43 while India ranked 29 as per this index.

Soundness of the banking sector, which basically reflects on the quality of performance of the sector, is measured by indicators such as capital adequacy, asset quality, management quality,

[2] In India, for example, population per bank branch was 13466 in FY 2010-11 (Reserve Bank of India; http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?id=669 accessed 02/11/2012).
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earnings, liquidity and sensitivity to market risks (CAMELS). In 1996, Bangladesh Bank adopted Basel I replacing the liability-to-capital approach with the risk-based capital approach which was adopted in 1991. Minimum capital requirement (MCR) was 8 percent of risk weighted asset (RWA) with 4 percent core capital. In 2002, MCR was raised to 9 percent of RWA with 4.5 percent of core capital. In line with Basel II requirement, to measure capital adequacy banks have now adopted the Basel minimum capital requirement in a phased manner. Accordingly, during January 2010 to June 2010 the minimum capital of banks was 8 percent of RWA with core capital equal to 4 percent of RWA; for the July 2010 to June 2011 period these rates were 9 percent and 4.5 percent respectively. Since July 2011 the minimum capital of banks should be 10 percent of RWA with core capital equal to 5 percent of RWA.

Over the last few years the banking sector of Bangladesh has made significant progress with regard to these indicators. As shown in Table 2, in the recent past the situation of banks in terms of capital adequacy has improved and banks in Bangladesh have been able to maintain adequate RWA capital. The percentage share of non-performing loans (NPL) to total loans has reduced dramatically during 1997 to 2011. Similarly there were improvements in the case of bank management, profitability and liquidity. However, a disaggregated performance of these indicators for different categories of banks shows that the performance of the SCBs has been weaker than other categories of banks (Table 3).

Table 2: Banking Sector Performance

Soundness Indicators	**CY2004**	**CY2006**	**CY2008**	**CY2010**	**CY2011**	**2012 (June)**
Capital to Risk Weighted Asset (%)	8.7	6.7	10.1	9.3	11.3	
NPL to Total Loans (%)	17.6	13.2	10.8	7.3	6.2	7.17
Expenditure-Income Ratio (%)	90.9	91.4	87.9	70.9		
Return on Asset (%)	0.7	0.8	1.2	1.8	1.3	1.16
Return on Equity (%)	13.0	14.1	15.6	21.0	14.3	13.49
Liquid Asset (%)	23.4	21.5	24.8	23.0	21.0	
Excess Liquidity (%)	8.7	5.1	8.4	6.0		
Sensitivity to Risks	20.3	31.5	9.9			

Source: Bangladesh Bank.

Table 3: Capital to Risk Weighted Assets Ratio by Type of Banks

	Bank Type	**2004**	**2006**	**2008**	**2010**	**2011 (June)**	**2012 (June)**
Capital Adequacy	**Capital to Risk Weighted Asset (%)**						
	SCBs	4.1	1.1	6.9	8.9	9.5	
	DFIs	9.1	-6.7	-5.3	-7.3	-7.0	
	PCBs	10.3	9.8	11.4	10.1	10.4	
	FCBs	24.2	22.7	24.0	15.6	17.1	
Asset Quality	**NPL to Total Loans (%)**						
	SCBs	25.3	22.9	25.4	15.7	14.1	
	DFIs	42.9	33.7	25.5	24.2	21.8	

	PCBs	8.5	5.5	4.4	3.2	3.5	
	FCBs	1.5	0.8	1.9	3.0	3.1	
Management	**Expenditure-Income Ratio (%)**						
	SCBs	102.3	100	89.6	80.7	65.9	
	DFIs	104	103.5	103.7	87.8	101.7	
	PCBs	87.1	90.2	88.4	67.6	69.1	
	FCBs	76.3	71.1	75.8	64.7	45.4	
Profitability	**Return on Asset (%)**						
	SCBs	-0.1	0.0	0.7	1.1	0.6	0.75
	DFIs	-0.2	-0.2	-0.6	0.2	-0.3	-0.04
	PCBs	1.2	1.1	1.4	2.1	1.6	1.19
	FCBs	3.2	2.2	2.9	2.9	3.6	3.78
	Return on Equity (%)						
	SCBs	-5.3	0.0	22.5	18.4	10.0	11.72
	DFIs	-2.1	-2.0	-6.9	-3.2	-5.2	1.39
	PCBs	19.5	15.2	16.4	20.9	15.6	12.39
	FCBs	22.5	21.5	17.8	17.0	20.2	19.43
Liquidity	**Liquid Asset (%)**						
	SCBs	22.8	20.1	32.9	27.2	27.0	
	DFIs	11.2	11.9	13.7	21.3	22.1	
	PCBs	23.1	21.4	20.7	21.5	24.5	
	FCBs	37.8	34.4	31.3	32.1	31.1	
	Excess Liquidity (%)						
	SCBs	6.8	2.1	14.9	8.2	8.1	
	DFIs	4.7	3.8	4.9	2.3	3.1	
	PCBs	8.8	5.6	4.7	4.6	8.0	
	FCBs	21.9	16.4	13.3	13.2	12.2	

Source: Bangladesh Bank.

Even though there have been improved performances the SCBs continue to be grappled with problems of inefficiency and solvency. Thus the seemingly good performance does not capture the reality which raises elements of doubts as regards the real health SCBs.

2.2 Reforms in the Banking Sector

The Government of Bangladesh (GoB) played an active role in the economy as it envisaged a socialist economy after independence in 1972. As a result the government had a greater involvement in various sectors of the economy including banking and finance. The commercial and specialized banks were under the control of the government.

The government embarked on a policy of liberalization, through denationalizing the nationalized commercial banks (NCBs) in the 1980s. In view of the deteriorated performance and inefficient resource management the government decided to open up the banking sector and adopt a number of reforms for the sector. As part of the reform process two of the six nationalized commercial banks (NCBs) were denationalized and a few commercial banks were given license to operate in the private sector to create competition in the banking sector. The reform process accelerated towards the end of 1980s and the beginning of the 1990s under the directions of the World Bank and the International Monetary Fund (IMF). The National Commission on Money, Banking and

Credit was constituted in 1986 to look into the problems of the banking sector and suggest ways to overcome those under the direction of the World Bank. The Commission pointed out, among others, problems relating to the supervisory task of Bangladesh Bank, overall structure of the banking sector and pointed out that Non-Performing Assets (NPA) required improvement. The consequent Financial Sector Reform Programme (FSRP) and Financial Sector Adjustment Credit (FSAC) carried out in the 1990s were geared towards implementation of various reform measures in the financial sector. The objectives of these measures were to liberalize interest rate, enhance the capacity of loan classification and provisioning, capital restructuring and risk analysis, strengthening central bank and improving the legal system and framework for loan recovery.

Following the phase out of the FSRP in 1996, subsequent governments continued to undertake reform measures in the financial sector. The Commission on Banking and the Banking Reform Committee were formed in 1998 and 2002 respectively to make recommendations for the improvement of the performance of banks. A bill was passed in the national parliament in 2003 to bring more reforms in the banking sector. Most important of the relevant initiatives was the Bangladesh Bank Amendment bill 2003 through which Bangladesh Bank received the autonomy to operate on its own and also to formulate the monetary policy. The World Bank and the GoB undertook a reform initiative called the Central Bank Strengthening Project (CBSP) to put in place a strong and effective regulatory and supervisory system for the banking sector of the country. The focus of this project was on three broad areas such as (i) strengthening the legal framework; (ii) reorganization and modernization of Bangladesh Bank, and (iii) capacity building of Bangladesh Bank.

Another major reform attempt was the corporatization of four SCBs into limited companies and restructuring of three SCBs in 2007 to operate as more of a commercial entity. Supported by the World Bank and monitored by Bangladesh Bank, the reform initiative included measures such as selection of the chief executive officer (CEO), deputy managing director (DMD) and four general managers (GMs) of the SCBs through a competitive process and fixation of the compensation package that was commensurate with the private sector and in accordance with respective performance records. Monitorable goals were set for cash recovery of NPLs, limits on new NPLs, operations, computerization, income and profitability, increased net worth and disclosure.

As can be seen from Table 3, since the corporatization of the SCBs there have been some improvements in terms of achievement of the goals that were set out. The SCBs, for the first time, did earn profit in 2008 which they also continued afterwards. The NPL has reduced and the management performance has also increased which is reflected through lower expenditure-income ratio.

However, the reform initiatives for the banking sector in Bangladesh have not been able to deliver the expected results. Achievements in terms of efficient resource allocation through disbursement of credit to productive sectors, prudent risk analysis, supervisory and management quality have not been encouraging in many banks even after so many reforms since independence. Moreover, lack of governance has been featured prominently in the recent years in several banks including the SCBs. This only suggests that reform is still an unfinished agenda in the banking sector of Bangladesh.

3. Anatomy of the Hall Mark Incidence

As is revealed from the previous section, higher credit expansion, increased profitability, lower non-performing assets and increased financial inclusion have contributed to an improved banking system during the past decade. The regulatory framework has supported this growth to a large extent. It may be worth to note that at a time when major economies of the world are under tremendous pressure due to the second wave of financial crisis and bankruptcy of financial institutions and sovereign debt crisis, the banking sector of Bangladesh has been navigating through in a resilient manner.

However, recent shocks in the banking sector have exposed the vulnerability of the seemingly resilient financial systems in the country. Despite some positive results initially after the reform in 2007, the SCBs unfortunately could not sustain the momentum due to poor supervisory capacity and weak institutional framework. As a result, not only these banks are suffering from shortages of capital but their profitability has also started to decline (Table 3). Additionally, incidences of irregularities have weakened the overall performance and threatened the stability of the banking industry. The recently detected Hall Mark case of forgery through inland bills trade involving the largest SCB of the country Sonali Bank Limited (SBL), is a testimony to poor management, weak internal control and risk management, and above all total lack of governance on the part of the bank. Shocks in the banking sector of such nature and extent will only hamper the growth of the banking industry but can risk the economic growth of the country. This is the most despicable financial forgery in the banking history of Bangladesh which has surpassed all the earlier cases of misappropriation of resources from banks[3].

Box 1: Unauthorised Loans and Advances: A Record of Sonali Bank /Ruposhi Bangla Branch

The recently unearthed incidence of financial irregularities in the Ruposhi Bangla branch of Sonali Bank Limited reveals that as on 31 May 2012 total outstanding loans and advances related to international trade was Tk 3,699.53 crores, of which funded and non-funded unauthorized loans and advances was Tk 3606.48 crores. These unauthorized bank loan facilities were given by the General Manager and Assistant Manager of the branch to Hall Mark Group (Tk 2,667.45 crores), T and Brothers Group (Tk 685.63 crores), Paragon Group (Tk 144.44 crores), DN Sports Group (Tk 28.54 crores), Nakshi Knit Group (Tk 65.30 crores) and others (Tk 15.12 crores).

These loans and advances were given by disregarding the rules and regulations of the bank. Besides branch officials did not maintain relevant documentation properly on purpose. A significant fund was misappropriated through the inland bills trading. The branch opened inland letters of credit (L/Cs) in favour of three fictitious spinning mills which were customers of the said branch on account of another company, a concern of the Hall Mark Group. The branch transferred the money to the accounts of the three companies which after a few days advised the bank to transfer the money to the account of Hall Mark Group.

[3] Some of the previous cases of bank frauds include Tk 300 crores by Om Prakash Agarwal in 2002 through transfer from five banks, Tk 596 crores through withdrawal without cheques by the owners of the Oriental Bank in 2006 and Tk 622 crores by Nurunnabi in 2007 through fake L/Cs.

The branch manager resorted to a number of unauthorized ways to disburse huge amount of money to Hall Mark Group and other customers. Some of these are as follows:

- i. Provided credit facilities without any sanction;
- ii. Allowed credit facilities after the expiry of sanctioned period;
- iii. Illegally opened local back to back L/Cs and provided acceptance to documents raised by different banks in favour of non-existent spinning and textile mill on account of Hall Mark Group, T and Brothers Group, Paragon Group, DN Sports Group and Nakshi Knit Group;
- iv. Illegally opened local back to back L/Cs and provided acceptance to documents raised by inter/intra branch customers namely Star Spinning Mills, Max Spinning Mills, Anwara Spinning Mills and Master Cotton Yarn Ltd on account of Hall Mark Group and T and Brothers Group;
- v. Created unauthorized fresh loans to adjust unauthorized overdue loans;
- vi. Provided loan against fake export documents of Hall Mark Group, T and Brothers Group, Paragon Knit Composite Ltd, and Nakshi Knit Composite Ltd;
- vii. Provided excess pre-shipment credits (PSC) over approved limit;
- viii. Allowed PSC without L/Cs;
- ix. Allowed PSC after shipment date;
- x. Opened cash L/Cs without customers' existing liabilities and limits;
- xi. Opened cash L/Cs for capital machinery at zero margin without the approval of the head office of the bank;
- xii. FCMD debited head office NOSTRO account without obtaining reimbursement from the branch;
- xiii. Reported irregular payment against documents (PAD) loans as regular in classified loan report;
- xiv. Opened foreign back to back L/Cs without office note and realizing commission;
- xv. Transferred fund illegally by debiting sundry deposit accounts;
- xvi. Purchased export bills before completion of exports;
- xvii. Applied incorrect exchange rates for purchasing deferred payment export bills;
- xviii. Overdue export bills were not reported to the central bank; and
- xix. Allowed temporary overdraft illegally against cash incentives.

Source: Report on Financial Audit of Ruposhi Bangla Branch of Sonali Bank Limited, August 2012.

3.1 Magnitude of the Hall Mark Scam

In a resource constraint country such as Bangladesh where the government has to struggle for allocating resources among competing priorities, Tk 3606.48 crores have significant implications for public investment. Box 2 reveals why this scam is too important to be ignored exclusively on economic grounds. One may also wonder why does the country bows down to stringent conditionalities of donors for the construction of infrastructural projects when domestic resources are being plundered in this manner.

It is also alarming to observe that SBL disbursed an amount equivalent to almost 237 percent of the paid up capital of SBL[4] only to Hall Mark Group (Tk 2667.45 crores). This is an utter

[4] As on 31 December 2011, SBL had a paid up capital of Tk 1125 crores (http://www.sonalibank.com.bd/PDF_file/fs2011.pdf)

violation of the ‘Single Party Exposure Limit’. Bangladesh Bank has determined that banks cannot give loan more than 35 percent of its capital to any individual, enterprise or group, of which funded loan should not exceed 15 percent of bank’s capital. In case of the export sector, a client can be granted a loan up to 50 percent of bank’s capital, of which funded loan has to be kept within 15 percent of bank’s capital.

Box 2: What is the value of Tk 3606.48 crores?

Taka 3606.48 crores is equivalent to:

320.6 percent of Sonali Bank’s paid up capital!
6.6 percent of Annual Development Programme of FY2012-13
15.9 percent of allocation for social safety net programme in FY2012-13
38.6 percent of allocation for health in FY2012-13
16.8 percent of allocation for education in FY2012-13
0.3 percent of projected GDP of FY2012-13
15 percent of the finance requirement of the Padma Bridge
42.9 percent of the envisaged support by the World Bank for the Padma Bridge

Source: Compiled by the author.

3.2 Fault Lines of the Hall Mark Episode

It is more or less clear now that weak risk management, pressure exerted by powerful sections, connivance and unholy alliance between senior managers of the bank and the client, lack of supervision from the head office of the bank, oversight of the Board and lack of regulatory hindsight had been the reasons behind the embezzlement of this huge amount of money from a small branch of SBL. As is shown in Box 1, irregularities were of various natures and at a large scale. This cannot be performed by a sole manager of a small branch. A number of reasons have been identified by the audit team which helped this forgery to happen. These are summarized below:

a. The branch manager was posted in the same branch for five years exceeding the limit of three years at one branch. The principal office of the bank warned the manager back in 2007 about some irregularities. Again in 2010, serious irregularities relating to international trade were found by the GM office and International Trade Finance Division (ITFD) of the Head office. However, no steps were taken by the ITFD to regularise the irregularities of the said branch of the bank.

b. Neither the budgeting and monitoring department nor the ITFD of the bank did inquire about the huge growth of loans and advances of the branch. No detailed inspection was carried out to investigate abnormal increase of loans and advances. On the contrary, Inspection and Audit Division (IAD) -2 of the head office graded the branch as ‘Low Risk’ branch in February 2011 and they did not mention any irregularities. More shocking is that the IAD-2 commended the branch manager saying that he was “managing the branch efficiently with his extraordinary talent, foresight and banking knowledge”. One can easily understand how the branch manager was encouraged to continue the unethical activities!

c. Since June 2010 the management of the bank introduced a detailed monthly report on branches containing 85 columns. A close scrutiny of this factsheet can reveal the status of branches. However, it seems these reports were not reviewed properly by the GM office and the CEO also overlooked these reports.

d. There was a general reluctance towards inspection and audit of the Ruposhi Bangla branch even after complains of irregularities were made. Principal office requested the DGM of IFTD and IAD-2 to carry out inspection of the branch on its irregularities. But none of the bodies acted on this. The branch was brought under the supervision of the GM office since July 2011. No quarterly inspection was undertaken till 31 January 2012. On 26 January 2012 the ITFD finally put up a note for inspection of the branch. However, the inspection began after two months.

e. The irregularities were easy to be carried out by the branch due to the absence of an automated transaction system with central control and monitoring facilities.

4. Lessons Learnt and Recommendations

The recent financial scam is an eye –opening incident for all associated with banking sector as well as the policy makers exposing the inherent weaknesses of the banking sector of the country. In view of the recent irregularities, appropriate measures ought to be undertaken in the short to the medium term towards improved performance of the sector. This should range from proper investigation and punishment of involved persons to improvement of the monitoring and governance of the SCBs. Specific recommendations are the followings:

i. Absence of Risk Management Policy

Absence of a comprehensive risk management policy in many banks makes it difficult to handle fraud and other extra-ordinary cases. Bangladesh Bank has identified six core risks and asked banks to formulate and implement appropriate guidelines on those. These core risks include the following: (i) Credit Risk Management; (ii) Foreign Exchange Risk Management; (iii) Asset-Liability Risk Management; (iv) Internal Control and Compliance Risk Management; (v) Money Laundering Prevention Risk Management; and (vi) Guidelines on Information and Communication Technology. Needless to say, these guidelines are hardly followed by most of the banks, specially the SCBs. The manual for loans and advances containing policies, procedures, processing and reporting transactions, review of security and collateral and responsibilities at different levels makes is not followed by many banks due to which it becomes for them to handle and manage clients with various levels of exposures.

ii. Lack of Internal Control

The internal control department which ought to be the most critically important department of any bank is weak in the SCBs. This is mainly due to incentive failure which prevents hiring of qualified persons for this department. As the nature of the job involves patient scrutiny of compliance, people are reluctant to work here, and those who do, are often in a way dumped in this department. Absence of information technology (IT) makes their work even more boring. Bangladesh Bank guidelines on internal control require that if there is any incidence of a loss equivalent to Tk 1 crore the Board of Directors of Banks should be informed immediately. Besides, any major irregularities, fraud and embezzlement have to be presented through a report during the monthly assessment of banks. In the case of Hall Mark scam it seems that the bank management was hiding the illegal activities in the said branch for a prolonged period.

iii. Political Baggage of the Board of Directors

The tradition and practice of appointing Directors of the Board of the SCBs based on the political loyalty and affiliation have to be changed. Members of the Board of the SCBs should be independent, qualified, efficient and socially acceptable persons with unquestionable integrity. Bangladesh Bank Guidelines 2010 for the directors of banks spelt out the 'Fit and Proper Test Criteria' for the nomination of Directors along with their responsibilities and power. These criteria are yet to be implemented fully. Due to political baggage, Directors of SCBs cannot perform their duties independently and remain morally obliged to listen to political instructions of the government. This results in weak corporate governance. As the Broad members are also members of various committees of a bank constituted to closely guide various operations of the bank, the independence of the audit committee, the most important board committee which has to ensure compliance of business strategy and policy of the Board, cannot be maintained as well. Given the emerging challenges and dynamism of modern banking business, it is thus important that Directors of the Board have the pertinent knowledge and skill of running bank with efficiency and sincerity.

The accountability of the Directors should also be determined clearly. In case of the Hall Mark scam it has been reported that the Board was not informed of the unscrupulous inland bill trading. However, the fact that the responsible branch was not audited and the accused branch manager was not transferred even after completion of his three years tenure are some of the issues which the Board cannot shrug off its oversight responsibility.

iv. Inappropriate Appointment of CEOs and Senior Officials

The scam has also exposed total failure of the Chief Executive Officer (CEO) and responsible senior managers of the bank in discharging their duties. In the SCBs, preoccupation of most CEOs is to keep the Board in good humour and sing the songs the way the Board likes to hear so that their position is well secured under any circumstances. It is difficult to find any instance where the CEO has been asked to leave the job because of bad performance. One may argue that in a setting where the Board is constituted of political candidates, the CEO is handicapped in taking any decision guided purely by banking ethics, norms and perceived risks. This however, is not a saleable point. Good business plan, effective people management programme, regulatory compliance practice, effort towards clients' satisfaction and high work ethics of any CEO of a bank are bound to be endorsed by a Board no matter how political it may be. Performance of CEOs should be evaluated from time to time by the Board based on Key Performance Indicators (KPI). The Board can only guide and support the CEO to achieve the targets that are of benefit to the bank.

In appointing GMs, suggestions have been made to have a common and single selection and promotion committee under Bangladesh Bank and the Ministry of Finance for selecting GMs or promoting deputy general managers (DGMs) to GMs and for posting them in different banks following their selection. GMs should also be transferred from one SCB to another in order to not only help transfer of good practices, but also to reduce the possibility of fraudulent and unethical practices.

v. Shortcomings of Human Resource Policy

Human resource (HR) development has been a neglected issue in the SCBs. As mentioned earlier, the World Bank supported reform of 2007 recommended a number of measures for the improvement of skills and performance of the officials in the SCBs. However, the HR department of the SCBs remains weak and powerless to take decisions on recruitment and promotion, partly due to lack of capacity and partly due to external influence. In the modern day business, banks have to provide value added products and services to customers in addition to traditional banking functions. However, the SCBs suffer from skilled and qualified human resources for undertaking such operations. The HR policy of banks should not only arrange for appropriate training but also should include the reward and punishment practices of the bank.

vi. Inertia for Automation and Management Information System

An issue related to the HR development is the automation and management information system in banks. It is apprehended by experts with fair amount of certainty that there may be many more Hall Mark cases that wait to be uncovered in other banks. Unless these are dug out through transparent and automated banking practices with the help of information technology, the mess may be piled up and reach an unmanageable stage. Even after several reform initiatives, the inertia of the SCBs in adopting IT based banking services and the MIS is not only disappointing but also quite surprising. Due to lack of MIS, the Hall Mark case was not detected in time even though clearing was going against SBL continuously for many months due to loan increase in a branch of the bank.

There have been comprehensive programmes for the last several years to establish automated clearing house and credit information bureau (CIB), computerization of the head offices and branches of all banks, electronic banking services, online corporate banking service, electronic fund transfer, automated teller machine (ATM) and internet banking. While all the foreign banks (FCBs) and most of the private commercial banks (PCBs) have implemented these automated and electronic banking services, the SCBs are way behind in meeting these requirements. This is not only affecting their efficiency and profitability but also giving rise to opportunities for committing scams such as the Hall Mark. The archaic manual system of transaction records has indeed facilitated the Hall Mark forgery. Mentionable that the as part of the reform programme the World Bank had supported a consultant in the rank of the general manager for IT in the SCBs for two years with a higher compensation package. The general managers for IT were supposed to work on procuring computers, developing and buying software and training officials. These initiatives are yet to see any meaningful result as the automation process is almost non-existent in the SCBs.

vii. Dualism in the Regulatory Mechanism and Regulator's Oversight

It is no secret that there exists a strained relationship between Bangladesh Bank and the Ministry of Finance over the supervisory and regulatory role on SCBs. Though Bangladesh Bank can exercise its full authority in supervising the PCBs and FCBs, the Ministry of Finance oversees the SCBs to some extent. The Ministry of Finance appoints the Directors of the Board, CEOs, DMDs and GMs of the SCBs. However, due to less articulated mandate, Bangladesh Bank faces problems in implementing recommendations of audits and ensuring overall governance of the SCBs.

Full autonomy of the central banks has been suggested by many concerned stakeholders including the donors. The International Monetary Fund (IMF) has asked for amendment of the Banking Company Act (BCA) giving full legal supervisory and regulatory authority of Bangladesh Bank over all commercial banks within September 2012 as a precondition for contracting a loan to Bangladesh for USD 987.06 million under the Extended Credit Facility (ECF) in April 2012. There has also been suggestion by many to dismantle the Banking and Financial Institutions Division at the Ministry of Finance in order to keep the SCBs away from political influence. While this is necessary for smooth functioning of the banking sector the supervisory and monitoring role of Bangladesh Bank needs to be significantly strengthened as well. Though the Ministry of Finance is in the driving seat to monitor and control the SCBs, Bangladesh Bank has to perform audit and inspection in all commercial banks including the SCBs. As in the other previous financial chaos in the country such as the capital market debacle, Bangladesh Bank played a reactive role long after the irregularities have actually been in place. Firm supervision and effective monitoring could have controlled the damage suffered by SBL. The fact that clearing of SBL was going against the bank, the amount of loan was increasing, and finally the bank became a borrower from a lender in the interbank market, indicates the weak off-site supervision mechanism of Bangladesh Bank.

viii. Need Commission for the Financial Sector

Though banking sector has achieved considerable success due to the reforms in the 1990s and 2000s the sector will have to prepare for the next generation global regulatory framework and meet emerging clients' needs. In the coming days the banking industry will have to achieve the ability to absorb shocks arising from financial and economic stress, improve risk management and governance, and strengthen banks' transparency and disclosures through complying with Basel III requirements which is scheduled to be introduced from 2013 until 2018.

In view of the recent shocks in the banking sector and emerging challenges a Commission for the financial sector should be formed which will scrutinize the overall performance of the sector, assess the need of customers and the economy, identify the current problems and emerging challenges and suggest concrete recommendations for prudential banking to be implemented in the short to medium terms. Considering the emerging need and in order to build up more transparent and responsible banking sector the commission can also include non-bank financial institutions, such as insurance companies and capital market under its jurisdiction as they are interconnected. The broad terms of reference (ToR) of the Commission will be to critically assess the problems and weaknesses of the banking industry in order to find whether there is any disconnect between demand of the growing economy and the realities of a back dated financial system that is failing to meet the emerging need. On the basis of a comprehensive scrutiny the Commission will prepare guidelines and make recommendations as regards automation, risk management, internal control, the role of various players in banks and other financial institutions.

5. Concluding Remarks

The Hall Mark incident is not only a case of financial loss but also a deep dent on the confidence and trust of the customers of the bank. It is also not the loss of good will of the particular bank only, but of the total banking industry. Such an erosion of reputation of banks could have multiple chain effect including reduction of deposit in the concerned bank and fall of share prices of the whole banking sector. This can also constrain the role of the banking sector in catalyzing the growth of the economy. Without radical changes in the banking practices in the country such expectations may remain largely unfulfilled. During the run up to attaining the ambition of being a middle income country there is a need to significantly strengthen the banking industry if goals are to be realised. From the 1990s onwards, the Bangladesh economy has evolved and the banking sector has evolved as well. With the speed up of economic growth through higher investment the demand on the banking sector will still be higher. This reiterates the need for improved efficiency of the sector in terms of resource allocation for the productive sectors and management. As the global regulatory environment is becoming tighter, global economic environment is facing more volatility and resources are getting more scarce, banks in Bangladesh will have to find innovative ways to conduct their business. There will be demand for higher capital and skilled human resources for smooth functioning of banks and for ensuring compliance in the coming days. Therefore, the banking sector in Bangladesh has to focus on using both its financial as well as human resources in a far more innovative and efficient way to cater to the demands of the future.

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