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Editorial Notes

Bangladesh achieved sustained annual growth of a bit more than 6 per cent in the Non-performing Loans (NPLs) of the banks have gone up and are on the rise. These rising NPLs and capital market exposures of banks entail more credit risk and make the banking system vulnerable to the risk of failure unless it is systematically addressed by Bangladesh Bank and banks' management through extending risk-based supervision and bank risk management respectively. Despite rescheduling of some of them with laxity, required provisions have to be maintained causing profitability of the banks in 2014 in terms of EPS had fallen much more than that of last year. For State owned banks, government had to recapitalize Taka 50 billion already and have to recapitalize further Taka 101 billion for meeting shortfall of capital adequacy.

The first article of this issue focuses on the role of risk-based supervision as a tool for risk management, along on a consolidated basis, and some aspects of it in addressing the risk of bank failure from the best practice and its development in the context of Bangladesh. It also emphasizes risk-based supervision must be commensurate with the overall risk profile of a bank or a NBFI. While detailing risk-based supervision versus compliance-based supervision, it is argued that risk-based approaches to prudential supervision are better placed to enable a central bank to make a notable difference in the prudential health of the financial institutions. Supervisors must factor these risks of wider fluctuating net interest income or return on investment into forward looking judgment about the capability of the bank to survive the adverse shocks in the macroeconomic parameters. In addition to compliance -based supervision, Bangladesh Bank partially conducts risk-based supervision. To this end, Bangladesh Bank issued six core risk guidelines and also issued "Risk Management Guidelines for Banks". With the amendment of Bank Company (Amendment) Act, 2013, Bangladesh Bank got mandate of conducting consolidated supervision and accordingly it issued circular on "Consolidated Capital Market Investment Limit for the scheduled banks" - maximum exposure limit of capital market of the banks be 25% of equity. Besides, Bangladesh Bank monitors maturity profile of the banks' interest rate sensitive assets and liabilities, and assessment of other risks through its off-site supervision of the report of stress testing submitted by banks on quarterly basis. A number of issues related to corporate governance have been incorporated into the Bank Company (Amendment) Act, 2013, putting in place checks and balances comprising of a mix of legal, regulatory and institutional provisions specifying the roles and accountabilities of the Boards, the executive management, external and internal audit, disclosure, and transparency prescriptions.

The second article highlights the issues concerning to the preparation of Green Annual Report by listed banks for minimizing paper consumption with confronted challenges. The result shows that banks are to print annual report in large volume complying with current practicing laws and their internal policies. Introducing Green Annual Report may be compassionated with the initiative for environmental protection at minimizing cost. Printing and distributing an abstract of annual report along with a comprehensive highlight and uploading the comprehensive annual report on website may be proper approach of Green Annual Report. According to UNEP, Center for Corporate Governance in Africa and Deloitte, 2012, a company's ability to attract capital, build brands and establish a solid reputation will in the near future depend on how well it communicates not only its financial, but also its social and ecological goals.

The third article deals with empirically examining the dynamic interdependence of monetary variables and inflation, and their speed of adjustment in Bangladesh. The study identifies lending interest rate and depreciation of Taka, that affect inflation via reserve money (RM) as the economy is fifty percent monetized. The study reveals that sale of foreign exchange by the DMBs creates local currency liquidity in the market creating demand pull inflation, which need to mop up using BB Bill resulting increase in NFA of RM. Simultaneously proper devaluation can be used to boost export and remittances and reducing import to protect the cost push inflation. Considering demand pull and cost push inflation, devaluation policy will be effective depending on use of open market operations (OMOs). Sterilizing policy can be used applying reverse repo and BB Bill for better monetary management and financial stability. The paper advocates that BB need to maintain appropriate liquidity preserving par value of Taka and try to smooth the flow of funds enlighten the need of the government and private sector bearing in mind the demand pull, cost push and other consequences of inflation due to monetary causality.

The last and final paper of this issue is concerned with highlighting the factors driving an unbundling of SME banking in Bangladesh and on the contemporary condition of SME banking on the face of evolving customer needs and emerging new technologies. Use of invariant definition of SMEs across all banks and alignment of business model after venturing into SME banking put banks on strong stepping stone especially for the current environment of squeezing margin and fierce competition in corporate and retail banking. Optimization of SME service for banks warrants diversification of revenue source by looking beyond loan products, cost economies from outsourcing of leads management, and freeing of credit underwriting from collaterals by riding it on the merit of the proposal.

Mahmood Osman Imam **31 March, 2015**
Editor