



**Project on : Loan Classification, Provisioning Requirement
& Recovery Strategies of Eastern Bank Limited & Prime
Bank Limited, A Comparative Overview.**

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*Nice work
formatting.*

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It is an immense pleasure for me to thank a large number of individuals for their help and encouragement who have contributed directly or indirectly to prepare this report. First of all my department helped me to get such an opportunity for Project at Eastern Bank Ltd. and Prime Bank Ltd. I convey my sincere gratitude to my honorable teacher **Md. Shariful Islam, Leturer, Dept. Of Business Administration.**

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Finally I would like to thank all of the employees at Gulshan Branch EBL and friends who helped me to prepare this report directly and indirectly.

December 17, 2006

To
Md. Shariful Islam
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Subject : Submission of the Project

Dear Sir,

It gives me immense pleasure to submit the Project report on "Loan Classification, Provisioning Recovery Strategies of Eastern Bank Limited & Prime Bank Limited, A Comparative Overview. The report emphasize on the defaulter scenario of the two banks. But the reader will also get an overall idea about the defaulter culture of the country.

In preparing this report, I have tried my level best to include all the relevant data & analysis to make the report comprehensive.

As a student of Finance, I truly appreciate the opportunities that put forth by my university and have enjoyed working in a real life setting. Please inform me if you need any further clarification or if there is any information you want to know regarding this report.

Hope that, you will enjoy reviewing this report.

Yours Sincerely,



Md. Shakhawat Hossain Bhuyain
ID#2002-3-10-053

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EXECUTIVE SUMMARY

The report entitled “Loan classification, provisioning requirement and recovery strategies of Eastern Bank Limited & Prime Bank Limited, A comparative Overview.” focus on the defaulter scenario of the two banks. At the same times, this report also emphasizes on the provisioning conditions and recovery strategies of those banks.

Identifications the reasons for which the loans are actually becoming classified are a hard job. It requires expertise in banking field. In this report, I basically try to discover the reasons by analyzing several real classified loans of the two banks. These reasons are basically divided into three types. First of all, the fault is with the bankers. Most of the times they fail to identify the motivation of the clients. Then they rely on the data provided by the clients, which are not cent percent valid. At the same time they don't analyze the data properly. Secondly, client's over confidence about the project. Finally, existing rules are encouraging tonic for the intentional defaulters because, for recovery banks have to go for a time consuming procedure and most of the time bank fail to recover.

The most related factor associated with loan classification is provisioning. The rate of provisioning is not same for all classes. For substandard loan bank keeps 20%, for doubtful 50% and for bad 100% of loan amount. Here loan amount does not mean the total amount, which was paid by the bank. Fixed deposit, security, interests are deducting from the loan amount and provision creates on rest of the figurers.

The final step of loan classification is to recover the loan amount from the respective client. Here the procedure is almost same for every bank. At

beginning they give reminder letter. Then they send letter informing that bank is going to sue against the client. If client does not give satisfactory response after this letter then bank sue against the client. Mainly banks sue in the "Artha Rin Adalat" located at *Rai Shabar Bazar*. There is a separate act for banks called "Bank Act 1993".

In Findings and Analysis part, I try to critically analyze the factors, which are playing around the NCBs, PCBs, FCBs and cause classified loans. In reality NCBs, and FCBs enjoy more facilities than the PCBs. FCBs's cost of fund is lower than others. So they can charge lower than other types of banks. As a result, FCBs have more options than others to choose clients and they take the best ones. Now NCBs is the quickest credit facility provider. They are faster than others because they don't really go through the feasibility study of the client. For this reason, NCBs holds this highest amount of classified loans. Now the cost of fund of PCBs is higher than FCBs and they take more time than NCBs to provide credit facility. But only because of the efficient management they (PCBs) are able to keep their position in between of NCBs and FCBs in case of percentage of classified loan.

Later on in comparison of EBL, & PBL I discovered several factors for which PBL is superior than EBL. First of all, PBL provide faster credit facility than other two. Secondly, PBL's client selection is better than other two. Finally and most importantly, as the management of PBL provides more empowerment to the employees, they become more responsible to their jobs. All of these reasons makes PBL superior not only among the other two banks but also among all PCBs. It reflects on the CAMEL rating. PBL is the only local commercial bank, placed at "A" category of CAMEL rating. Other than CAMEL rating, their percentage of classified loan also show their superiority. Now the problem with EBL is they are oldest bank among two. For this reason their classification rate is higher than others. Now all banks are common in one area that is the Board of directors approves every credit facilities. And the members of this board are most

risk averse. They choose the area where already others invested. The related factor of classified loan is provisioning, it cause pull down profit. At the same time it reduce tax for banks. The final stage of classified loan is recovery. Here for this recovery EBL has a separate department called Special Asset Management Department. But the others don't have this short of this separate department.

At last I give recommendations to remove the classified culture from our banking sector and conclusion. Basically the recommendations are for the Govt. who is responsible to impose rules and regulations. Although all classified loans are not become so because of the existing laws. But the existing laws inspire the intentional defaulters. Now the recommendations are not only for the Govt. but also for the authority of the Banks. From the very beginning of sanctioning loan, Banks have to be careful. They always have to put one idea in their mind that the loan can become classified. As a result proper documents are essential. So for documents they have to think, " Whether we have what we need". Finally Conclusion basically put emphasizes on the importance on loan classifications. Because classified loans destroy the bank's value to both the stockholders and clients. The stockholders and client can easily measure the efficiency of the banks by checking the percentage of classified loans.

Part -1

INTRODUCTION

01.01. Introduction

The needs for commercial banks in any country are important for its economic growth. Primarily, commercial banks are the one of the major source of funds in the economy. By borrowing money from the locals and lending the same to the locals as loans and advances, they perform an important function. People and Govt. itself are very much dependent on the effective and efficient services provided by the banks in the financial markets of the country. Commercial banks act as financial intermediaries by performing the functions of mobilizing the funds and utilizing them in the proper way. Banks make reasonable amount of profit after meeting the cost of fund. In Bangladesh, one common problem is the cost of fund is very high because of the high transaction and ledger costs and limited source of fund. Competition is intense for funds in the country. Combining all these issues, financial environment is tough to operate in Bangladesh; moreover the stringent rules, regulations, and Govt. control on market make things worse. Now this report focuses on an important side of banks that is how efficient they are in providing credit facilities. Their efficiency is reflected by the amount of classified loan. Another two factors are also associated with these classified loans – provisioning strategy and recovery strategies.

01.02. Origin of the report

Now a days, education is not just limited to books and classrooms. In today's world, education is the tool to understand the real world and apply knowledge for the betterment of the society as well as business. From education the theoretical knowledge is obtained from curses of study, which is only the half way of the subject matter. Practical knowledge has no alternative. The perfect coordination between theory and practice is of paramount importance in the context of the modern business world in order to resolve the dichotomy between



these two areas. Therefore, an opportunity is also offered by Finance Department for its potential business graduates to get three months (twelve weeks) practical experience, which is known as “Internship Program” that is taken when the student is at the leg of the Bachelor Degree. For the competition of this internship program, the author of the study was placed in a bank namely, “Eastern Bank Limited”. Internship Program brings a student closer to the real life situation and thereby helps to launch a career with some prior experience. Department of Finance has goals to produce world-class graduates within the local environment with knowledge and skill to provide leadership in enterprise, public service and welfare of our society. Internship of this Department is a step towards fulfilling this commitment by given the students an opportunity to get ready for the real world before they enter into their practical life.

Involvement of the banking sector in different financial events is increasing day by day. At the same time the banking area is becoming wider and the process is becoming faster, easier. As the demand for better services increases, the banking organizations are coming with innovative ideas. In order to survive in the competitive field of the banking sector, all banking organization are looking for better service opportunities to provide their clients. Now a days, it has become essential for every person to have some idea on the bank and banking procedure.

This report entitled “Loan Classification, Provisioning Requirement & Recovery Strategies of Eastern Bank Limited & Prime Bank Limited, A comparative Overview ” originated from the partial fulfillment of the internship program. For the internship program, each student is attached with an organization. My internship was at the “ SME Department of Eastern Bank Limited at Gulshan Branch.



01.03. Objectives

There are some objectives set forward in doing this report. The objective of the report can be divided in two parts-

Primary Objectives:

- To fulfill the partial requirement of Department of Finance.
- To familiarize with the EBL, its operation and activities, management style and attempt to realized the gap between the theoretical knowledge with the real business world.
- To learn about the loan classification process, provisioning requirement and recovery procedure of Eastern Bank Limited & Prime Bank Limited.

Secondary Objectives:

- To understand the different functions that is carried out by a bank and to understand the procedure in which these are carried out.
- To know the client booking process.
- To know the different service provide by EBL.
- To know the preparation of credit line proposal.

01.04 Methodology:

To determine the reasons for which the loans have become classified I have gone through several real classified loans of the three banks. At the same time I forecast about three loans of EBL and PBL, whether the loans will turn classified or not. When I have gone through the classified loan cases, basically I put emphasizes on several factors like-

First of all, whether the project was viable or not. At the same time whether the client's prediction was too much optimistic or not.



Secondly, whether the client was fresh or not. If the bank renewed the credit facility, what is the background of the client.

Thirdly, whether the security is reliable or not. Here reliable security means lands, buildings and unreliable means inventories, furniture, machineries etc.

Fourthly, whether the bank takes too much risk or not.

Finally and most importantly, Client's past performance, which is shown by the data.

Later on I forecasts about the three clients of the two banks, whether they become classified or not. Here I emphasizes on the sales figure, project's feasibility and security. Now this task requires experience in the banking field. As a business graduate with having just three months of internship experience in corporate banking, I am not sure whether my judgment is valid or not. But I give my best effort to discover those reasons.

Now for provisioning I have gone through the annual reports of the banks and find out its effect on the respective bank. Basically profit is affected by provisioning. As net profit comes from the deduction of provisioning fund, more provisioning means less profit. But this doesn't mean fewer dividends. Although dividend comes from the deduction of retained earnings from profit but banks can give dividend from previous retained earnings. Provision also has a positive effect on the bank. It reduces bank's tax because Govt. charge tax on the amount of profit after deducting provision.

Finally, for recovery I talk with several bankers and find out that there is not any written guideline for this. Initially they send letters and finally sue against the client to the "Artharin Rin Adalat" under Bank Act 1993.



01.05. Sources of information

All the information incorporated in this report have been collected from primary sources as well as secondary sources.

Primary Sources

1. Interviewing the credit officers of EBL & PBL.
2. Interviewing the borrowers of EBL.

Secondary Sources

1. Files of the classified client.
2. Annual Reports of EBL & PBL from 2001 to 2005.
3. Brochures of EBL
4. Credit Manual of Prime Bank Ltd.
5. BIBM reports
6. Other necessary books, magazines, business out lets and materials.

01.06. Techniques of data analysis

Basically this report is divided into three parts- Classification, Provisioning and Recovery. For classification I have to go through several files and listen to the employees in order to clarify the reason about the classified loan. For Provisioning I just went through the annual reports. For the Recovery I have to talk with the employees because written documents for this is not available.



01.07. Scope

- Loan Classification
- Provisioning Requirement
- Recovery Strategies.

01.08. Limitation

- Load at the work place was one of the main barriers to prepare this report. Although the officers of EBL have been very helpful but they don't have enough time. So, in some cases, observation was needed.
- Due to lack of experience, faults may take place in the report. But I give maximum efforts to avoid mistakes.
- Getting information from other banks is very tough job. As the classified cases are confidential banks don't want to provide information on this.
- Lack of secondary information was another major problem.



Part - 2

INSTITUTIONAL BACKGROUND

02.01. Eastern Bank Ltd.

EBL commenced its operation on August 16, 1992 under the Bank of Credit & Commerce International [BCCI] reconstruction scheme 1992. As per the scheme, EBL took over the entire business, assets & liabilities of the branches of the erstwhile BCCI in Bangladesh. Now EBL is one of the fastest growing commercial banks and the largest capital based bank in Bangladesh.

02.01.01. Vision

To become the bank of choice by transforming the way we do business and developing a truly unique financial institution that delivers superior growth and financial performance and be the most recognizable brand in the financial services in Bangladesh.

02.01.02. Mission

We will deliver service excellent to all our customers, both internal and external.

We will constantly challenges our systems, procedures and training to maintain a cohesive and professional team in order to achieve service excellent.

We will create an enabling environment and embrace a team-based culture where people will excel.

We will ensure to maximize shareholder's value.

02.01.03. Competitive Situation in the Industry

Moderately high quality and comparatively high demand services in the industry, EBL is most likely in the form of differentiated oligopoly structure in our country. Eastern Bank is one of the market leaders in this industry. In this industry most of the banks are partially differentiating their products along



lines of quality features: Styling sophistication, finishing compatibility and service. Major competitors are local and private banks

02.01.04. Eastern Bank's Competitive Differentiation

Product Differentiation of Eastern Bank

Banks worldwide are offering fairly similar products and services. The area of competition is variation in the way they are presented to the customer, the charges and interests offered and collected from customers, service quality, etc.

The multinational banks capitalized on the people's weakness for quality, attention to customers, and good service. EBL provides that to a large extent without charging as high as multinational banks, which has been its main feature and reason for success.

Performance Of Eastern Bank

Eastern Bank always secures its higher profitability by introducing its special quality services to a large number of customers but charging less per customer. It benefits from more repeat use by existing customers leading to growth of consumer loyalty and positive word of mouth.

Conformance of Eastern Bank

One of the major reasons for the high quality reputation enjoyed by Eastern Bank Ltd. is that its products and services do not cause inconvenience to customers.

Services Differentiation Of Eastern Bank Limited

Eastern Bank Limited maintains its excellence by including speed, accuracy and care to attend the delivery of its services.



Human Resource Differentiation Of Eastern Bank

Eastern Bank Limited holds the excellence of a team of financial planners, qualified and experienced bankers and highly skilled marketers and internal support staff.

Image Differentiation

Quest for excellent quality and continuous support of the valued customer have given EBL the position of the header for quality banking as it is able to provide services similar to multinational banks but are priced in a manner that the service can be brought into the grasp of the common people.



02.02. Prime Bank Ltd.

Prime Bank Ltd. is a fast growing private sector Bank and the Bank is already at the top slot in terms of quality service to the customers and value addition for the shareholders. The Bank made satisfactory progress in all areas of business operation in 2002. Despite difficult circumstances , the Bank closed the year with a number of achievement. The bank further expanded and consolidated its customer base in both of its core business and retail banking . The bank retained its lead position with the capital adequacy ration of 12.43% as on December end 2002, which is well above the stipulated of 8%. The return on assets was 3.73% well above the industry average.

02.02.01 Vision:

To be the most efficient bank in terms of customer service , profitability and technology application.

02.02.02 Mission:

Continuous improvement in our business policies and procedures. Cost reduction thorough integration of technology at all level.

02.02.03 Efforts:

On delivery of quality services in all areas of banking activities with the aim to add increased value to shareholders investment and offer highest possible benefits to customers



02.02.04 Strategic Priorities:

To have sustained growth, broaden and improve range of products and services.

02.02.05 Competitive Situation in the Industry:

Banks worldwide are offering fairly similar products and services. The area of competition is variation in the way they are presented to the customer, the charges and interests offered and collected from customers, service quality, etc.

The multinational banks capitalized on the people's weakness for quality, attention to customers, and good service. PBL provides that to a large extent without charging as high as multinational banks, which has been its main feature and reason for success.



Part -3

LOAN

**CLASSIFICATION,
PROVISIONING &
RECOVERY STRATEGY**

03.01. Loan classification:

When the borrower fail to pay installments timely, banks ranks the client in three classes according to the risk associated with the client. Any Loan if not repaid/renewed within the fixed expiry date for repayment will be treated as irregular just from the following day of the expiry date. This loan will be classified as

- ◆ Sub-standard if it is kept irregular for 6 months or beyond but less than 9 months.
- ◆ Doubtful' if for 9 months or beyond but less than 12 months and
- ◆ Bad Debt' if for 12months or beyond.

03.01.01. Policy on loan classification of EBL:

The process of gradually upgrading the policies on loan classification and provisioning to the international level is going on. Measures have been taken to strengthen the credit discipline and the process of classification has been simplified. The following revised policies on loan classification and provisioning has been issued.

Categories of Loans: All loans and advances will be grouped into 3(Three) categories for the purpose of classification, namely

- (a) Continuous Loan
- (b) Demand Loan
- (c) Fixed Term Loan and



- ◆ **Continuous Loan:** - The loan Accounts in which transactions may be made within certain limit and have an expiry date for full adjustment will be treated as Continuous Loans. Examples are: CC, OD etc.
- ◆ **Demand Loan:** The loans that become repayable on demand by the bank will be treated as Demand Loans. If any contingent or any other liabilities are turned to forced loans (i.e. without any prior approval as regular loan) those too will be treated as Demand Loans. Such as: Forced LIM, PAD, FBP, and IBP etc.
- ◆ **Fixed Term Loan:** The loans, which are repayable within a specific time period under a specific repayment schedule will be treated as Fixed Term Loans.

03.01.02. Basis for Loan Classification of EBL:

Objective Criteria:

(a) Any Continuous Loan if not repaid/renewed within the fixed expiry date for repayment will be treated as irregular just from the following day of the expiry date. This loan will be classified as Sub-standard if it is kept irregular for 6 months or beyond but less than 9 months, as 'Doubtful' if for 9 months or beyond but less than 12 months and as 'Bad-Debt' if for 12 months or beyond.

(b) Any Demand Loan will be considered as Sub-standard if it remains unpaid for 6 months or beyond but not over 9 months from the date of claim by the bank or from the date of forced creation of the loan; likewise the loan will be considered as 'Doubtful' and 'Bad/loss' if remains unpaid for 9 months or beyond but not over 12 months and for 12 months and beyond respectively.

(c) In case any instalment(s) or part of instalment(s) of a Fixed Term Loan is not repaid within the due date, the amount of unpaid instalment(s) will be termed as 'defaulted instalment'.



(i) In case of Fixed Term Loans, which are repayable within maximum five years of time: -

- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 6 months, the entire loan will be classified as "Sub-standard".
- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 12 months, the entire loan will be classified as "Doubtful".
- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 18 months, the entire loan will be classified as "Bad -Debt."

(ii) In case of Fixed Term Loans, which are repayable in more than five years of time: -

- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 12 months, the entire loan will be classified as 'Sub-standard.'
- If the amount of 'defaulted installment ' is equal to or more than the amount of installment(s) due within 18 months, the entire loan will be classified as 'Doubtful'.
- If the amount of 'defaulted installment 'is equal to or more than the amount of installment(s) due within 24 months, the entire loan will be classified as 'Bad-Debt'.

Explanation: If any Fixed Term Loan is repayable at monthly installment, the amount of installment(s) due within 6 months will be equal to the amount of summation of 6 monthly installments. Similarly, if repayable at quarterly installment, the amount of installment(s) due within 6 months will be equal to the amount of summation of 2 quarterly installments.



Qualitative Judgement:

If any uncertainty or doubt arises in respect of recovery of any Continuous Loan, Demand Loan or Fixed Term Loan, the same will have to be classified on the basis of qualitative judgment be it classifiable or not on the basis of objective criteria.

If any situational changes occur in the stipulations in terms of which the loan was extended or if the capital of the borrower is impaired due to adverse conditions or if the value of the securities decreases or if the recovery of the loan becomes uncertain due to any other unfavorable situation, the loan will have to be classified on the basis of qualitative judgment.

Besides, if any loan is illogically or repeatedly re-scheduled or the norms of re-scheduling are violated or instances of (propensity to) frequently exceeding the loan-limit are noticed or legal action is lodged for recovery of the loan or the loan is extended without the approval of the proper authority, it will have to be classified on the basis of qualitative judgment.

Despite the probability of any loan's being affected due to the reasons stated above or for any other reasons, if there exists any hope for change of the existing condition by resorting to proper steps, the loan, on the basis of qualitative judgment, will be classified as 'Sub-standard'. But even if after resorting to proper steps, there exists no certainty of total recovery of the loan, it will be classified as 'Doubtful' and even after exerting the all-out effort, there exists no chance of recovery, it will be classified as 'Bad-Debt' on the basis of qualitative judgment.

The concerned bank will classify on the basis of qualitative judgment and can declassify the loans if qualitative improvement does occur.

But if any loan is classified by the Inspection Team of Bangladesh Bank, the same can be declassified with the approval of the Board of Directors of the bank. However, before placing such case to the Board, the CEO and concerned



branch manager shall have to certify that the conditions for declassification have been fulfilled.

Accounting of the interest of classified loans of EBL:

If any loan or advance is classified as 'Sub-standard' and 'Doubtful', interest can be charged in the loan account; but the interest thus charged cannot be transferred to Income account. The total interest charged in the 'Sub-standard' and 'Doubtful' loan accounts will have to be preserved in the 'Interest Suspense' account.

As soon as any loan or advance is classified as 'Bad Debt', charging of interest in the same account will cease. In case of filing a law-suit for recovery of such loan, interest for the period till filing of the suit can be charged in the loan account in order to file the same for the amount of principal plus interest. But interest thus charged in the loan account has to be preserved in the 'Interest Suspense' account. If any interest is charged in any 'Bad-Debt' account for any other special reason, the same will be preserved in the 'Interest Suspense' account.

If classified loan or part of it is recovered i.e., real deposit is affected in the loan account, first the interest charged and not charged is to be recovered from the said deposit and the principal to be adjusted afterwards.

A Continuous credit, Demand loan or a Term loan which will remain overdue for a period of 90 days or more, will be put into the "Special Mention Account" and interest accrued on such loan will be credited to Interest Suspense Account, instead of crediting the same to Income Account.



03.01.03 Classified Loans and advances of EBL:

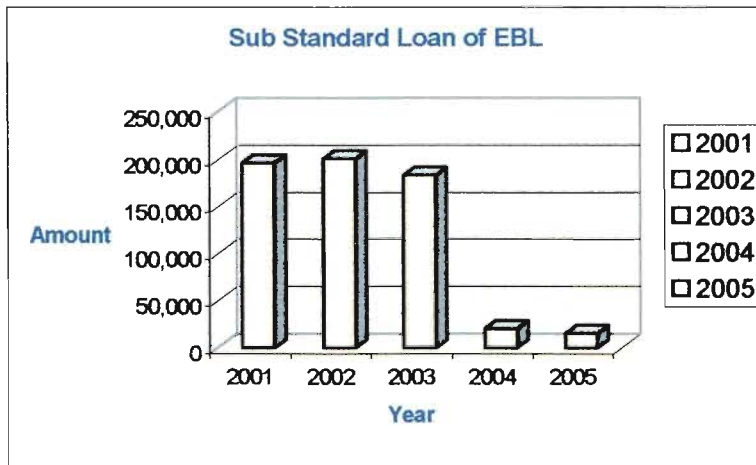
As per Bangladesh Bank's circulars the amount of three types of classified loans of EBL are shown by the following table

(Amount in take `000)

Year	Sub standard	Doubtful	Bad/Loss	Total
2001	1,96,861	85,346	15,56,157	18,38,364
2002	2,01,256	65,265	14,51,864	17,18,385
2003	1,83,841	90,782	12,61,425	15,36,048
2004	20,617	4,140	10,52,527	10,77,284
2005	15,697	6,862	9,24,364	9,46,923

Table: Classified Loans and advances of EBL

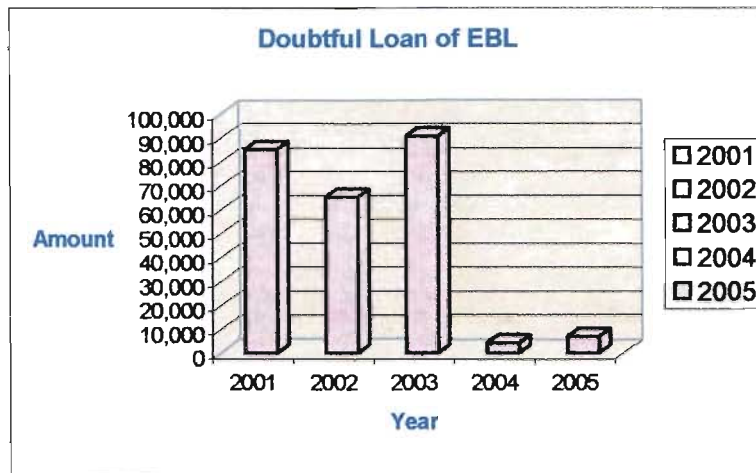
If the data of the above table are plotted in the graph sheet, the following graph can be drawn for the classified loans of EBL.



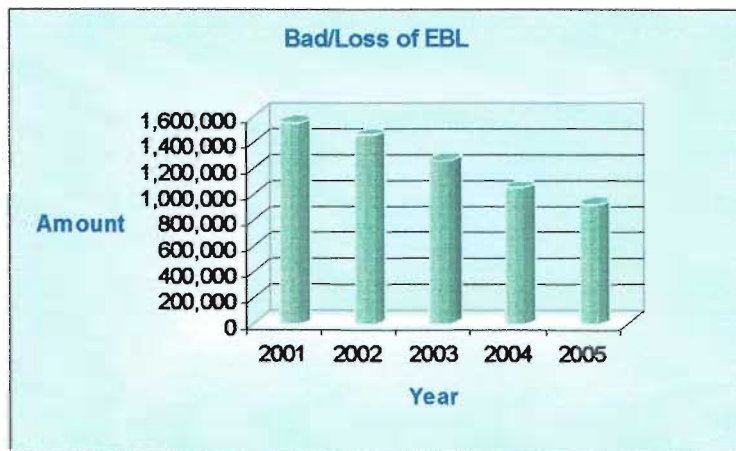
The following graph shows the substandard loans and advances of last five years of EBL. From the graph we can see that the amount of sub standard loans in the first 3



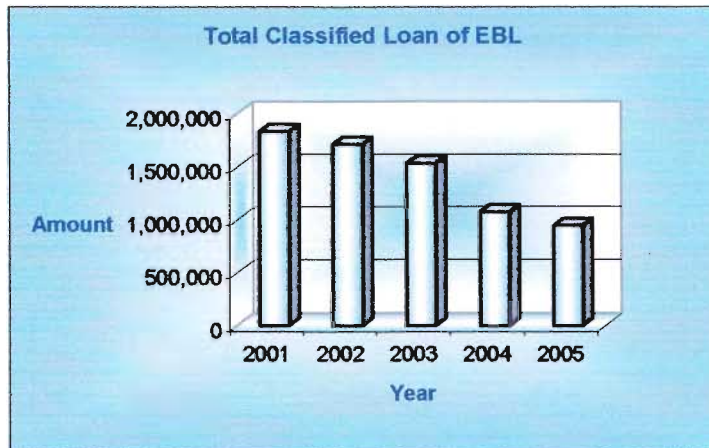
years are much higher. But in the last 2 years the bank was able to reduce a bulk amount because of its provisionary and recovery strategies and the bank is expecting that the reducing trend will continue for the following years.



The following graph shows the doubtful loans and advances of last five years of EBL. From the graph we can see that the amount of sub doubtful loans in the first 3 years are fluctuating. But in the last 2 years the bank was able to reduce a bulk amount because of its provisionary and recovery strategies. But in comparison to year 2004, the amount of doubtful loans in year 2005 is increased and the bank is quite aware to reduce the amount in the next coming year.



The following graph shows the bad/loss loans and advances of last five years of EBL. From the graph we can see a reducing trend of the amount of bad/loss loans in the last 5 years and the bank is quite aware to hold the reducing trend in the next coming year.



The following graph shows total classified loans and advances of last five years of EBL. From the graph we can find a decreasing trend among the last 5 years. It is possible because of the provisionary and recovery strategies of the bank. The bank is quite aware to hold the decreasing trend in the next coming year.



03.01.04. Classified Loans and advances of PBL:

As per Bangladesh Bank's circulars the amount of three types of classified loans of PBL are shown by the following table

(Amount in take `000)

Year	Sub standard	Doubtful	Bad/Loss	Total
2001	86,163	53,646	2,064,565	2,204,374
2002	164,863	65,485	1,265,496	1,495,844
2003	194,563	102,665	1,389,464	1,686,692
2004	128,644	56,523	1,094,661	1,279,828
2005	94,132	46,862	946,656	1,087,650

Table: Classified Loans and advances of PBL

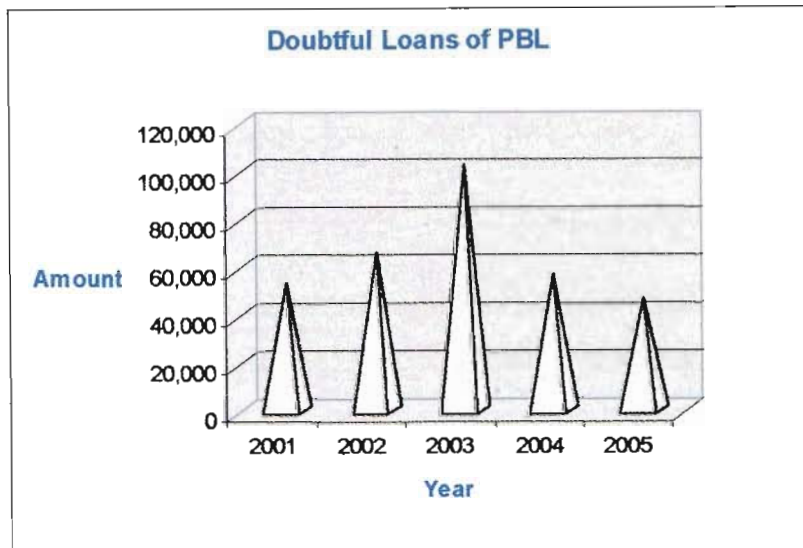
If the data of the above table are plotted in the graph sheet, the following graph can be drawn for the classified loans of PBL.



The following graph shows the substandard loans and advances of last five years of PBL. From the graph we can see that the amount of sub standard loans

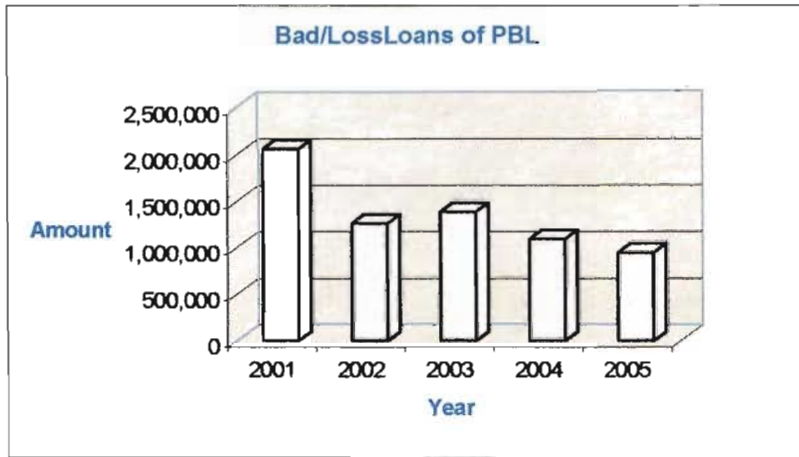


are fluctuating among the last five years. From year 2001 it was going to increase up to year 2003 but from year 2003, it was able to achieve a decreasing trend in the last 2 years. The bank was able to reduce the amount because of its provisionary and recovery strategies and the bank is expecting that the reducing trend will continue for the following years.

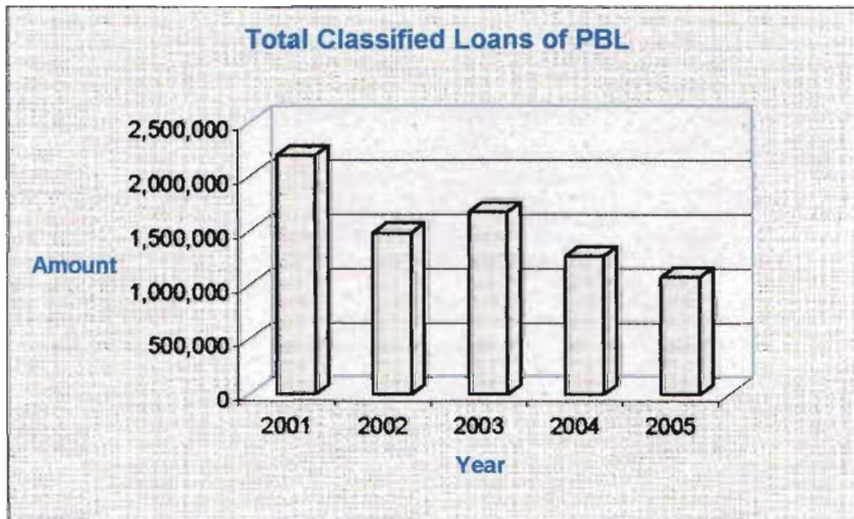


The following graph shows the doubtful loans and advances of last five years of PBL. From the graph we can see that the amount of sub doubtful loans in the first 5 years are fluctuating. But in the last 2 years the bank was able to reduce a bulk amount because of its provisionary and recovery strategies. But in comparison to year 2003, the amount of doubtful loans in year 2004 and 2005 has decreased in a significant amount. The bank is quite aware to hold the trend in the next coming year.





The following graph shows the bad/loss loans and advances of last five years of PBL. From the graph we can see a reducing trend of the amount of bad/loss loans in the last 5 years and the bank is quite aware to hold the reducing trend in the next coming year.



The following graph shows total classified loans and advances of last five years of PBL. From the graph we can find a decreasing trend among the last 5 years.

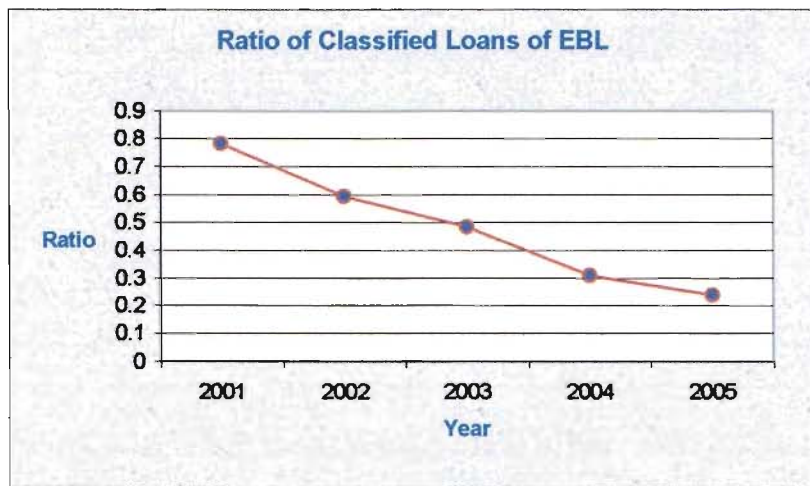


It is possible because of the provisionary and recovery strategies of the bank. The bank is quite aware to hold the decreasing trend in the next coming year.

03.01.05 Ratio of Classified loans of EBL:

(Amount in take `000)

Year	Total outstanding loan	Amount of Classified loans	Ratio (%)
2001	134,659,627	18,38,364	0.7834
2002	189,133,546	17,18,385	0.5943
2003	216,456,284	15,36,048	0.4854
2004	246,864,565	10,77,284	0.3106
2005	294,634,661	9,46,923	0.2399



From the graph we find a decreasing trend in the ratio of classified loans, which mean the amount of classified loans of EBL are decreasing over the years. It is

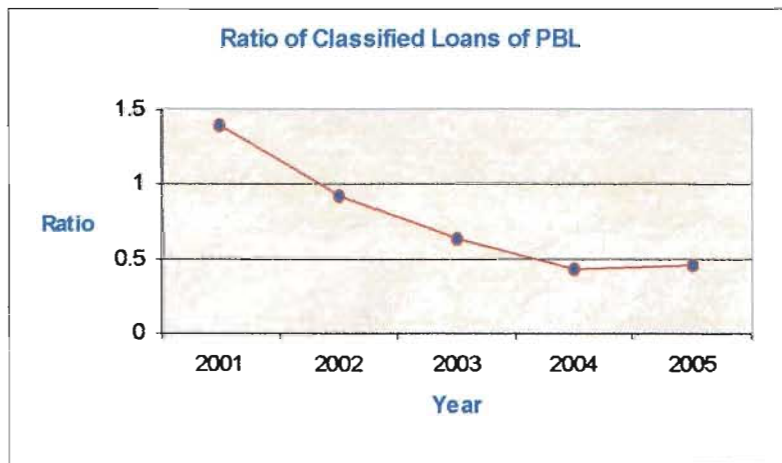


possible because of the provisionary and recovery strategies of the bank. The bank is quite aware to hold the decreasing trend in the next coming year.

03.01.06. Ratio of classified loans of PBL:

(Amount in take`000)

Year	Total outstanding loan	Amount of Classified loans	Ratio (%)
2001	163,456,561	2,204,374	1.389
2002	162,313,654	1,495,844	0.922
2003	268,165,965	1,686,692	0.629
2004	299,684,949	1,279,828	0.427
2005	239,896,476	1,087,650	0.453



From the graph we also find a decreasing trend in the ratio of classified loans, which mean the amount of classified loans of PBL are decreasing over the years. It is possible because of the provisionary and recovery strategies of the bank. The bank is quite aware to hold the decreasing trend in the next coming year.



03.02. Provisionary Requirements

03.02.01. Loan Loss Provision Procedure:

As part of pragmatic and conservative approach to sustain the quality of the Bank's loan portfolio, Loan Loss Provision exercise made mandatory for all Line of Business. Such exercise is decided by:

- a) Generally accepted banking practice,
- b) Conservative approach to assess the quality of Risk Assets whereby the most accurate health of the Loan Portfolio is reflected on the books of the Bank and
- c) To be guided by Bangladesh Bank instructions on provisioning.

Following guidelines are to be observed by the banks:

- i. The prudential Provision Practice dictates that rather than wait until the close of the fiscal year; provision exercise would be an on-going one, with the needed provision created, when an account is classified and continues to remain classified. The provision exercise is to be carried out by each quarter end, based on reports on Classified Accounts related to previous quarter.
- ii. Bangladesh Bank instructions are to be followed for the purpose of Loan Loss Provision exercise.
- iii. Unless otherwise enhanced by Bangladesh Bank regulatory body, Loan Loss Provision Policy as per the matrix given below is to be adopted and followed by the Bank:



Past Due O/S Expired Credit (CRITERIA)	Classification Status	Maximum Provision to be held against Net Loan Value
180 days	Substandard	20%
270 days	Doubtful	50%
360 days	Bad / Loss	100%

- iv. Following formula is to be applied in determining the required amount of provision:

Particulars	Amount
Gross Outstanding	XXX
Less: (I) Cash margin held or fixed Deposit	XXX
(II) Interest in Suspense Account	XXX
Loan Value	XXX
(For which provision is to be created before considering estimated realizable value of other security/collateral held)	
Less: Estimated salvage value of security / collateral held	XXX
Net Loan Value	XXX

03.02.02. Maintenance of provision of EBL:

(a) Bank will maintain provision at the following rates in respect of classified Continuous, Demand and Fixed Term Loans:

- (i) Sub-standard 20%
- (ii) Doubtful 50%
- (iii) Bad-Debt 100%



(b) Provision will be maintained at the above rate on the balance to be ascertained by deducting the amount of 'Interest Suspense' and the value of eligible securities from the outstanding balance of classified loan. General Provision @ 1% against unclassified loans is also to be maintained.

(c) In the definition of 'Eligible Securities ' as mentioned in the above paragraph the following securities will be included:

- 100% of deposit under lien against the loan
- 100% of the market value of gold or gold ornaments pledged with the Bank.
- 100% of the value of Govt. bond/Sanchayapatra under lien.
- 50% of the market value of easily marketable commodity kept under the control of the bank
- 50% of the market value of land and building mortgaged with the bank
- 50% of the average market value for last 06 months or 50% of the face value, whichever is less, of the shares traded in stock exchange.

(d). In terms of the above policies, the EBL will conduct their classification-activities on quarterly basis. Detailed statements in respect of classification, provision and 'Interest suspense' accounts will have to be submitted to Bangladesh Bank within 30 days from the reference date.

03.02.03. Probable Loss:

Only for the purpose of Prudential Provision Exercise "Probable Loss" category of rating is to be determined. In general, accounts, which are already classified



“Doubtful” but have not been down graded to “Loss” should be evaluated from the “Probable Loss” perspective.

To determine this, review the following factors and assign score against each (High score will mean higher probability of Loss and vice versa).

	Low Risk	High Risk
1. Known history of defaults by borrowers in the particularly industry or business segment	0	to 10
2. Attitude of Borrower: Co-operative & willing to work with bank or unco-operative & unwilling	0	to 10
3. Life of account in doubtful category (a period 270 days or more is a strong contender of higher risk and loss probability)	0	to 10
4. Past recovery efforts and success rate (account with less than 25% success rate of recovery of gross O/S is a strong contender of loss probability)	0	to 10
5. Tangible Collateral/Securities held:	0	to 40
I. Clear priority of lien, or charge that is 1st registered mortgage (lack of this: higher risk)		
II. Perfected documentation allowing smooth attachment process through legal means.		
III. Historical time from to obtain attachment orders (longer expected action time will mean higher probability of loss)		
IV. Ready salability prospects at market value (Higher % of realizable value will mean lower risk and vice versa.)		



An account scoring more than 50% may qualify to be high as a “Probable Loss” and would despite being classified Doubtful, may deserve a higher provision on a Net Loan value basis.

03.02.04. Non-Earning Loans:

Following guidelines are to be strictly observed for treatment of unpaid interest in classified accounts:

- I. If interest is over-due by more than 180 Days the outstanding must be classified sub-standard – Non-Earning or even lower (such as Doubtful), if not already so classified.
- II. If any loan is classified Sub standard or doubtful, interest should be charged on this cannot be treated as income. All such interest will be credited to Interest Suspense A/C or any other account specially designed for this purpose by Bangladesh Bank.
- III. If a loan is classified as Bad or Loss, charging of interest (hereafter to be suspended from the dates of Bad & Loss classification. A contingent entry to be taken up for the interest being suspended, which should be reversed back as actual liability at the time of suit being filed for recovery.
- IV. A properly conducted overdraft facility can be considered earning as long as outstanding with interest debited to the account remain within approved and valid limit.



03.03. Recovery Strategy

03.03.01. Signs for Classification:

First and foremost requirement for any credit managers is to identify a problem credit in its earliest stages by recognizing the signs of deterioration. Such signs include but not limited to the following:

01. Non-payment of interest or principal or both on due dates or past dues beyond a reasonable period or recurring past dues.
02. In case of Overdraft no movement in the account beyond a reasonable period.
03. A deterioration in financial condition of the client, as gathered from client's latest financial statement.
04. A shortfall in collateral coverage, particularly if the collateral was a key factor in the decision-making.
05. Death or withdrawal of key owner(s) or management personnel.
06. Company filing for bankruptcy or voluntary dissolution.
07. Adverse market report about the company itself or its principal owners.

03.03.02. Steps to follow for Classification:

Steps to follow in such situations would be:

01. Recheck the account, for all outstanding, including any outstanding in allied or sister company or in owner's or partners' or directors personal names.
02. Thoroughly review loan documentation to confirm, "We have what we need", documents are in proper form, properly executed and current (i.e. not time barred).



03. If possible take current market value of the securities according to liquidation basis. And take a close look at the assets and liabilities to determine who has the prior right on those assets.
04. If Grantors are involved, look closely at the net worth statement and send demand notice.
05. Once the account is classified Sub-Standard, credit lines must be frozen.

03.03.03. Classification Process:

For the purpose of determining the “Classified” status of an account, following guidelines are to be observed

01. The process of classification of an account will start with strict application of the risk rating assessment that is
 - i. Sub-standard
 - ii. Doubtful
 - iii. Bad or Loss
02. However unpaid interest or Principal or Expired Limit for a period of 180 days or more or recurring past dues will remain the most significant rules for classification.

03.03.04. Up-Down Grading Classification:

After classification the client has only two options in hand – either payoff the whole or partial liabilities and erase or down grade the name from the classified list. Or the client can refuse to pay and up grade their position in the classification list.



03.03.05. Special Asset Management Department

[SAMD]:

EBL has a special department called SAMD who are responsible for all accounts classified in the bank's portfolio. Actually they have work like CID officers. However SAMD's responsibility will cover the areas of

01. Monitoring and controlling the classified accounts through monthly reporting and quarterly review.
02. Actively follow the borrowers for recovery.
03. Negotiate and reschedule the debts.
04. If the client don't utilize the new offer than it is the SAMD's responsibility to file suit against the client.
05. SAMD will also prepare a Consolidated Report of all bad loans written-off on a quarterly basis.

03.03.06. Recovery Probability Categories to be assigned To All Classified Loans:

Category

- I. Loans determined to have high probability of recovery within 6 months; recovery efforts to continue on an on-going basis.
- II. Loans determined to have moderate probability of recovery within 1 year; review recovery efforts on a 3 months basis.
- III. Loans determined to have low and remote probability of recovery; review case on a 6 months basis.



IV. Loans determined to have virtually no chance of recovery: charge-off the books. However in these situation proper approval from the appropriate approving authorities should be obtained and also shall be guided by Bangladesh Bank instructions and subject to complete analysis of:

- ◆ Banking practice.
- ◆ Legal and tax implication and
- ◆ Status of each individual credit.

Notes for assessment of category

Estimate the cost of continued collection efforts against any money, which can be reasonably expected to be recovered. Include in the cost (i) employee man-hour, (ii) legal expenses, (iii) charge of any external collection agency if used.



Part – 4

CASE STUDY ON CLASSIFIED LOANS

4.01. Case Study on a sub Standard Loan of EBL:

- ◆ **Name:** MARIUM DEVELOPMENT CONSORTIUM LIMITED
- ◆ **Address:** House: 5, Road: 23/A, Gulshan 1, Dhaka: 1212.
- ◆ **Legal Status:** Private Limited Company.
- ◆ **Owner's Name:** Mr. Md Mahboob Iqbal Ahmed.
- ◆ **Nature of Business:** Hotel & Construction Business.
- ◆ **Facility:** AOS, Loan Against Other Securities.

◆ Purpose:

The purpose of the loan is to finish the works of a Seven storied Building (including basement) with 40 (forty) international standard guest rooms (hotel De Crystal Crown limited), resturant, business center, fitness center and a lobby including most modern amenities and facilities situated at House: 5, Road: 23/A, Gulshan:1, Dhaka and also to finance the partial financing work of Marium Tower – 2 a sixteen storied building at Gulshan.

◆ Repayment Source:

Repayment will be made from the rent of newly built Guesthouse (Hotel De Crystal Crown Limited) and also from the sale proceed of Newly constructed Marium Tower –2 at Gulshan. Monthly cash flow of the customer's own sources (including Hotel De Crystal Crown Limited) is about Tk. 68,53,125.00.



◆Securities:

01. Registered mortgage of Plot measuring 6 Katha at House:5, Road: 23/A, Gulshan: 1, Dhaka with **seven storied Building** (including Basement) with Force sale value Tk. 4.40 crore (Professionally the value of the land and Building is Tk. 1.50 Crore respectively) owned by the **Mr. Alam Ahmed**.

02. Personal guarantee of all the directors of the company having net worth of Tk. 495,000.00

◆Industry Condition:

Presently Hotel and guesthouse are growing at a steady rate. Bangladesh has a lacking of good hotel and guesthouse. So the demand of good hotel and guesthouse is very high. Again high buildings are rapidly coming up at different places in Bangladesh. Real Estate development as an industry sector has witnessed a slump in the recent past in Bangladesh. The economic crisis in South East Asia and South-East Asia have also led to the recent for the slump in the industry in Bangladesh. M/S. Concord Construction Ltd, M/S. East West Development Ltd and M/S. Sheltech Ltd are three of the leading companies engaged in this line of business.

◆Client's Competitive Position:

The site or location of the building may be considered as an added advantage since it is conveniently located near Gulshan Lake, which is very good, position for Guesthouse. The customer has already running one Guest House (Hotel) in Gulshan, is one of the most positive point to do well in business. The demand of the flat of Marium Tower – 2 at Gulshan is very



high. Manarat International University is has assured the client to buy the whole Marium Tower-2.

◆ **Project Details:** Locaton: House #5, Road # 23/A, Gulshan Circle:
 1, Dhaka-1212.
 No. of Floor: Seven storied (including basement)
 No. of Rooms: 40
 Total Area: Structure 8th storied per Floor area 3350 S.
 Ft. i.e. total area 26,800 Sq. Ft.
 Cons. Cost: Tk. 1080 per sq. ft.
 Total Con. Cost: Tk. 1,80,00,000.00
 Other Cost: Tk. 3,30,57,590.00
 Total Cost: Tk. 8,00,01,590.00

BALANCE SHEET

(fig. In Tk. '000)

Particulars	2000
Asset	
Cash in Hand / Bank	300
Inventory / stock	981
Work in process	4831
Prepaid Expenses	750
Other Current Asset	20
Total Current Asset	6882
Fixed Assets	
Furniture & Fixture	370
Office Equipment	236
Construction Equipment	1565



Vehicles	650
Total Asset	9703
LIABILITIES	
Cash Credit	460
Sundry Creditor	1571
Current Liabilities	2031
Long term Liabilities	
7662	
Total Liabilities	9693
Equity (Total Asset - Liability)	10

Reasons for Becoming Substandard:

01. Mr. Iftekher Hossain proposed the loan. At that time he was a new member in corporate banking and because of lacking of experience he fails to understand the motive of the client.
02. The client has over confidence about the success of the project. But the thing does not happen in reality, because of several reasons. First of all, they fail to understand the number of the target customer. Basically the foreign and "B" graded people are the customer of such rest house. The "A" graded or VIP people search for the 5 star hotels. Now the supply of the rest house exceeds the demand for rest house. Finally and most importantly because of 11th September the rate of foreigner's becoming shrink comparing to previously. Moreover for better security those who came choose the hotels.



03. But for the most valid reason for which the loan becomes classified is the willingness of the client. Its true that the response of the customer was not satisfactory but the response was enough to pay the installment. Basically the client invests the proceeds from the rest house to another business. Form the very beginning it was the target of the client that invest the proceed to another business and if something left over then go for monthly installment.
04. Problem is also with the source of repayment and securities. For source of repayment they talk about two sources – rent proceed from the guesthouse and the Marium Tower – 2. But for security they don't keep Marium Tower – 2 as registered mortgage security. Now the question arise what is the base that the client will use the rent proceed as loan installment. Although the client use some portion of loan for the construction of Marium Tower – 2.
05. Problem is also with their Balance Sheet. It shows that they have long-term liabilities amount of TK. 7,662,000. But against that they have fixed asset amount of TK. 2,821,000. And these assets contain furniture, office & equipment and vehicles. Although these assets has show their book value but in reality they don't have that much of value. But the most interesting thing is they don't keep any land for fixed asset, which is the most reliable.



04.02. Case Study on a doubtful Loan of EBL:

- ◆ **Name:** LATIF APPARELS LIMITED
- ◆ **Address:** 43/3-4, Wireless Gate, Mohakhali, Dhaka-1212.
- ◆ **Legal Status:** Private Limited Company.
- ◆ **Owner's Name:** Mr. Md. Saidur Rahman.
Mr. Md. Mezbaul Haque
- ◆ **Nature of Business:** Manufacturer of 100% export Oriented readymade Knit & Woven garments.
- ◆ **Market:** They basically export in Italy, UK, Finland, France, Hong Kong & Germany.
- ◆ **Sales/Export:** 3500 DZ /Month.
- ◆ **Facility:** SOD for Tk. 25.00 Lac and BB LC for \$ 6.00 Lac.
- ◆ **Purpose:** BB L/C: For opening of L/C for import or raw materials for Manufacturing all kinds of garments.
- ◆ **Repayment Source:** From export proceed.
- ◆ **Securities:**
 01. Registered mortgage of 7.62 decimal of land located at Dhaka district worth of 25.00 Lac Tk.
 02. Personal guarantee of all the directors of the company having net worth of Tk. 11.00 crore.
 03. Stock of raw material worth of 1.0 crore.
- ◆ **Industry Condition:** Export oriented garments industry is playing an important role in the economy of Bangladesh. The demand for garments is increasing every year. As such more industries are being setup in the sector, which will increase earning of valuable foreign exchange of the



Garments manufacturers, which industry is in the 1st position in respect of export goods.

◆ **Client's Competitive Position:**

Latif Apparels Ltd; a 100% export oriented readymade garments manufacturing unit was established on February, 1997 by changing its ownership. Through Latif Apparels Ltd. is specialized in readymade garments manufacturing, they are constantly receiving orders from their buyers for their items. Recently they have received an export order for \$90,000.00.

Income Statement:

[fig. In Tk. '000]

Particulars	Yr-2003	Yr-2004
Sales	71,90	1,96,00
Less, Cost of Good Sold	38,42	1,44,41
Gross Profit	33,48	51,59
Less: Administration Exp.	17,23	34,12
Less: Interest Exp.	60	9,20
Operating Profit / Loss	15,64	8,27
Add Other Income		
Add Other Exp.		
Profit / Loss before I. Tax	15,64	8,27
Income Tax		
Net Profit / Loss	15,64	8,27



Financial Ratios:

Ratio	2003	2004
Current Ratio	00.68	00.73
Quick Ratio	00.40	00.22
Leverage	04.57	08.19
Debt to Asset	00.82	00.89
Inventory Turnover [in days]	77	115
Total Asset Turnover	01.20	01.40
Gross Profit to Sales	22	04.22
Return on Equity	146	54

Balance Sheet:Capital & Liability

Authorized Capital	1,00,00,000/-
Paid up Capital	7,00,000/-
Loan & Advances	1,18,40,915/-
<u>Outstanding</u>	
<u>Liabilities:</u>	
Transport	5,20,940/-
Provision for EX.	1,50,000/-
Net Profit	8,27,154/-

1,40,39,009/-Particular & Asset

Plant & Machinery	30,51,168/-
Furniture & Fixture	3,49,439/-
Electrical Installation	2,00,344/-
Office Equipment	2,14,308/-
Land Purchase	37,50,000/-
<u>Current Assets</u>	
Stock in Store	45,54,000/-
Pre-payment	15,50,000/-
Cash in Hand	14,750/-
Cash in Bank	3,55,000/-

1,40,39,009

Reasons for Becoming Doubtful:

01. EBL take excessive risk in the case for this client. The client is not a fresh client with EBL. At the very beginning the client was regular but later on they are becoming irregular because of failure to satisfy the foreign buyers. And EBL decides to cut up their relation. But the client wanted a last chance and fail to deliver the product timely. As a result the foreign orderer refused to accept the goods and the client become classified.

Basically there is no reason that takes 100 Tk worth of risk to collect 50 Tk.

02. Their comparative income statement contains some problem. Although the sales increases 273% but cost of good sold increases 376%. Only because of this cost of goods sold the net profit decreases 53%. So the bottom line is they were not efficient to control the operating expenditure.



04.03. Case Study on a bad/loss Loan of EBL:

- ◆ **Name:** EXIMPO TRADING LIMITED.
- ◆ **Address:** House# 2A, Road #73, Gulshan 2nd Circle, Dhaka-1212.
- ◆ **Legal Status:** Private Limited Company
- ◆ **Owner's Name:** Commodore (Rtd) S.S. Nizam.
Mr. Shahriar M. Salahuddin.
Mrs. Kamrul Ara Nizam.
- ◆ **Nature of Business:** Importer of commercial transport & Exporter of jute goods.
- ◆ **Facility:** Cash Credit (CC)
Loan Against Other Securities (LAOS)
- ◆ **Purpose:** Open L/C for import of commercial transport vehicles.
CC for working capital.
- ◆ **Repayment Source:** Profit from the operation.
- ◆ **Securities:** 01. Hypothecation of stock of imported vehicles/parts & accessories for Tk. 1.50 crore.
02. Registered Mortgage of 21 katha land with a 3 (three) storied building thereon located at Dhanmondi R/A, Plot No. 47, Road No. 3/A, Dhaka. Estimated value of the land is Tk. 3.50 crore.



- ◆ **Industry Condition:** The commercial vehicles have a good demand in the country. But the jute product don't have that much of market in abroad because of price.
- ◆ **Client's Competitive Position:** Basically they ordered for new lot of vehicles whenever their stock falls short. And demand for vehicles increases.

Reasons for Becoming Bad or Loss:

The client has not intentionally become classified. Only because of ill fated they become so. The trip of their vehicles was returning by "Banglar Kakali" of Bangladesh Shipping Corporation. The ship reached in the port 4 months delay because the ship was caught by storm and caused heavy damage to the vehicles. Although the client sue against the Bangladesh Shipping Corporation in Admiralty Court but the sue is still pending. Unfortunately the client don't contact with any insurance company for the vehicles.

04.04. Case Study on a substandard Loan of PBL:

- ◆ **Name of the Client** : Ms. Naima Islam.
- ◆ **Nature of Facility** : Consumer Credit Scheme.
- ◆ **Amount Sanctioned** : Tk. 72,000.00
- ◆ **Account Status** : Classified as Substandard.



Account History:

Ms. Naima Islam, Air-cargo Manager of an American Logistic Company was sanctioned from Prime Bank Limited, Gulshan Branch a Consumer Credit facility for Tk. 80,000.00 to purchase household items viz. Refrigerator, Television and Microwave Oven. The cost of the items was as under:

Refrigerator	:	Tk. 37,000.00
Television	:	Tk. 25,000.00
Microwave Oven	:	Tk. 18,000.00

10% down payment was taken from the client and the bank took the exposure of 90% i.e. an amount of Tk. 72,000.00 of the quoted price. However prior to sanction of the loan, the following things were done as a part of selecting a borrower.

- Verification of identify of the applicant by personal visit to the company she worked in.
- Verification of her monthly salary that she had mentioned in the bank's loan application from.
- Justification of her need of the items proposed to be purchased.

Upon fulfillment of all the pre-requisites for sanction of the loan and above verifications, the loan was finally sanctioned and payment was made through a payment order in favor of the seller of the items.



Rate of Interest & Terms of Repayment:

The rate of interest of the loan was set 15% p.a/. The total principal and interest was structured to be in 24 equated monthly installments of Tk. 3,500.00.

Security:

- Hypothecation of the goods purchased.
- Personal guarantee of third party accepted by the bank.

Reasons for Becoming Substandard:

During security documentation formalities a guarantee from the employer should have been obtained to the effect of default of the client, the company would repay the loan on behalf of the client.



04.05. Case Study on a doubtful Loan of PBL:

Name of the client	:	Selim Fashions.
Nature of Facility	:	Cash Credit (Hypothecation).
Facility Amount	:	Tk. 30,00,000.00.
Account Status	:	Classified as doubtful.

Account History:

M/s Selim Fashions is a proprietor concern engaged in trading in readymade garments and handicrafts. The proprietor of the firm approached Prime Bank Limited, Dhanmondi Branch for sanctioning of a Cash Credit (Hypo) against hypothecation of stock in the form of readymade garments and handicrafts along with registered mortgage of a land with three buildings at Modammedpur, Dhaka. The valuation of stock and land * building was done as under:

Hypothecation of Stock	:	Tk. 20,00,000.00
Land & Building	:	Tk. 45,00,000.00

Mr. Selim, the proprietor, in fact, was solicited for business and introduced to the bank. M/s Selim Fashions had a very good business and the yearly turnover of the firm was about Tk. 85.00 lac. He also used to maintain the established business, reputation and yearly turnover along with other positive financial figures, sanctioned the loan.



The firm, since sanction of the loan, carried on very smooth transaction and always operated the account being within the limit sanctioned to them. The servicing of interest was also very regular.

Reasons for Becoming Doubtful:

Insurance coverage is one of the most vital documents to be obtained prior to any sanction or renewal of loan.

04.06. Case Study on a bad or loss Loan of PBL:

Name of the client	:	M/s. Netcon Computers.
Nature of Facility	:	I) Letter of Credit (LC) II) Loan Against Imported Merchandise (LIM)
L/C Amount	:	Tk. 15,00,000.00
LIM Amount	:	Tk. 12,00,000.00
Account Status	:	Bad or Loss.

Account History:

M/s. Netcon Computers is engaged in import and sales in Computer hardware and peripherals. They are engaged in this line of trade for the last 2 years. The key person of the firm is the proprietor who is a man at his twenties now.



Netcon Computers has been banking with Prime Bank Limited, Motijheel Branch for about last one year. During their short tenor of banking relationship they imported quite a voluminous amount of computer accessories like- Hard Disk, Printer, RAM, CD-ROM etc. The performance of their account was also up to the satisfaction of the branch.

On the basis of their past record of transaction, an L/C for US\$ 25,420.00 (equivalent Tk. 15,00,000.00) at 20% cash margin was opened to import 1000 pieces of 128 MB RAM from Singapore.

After 32 days from the date of the opening of the L/C, the original documents arrive at the bank. The documents were scrutinized as a regular practice and it was found that all the terms and conditions as stipulated in the original L/C had been complied with. There was no discrepancy in the documents and the fact was intimated to the client immediately. They were also requested to retire the documents at the earliest.

After three days from the date of arrival of documents the bank, having found no discrepancy in the documents, makes payment to the negotiating bank in Singapore and creates a liability in the name of Netcon Computers.

Bank's officials kept on reminder the clients and paid frequent visit to their office. At last, on expiry of PAD i.e. after 21 days the bank had no other alternative but to create a force loan in the form of LIM in favor of the client enabling them to take consignments from bank's custody and sell them and then pay back the money to the bank.

The LIM created for Tk. 12,00,000.00 (L/C amount- L/C margin paid by the clients) was partially adjusted and reduced to Tk. 4,50,000.00 by the end of 3 months. The bank, through classified the loan as the outstanding was not



adjusted within three months, the present repayment ensures recovery of the loan from the personal sources of the proprietor or from the business earning.

Reasons for Becoming Bad or Loss:

- The bank did not do forecasting of the market of the imported merchandise.
- The client having only 2 years of experience and age below thirty years was very young for this venture.
- The credibility of the client was not assessed.

As per the terms of repayment the 2nd and 3rd installments were also paid from the sale proceeds of the apartments. However, due to market saturations of the apartments and the market becoming very competitive, the sale of apartments of Atlantic Builders Ltd. suddenly fell down to zero level. Out of their cash-in-flow. As a result the repayment against the loan was disrupted and 4th and 5th installments could not be paid by the clients. **Recover**

The bank, having issued a number of reminders but failing to recover the past dues from the clients, was forced to classify the account and issuance of legal notice to the clients. Finally PBL sue against the client in Artha Rin Adalat and win the case and after 2 years successfully able recovered the loan.



Part -5

FINDINGS

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ANALYSIS

05.01. EBL vs PBL

At the end of each year there a rating is done by Bangladesh Bank called CAMEL rating. CAMEL i.e. five components are considered at the time of rating. Example C for Capital, A for Asset, M for Management, E for Earning and L for Liquidity. Those who are stronger on these categories, their given number is 1 (one), satisfactory is 2 (two), fair is 3 (three), marginal is 4 (four) and unsatisfactory is 5 (five). CAMEL rating determines all banks positions.

Now the reasons for which these three banks are selected for this report is their position in the CAMEL rating. PBL (only PCB) located in the 1 category, EBL is in the 2 or satisfactory level.

Now puts our attention the reasons for which they hold these positions. Prime Bank Limited, it is the only private commercial bank in the 1st position in the CAMEL rating. At the same time it holds negligible number of classified loans because of two reasons. First of all, their loan sanction system is simple and easier than other banks. If anybody wants to take loan than he or she would contract with the branch manager. The manager took the necessary documents form the client and send it to the Credit division located at Head Office. The credit division verifies the documents and the client and sends the proposal to the Board of Directors for approval or rejection. If the board approved the loan then Branch Manager will proceed next and continue to communicate with the client. And he has to take all responsibility against the client, none else. As a result, he becomes conscious about his job. Secondly and finally, Prime Bank Limited put more concentration on the consumer client than corporate client. Here consumer client means the borrower is a person rather than limited or proprietor based business organizations. And it is easy task to handle those



consumer clients. Moreover their client selection is better for which they are able to take this position.

Eastern Bank Limited starts their operation by carrying all asset and liabilities of BCCI in 1991. Still now some of the classified loans are provided by the BCCI and EBL carry forward those. Actually EBL starts their operation after the close down of BCCI for eleven months. Within this period some of the classified borrower some how remove necessary documents from BCCI. And after begin operation EBL can't do any thing because of short of proper documents. But fortunately there is a rumor in the market that Govt. is going to introduce "write-off facility". Write-off facility means, Banks can erase those classified borrowers name from the classified list, from whom there is no chance to collect money. But Banks doesn't give away their claim on the borrower. If Govt. does so then EBL's classified amount will reduce by thirty percent. Now lets try to discover why EBL holds highest (comparing to other two banks) classified loans. First of all, EBL still now carry forward the classified loans of BCCI. Secondly, their conservative approach. They don't go for the new business sector, which they termed as Green Field investment. They choose those sectors, which is near over investment and the chance of defaulter is high. We can also term this reason as bad client selection. Finally and most importantly they loose good customers because of their lengthy operation. In Dhaka city they have only two corporate units. The job of these units is to deal with the client of their own area and the areas where corporate units are not existed. For more illustration in some area EBL has branch only for General Banking like Mirpur branch. Now if any client located at Mirpur area wants loan facility then he or she have to submit papers to Mirpur branch and they send it to the nearest corporate unit that is Gulshan Branch. Then Gulshan branch contract with the client, verify their papers and placed proposal to the Board of Director at Head Office to approval or rejection. If the proposal approved then the client have to communicate with Gulshan to continue their credit facility. But for money



transaction they have to contract with the Mirpur Branch. It is a time consuming process and clients don't like this. Moreover the corporate members are powerless, for every decision they have to ask the Head Office. And the ultimate result is the honorable clients don't like these time consuming process.

If we compare the above two banks then we'll find that the easiest credit facility is provided by PBL. As a result they get more options to choose clients and select the bests. Moreover their branches are more or less autonomous. Because of this, the branch managers take risk on their own shoulder and become responsible for their activities. Here another point is that like EBL they don't only deal with the corporate client. And to handle these clients are the riskiest venture. Still now consumer clients are existed in their credit basket. Now the problem with EBL is lacking of responsibility among the employees. This is because of the organization structure of EBL. Although the credit people send proposal to the Board of Directors but for approval they don't relay on the papers, which are created by the corporate people. The board takes their own judgment. As a result the corporate people become demoralized. But a department called Special Asset Management Department does the worst thing. Whenever the related corporate people fail to handle the classified clients, they handover their responsibilities to the department. This department then act like CID officers. Their task is to recover money from those clients. So far this may sound nice, but the problem is because of this system the corporate people become irresponsible and inefficient. They are supposed to be responsible for the classified client until the recovery of the money.

But they should give their best effort to minimize the figures of classified loans. And interestingly the bank, which is older carries more classified loan than others. If apply this rule among the two banks then we will find the reflection of this rule. Among the two banks EBL is the oldest. Although it starts its operation from 1992 but it carries the classified loans of BCCI, which established in 1976.



So it is reasonable for them to hold this amount of classified loans. Prime Bank Limited starts their operation in 1995.

05.02. Board of Directors of EBL vs PBL:

There is a common thing with each bank is the loans are approved by the Board of directors. The Board approves each and every proposal. Now the problem with Board is with the members. Basically these peoples are most risk averse. Because they know that if any client becomes bankrupt ultimately they will lose money. So whenever any new proposal came to the board they first of all think whether any other banks already invest in the same field or not and what is the outcome. As a result the same fields enjoy over investments and become bankrupts. Whereas though the new sectors contain more risk but bank can impose more rules and charge more interest. But the main benefit will be enjoyed by the country because GATT 2005, will take place after one and half years. From 2005, we have to just rely on our own strength. Our business organizations will face tremendous competition. So from now on we should find out in which area we are strong and put more emphasis on that. At the same time we should look for new fields for investment. Banks can play an important role here by giving loan to the so-called "Green Field" business. But unfortunately most of the banks are not aware of this issue and avoid new business fields.



05.03. What are the main reasons behind classification?

01. **New Banker, or lacking of experience.**
02. **Most of the time bankers have to relay on the documents provided on the client. But what is the purity of these data. Although the CA firm certifies the dates but financial jugulating is practicing around the world.**
03. **Client's over confidence about the project.**
04. **Change in National and International Political scenery.**
05. **Sometimes borrower talks about some other repayment source out of the proposed project but they don't keep the source as security to the bank.**
06. **Sometimes other than land or building banks also keep furniture and machinery as security. Later on when bank come to sell those, they found that the market value of those assets is much lesser than the book value.**
07. **Sometimes bankers don't go through the financial figures properly.**
08. **Most of the cases clients have done some financial jugulating on their data.**
09. **Sometimes Clint caught by some unavoidable circumstances like-ship sink,**
10. **Sometimes bank don't take appropriate security from the client or granter.**
11. **Sometimes bank don't put concentration about the insurance.**
12. **Most of the cases the bankers fail to forecast the future business condition of the clients.**



05.04. What's wrong with Provision:

Although provisioning is associated with classified loans but it has a positive effect on the banks. The Income Statement shows net profit after deduction of provisioning fund. As a result tax goes down. But the most important thing is, it doesn't affect the dividend. Although naturally banks pay dividends from net profit but some times they pay dividends from previous retained earnings. Moreover banks don't keep money as idle fund for provisioning. Money circulates among the operations. They just show this fund to cover actual loss. So the bottom line is nothing is wrong to provision though it is associated with classified loans.

05.06. EBL is different in Recovery:

EBL has a department called Special Asset Management Department. The task of this department is to collect money from the classified clients. But in the other two banks the Branch Manager does this job. Other than that the recovery criteria are more or less same for the banks. At the very begging they send reminder letter. Then they send letter to inform them that they (bank) are going to sue against the client. Finally the banks sue against the client.



05.07. Why Recovery takes so much time:

Only because of existing rules and regulation recovery is a time consuming procedure. I think an example will make this thing clear. Let, Mr. X took loan from Y bank by giving a land as registered mortgage and become bad. Now bank cannot sell the land without the permission court though the land was as registered mortgage to bank. So bank has to sue against Mr. X and court send notice to Mr. X. But Mr. X can delay his coming by saying he is sick and asking for more time. Court give new date to settled the matter. Then on new date a person came to the court saying that he is the brother of the client and the land is their father's property. And most importantly, client didn't notify him before give the land to the bank. So court asks him to prove his claim. Finally, if court gives injunction in favor of bank, they face problem to sell the land. Because client put mussel-men protect the land from bank. Moreover people are not interested buy land on occasion from court. Finally the interesting thing is most of the time the same client but the land in anther name in lower price.



Part - 6

RECOMENDATIONS

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CONCLUSION

06.01. Recommendations:

1. Manager of the respective branch or respective credit officer, who sanctions the bad loan can't leave the bank before fix up the bad loan.
2. In case of loan against mortgage, the client should register the land to the bank in the terms that if the client fail to pay off the loan than the bank can capture the land without notifying the court.
3. In case of mortgage loan, if anybody sues against the land the person should put proper documents to the court.
4. If court want to give injunction to a person, they have to listen both parties and check the adequate documents.
5. When the client applied for loan then bank will not pay cash money rather than check. As a result the bank can know the party with whom the client is doing business.
6. The respective bank should check, for which purpose client use the money- private or business purpose.
7. The persons, who work in Special Asset Management Department, should include in credit approval board.
8. Credit approval board should include Bangladesh Bank person.
9. There should chance that any person can give information about the credit to the Credit Approval Board.
10. Before sanctioning credit facility bank should check about documents "whether they have what they need".
11. Credit officer should go through the feasibility study properly about the project.
12. They should not relay on the data provided by the client. They should judge the validity of those figurers by checking client's account books.



13. Management should give more authority to the credit officers to make them responsible.
14. Bank should give priority to the limited companies rather than proprietorship business because after the death of any proprietor, bank cannot sue for the asset of the proprietor. The assets distributed among the family members. It does not matter whether the assets was keep as security to the bank or not.



06.02. Conclusion

The lending function of a bank needs to add value to the bank. The lending function comprises organizations, funding, monitoring and servicing of loan. This process is an ongoing one that begins when a loan application is made and screened and continues until the loan is repaid. Now unpaid loans are incomplete transactions for lenders. These incomplete transactions will not add rather destroy value. The primary danger in granting loan or credit is the possibility that the transaction may remain incomplete or in other words, the borrower may not repay the loan on a timely basis, which is properly known as credit risk or default risk. Proper and prudent management of default risk is the way to create value in the lending function. Excessive credit risk manifests itself in the form of excessive non-performing loans and loan loss provisions, which destroy bank value. Therefore, the value creation objective on the part of banks can be achieved by emphasizing the prevention of potential non-performing loans and identification and resolution of existing problem loans.

The question of loan default is related with (non) recovery / repayment of loans. When a borrower cannot repay interest and/or installment on a loan after it has become due, then it is qualified as default loan or non-performing loan. It is known as non-performing, because the loan ceases to perform or generate income for the bank. The default/non-performing loan is not a “uni-class”, rather a “multi-class” concept. It implies that the default/non-performing loans can be classified into different groups usually based on the “length of overdue” of the said loans. The international standard classification terminologies are sub-standard, doubtful and bad/loss loans. Since 1980s, the central banks of the developing world, followed the practices of the developed countries, have



adopted the “prudential norms for asset classification” with a view to ensure transparency and “quality” of the loan portfolio of the banks.

The prudential guidelines also call for making adequate “provisions” against classified loans in order to protect the financial health of the banks. The economic implications of the non-performing / default loans are not only stoppage of creating new loans but also the erosion of banks profitability, liquidity and solvency, which might sometimes lead towards collapse of the banking financial system. It has, therefore become essential for policy makers to study the loan default scenario of the banking sector on a routine basis for estimating classified loan, making appropriate provisioning, adopting effective recovery strategy and thus ensuring soundness and efficiency of the banking sector.



APPENDIX

Table 1: Loan Classification System, 1989.

<i>Length of overdue</i>	<i>Status of classification</i>	<i>Rate of provision</i>	<i>Frequency of classification</i>
All loans except agricultural Loans:			Annually
Less than 1 year	Unclassified	1%	
Loans overdue for 1 year but Less than 3 years.	Substandard	10%	
Loans overdue for 3 years but less than 5 years	Doubtful	50%	
Loans overdue for 5 years or more	Bad/Loss	100%	
For Agricultural Loan:			
Loans not overdue for 5 years or more	Unclassified, Substandard, doubtful	5%	
Loans overdue for 5 years or more	Bad/Loss	100%	

Source: BCD Circular No. 34, 1989.



Table 2: Status, type and definition of classification

<i>Unclassified</i>	<i>Types of Loans</i>	<i>Definition</i>
Unclassified	All current loan	All current loan with required eligible security.
Sub Standard (SS) when degree of risk for non-payable is high but there is reasonable prospect that the loan condition can be improved.	<u>Continuous/Demand/ Term Loan</u> (Less than 5 years)	Overdue is more than 3 months but less than 6 months if default amount of installment is equal to installment payable in 6 months.
	More than 5 years	If default amount of installment is equal to installments payable in 12 month.
	Short term Agri. Credit & Micro Crdit	Overdue is more than 12 months but less than 36 months.
Doubtful (DF) when chance of recovery is uncertain.	Continuous & Demand	Overdue is more than 6 months but less 9 months.
	<u>Term Loan</u> (less than 5 years)	If default amount of installment is equal to installment payable in 12 months.
	More than 5 years	If default amount of installment in equal to installment payable in 12 18 months.
	Short-term Agri. Loan and micro credit	Overdue is more than 36 months but less 60 months.
Bad/Loss (B.L.) No security held Borrower not traceable, time barred loans, no hope of recovery.	Continuous & demand	Overdue is more than 12 months
	Continuous & demand	Overdue is more than 12 months.
	<u>Term Loan</u> (upto 5 years)	If default amount of installment is equal to installment payable in 18 months.
	More than 5 years	If default amount of installment is equal to installment payable in 24 months.
	Short term Agri. Loan & micro credit	Overdue is more than 60 months.

Source: Bangladesh Bank, BRPD Circular No. 16 of 1998.



Table 3: loan classification system, 2001

<i>Length of overdue</i>	<i>Status classification</i>	<i>of Rate provision</i>	<i>of Frequency of classification</i>
Less than 6 months	Unclassified	1 %	Quarterly
Loans overdue for 6 months but less than 9 months	Substandard	20 %	
Loans overdue for 9 months but less than 12 months	Doubtful	50 %	
Loans overdue for 12 months or more	Bad/loss	100 %	

Source: Bangladesh Bank, BRPD Circular No. 09 of 2001.

Table 4: Loan classification system (international standard)

<i>Length of overdue</i>	<i>Status classification</i>	<i>of Rate provision</i>	<i>of Frequency of classification</i>
Less than 3 months	Unclassified	1% - 5%	At least
Loans overdue for 3 months but less than 6 months.	Substandard	10% - 25%	quarterly, usually monthly
Loans overdue for 6 months but less than 9 months.	Doubtful	50% - 75%	
Loans overdue for 9 months or more.	Bad/Loss	100%	

Source: Studies in Bangladesh Banking, BIBM, 2000.



Table 5: Statement of Suit Filed & Settled In Artha Rin Adlat during 1991 to 2001

(Tk. in Crore)

<i>Year</i>	<i>No. Of suits filed</i>	<i>Amount of suit filed</i>	<i>No. of settled suits</i>	<i>Amount recovered</i>	<i>% of settled suits</i>	<i>Recovery rate</i>
1991	23010	1479.18	2667	54.06	11.59	3.65
1992	28524	2262.77	4418	85.12	15.49	3.76
1993	33961	2802.21	6144	127.20	18.09	4.54
1994	38995	3444.49	4754	181.82	20.14	5.28
1995	42789	4071.12	9726	237.50	22.73	5.83
1996	45777	4838.72	12647	313.94	27.63	6.49
1997	51802	5765.34	14862	387.21	28.69	6.72
1998	56304	6936.87	17181	492.60	30.51	7.10
1999	60190	8270.06	19857	575.37	32.99	6.96
2000	65569	9373.92	22025	717.72	33.59	7.66
2001	69014	10562.07	26024	934.62	37.71	8.85

Source: Banking regulation and policy department (BRPD), Bangladesh Bank, 2001

Table 8: Classified Loan as a % of total Loans:

<i>Bank's Name</i>	<i>Year</i>				
	1998	1999	2000	2001	2002
FCBs	3.58	4.14	3.80	3.38	3.33
NCBs	36.57	40.38	45.62	38.56	37.02
PCBs	31.42	32.72	27.09	22.01	16.98
E. B. L.	6.96	6.85	8.77	8.21	11.52
P. B. L.	1.78	1.63	1.49	1.13	1.48
O. B. L.		2.15	2.78	2.45	8.12

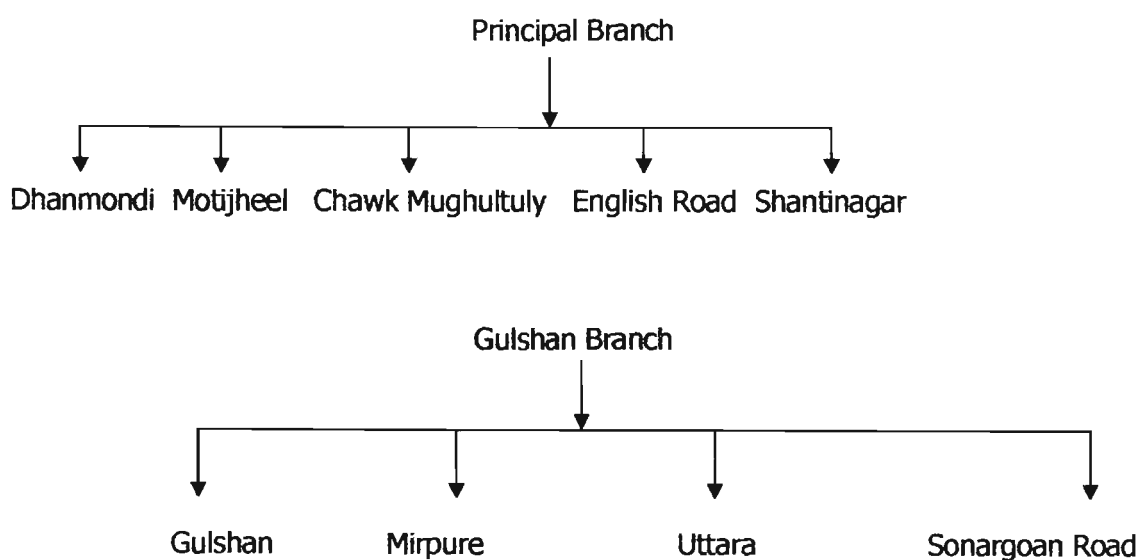
Source: Banking Regulation & Policy Department, Bangladesh Bank, 2003



Table 8: Yearly Provisioning Amount of the three Banks

Bank's Name	Year				
	1998	1999	2000	2001	2002
E. B. L.	87,785,125	122,142,374	152,589,000	150,000,000	170,259,000
P. B. L.	58,129,418	44,256,521	67,000,000	51,000,000	51,000,000
O. B. L.		68,127,496	89,419,239	75,196,413	152,854,929

Chart 1: Branches under Corporate Banking of Eastern Bank



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LIST of acronyms

RM	=	Relationship Manager.
EBL	=	Eastern Bank Limited.
PBL	=	Prime Bank Limited.
OBL	=	One Bank Limited.
BCCI	=	Bank of Credit & Commerce International.
PAD	=	Payment Against Deposit.
LTR	=	Loan against Trust Receipt.
LAOS	=	Loan Against Other Securities.
SOD	=	Secured Over Draft.
OAP	=	Own Acceptance Purchased
O/S	=	Outstanding
NCB	=	National Commercial Bank.
PCB	=	Private Commercial Bank.
FCB	=	Foreign Commercial Bank.
GATT	=	General Agreement on Trade & Tariffs.
CA	=	Chartered Accountant.
BRPD	=	Banking Rules & Policy Department, Bangladesh Bank.

