



Internship Report on
“Credit Risk Management Practices”
in Sonali Bank Limited.

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Subject: Submission of Internship report

Sir,

In accordance to your advice, I have prepared my Internship report on Credit risk management practices in Sonali Bank Limited. In my report, I have tried to focus on the relevant information which would cover the objectives of the report. But no doubt, my effort and contribution will be best evaluated on your sharp scale of acceptance and remarks.

I sincerely hope this report will fulfill the requirements suggested by you under the course BUS-400. Rather, in case of any further clarification or elaboration on my work, I would welcome the opportunity to consult with you.

Thanking you.

With best regards,

Shajjad Ahmed Bappy

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BUS:400

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BRAC University.

Acknowledgement

At the very beginning, I am solemnly thanking the Almighty Allah.

I am sincerely thankful to my academic supervisor, Md. Saif Hossain, Senior Lecturer of BRAC Business School, BRAC University; who permitted and supported me to work on the Credit risk management practices in Sonali Bank Ltd. I am extremely grateful for giving me such an opportunity that has enriched my area of knowledge vastly.

Furthermore, I want to thank my organizational supervisor, Mr. Khairul Islam, Manager, Sonali Bank, Mirpur Shilpa Elaka Branch; for giving me the required information and also for giving permission to do the necessary work to commence this project.

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Executive Summary

Sonali bank Ltd. follows the rules and regulation prescribed by the Bangladesh bank. To manage credit risk, the Bank applies credit limits to its customers and obtains adequate collaterals. Credit risk in the Sonali Bank Ltd.'s portfolio is monitored, reviewed and analyzed by the Credit Risk Management (CRM). Sonali Bank Ltd. has established Asset-Liability Management Committee (ALCO) to determine the maximum risk exposure. Management is aware about guidelines of Bangladesh Bank and implemented new capital accord BASEL-II.

Sonali Bank Ltd. constantly monitors, reviews and analyzes its credit portfolio to minimize potential losses and ensure efficient credit process. To manage the Non-Performing Loans (NPL), Sonali Bank Ltd. has a comprehensive remedial management policy, which includes a framework of controls to identify weak credits and monitoring of these accounts constantly.

A through credit risk assessment is done by analyzing borrower, industry, demand/buyer, historical financial statements etc. Bank reviews documents like loan applications, financial statements, market reputation, CRG, CIB report etc. to investigate credit risk. Manager has to enquiry about loan applicant. Proper documentation is required before sectioning loans. They must conduct necessary KYC (Know Your Customer) part on the customer and Money Laundering Guidelines must be followed. On the basis of investigation the branch manager will prepare a credit report as per format provided by their head office.

Sonali bank Ltd. Mirpur Shilpa Elaka branch is where I did my internship. Loan and advances are sanctioned according standard procedure. In this particular branch consumer loan and SHBL are most popular. Credit risk is relatively low. Recovery rate is 100% in consumer loans and SHBL. Performance of other loans is also good. As most of its credits are related only to two kinds of loans, its credits are not well diversified. So it faces credit concentration risk. As it is a rural branch opportunity for

sanctioning large scale or industry loan is very limited. Most of the deposits are added to Sonali bank general account.

To understand the effectiveness of CRM practices, I analyzed some key aspects which include Process of credit risk management in Sonali Bank, Credit risk management practices followed in Sonali Bank, The credit risk faced by the bank and Methods used to mitigate credit risk. I found the credit risk management practice of Sonali Bank Ltd. is quite admirable. However the credit sanctioning procedure is quite lengthy compared to today's business world. Systematic and timely monitoring and appropriate documentation are tried to be maintained. Scams like "Hall-Mark" exposed major weakness in top management. The bank should emphasize on reducing the classified and non-performing credits by concerted efforts. Filing has to be dealt with importance and Salary scale should be revised.

The Organization:

Introduction:

Sonali Bank Ltd. is the largest state owned commercial bank in Bangladesh. It was incorporated in Bangladesh on 03 June 2007 as a Public Limited Company under Companies Act 1994. Formally this bank was incorporated as a nationalized commercial bank named as Sonali Bank established by The Bangladesh Bank Order 1972 (Presidential Order no. 26 of 1972) and was fully owned by the Government of the People's Republic of Bangladesh. After incorporation dated 15 November 2007, Sonali Bank Ltd. has taken over the undertaking and business of Sonali Bank. The Bank has total of 1203 branches throughout the country including 858 branches in rural, 343 branches in urban area and two overseas branches at Kolkata and Siliguri in India as on 13 November 2013. The functions of the bank covered a wide range of banking and functional activities to individual, firms, corporate bodies, Multinational agencies and the rural area. The bank provides more than 21 types of free services on behalf of the government of Bangladesh through its rural and urban branches as part of their commitment to society.

History:

Sonali Bank, the largest commercial bank in the country, was established under Bangladesh Bank (Nationalization) Order 1972 (presidency Order No.26 of 1972). By taking over branches of former National Bank of Pakistan, Bank of Bahawalpur limited and Premier Bank Ltd. Were two private banks performing class banking over

the century in that period and National bank of Pakistan was government supported bank which was established to finance the jute sector in East Pakistan in the early period of Pakistan. After the birth of Bangladesh on 16th December 1971, newly formed Sonali Bank for mass banking got special facilities from the government to work on behalf of Bangladesh bank in those areas where Bangladesh bank is not available. With the increase of commercial and by virtue of performance within a few years, it becomes the largest commercial bank of the country with 1203 branches up to now.

Services:

Core Business Services:

- Corporate Banking
- Project Finance
- SME Finance
- Remittance
- Lease Finance
- Consumer Credit
- Trade Finance
- Loan Syndication
- Foreign Exchange Dealing
- International Trade
- NGO-Linkage Loan
- Consumer Credit
- Investment
- Government Treasury Function
- Money Market Operation
- Rural and Micro credit
- Capital Market Operation
- Special Small Loan

Islamic Banking Services

Deposit Products:

- Al-Wadeeah Current Account (AWCA)
- Mudaraba Savings Account (MSA)
- Mudaraba Special Notice Deposit Account (MSNDA)
- Mudaraba Term Deposit Account (MTDA)
- Mudaraba Hajj saving Account (MHSA)
- Mudaraba Sonali Monthly Deposit Scheme (SMDS)
- Mudaraba Monthly Profit Scheme (MMPS)

Investment Products:

- Bai-Murabaha
- Bai-Muajjal
- Bai-Salam
- Bai-Istisna
- Hire Purchase Under Shirkatul Melk

Other Services:

- Government Treasury Bonds
- Locker Service
- A.T.M. Card

- Utility Bills Collection
- Ancillary Services
- Merchant Banking

As mentioned earlier, the bank provides 21 different types of free services. The followings are their most recent online services:

- Ancillary Services,
- Locker Service,
- Automation Status,
- Q-cash ATM Network Services,
- ATM Location and Services,
- Credit/Debit Card Services,
- Online Tax Payment Services,
- NBR-Sonali Bank e-Payment Service etc.

Management:

The management of the bank is vested on a board of directors, subject to overall supervision and directions on policy matters by the board which is constituted in terms of Bangladesh bank (Nationalization) Order 1972 (**Figure-.....**). Board of directors, constituted by seven members has authority to organize, operate and manage its affairs on commercial consideration within the board policy of government. There are directors appointed by the government. Other members of the board including MD are also government appointed out of that at least three have the experience in the field of Finance, Banking, Trade, Commerce, Industry and Agriculture. The managing director is the Chief Executive of bank. He executes all the activities under the direction of board. All line and staff personnel of bank's are own recruitment except member of board of Direction.



[Figure-2.1: Hierarchy of Position]

Mission:

Dedicated to extend a whole range of **quality products** that support divergent needs of people aiming at enriching their lives, **creating value** for the stakeholders and contributing towards socio-economic development of the country.

Vision:

Socially committed leading **banking institution** with global presence.

JOB DESCRIPTION:

It was a good experience to work with Sonali Bank. The working hour of the job was 10 a.m. to 5 p.m. As I had to learn about all the sections of the bank, so I went from table to table, talked with the employees and learnt how their staffs were going on everyday. Mostly I Worked on Loan Investigation and Sanction Criteria and while doing that, I did different types of staffs. For instance, some of my works are given below:

- Investigated the CIB report
- Bangladesh Bank Clearance Certificate
- TIN Certificate Number
- Internal Employee Loan Form etc.

- Filled up the Loan Sanction Form
- Deposit Form
- Fixed Depository Book etc.

Critical Observations and Recommendation:

These are some observations and recommendation that I would like to mention about the job:

- No fixed or assigned work criteria,
- Had to move from table to table to learn the topics,
- Lack of published materials,
- Difficulty in collecting the information from various personnel for their job constraint,
- It was my first work and experience.

Project:

Summary:

To support my internship report I worked as an intern (at least ninety days) in Sonali Bank Ltd. Mirpur Shilpa Elaka branch and my topic of the report is "**Credit risk management practices in Sonali Bank Ltd.**" as part of the fulfilment of internship requirement. One of most significant challenges for a bank is to strongly manage its credits. Since the largest slice of income generated by a bank and a major percentage of its assets is subject to this credit, it is obvious that sensible management of this credit is fundamental to the sustainability of a bank.

Objectives of the study:

Preparation and presentation of this report contains few specific objectives. These are:

- To have a sound understanding of credit risk management system and procedure followed in the Sonali Bank Ltd.
- To gain knowledge about the credit related operations and maintenance in this bank.
- To analyse in detail the credit risk management process of the bank and to make recommendations if needed.
- To get knowledge about the effectiveness of loan and sanction procedure that is conducted on the evaluation of credit risk.
- To have a general idea about the credit risk management performance of this bank.

Methodology:

For the completion of the report, I conducted a case study on the loan sanction procedure of the bank. To do this, I interviewed some of both employees and customers of the bank. In the interview session, the following questions were asked:

1. What's the idea of credit?
2. What's the idea of risk management?
3. What are the guidelines of Bangladesh Bank concerning CRM?
4. What are the Basic Activities of the Bank of Sonali bank Ltd.?
5. What are the rules and regulation followed by Sonali bank Ltd.?
6. What are the sources used for Credit risk investigation?
7. How risk assessment is done?
9. How is its documentation process?

10. How they deal with non-performing loans?
11. How to arrange the criteria of lending before sanctioning?
12. What sectors the bank has to give emphasis on providing loans and advanced?
13. Types of credit facilities of the bank.
14. What are the basis on loan classification and provisioning?

Sources of data:

To perform the study data sources are to be identified and collected, the data are to classified, analyzed, interpreted and presented in a systematic manner.

Primary Sources:

- Face to face conversation with the official staffs.
- Practical desk work.
- Questionnaire
- Simple Depth interview technique was used by asking number open-ended questions to collect the information.
- Relevant file study as provide by the concerned officer.

Secondary Sources:

- Financial Statements & Auditors' report of Sonali Bank Ltd., 31 December 2012
- Disclosure on Risk Based Capital (Basel-II), December 2012.
- Annual Reports (2011, 2012 and 2013) Sonali Bank Ltd.
- Risk Management Guidelines for Banks, February 2012, Bangladesh Bank.
- Credit Risk Grading Manual for banks, June 2007, Bangladesh Bank.

Limitations:

The presented study was not out of limitations. But it was a great opportunity for me to know the banking activities of Bangladesh specially Sonali Bank Ltd. The study carried on has the following limitations:

- The main constraint of the study is inadequate access to information, which has hampered the scope of the analysis required for the study.
- Lack of published materials.
- Some problems create confusions regarding verification of data.
- It was very difficult to collect the information from various personnel for their job constraint.
- Lack of knowledge and experience among the officials.
- As some of the fields of banking are still not covered by our courses, there was difficulty in understanding some activities.
- The time is insufficient to know all activities.
- And as it was my first work and inexperience was a problem. So there may be some personal mistake in the report.

Credit Risk Management:

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Concentration of credit risk arises when a number of counter parties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. To manage credit risk, the Bank applies credit limits to its customers and obtains adequate collaterals. Credit risk in the Sonali Bank Ltd.'s portfolio is monitored, reviewed and analyzed by the Credit Risk Management (CRM).

CRM determines the quality of the credit portfolio and assists in minimizing potential losses. To achieve this objective, CRM formulates appropriate credit policies and procedures for the Bank to ensure building and maintaining quality credits and an efficient credit process.

Sonali Bank Ltd. has established Asset-Liability Management Committee (ALCO) determine the maximum risk exposure. ALCO also assesses, recommends and controls cross border/country risk.

To manage the Non-Performing Loans (NPL), Sonali Bank Ltd. has a comprehensive remedial management policy, which includes a framework of controls to identify weak credits and monitoring of these accounts.

Implementation of BASEL-II:

To comply with International best practices and to make the Bank's capital more risk-sensitive as well as to build the Banking industry more shock absorbent and stable, Bangladesh Bank provides revised regulatory capital framework "Risk Based Capital Adequacy for Banks" which is effective from 1st January 2009. According to the BRPD Circular no-09 dated 31st December 2008, following specific approaches are suggested for implementing BASEL-II:

- Standardized Approach for calculating Risk Weighted Assets (RWA) against Credit Risk;
- Standardized (Rule Based) Approach for calculating RWA against Market Risk;
- Basic Indicator Approach for calculating RWA against Operational Risk.

Under the Standardized Approach of the Risk Based Capital Adequacy Framework (Basel II), Credit Rating is to be determined on the basis of risk profile assessed by the External Credit Assessment Institutions (ECAIs) duly recognized by Bangladesh Bank.

Along with the existing capital adequacy rules and reporting Bangladesh Bank (ref. BRPD Circular no.10 dated 25.11.2002) Banks will start quarterly reporting as per the set of the reporting formats provided by Bangladesh Bank. Sonali Bank Ltd. Management is aware about guideline of Bangladesh Bank and prepared for implementing new capital Accord BASEL-II.

Credit Rating of the Bank:

As per the BRPD instruction circular No.6 dated July 5, 2006, the bank has done its credit rating by Credit Rating Information and Services Limited (CRISL) based on the financial statements dated 31 December 2011.

SWOT Analysis:

Strengths:

- Branches throughout the country to serve its customer.
- Very strong relation with Bangladesh bank.
- They have corresponded relationship with other banks so the bank can provide services of their customers.
- Strong local remittance management systems.
- They have strong relation between every team.

Weakness:

- The services are very slow.
- Slow modernization due to its huge size.
- Low salary scale compared to industry.

Opportunities:

- The bank can offer more innovative types of services than other banks.
- Since Sonali Bank Ltd. has so many branches it can easily influence the banking sector.
- Being a large Bank it can provide large investment.

Threats:

- Increase in the competition in banking sector.
- Increase in the use of modern technology and services like online banking, mobile banking, internet banking etc.
- About remittance business these days many banks are showing greater interest in the remittance business.
- Recent events like frauds and stealing where employees were found involved.

Sources of Credit Investigation:

The following are the sources of credit information

- Loan application
- Financial statements (profit and loss account, Balance sheet, cash flow statement).
- Study of accounts
- Market reputation
- CRG

- Report from CIB
- Personal interview
- Personal visit
-
- Other sources, i.e.:
 - ❖ Income tax statement
 - ❖ Registration office
 - ❖ Press report
 - ❖ Revenue and municipal rent receipt register of joint stock company
 - ❖ VAT return
 - ❖ Confidential report from fellow banks.

For investigation the manager have to enquiry about:

- Who is the borrower?
- Nature of business
- Location/ site of the business
- Living standard /living style of the Borrower
- Experience in the business
- Equity in the business
- Purpose of borrowing
- Duration of loan
- Sources of repayment
- Means and security offered
- Physical verification of security
- Profitability of the transaction
- History of accounts operated by borrower
- Market reputation regarding character, honesty, integrity etc.

Credit Risk Assessment:

A thorough credit risk assessment should be conducted prior to the sanctioning of credit facilities. They must conduct necessary KYC (Know Your Customer) part on the customer and money laundering guidelines must be followed.

Following risk areas in the credit proposal should be addressed and assessed before sending to Head Office.

1. Borrower Analysis:

- a. Share holding
- b. Reputation
- c. Education
- d. Experience – success history
- e. Net worth
- f. Age etc.

2. Industry Analysis:

- a. Industry Position/Threat/Prospect.
- b. Risk factors pertaining to the industry.
- c. Borrower's position / share in the industry.
- d. Strength, weakness of the borrower compared to the competitors etc.

3. Supplier/ Buyer Risk Analysis

- Concentration on single/few buyer/supplier is addressed.

4. Demand Supply position
5. Technical feasibilities / Infrastructural facilities
6. Management Teams Competence
7. Seasonality of demand
8. Debt to equity Ratio
9. Historical financial analysis:
 - a. An analysis of 3 years historical financial statements.
 - b. Earning – its sustainability.
 - c. Cash flow
 - d. Leverage
 - e. Profitability
 - f. Strength and reliability of Balance Sheet etc.
10. Projected Financials:
 - a. Sufficiency of cash flows to service debt repayment.
 - b. Debt Service Coverage Ratio.
11. Trade Checking
12. Account conduct:
 - a. For existing customer the repayment history, credit turnover, study of account statement

b. If the customer is proposed to be migrated from other Bank, statement of account from present Banker is required:

- Allied deposit with our Bank.
- Other business with our Bank.

13. Security:

a. A current valuation of collateral security by Professional Enlisted Surveyor be obtained with photograph and site map. Collaterals within command area of the respective branch location are preferred. Third Party property and vacant land should be discouraged.

b. Loans should not be considered based solely on collateral.

c. Adequacy and extent of Insurance coverage should be assessed. Insurance Policy should be obtained from approved Insurance Company. Premium should be paid through Bank, duly stamped money receipt be obtained. Insurance Policy be held by the Bank. The Policy be renewed in time. Letter of authority be obtained from the customer to debit account to pay premium for renewal/enhancement of the policy.

14. Succession issue:

Margin, volatility of business, high debt (Leverage / gearing), over stocking, huge receivables with long aging, rapid expansion, new business line, management change, lack of transparency should be addressed.

15. Adherence to credit guidelines:

a. It should be clarified whether the customer is agreeable to comply with guidelines in respect of regulatory requirement and Bank's policy requirement.

b. Any deviation be clearly identified and maintained.

16. Mitigating Factors:

- a. Risk factors be identified and side by side mitigating factors of those risks should also be mentioned to justify the proposed facility.

17. Environmental factor.

18. Employment generation and contribution to the national economy.

Preparation of credit report

On the basis of investigation the branch manager will prepare a credit report as per format provided by their head office.

After preparing credit report banks ask for loan documentation.

Analysis

To understand how effective CRM practices is I have identified some aspects which are core to risk management. The analysis was carried out in the following aspects:

- Process of credit risk management in Sonali Bank ltd.
- Credit risk management practices followed in Sonali Bank ltd.
- The credit risk faced by the bank.
- Methods used to mitigate credit risk.

Processes and practices of credit risk management

- Credit risk in the Sonali Bank Ltd.'s portfolio is monitored, reviewed and analysed by the Credit Risk Management (CRM) to minimize potential losses and ensuring efficient credit process.
- They have identified the types of risks and disclosed in the BASEL II disclosures according to the BRPD Circular no-09 dated 31st December 2008.
- Credit risk faced by the bank is properly identified which includes the following:
 - The gross credit risk exposure has grown to BDT 37,814.44 crore as of December
 - 2012.
 - Credit quality is standard due to their sound credit risk management system.
 - They have made sufficient provisions for NPAs, NPIs and depreciation.
 - Volume of off-balance sheet exposures is BDT 4,438.83 crore.
- Sonali Bank Ltd. has its own Credit Risk Management guidelines in terms of Core Risks Management guidelines of Bangladesh Bank. The Bank also follows other instructions/guidelines of Bangladesh Bank in this regard.
- The bank decides on how much risk to take based on their risk appetite as well as government guidelines.
- To manage the Non-Performing Loans (NPL), Sonali Bank Limited has a comprehensive remedial management policy, which includes a framework of controls to identify weak credits and monitoring of these accounts constantly.

The credit risk faced by the bank

The Movement of Non-Performing Assets (NPL) as disclosed in Basel II shows increase in outstanding Loans & advances. Closing balance of non-Performing loan of December 31, 2012 was BDT 13220.50 crore whereas opening balance was BDT 6607.53 crore. Reduction in outstanding amount of that year was BDT 846.84 whereas additions was about BDT 7459.81 crore.

To manage the Non-Performing Loans (NPL), Sonali Bank Ltd. has comprehensive remedial management policy, which includes a framework of controls to identify weak credits and monitoring of these accounts.

Methods used to mitigate credit risk.

- Based on the policies strategies are developed by the bank to mitigate credit risk.
- Credit risk is mitigated by appropriate credit appraisal systems before lending and proper collateral or guarantees are taken to hedge the risk.
- Risk management system is put in place for better management of credit risk and a risk rating is installed which is in compliance with BB guidelines.
- The risk management function is reviewed periodically usually every quarter.
- The rating system for term loans is annual.
- Investment is made in different sectors to diversify risk. Disclosure on Risk Based Capital (Basel-II)" (December 2012) shows Industry or counterparty type distribution of exposures:

So in short, the bank's board of directors and senior management are responsible for ensuring that the bank have appropriate credit risk assessment processes and effective internal controls. Bank have a system in place to reliably classify loans on the basis of credit risk. Bank's credit risk assessment process for loans provides the bank with the necessary tools, procedures and observable data to use for assessing credit risk,

accounting for impairment of loans and for determining regulatory capital requirements.

Results and Discussion:

The Results(findings) of this study are summarized below:

- The credit risk management process of Sonali Bank Ltd. is quite commendable. Systematic and timely monitoring and appropriate documentation are tried to be maintained.
- Customer satisfaction level is quite good. Informal conversation with some customers reveals that they approve the credit evaluation and management process of Sonali Bank Ltd.
- Governments orders like account opening for 10 taka, etc. increases cost. SME loans for farmers without collateral not only increases credit risk but also costly for banks But return on these services are low.
- Hall-Mark scam exposed major weakness in top management.
- Filing procedure is not maintained in a definite and clear manner. It is difficult to locate the documents in a chronological and sequential manner. A definite practice, though mentioned in the credit policy is not always maintained by the credit officials.
- The credit sanction and disbursement procedure is quite lengthy.

Recommendation:

The failure of commendable banks occurs mainly due to bad loans, which occurs due to inefficient management of the loans and advances portfolio. Therefore any banks must be extremely cautious about its lending portfolio and credit policy. In the light of the above findings, following recommendations are proposed:

- The credit sanction procedure should be made quicker since competition is very hard in today's business world. People do not want to wait for three to four weeks on an average to get a loan which is even protected by security.
- Decision making process can be made more decentralized.
- The bank should emphasize on reducing the classified and non-performing credits by concerted efforts.
- In the credit department, strict supervision is necessary to avoid loan defaulters. Bank officials should do regular visit to the projects.
- Central monitoring system should be more active to maintain classified loan to a minimum level.
- Filing is a very important component of proper documentation. It has to be dealt with importance.
- Salary scale should be increased to motivate extremely dissatisfied employees and to reduce misconduct.
- Vaults security should be increased.
- To attract more clients should sought new marketing strategy.
- An uninterrupted network system has to be ensured. It will save the officials from much hassle and will save time.
- Politically influenced Lending or project finance should be checked.

Conclusion:

Sonali Bank Ltd. is much different in any terms. Its activities are vast and in cases unique to any other bank. Its deposits and loans are huge compared to other banks. It finances government projects, provides unique services to people in need, even in places it works as central bank. This Bank often make decision for the welfare of general public despite risk of credit exposure.

The bank has established a sound credit risk management and credit risk mitigation policy. Compliance with Basel II norms helps the Bank to improve their profitability through better credit risk management systems.

From the discussion in this report, it has become clear that credit risk management is a complex and ongoing process and therefore Banks or any financial institutions must take a serious approach in addressing these issues.

Resources :

1) annual report 2013

2) web: [www.sonali](http://www.sonali.com.bd)bank.com.bd