

Internship on Assessing the Investment department on the context of overall Default profile of FIRST SECURITY ISLAMI BANK LTD., Banani Branch.



Inspiring Excellence

SUBMITTED TO

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LETTER OF TRANSMITTAL

26th September 2017

Dr. Salehuddin Ahmed

Former Governor

Bangladesh Bank

Professor, Business School

BRAC University

Subject: Submission of internship report on First Security Islami Bank Ltd

Dear Sir,

I am pleased to prepare my internship report and submit to you on “Assessing Investment sector in the context of overall default profile of First Security Islami Bank Ltd., Banani Branch”. It was a great opportunity for me to complete the internship from First Security Islami Bank Ltd. It is my pleasure to carry out the internship report under your supervision.

For my internship report, I do focus on investment sector and default loan of First Security Islami Bank limited. In my report I do try my level best to present how they regulate their investment, investment policies, default loan account in FSIBL. I hope that this internship report will be of great value to you.

Thank you.

Sincerely

Nusrat Islam

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ACKNOWLEDGMENT

At first I want to thank our creator almighty Allah. And I would like to express my sincere gratitude and cordial thank to my academic supervisor Dr. Salehuddin Ahmed for his constant supervision, moral support, valuable instruction and helpful advice in preparing of the report. His direction, critical comments, criticism, generous patience greatly helped me to carry on the dissertation and give it a final shape.

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I would also like to give thanks to Hassan Sayeed (Probationary officer), Saif-ul-Arefin (Probationary Officer), Md. Amir Hossain (Officer) & Md. Arif Amin (Assistant officer) for their hearty co-operation to learn about FSIBLs “General Banking practice at Rupnagar Branch”.

Finally, I would like to convey my gratitude to all of my teachers and friends who extended their support to prepare the report.

Abstract

FIRST SECURIRITY ISLAMIC BANK LIMITED (FSIBL) was established in 29 August 1999 with a clear manifesto of demonstrating the operational meanings of participatory economy, banking and financial activities as an integral part of an Islamic code of life. The philosophy of FIRST SECURIRITY ISLAMIC BANK is to establish an egalitarian society based on the principle of social justice and equity.

This report is to assess the investment department on the context of overall default profile in First Security Islamic Bank Limited, Banani branch. This report gives an idea about investment and investment risk management, default loan, default profile of FSIBL. I discussed with the officials and executives of the FSIBL, Banani Branch and found the approximate data which has been used in this report. In order to achieve the set objectives of the study, both primary and secondary data was used. The primary data was collected using a questionnaire. The questionnaire had both closed and open-ended questions. The closed ended questions enabled me to collect quantitative data while open-ended questions enabled to collect qualitative data. The secondary data was obtained from the annual reports, disclosure on risk based capital Basel-III 2016 report of the banks. Data collected covered a period of 6 years, from 2012 to 31, August 2017. The bank has a sound credit risk management system. The Bank tries to extend credit facilities to the various sector of the economy. This year FSIBL have two default loan accounts and both of the accounts are SME loan accounts and the default amount is 5.22 Million taka. The clients were giving their installments regularly but due to having external issues they are missing the schedule payments. Bank have decided to give them more time and contacting with the clients regularly,

From the survey I have found that this year it seems almost constant but NPL has increased year after year in this FSIBL, Banani branch.

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Chapter 1

Introduction

1.1 Introduction

Banking is the backbone of national economy. All sorts of economic and financial activities revolve around the bank. As the industry produces goods & commodities, bank creates & controls money-market and promotes formation of capital. Banking is a powerful medium to bring socio-economic changes in a developing country like Bangladesh. Three important sectors like Agriculture, Commerce and Industry provide the bulk of the country's wealth. So the nourishment of these sectors is only possible through satisfactory banking facility. The banking service facilitates the integration of these three. For rapid economic growth, a fully-developed banking system can provide the necessary boost. Banks provide both short and long term credits. The customers come from all walks of life, from a small business to a multi-national corporation having its business activities all around the world. The banks have to satisfy the requirements of different customers belonging to various social groups. The banking business has, therefore, become complex and requires specialized skills. It functions as catalytic agent for bringing about economic, industrial growth and prosperity of the country. As a result different types of banks have come into existence to suit specific requirements. Regardless of the number of banks and nature of their functions & activities, central bank regulates the activities of all other banks. In Bangladesh, the role of the central bank is performed by Bangladesh Bank. The private banks had concentrated their activities only in a few areas. The new banks try to share the most potential market, forcing others to face tougher competition. This also restricts others to expand fast to cater for the banking needs of the people in other areas. The International Monetary Fund (IMF) and The World Bank earlier asked the government to reconsider its decision to permit new banks without restoring discipline in the sector, crippled by huge amount of bad debts.

1.2 Origin of the study

The current world is changing rapidly. To face the challenge of competitive free market economy, to keep pace with the trend of every organization who demanded executive with modern knowledge and to provide fresh graduate with modern theoretical and professional knowledge in banking as well as all other different institutions, BRAC University has assigned the internship program for the students to help them out to have a practical knowledge to work in

a real office environment. Under this program the students are sent to gather practical knowledge about the working environment and activities. The report is a requirement of the internship program for my MBA degree. My University supervisor Dr. Salehuddin Ahmed, Professor suggested me that the topic of my report would be **“Assessing the Investment department on the context of overall Default profile in FIRST SECURITY ISLAMI BANK LTD., Banani Branch.**

1.3 Rationale of the study

Banks in Bangladesh are primarily of two types: Scheduled Banks: The banks which get license to operate under Bank Company Act, 1991 (Amended upto 2013) are termed as Scheduled Banks. Non-Scheduled Banks: The banks which are established for special and definite objective and operate under the acts that are enacted for meeting up those objectives, are termed as Non-Scheduled Banks. These banks cannot perform all functions of scheduled banks. First security islami bank is also a scheduled bank. I have chosen First security Islami Bank Bangladesh Limited, which has some special mission & vision to establish. There are other banks who have default loan of various percentages. I wanted to know about their investment policy and and their default loan profile. So, I have selected the topic **“Assessing the Investment department on the context of overall Default profile in FIRST SECURITY ISLAMI BANK LTD., Banani Branch.”**. The dissertation report is an integral part of the MBA program of the university. So it is obligatory to undertake such task by the students who desire to complete and successfully end-up their MBA degree. This also provides an opportunity to the students to minimize the gap between theoretical and practical knowledge. Students are required to work on a specific topic based on their theoretical and practical knowledge acquired during the period of the internship program and then submit it to the respective authority. That is why I have prepared this report.

1.4 Scope of the Study

The scope of the organizational part covers the organizational structure, background, products and services and the financial performance of First Security Islami Bank Bangladesh Limited as a whole and the main part covers non-performing loan management or investment risk management of FSIBL, Banani. As I was an intern, my scope was limited and restricted for some

purpose. I had maintained some official formality for the collection of data of my report. This report helps us to understand the clear real-time experience about the investment business operations of FSIBL, Banani. It also helps us to understand how they deal with the investment clients alongside the way of managing investment and investment risk.

This report is only done for gathering information about default profile of the investment department and investment risk or default risk management of FSIBL by focusing on the performance and management of investment business alongside investment risk while ignoring any other department of the bank.

1.5 Objectives of the study

This study has been conducted as partial fulfillment of requirement of the Master in Business Administration (MBA) under Investment performance of First Security Islami Bank Ltd, Banani.

Moreover, the objectives of the study are:

1. Default loan of the Banani branch of FSIBL is increasing or decreasing or constant.
2. Which borrowers are less risky and not defaulter compared to others.

1.6 Methodology

This report has been prepared on the basis of experience gained during the period of internship. Data has been collected from primary as well secondary sources.

1.6.1 Primary Sources

- ❖ Face to face conversation with bank officers.
- ❖ Questionnaire.
- ❖ Personal observation – during bank hour.
- ❖ Discussion with the bank personnel.
- ❖ Work in different departments of the bank- accounts opening, accounts, clearing, foreign exchange & remittance departments.
- ❖ Face to face conversation with the client.
- ❖ Facing some practical situation related with the day to day banking activities.

1.6.2 Secondary Sources

- ❖ Banks financial statement.
- ❖ Annual Reports
- ❖ Web Sites
- ❖ FSIB published documents

1.7 Limitations of the report

As a financial institution every bank has to maintain high level privacy for each and every task. It is quite difficult to get a clear picture. So, the study is simply able to give an idea not the whole picture. Some limitations are as under:

- The main constraint of the study was insufficiency of information, which was required for the study. There are various information the bank employee can't provide due to security and other corporate obligations.
- Lack of in-depth knowledge and analytical ability for writing such report.
- Learning all the banking functions about the investment risk management within just 90 days was really tough.
- Data and information used in this study are mostly from secondary sources.
- Large scale research was not possible due to the constraints and restrictions posed by the bank.
- Another limitation of this report is the bank's policy of not disclosing some data and information for obvious reason, which might make the report more worthy.

The report has encountered these limitations that may hinder the progress of the study but with constant effort, I try to minimize the negative effects of these limitations.

Chapter 2

Overview of First Security Islami Bank Limited

2.1. History

First Security Islami Bank Limited (FSIBL) was incorporated in Bangladesh on 29 August 1999 as a banking company under Companies Act 1994 to carry on banking business. It obtained permission from Bangladesh Bank on 22 September 1999 to commence its business. The commercial banking activities of the bank encompass a wide range of services including accepting deposits, making loans, discounting bills, conducting money transfer and foreign exchange transactions, and performing other related services such as safe keeping, collections and issuing guarantees, acceptances and letter of credit. The bank has been operating with talented and brilliant personnel, equipment with modern technology so as to make it most efficient to meet the challenges of 21st century. At first in 1999 the bank incorporated as First Security Bank Ltd. and then in January 01, 2009 the bank changes its name and mode of business and incorporated as First Security Islami Bank Ltd.

2.2 Vision

To be the premier financial institution in the country by providing high quality products and services backed by latest technology and a team of highly motivated personnel to deliver excellence in Banking.

2.3. Mission

- To contribute to the socio-economic development of the country.
- To attain the highest level of satisfaction through the extension of services by dedicated and motivated professionals.
- To maintain continuous growth of market share by ensuring quality
- To ensure ethics and transparency in all levels.
- To ensure sustainable growth and establish full value of the honorable shareholders and
- Above all, to contribute effectively to the national economy.

2.4 Strategies

- To achieve our customer's best satisfaction & win their confidence.
- To manage & operate the bank in the most effective manner.

- To identify customer's need & monitor their perception towards meeting those requirements.
- To review & update policies, procedures & practices to enhance the ability to extend better customer services.
- To train & develop all employees & provide them adequate resources so that customers can reasonably addressed.
- To promote organizational efficiency by disclosing company plans policies & procedures openly to the employees in a timely fashion.
- To ensure a congenial working environment.
- To diversify portfolio in both retail & wholesale market.

2.5 Core values and commitment

2.5.1 Core value

- Trust in almighty Allah
- Highest Standard of Honesty, Integrity & Morale
- Welfare Banking.
- Equity and justice
- Environmental Consciousness.
- Personalized Service.
- Adoption of Changed Technology.
- Proper Delegation, Transparency & Accountability

2.5.2 Commitments

- To Shariah.
- To the Regulators.
- To the Shareholders.
- To the Community.
- To the Customers.
- To the Employees.

- To other Stakeholders.
- To Environment.

2.6 Corporate profile

Chairman	Mr. Mohammad Saiful Alam
Vice Chairman	Mr. Alhaj Mohammad Abdul Maleque
Managing Director	Mr. Syed Waseque Md. Ali
Company Secretary	Mr. Oli Kamal
Legal Status	Public Limited Company
Date of Incorporation	August 29, 1999
Date of Commencement of Business	August 29, 1999
Date of getting license from Bangladesh Bank	September 22, 1999
Date of Opening of First Branch	October 25, 1999
Corporate Head Office	House- SW(I) 1/A, Road-8, Gulshan-1, Dhaka-1212, Bangladesh.
Registered Office	23, Dilkusha, Dhaka-1000, Bangladesh
Line of Business	Banking
Authorized Capital	Tk.10,000 Million
Paid up Capital	Tk.6,788.74 Million
Date of consent for IPO	04 June 2008
Phone	88-02-9888446 (Hunting), 8402613-8402625 (ICT Division).
Fax	880-02-9891915
E-mail	bc@fsiblb.com , info@fsiblb.com
SWIFT Code	FSEBDDH
Auditors	Shafiq Basak & Co, Chartered Accountants, Shatabdi Centre (6 th Floor), 292, Inner Circular Road, Fakirapool, Motijheel, Dhaka. Phone: 02- 7192098, Tel/ Fax: 02- 7194870, E-mail: shafiq_basak@yahoo.com
Legal Advisor	The Law Counsel, Barrister & Advocates, City Heart (7th Floor), Suit No. 8/8, 67, Naya Paltan, Dhaka-1000. Phone: 9349647-8, Fax: 9349866, 9567029, E-mail: l.counsel@bdonline.com .
Tax Consultant	K.M. Hasan FCA, K.M. Hasan & Co. Chartered Accountants, Dhaka Office Home Tower Apartment (8 th & 9 th Floor), 87, New Eskaton Road , Dhaka – 1000, Phone: 9351457,9351564, Fax: 9345792-112.

2.7 Shariah board: Shariah members

Name	Position	Address
Sheikh (Moulana) Mohammad Qutubuddin	Chairman	Baitush Sharaf Complex, Shah Abdul Jabbar (R) Road Dhanialapara, Chittagong-4100.
Mufti Sayeed Ahmed	Vice Chairman	Markaz-e- Eshaete Islam 2/2 Darus Salam, Mirpur, Dhaka
Moulana M. Shamaun Ali	Member Secretary	491, Wireless Railgate, Bara Moghbazar, Dhaka-1217
Moulana Abdus Shaheed Naseem	Member	2/C Green Valley Apartment 493, Wireless Railgate, Bara Moghbazar, Dhaka-1217
Mr. Mohammad Azharul Islam	Member	Lecturer Department of law, University of Dhaka, Dhaka-1000

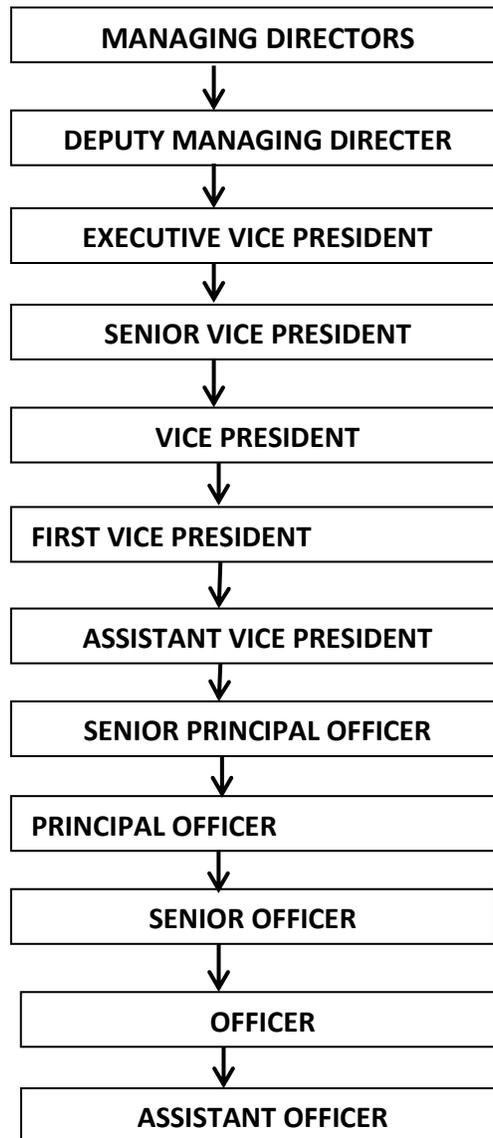
2.8 Observer member

Name	Position	Address
Alhaj Mohammed Abdul Maleque	Vice Chairman, Board of Directors, FSIBL & Observer Member, Shari'ah Council	8/A, OR Nizam Road Panchlaish R/A Chittagong .
Mr. Shahidul Islam	Board of Directors FSIBL & Observer Member, Shari'ah Council	House# 7, Road# 1, Nasirabad Housing Society, Post: Medical P.S: Panchlaish, Dist.: Chittagong.

2.8 Managing Director

Name	Position	Address
Syed Waseque Md. Ali	Managing Director, FSIBL & Observer Member, Shari'ah Council	House SW(I)1/A(4th Floor), Road – 8, Gulshan -1, Dhaka-1212

2.9 Organization hierarchy



2.10 Board of Directors

The present Board of FSIBL consists of eleven non-executive members including two Independent Directors and one nominated director excluding ex-officio Managing Director. The Executive Committee, consisting of five members, is entrusted with the responsibilities of policy making and taking important and strategic decisions as authorized by the Board within the norms

set by Bangladesh Bank. All the Directors of FSIBL are non-executive Directors except the Managing Director.

2.12 Risk management wing of FSIBL

First Security Islami Bank has set up a separate and independent ‘Risk Management Division’ with required number of skilled officers and executives as per Risk Management Guidelines for Banks issued by Bangladesh Bank. There is a two-layer management system for risk management: Board level and Management level.

‘Risk Management Committee of the board comprises of one honorable vice-chairman of the bank as chairman and two directors member. The committee defines the risk appetite for the bank, designs organizational structure to manage risk within the bank, reviews and approves risk management policies, enforces and uses adequate recordkeeping and reporting system, and monitors compliance of overall risk management in the bank.

There is a high-powered ‘Risk Management committee (management level)’ where an additional Managing Director is chairman of the committee. Another Additional Managing Director and 11 other divisional heads including six core divisions are members. The committee sets target for capital ratio and capital composition, manages the balance sheet and funding structure, develops risk policies for business units, determines overall investment strategy, and identifies monitors and manages bank’s current and potential operational risk exposures. Another senior management level committee is ‘ALCO (Asset Liability Management Committee)’ that supervises market risk of the bank.

2.13 Corporate Culture & Recognition

Since inception, FSIBL has been practicing corporate culture at all levels. FSIBL has always been trying to run the Bank professionally and showed its competence during last 18 years of operation. The workforce of FSIBL starting from the CEO down to a Messenger are very much involved and committed professionals and thus could develop the Bank as one of the highly complied one. They work under the guidelines of Bangladesh Bank, other Regulatory Authorities and policies framed by the Board of Directors without any interference from any corner. First

Security Islami Bank Ltd. was awarded the Corporate Social Responsibility (CSR) Award 2009 by Bankers' Forum. The bank was awarded the CSR award in recognition of its active participation in the field of Corporate Social Responsibility (CSR) Program. It was also received the Best Sponsor Award 2014 for its contribution in sports development.

2.14 Products and Services

a) Deposit schemes

- | | | | |
|-------------|------------------|-----------|-----------|
| • Bandhan | • Niramoy | • Alo | • Aboshor |
| • Ankur | • Prapti | • Probin | • Somman |
| • Hajj | • Agrosor | • Jakat | • Morjada |
| • Araba | • Ghoroni | • Swadesh | • Unnoti |
| • Suvechcha | • Triple benefit | • Projonm | • Proyash |
| • Uddipon | • Cash waqfa | • Mehnoti | |

b) Investment products

- Corporate finance
- Hire-Purchase Finance
- Commercial finance
- Industrial finance
- Lease finance
- Syndicate finance
- Real Estate
- Small medium finance
- Women Entrepreneur Investment Project
- Agriculture Investment Project

c) Services:

- ATM Card
- Remittance service
- SMS service
- Locker service
- Collections of utility bill
- Mobile banking
- Internet banking
- Student mobile banking

Chapter 3

Theoretical part

3.1 Islamic Bank and Banking

Islamic banking is a banking system that is based on the principles of Islamic law (also known as Shariah) and guided by Islamic economics. Two basic principles behind Islamic banking are the sharing of profit and loss and, significantly, the prohibition of the collection and payment of interest. The Islamic banking system uses methods of profit and loss sharing to facilitate financial transactions: for some types of loans, the borrower only needs to pay back the amount owed to the lender, but the borrower can choose to pay the lender a small amount of money to serve as a gratuity. Since this system of banking is grounded in Islamic principles, all the undertakings of the banks follow Islamic morals. Therefore, it could be said that financial transactions within Islamic banking are a culturally distinct form of ethical investing (for example, investments involving alcohol, gambling, pork, etc. are prohibited).

Islamic banking has been defined in a number of ways. The definition of Islamic bank, as approved by the General Secretariat of the OIC, is stated in the following manner. *"An Islamic bank is a financial institution whose status, rules and procedures expressly state its commitment to the principle of Islamic Shariah and to the banning of the receipt and payment of interest on any of its operations"*. Shawki Ismail Shehta viewing the concept from the perspective of an Islamic economy and the prospective role to be played by an Islamic bank therein opines: *"It is, therefore, natural and, indeed, imperative for an Islamic bank to incorporate in its functions and practices commercial investment and social activities, as an institution designed to promote the civilized mission of an Islamic economy"*.

It appears from the above definitions that Islamic banking is a system of financial intermediation that avoids receipt and payment of interest in its transactions and conducts its operations in a way that it helps achieve the objectives of an Islamic economy.

3.2 Islamic Investment

Investment is the action of deploying funds with the intention and expectation that they will earn a positive return for the owner. Funds may be invested in either real assets or financial assets. When resources are used for purchasing fixed and current assets in a production process or for a trading purpose, then it can be termed as a real investment. The establishment of a factory or the

purchase of raw materials and machinery for production purposes are examples in point. On the other hand, the purchase of a legal right to receive income in the form of capital gains or dividends would be indicative of financial investments. Specific examples of financial investments are: deposits of money in a bank account, the purchase of Mudaraba Savings Bonds or stock in a company. Ultimately, the savings of investors in financial assets are invested by the respective company into real assets in the form of the expansion of plant and equipment. Since Islam condemns hoarding savings and a 2.5 percent annual tax (Zakat) is imposed on savings, the owner of excess savings, if he is unable to invest in real assets, has no option but to invest his savings in financial assets.

Conventional loan or credit	Islamic Investment
In conventional financing, lenders lend to borrowers to make a profit from the interest charged on the principal amount.	Islamic financing avoids interest-based transactions, and instead introduces the concept of buying something on the borrower's behalf, and selling it back to the borrower at a profit.
For loans, borrowers pay an interest on the outstanding principal amount. Interest rates can be a fixed rate or based on a floating rate.	In place of interest, a profit rate is defined in the contract. Like conventional financing, profit rates can be a fixed rate, or based on a floating rate.
The lenders have the certainty of getting interest.	The investor does not have the certainty of profit. The investor may face profit or loss both.
Loan is given to any sector.	Generally investment is given to productive and business sector.

3.3 Factors Related to Investment

- Risk
- Interest Rate
- Operating Expense
- Inflation
- Time
- Security or Collateral
- Legal Considerations
- Finance Charge

3.4 Risk

Risk implies a situation that threatens or limits an organization's ability to achieve its goal. Risk in a banking organization is the possibility that the outcome of an action or event could bring up adverse impacts. Banking operations are mainly exposed to investment risk, market risk, operational risk, and residual risk, investment concentration risk, liquidity risk, strategic risk, environmental risk, interest rate risk etc. Risk management means a process for identifying, measuring and mitigating all sorts of foreseeable risks for sustainable growth of an organization and its shareholders' value.

3.5 Investment (Credit) Risk

Risk Management in Islamic banking is not significantly different from conventional banking. Credit risk is known as investment risk by the Islamic banks literally both of them are same. Investment risk is the risk of loss that may occur from the failure of any counterparty to abide by the terms and conditions of any financial contract with the bank, principally the failure to make required payments. This risk is broadly the possibility of losses associated with the diminution in the credit quality of borrowers and counterparties.

Credit risk or default risk involves inability or unwillingness of a customer or counter play to meet commitments in relation to investing, trading, settlement and other financial transactions. The Investment risk is generally made up of transaction risk or default risk and portfolio risk. Islamic banks face credit risk in most of the modes of financing that they use. It is well known that Murabaha, Istisna, and installment sale or sales with delayed payment thus generating debts in the accounts of the banks. The fundamental form of risk in all these contracts is credit risk. Salam gives rise to a commodity debt rather than a cash debt, but it also involves credit risk. Mudaraba and Musharaka, on the other hand, are contracts of participation, and the funds given by the bank to entrepreneurs are not liabilities. Yet, these two also bears a credit risk in two ways. First, in the case of tort or negligence, the entrepreneur is liable to guarantee the capital which means a debt liability. Second, when the capital of Mudaraba or Musharaka are employed in a deferred sale, which is what takes place in most Mudarabas, the owner of capital, the bank in

this case, bears an indirect credit risk. This risk pertains to the ability of the counter parties to repay.

The unused portion of any claim or exposure (other than claims secured by residential property) that is past due for 60 days or more, net of specific provisions (including partial write-off) will be risk weighted as per Table 7 of Basel III guidelines. For the purpose of defining the net exposure of the past due investment, eligible financial collateral (if any) may be considered for investment (credit) Risk Mitigation. General provision maintained against Special Mention Account (SMA) Investment will not be eligible for such net off.

3.6 Investment (Credit) Risk Management

The investment (credit) portfolio of a bank usually consists of a money market portfolio, capital market portfolio and general credit portfolio. Here a bank is highly exposed in the risks of capital market and general credit portfolio. In recent times, the awareness among the bankers has grown regarding the need for managing perceived risks in credit related activities. One of the goals of credit risk management in banks is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within the acceptable level. Hence, the credit risk assessment and grading system are being applied to evaluate, identify, measure and monitor the level or status of perceived risk associated with a credit proposal.

A number of financial and non-financial factors or parameters are used by the banks for these purposes. The use of comprehensive credit risk assessment and grading techniques increasing very rapidly in the banking sector in Bangladesh because of deterioration in the credit standing of the clients, adoption of Basel accords, compliance of International Accounting Standards (IAS) & International Financial Reporting Standards (IFRS) and the vast revolution of technologies that has made the bankers user friendly in the adoption of these techniques.

3.7 Non-performing loans (NPL)

Non-performing loans (NPLs) are loans that are in default or close to being in default. Many loans become non-performing after being in default for 90 days, but this can depend on the contract terms. A loan is non-performing when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full (International Monetary Fund, 2005).

Prudential Guidelines (2006) defines non-performing loan as a loan that is no longer generating income. The guidelines state that loans are non-performing when: principal or interest is due and unpaid for 90 days or more; or interest payments for 90 days or more have been re-financed, or rolled-over into a new loan.

There is a growing body of empirical evidence to suggest that non-performing loans (NPLs) have adverse effects on bank profitability that often lead to bank failures. Profitability is an indicator of a bank's capacity to carry risks and / or to increase its capital. The capital adequacy of a bank is generally gauged by the extent to which owners' fund provide cover for depositors in the event of loans and advances becoming non-performing.

3.8 Non-performing loan portfolio

In discussing credit risk management, it was found necessary to examine the process of measuring loan portfolio quality which is considered the key to loan portfolio management. Assessing the current performance of the most important asset of a financial institution (the loan portfolio) is a basic requirement for being able to actively manage the level of risk exposure and the profitability of that institution.

In general, portfolio quality indicators identify performing and non-performing aspect of the loan portfolio and relate them to specific indicators which provide a view or a snap shot of the status of the portfolio's performance. By comparing indicators at different points in time, trend analysis is carried out to identify upturn or downturn developments. In assessing the quality of a loan portfolio, classification and provision for bad debt are very crucial. There can be a number of reasons to explain to deterioration in loan portfolio quality. It is unavoidable that banks make

mistakes in judgement. However, for most failed banks, the real problems are systemic in nature and rooted in a bank's credit culture and management style.

3.9 Determinants of Non-Performing Loans

According to Basel (1999) a sound and comprehensive credit risk management program need to address these four areas:

- (i) Establishing an appropriate credit risk environment
- (ii) Operating under a sound credit granting process
- (iii) Maintaining an appropriate credit administration, measurement and monitoring process
- (iv) Ensuring adequate controls over credit risk.

Although specific credits risk management practices may differ among banks depending upon the nature and complexity of their credit activities. These practices should also be applied in conjunction with sound practices related to the assessment of asset quality, the adequacy of provisions and reserves, and the disclosure of credit risk.

3.9.1 Establishing an appropriate credit risk management

In establishing a proper credit risk environment, the first principle is that the board of directors should have responsibility for approving and periodically (at least annually) reviewing the credit risk strategy and significant credit risk policies of the bank. The strategy should reflect the bank's tolerance for risk and the level of profitability the bank expects to achieve for incurring various credit risks. The second principal is that the senior management should have responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of both the individual credit and portfolio levels. Lastly, the banks should identify and manage credit risk inherent in all products and activities. Banks should ensure that the risks of products and activities new to them are subject to adequate risk management procedures and controls before being introduced or

undertaken, and approved in advance by the board of directors or its appropriate committee (Basel, 1999).

3.9.2 Operating under a Sound Credit Granting Process

Basel Committee (1999) also agrees that, to have a sound credit granting processes banks must operate within sound, well-defined credit-granting criteria. These criteria should thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment. Banks should establish overall credit limits at the level of individual borrowers and counterparties, and groups of connected counterparties that aggregate in a comparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

Another principle is that banks should have a clearly-established process in place for approving new credits as well as the amendment, renewal and re-financing of existing credits. Also, all length basis. In particular, credits to related companies and individuals must be authorized on an exception basis, monitored with particular care and other appropriate steps taken to control or mitigate the risks of non- (Basel, 1999).

3.9.3 Maintaining an Appropriate Credit Administration, Measurement and Monitoring Process

To maintain an appropriate credit administration measurement, monitoring process, Basel (1999) sets out a number of principals. One is that Banks should have in place a system for the ongoing administration of their various credit risk-bearing portfolios. Banks must have in place a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves; and third, they are encouraged to develop and utilize an internal risk rating system in managing credit risk. The rating system should be consistent with the nature, size and complexity of a bank's activities.

Another principle to guide in maintaining an appropriate credit process is that banks must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on- and off-balance sheet activities. The management information system should

provide adequate information on the composition of the credit portfolio, including identification of any concentrations of risk. Moreover, banks must have in place a system for monitoring the overall composition and quality of the credit portfolio. Lastly, banks should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios, and should assess their credit risk exposures under stressful conditions (Basel, 1999).

Therefore, to have a sound credit risk management system, it is necessary to establish a proper credit risk environment, sound credit granting processes, appropriate credit administration, measurement, monitoring and control over credit risk, policy and strategies that clearly summarize the scope and allocation of bank credit facilities as well as the approach in which a credit portfolio is managed i.e. how loans are originated, appraised, supervised and collected, a basic element for effective credit risk management (Basel, 1999).

3.10 Effects of Credit Risk Management on Non-Performing Loans (NPLs)

Ekrami and Rahnama (2009) stated that the high amount of NPLs represents high credit risk in today bank system and this encounters banks with market risks and liquidity risk. Although banks are trying to control the risks within the organization, but high percentage of this risk and its consequences for the future could not be ignored. NPLs create due to weak criteria of credit assays, ineffective policies, risk acceptance without regard to limitation of bankroll and wrong functional indicators (Morton, 2003).

Keeton and Morris (1987) present one of the earliest studies to examine or show the relationship between non-performing loans and credit risk management. The authors examined the losses by 2,470 insured commercial banks in the United States (US) over the 1979-85. Using NPLs net of charge-offs as the primary measure of loan losses. Keeton and Morris reported that commercial banks with greater risk appetite tend to record higher losses. Several studies which followed the publication of Keeton and Morris have since proposed similar and other explanations for losses/non-performing loans in banks. For instance, a study by Haneef et al (2012) concluded

that non-performing loans are increasing due to lack of risk management which threatens the profitability of banks.

Chapter 4

Analysis of Loan or Investment in FSIBL, Banani

4.1 Investment operation

Islamic Banks emphasis on legitimate (Halal) business. Islamic bank does not invest in loans and fixed interest securities. It can invest in ordinary share only while interest based bank can invest in loans and different kinds of securities. FSIBL establishes and participates in project with its client as a partner and bears the risk along with the client on a proportionate basis. Finally, the concept of FSIBL is to establish an egalitarian society based on principals of social justice and equity. We have gathered the fact that investment management is the theme of FSIBL. The banks take deposits and invest the same based on the profit-loss sharing. Bank goes for the investment mainly which are long term and profitable in nature. FSIBL also give high concentration on the investment that will generate more employment. As investment one of the most priority areas for the FSIBL, so it needs to be cautious in investment decisions. To ensure proper investment FSIBL always go with in-depth study before making an investment. So in the next phase we are going to demonstrate the way FSIBL manage investment.

4.2 Investment Mechanism

The special feature of the investment of the Islamic bank is to invest based on profit-loss sharing system in accordance with the tenets and principles of Islamic Shari'ah. Earning of the profit is not the only motives and objective of the Islamic Banks investment policy rather emphasis is given in attaining social good and in creating employment opportunities.

FSIBL investment Mechanism mode is divided in three parts and those are described below:

4.2.1 Profit & Loss sharing Mode

Profit and loss sharing mode mainly related to FSIBL investment department. It is a major part of the bank. The marked up profit may be fixed in lump sum or in Percentage of the cost price of the goods. This mode is categorized into two different systems and those are:

- a. **Mudrarba:** It is a form of partnership where one party provides the funds while the other provides the expertise and management. The first party is called Sahib-Al-Maal and the latter is referred to as the Mudarib. Any profit accrued are shared between on a pre-agreed basis, while capital loss is exclusively borne by the partner providing the capital.
- b. **Musharaka:** an Islamic financial techniques that adopts “equity Sharing” as means of financing projects. Thus, it embraces different types of profit and loss sharing

partnership. The partners share both capital and management of the project so that profits will be distributed among them as per rations, where loss is shared according to rations of the equity participation.

4.2.2 Bai Mode (Buying and Selling)

Bai mode mainly related to buying and selling. The terms “Bai” have been derived from Arabic words and the word mean purchase and sale. Bai means sale for which payment is made at a future fixed date or within a fixed period. In short, it is a sale on credit. This mode has three different criteria and those are discussed below:

- a) **Bai-Murabaha:** The word Bai means purchase and sales and the word Murabaha means an agreed upon profit. Bai-Murabaha may be defined as a contract between a buyer and seller under which a seller sells a product to the buyer at a cost plus agreed profit payable in cash or on any fixed future date in lump-sum or by installments. The seller may also sell goods purchased by him as per order and specification of the buyer.
- b) **Bai-Muajjai:** Bai-Muajjai may be defined as a contract between a buyer and seller which under the seller sells a certain specific goods, to the buyer at an agreed fixed prices payable at certain fixed future date in lump-sum or within a fixed period or fixed installments. The seller may also sell the goods purchased by him as per order and specifications of the buyer.
- c) **Bai-salam:** Under this mode Bank will execute purchase contract with the client and make payment gains purchase of the product, which is under of production. Bai-salam contract will be executed after making any investment showing price, quality, quantity, time, place, and mode of delivery. The profit is to be negotiated. In this mode the payment as the price of the goods is made at the time of agreement and the delivery of the goods is deferred.

4.2.3 Rent Sharing Mode

The term Rent Sharing Mode has been derived from the Arabic words Ajr and ujrut which means consideration, return, wages or rent. This is really the exchange value or consideration, return,

wages, rent of the service of an asset. Rant sharing mode has two categories and those are given below:

- a) **Hire Purchase/Ijarah:** The term Ijarah derived from Arabic word Air and Ujrat which means consideration, return, wages or rent. This is really exchange value or consideration, return, wages, rent of service of an Asset. Ijarah has been defined as a contract between two parties, the hired and Hirer where the hirer enjoys or reaps a specific service on benefit under specific consideration or rent from the asset owned by the Hirer. It is a hire agreement under which a certain asset is hired out by the hiree to the Hirer against fixed rent or rentals for a specific period.

- b) **Hire Purchase under Sirkatul Meelk:** Under this mode bank may supply implements/ equipment/ goods on rental basis. The owner of the implements/ equipment/ goods will be with the bank and client jointly and the portion of the client will remain to the bank as mortgage until the closure of the investment account, the client will be authorized to process the equipment for certain period. The client, after completion of the installments, will be owned of the implements/ equipment/ goods.

Hire purchase under Shirkatul Melk is Special type of contract which has been developed through practice. Actually, it is a synthesis of three contracts:

- ✓ Shirkat
- ✓ Ijarah
- ✓ Sale

Shirkatul: Shirkat means partnership. Shirkatul Melk means share in ownership. When two or more persons supply equity, purchase an asset, own the same jointly and share the benefit as per agreement and bear the loss in proportion to their respective equity, the contract is called Shirkatul Melk.

Ijarah: Ijarah derived from Arabic words Air and Ujrat which means consideration, return, wages or rent. This is really exchange value or consideration, return, wages, rent of service of an Asset.

4.3 Loans and advances

All loans and advances will be grouped into 4 categories for the purpose of classification. These areas are-

- Continuous Loan
- Demand Loan
- Fixed Term Loan and
- Short Term Agricultural & Micro Credit.

4.3.1 Continuous Loan

The loan Accounts in which transaction may be made within certain limit and have an expiry date for full adjustment will be treated as continuous loan. For example: CC (cash credit), OD (Over Draft) etc. In continuous loan bank need some collateral securities to the customer. If customer wants to take a lone against his FDR (any bank account) he has to submit all documents of FDR. He also take loan against his fix assets like land, house.

4.3.2 Demand Loan

The loan that becomes 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. In demand loan bank need charged documents. If customer wants to take loan against his house, at first bank have to see all deeds and documents legal or not, then take the valuation of assets and give loan 80% (force rate) of value.

4.3.3 Fixed Term Loan

Loans which are repayable within a specific time period under a specific repayment schedule will be treated as Fixed Term Loans.

4.3.4 Short Term Agricultural & Micro Credit

Short Term Agricultural & Micro Credit will include the short-term credits as listed under the Annual Credit program issued by the Agricultural Credit department of Bangladesh Bank. Credit in the agricultural sector repayable within less than 12 months will also be included herein. Short-term Micro-Credits will include any Micro-Credits for less than Tk. 25,000/- and repayable within less than 12 months, be those termed in any names Such as nonagricultural credit, self-reliant Credit, Weaver's Credit or Bank's individual project credit. Actually this loan doesn't need special documents. It's only need chairmen /commissioner certificate.

FSIBL offers following types of Credit (loans and advances) as a whole.

- a. Cash Credit (Hypo)
- b. Term Loan
- c. Secured Overdrafts
- d. House Building Loan(HBL)
- e. Transport
- f. Hire Purchase Scheme
- g. Small Enterprise Financing

a. Cash Credit (Hypo)

Cash Credit or continuing credits are those that form continuous debits and credits up to a limit and have an expiration date. A service charge that is effect an interest charge is normally made as a percentage of the value of purchases. These credits may be of the nature of pledged and /or hypothecated and banks should report these in separate heads incorporated under the main head cash credit. A detailed explanation of hypothecation is given below.

Under this arrangement a credit is sanctioned against hypothecation of the raw materials or finished goods. The letter of hypothecation creates a charge against the goods in favor of the Bank but neither the ownership nor its possession is passed on to it; only a right or interest in the goods is created in favor of the Bank and the borrower binds himself to give possession of the goods to the bank when called upon to do so. When the possession is handed over, the charge is

converted into pledge. This type of facility is generally given to the reputed borrowers of undoubted integrity.

b. Term Loan

A term loan is a contract under which a borrower agrees to make a series of interest and principal payments on specific dates to the lender. Term loan have three major advantages over public offerings- speed, flexibility & low issuance costs. There are two of term loan one is short term another is long term. Short term loan is only five years or less than five years and long term loan up to five years. These two loan recovery system can be same like installment. Long term loan must need a grantor and need necessary documents.

c. Secured Overdrafts [SOD (FO)]

A loan facility against customer's financial obligations (MSS/DBDS/FDR/Share) at a Bank permitting him to overdraw up to a certain agreed limit for an agreed period. The customer has to a saving A/c in that branch. The terms of the loan are normally that it is repayable on demand or at the expiration date of the agreement. All the account documents have to submit in bank. It can be other bank MSSS/FDR/Share/double benefit scheme. Bank needs a guaranty for particular loan that fulfill account documents.

d. House Building Loan

Banks makes house building loans to fund the acquisition of real property: homes, apartment complexes, shopping center office building, warehouses, and other physical structures as well as land in some cases. House related all paper has to submit to bank then bank investigate all the requirements. After investigation if bank take a decision to give him loan then bank take all the documents as a mortgage. Bank also give apartment loan, this loan have to conceder as a tri part agreements. Builders' handover the flat to the bank and after covering all installment bank handover the flat to the purchaser.

e. Small Enterprise Financing

These a type of loans is provide to the small, medium enterprise for expanding their business activities in the long run. This is a short term loan. It provides for one year. Small Enterprise Financing loan doesn't need any securities or deeds and documents. Its need only grantor and provable documents of business like tread license, tread deal documents, tin certificate, bank statement.

Chapter 5

Survey, Data Analysis & Findings

5.1 Deposit & Investment

Depositors usually deposit money on a monthly installment for different periods. The deposit of First Security Islami Bank Ltd., Banani branch has increased 309.57 million tk to 736.45 million takas from 2012 to August 31,2017. Last year by December 31 the deposit was 701.95 million taka and this year by August 31 the deposit increased by 33.5 million taka already. Deposit is the “life-blood” of a bank. Bank has given utmost importance mobilization of deposit introducing a few popular and innovative schemes.

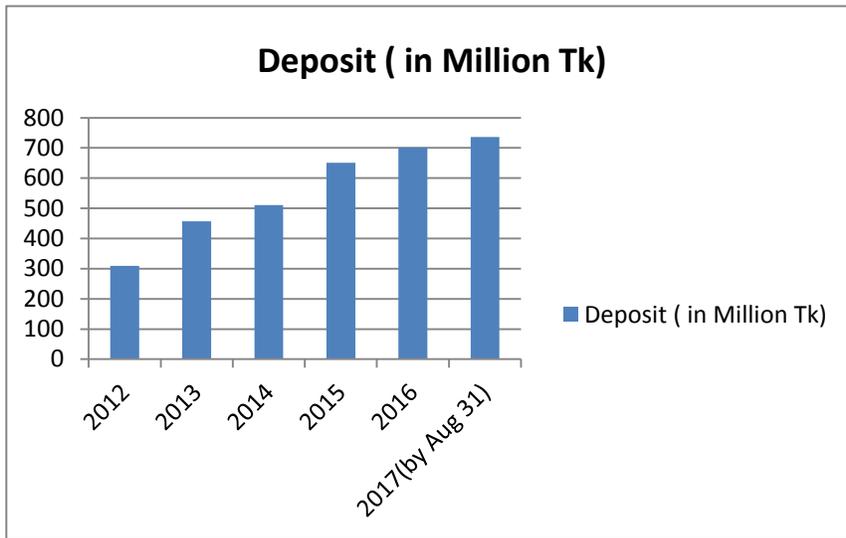


Fig: Deposit (2012-2017)

First Security Islami Bank Ltd. has increased its investment despite adverse condition in the domestic as well as in the global economy. Total amounts of loans of the bank stood at tk. 1063.11 million as on August 31,2017 against tk. 989.78 million as on December 31, 2016. The bank gives emphasis to acquire quality asset and does appropriate lending risk analysis and follow all the terms and condition all sorts of investments to client.

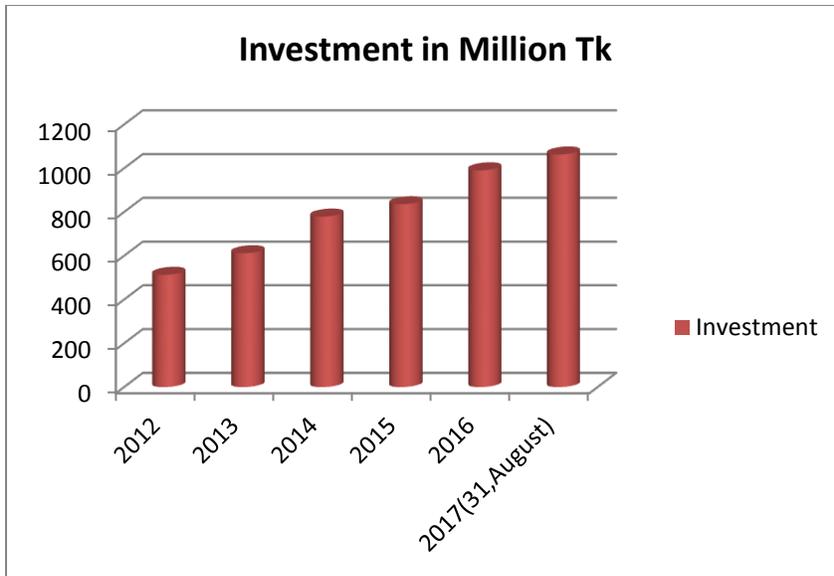


Fig: Investment (2012-2017)

5.2 Prior Investment Requirements

For any kind of lending or investment Bank needs guarantee from their customers. This guarantee or collateral could be FDR, DPS, land, building, goods, machinery, personal guarantee, corporate guarantee etc. Bank does not allow 100% loan on any condition. They have different percentage of loan allowance for different sector. For instance, 80% for secured loan (FDR, DPS), 50% for land value. They have always an opportunity to recover principal because before approving any loan account they always collect all kinds of information that is required, like ground checking, their asset values, ethical business or not, business type, in which stage it remains now etc. Bank usually don't do any kinds of bad behavior with their customer, they try to compliance regularly with the clients and handle everything with tactfully. But if there is any unavoidable situation, bank follows their rule by filing suit.

5.3 FSIBL provision policy

Bank has a monitoring system to detect NPL in an early stage. Basically it is the investment risk management team. Even after all of these, if there is any high risk account, FSIBL has few provisions:

General Provision: The Bank maintains General Provision in the following way:

- a. 0.25% against all unclassified loans of Small and Medium Enterprise (SME) as defined by the SME & Special Programs Department of Bangladesh Bank from time to time
- b. 1% against all unclassified Investments (other than Investments/loans under Consumer Financing, Loans to Brokerage House, Merchant Banks, Stock dealers etc., Special Mention Account as well as SME Financing.)
- c. 5% on the unclassified amount for Consumer Financing whereas it has to be maintained @ 2% on the unclassified amount for (i) Housing Finance and (ii) Investments/Loans for Professionals to set up business under Consumer Financing Scheme.
- d. 2% on the unclassified amount for Investments/Loans to Brokerage House, Merchant Banks, Stock dealers, etc.
- e. Same as standard on the outstanding amount of Investments/loans kept in the 'Special Mention Account'.
- f. 1% on the off-balance sheet exposures. (Provision will be on the total exposure and amount of cash margin or value of eligible collateral will not be deducted while computing Off-balance sheet exposure.)

Specific Provision: Banks will maintain provision at the following rates in respect of classified Continuous, Demand and Fixed Term Investments/Loans:

1. Sub-Standard-20%
2. Doubtful-50%
3. Bad/Loss-100%

Provision for Short-term Agricultural and Micro-Investments:

1. Unclassified and SMA @ 02.50%
2. Sub-Standard and Doubtful @ 05%
3. Bad/Loss @ 100%

5.4 Non performing loan of FSIBL

Failing financial institutions always have high level of non-performing loans prior to failure. It is argued that the non-performing loans are one of the major causes of the economic stagnation problems. Each non-performing loan in the financial sector is viewed as an obverse mirror image of an ailing unprofitable enterprise. Therefore, the eradication of non-performing loans is a necessary condition to improve the economic status.

From surveying, I have found that default loan is usually common in case of term loan and small enterprise financing sector. They are affected most because if there is any environmental shock like disputing due to property issues, political problems or not being able to deliver products timely etc. as they have small business in terms of other. One of the bank officials stated that, currently the two default loans that they have in their Banani branch are SME loan accounts and this year the default amount is 5.22 Million taka. One of them, borrowed 4 crore taka and was paying installments regularly, but recently his business place has demolished and have to change the current place due to governmental decision. That is why he missed consecutive payments schedule. Bank contacted with him and he assured that he may miss few more next scheduled payments but he will pay. FSIBL has decided to give him more time. Other party also has almost the similar problem for not being able to pay. FSIBL is maintaining contact regularly with both of the customers and they have taken the decision to give more time to collect their payments.

Though default amount has been fixed for this year but the investment has increased or been constant throughout the months. That is why from the graph we can see NPL to investment ratio was almost similar, 0.43 to 0.422 throughout the months. NPL to total investment ratio for this year, is given below...

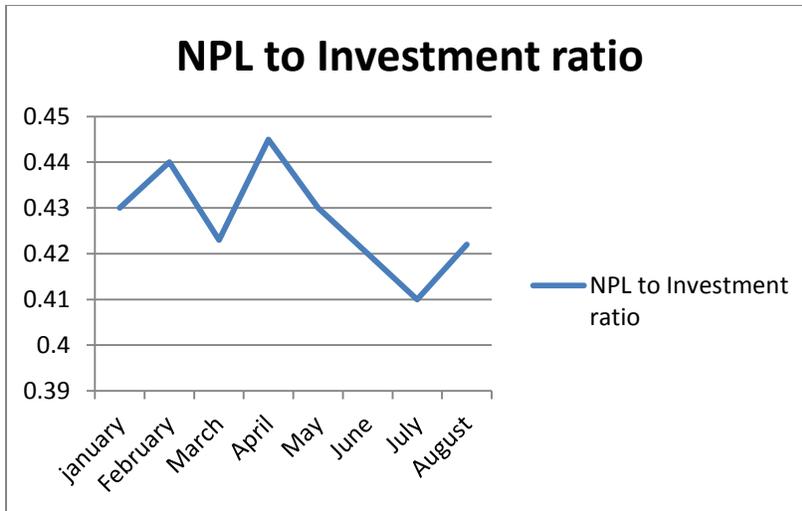


Fig: NPL to Investment ratio

Year after year NPL is moderately increasing in FSIBL, banani branch. The reasons of increasing could be so many issues like political imbalance, favoring clients without checking details and so on. A graph is given below-

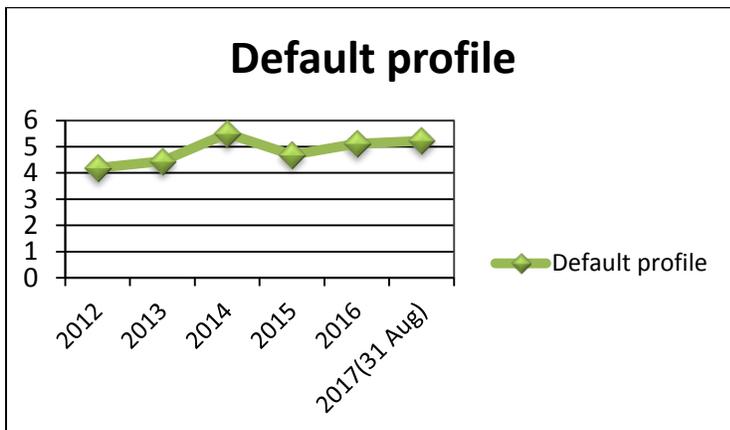


Fig: Default profile

Default profile should be in check, so that it cannot get higher. Because, a high volume of NPLs causes a significant drag on a bank's performance in the form of:

- reduction in net interest income;
- increase in impairments costs;

- additional capital requirement for high-risk weighted assets;
- lower ratings and increased cost of funding, adversely
- affecting equity valuations;reduced risk appetite for new lending;
- additional management time and servicing costs to resolve the problem.

5.5 Findings

I did internship for 3 months at FSIBL, banani branch. The topic I am working on, I talked to the bank officials, they tried to help me providing information as much as possible. They could not provide information with details as per banks regulations. So, here are the findings:

- As we observed the chart of total loan investment of FISBL it is found that the investment of the bank continuously increasing. It signifies that the Bank tries to extend credit facilities to the various sector of the economy.
- And the total deposit of FSIBL has also increased.
- From the chart, it is shown that NPL to investment ratio for this year is decreasing or almost similar throughout the year.
- The total amount of default loan or NPL is 5.22 Million tk. And both of the parties are small party and having temporary issues. They will soon recover from it and will start paying soon.
- Form the graph, it is clear that though in this year it is almost constant but NPL has increased year after year in this branch.

Chapter 6

Conclusion and Recommendation

6.1 Conclusion

First Security Islami Bank Limited has been established with the aim of contributing to the balanced growth and equitable development of the country through diversification of its investment portfolio by size, sector, geographical area etc. for the banks ultimate objective of ensuring justice and equity in the field of economy in the interest of all segments of people. The bank has been endeavoring hard towards the achievement of the above goals and making progress tremendously in this regard. The study concluded that the bank has an almost constant NPL but in this Banani branch, NPL or default loan is increasing.

The bank has a sound credit risk management system and the senior management of the bank develops policies and procedures for identifying, measuring, monitoring and controlling credit risk. FSIBL have established an appropriate credit risk environment, and they believe lack of appropriate credit risk environment leads to lack of evaluation of the borrowers, failure to account for risk associated with loan defaults and lack of use of credit reference Bureaus hence increasing the chances of loan defaults hence increase in the non-performing loans. Poor credit granting process leads to increase in loan default hence reducing the revenue of most of the banks. The bank always needs to have clients' full information regarding their purpose of the loans, because some clients take unsecured loans and then default.

Information and Analysis is not sufficient because it is difficult to measure and express perfectly within this short time of my internship period. This report basically deals with "Assessing the Investment department on the context of overall Default profile in FSIBL, Banani". But all information is not available about this topic. But it is a great opportunity for me to get use to with the operational environment of commercial banking of FSIBL. I have tried by soul to incorporate the research report with necessary relevant information in my report.

6.2 Recommendations

- Bank should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios.
- An Islamic bank earns its principal revenue from profit on investment. To avoid investment risk as much as possible through minimizing adverse selection, before sanctioning any investment (loan) the officers of the bank have to observe whether every aspect of principles of lending is filled and other things such as credit requirement, accountability, prepayment of loans, collections, insurance and other required fields are covered or not.
- An energetic investment recovery unit should also be formed to manage directly accounts with sustained deterioration of investment.
- Investment recovery unit also needs to be skillful enough to recover default loans. To encourage investment recovery unit incentive program may also be introduced.
- Deposit sector should also be monitored, so that more customers can deposit their money and bank have a cash flow.
- Default loan can happen any time, so to minimize it the bank needs to be more calculative, and have patience to recover their money. And if the default account is a longtime customer, he or she will be grateful having the repayment opportunity after default time. Next time he will try not to miss any installment and may be will bring more customers informing the banks reputation and decency.

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