Credit Risk Management Practices at Citibank N.A.: A Case Study from the Perspective of Credit Policy Guidelines of Bangladesh Bank

By

Lamia Shama

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Credit Risk Management Practices at Citibank N.A.: A Case Study from the Perspective of Credit Policy Guidelines of Bangladesh Bank

BUS 400: Internship

Internship Report

Submitted to:

Ms. Kulsum Popy

Lecturer in Management

BRAC Business School

BRAC University

Prepared By:

Lamia Shama

ID: 08104156

BBA Spring 2008 Batch

BRAC Business School

BRAC University

04 November, 2012

Letter of Transmittal

Date: 04 November, 2012

To

Ms. Kulsum Popy

Lecturer in Management

BRAC Business School

BRAC University, Dhaka

Bangladesh

Subject : Submission of the Internship Report on 'Credit Risk Management Practices at Citibank N.A.: A Case Study from the Perspective of Credit Policy Guidelines of Bangladesh Bank'

Dear Madam:

As a part of the internship program, I have prepared this report on the topic "Credit Risk Management Practices at Citibank N.A.: A Case Study from the Perspective of Credit Policy Guidelines of Bangladesh Bank". The report contains a detailed study and analysis on the Credit Risk Management Practices of Citibank N.A., Bangladesh. The report covers details of the activities of Credit Risk Management Services (CRMS) in which I worked for my entire internship period of four months. All the activities have been outlined and discussed there from the perspective of Credit Risk Guideline of Bangladesh Bank. As an intern of CRMS, I was not able to cover all the activities performed by CRMS. So, by and large, this report is based on the processes and policy to which I have gone through in detail and which I have grasped well.

I am, therefore, submitting this report with the hope that it lives up to your satisfaction. However, I would be glad if you enlighten me with your thoughts and views regarding the report. In addition, if you wish to enquire about any of the aspects of the report, I would be obliged to answer your queries.

Yours faithfully,

Lamia Shama
ID: 08104156

Acknowledgements

I hereby express immense gratitude to my supervisor, Ms. Kulsum Popy, for guiding me throughout the internship period. Her guidance and views were very much helpful to prepare this report. As an organizational supervisor and my reporting boss, Mr. Abul Kashem, Head of Credit Risk Management Services, Citibank N.A. was phenomenal and his guidance and cordial co-operation was truly encouraging for me. I am also very grateful to my colleagues Suzana Momen, Md. Mostafizur Rahman, Md. Shamsuddoha and Md. Himan Sheikh who helped me by sharing their knowledge and experiences relating to CRM practices of Citibank N.A. Much of their valuable professional insight has been borrowed to enhance my understanding of the CRMS and widen the scope of my project.

I am thankful to my fellow classmates who supported me by sharing their views and experiences which were instrumental in the preparation of the report. I am also much grateful to members of my family who provided me all sorts of support and inspired me by their presence beside me.

Finally, I convey my heartiest gratitude to my supervisor for allowing me her valuable time in supervising and mentoring me during the course of this internship. It would have been much more tedious if she were not such helpful and caring to me.

November, 2012 Lamia Shama

List of Acronyms

AEPZ- Adamjee Export Processing Zone

BB- Bangladesh Bank

BIS- Bank for International Settlement

BOI- Board of Investment

BRPD- Banking Regulation and Policy Department.

CEPZ- Chittagong Export Processing Zone

CGM- Citi Global Markets

CIB- Credit Information Bureau

CO- Credit Officer

CR- Credit Rating

CRG- Credit Risk Grading

CRM- Credit Risk Management

CRMC- Credit Risk Management Committee

CRMP- Credit Risk Management policy

CRMP- Credit Risk Management Policy

CRMS- Credit Risk Management Services

DEPZ- Dhaka Export Processing Zone

EPZ- Export Processing Zone

FCB- Foreign Commercial Bank

FI- Financial Institutions

FRR- Facility Risk Rating

GRR- Global Risk Rating

GSG- Global Subsidiaries Group

ICG- Institutional Clients Group

LCB- Local Corporate Banking

OBU- Offshore Banking Unit

ORR- Obligor Risk Rating

RM- Relationship Manager

SCO- Senior Credit Officer

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Executive Summary

Banking industry in Bangladesh has become a major contributor to the economy since the last decade. Economic prospects and business friendly environment of Bangladesh, foreign banks have come and opened banking operations here. Of the 9 Foreign Commercial Banks in Bangladesh Citibank N.A. has been a pioneer in innovative banking services. Citibank N.A. is a concern of Citigroup Inc. located centrally in New York.

Business entities require a huge amount of money to launch several projects. And money is provided by the banks in terms of credit. Credit is a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some later date. Credit risk means the risk of credit loss which results from the failure of a borrower to honor the borrower's credit obligation to the financial institution.

Bangladesh Bank has formulated Credit Risk Guideline to supervise the process of Credit Risk Management. As a scheduled foreign bank in Bangladesh, Citibank N.A. complies with that policy and it has the entire infrastructure in place and activities are performed accordingly. Besides this, in Citibank N.A. there is a separate Credit Risk Policy named as 'ICG Credit Risk Policy'. This is the global risk policy for the bank and Citibank N.A. follows this too for the internal compliance. Being a global bank Citibank N.A. has high risks in its business as it operates globally across 160 countries.

Credit process is a long one and it has several stages. Firstly the borrower's application is considered after examining its financial strength and quality of assets. Based on the financial and asset qualities a risk grading is tagged to the borrower. The Business unit decides whether the borrower will be provided credit facility or not. A separate Risk Chain monitors the whole process in collaboration with the business unit. After decision of lending primary documentation and account opening process is performed by the respective units and upon perfection of the required documentation, the borrower is provided credit facilities. Credit related documents are standard documents formulated by the legal team of the bank and the documents are printed and kept in safe custody of CRMS. For deferrals in documentation, respective RMs raise deferral request to the Risk Chain who monitors the process from India. Upon perfecting of documentation CRMS unit maintains the credit lines for the borrowers. Before letting the customer to take drawdown, CRMS collects the CIB Report from the Database of CIB and checks the status of the borrower in question. This is a major checking done by CRMS and the Head of CRMS deals with this to make sure there is no error in the process.

Loan monitoring is solely done by the CRMS unit. RMs as well as business and Risk Chain are informed about the availed facilities / utilization on a daily basis. Repayment schedules are closely monitored and classification status of the borrowers changes if there is any discrepancy or delay in repayment schedule. Thus the whole process goes on in both the pre sanction and post sanction stages.

For hypothecated assets of borrowers, RMs collect the stock reports and insurance cover notes of those assets so that those assets are safe and available for sale if the customer defaults. Non-performing loan in Citibank N.A is below 2% and this signifies the perfection of Citibank N.A in managing the credit portfolio.

CRMS reports to Bangladesh bank as part of the required regulatory reporting. There are 7 monthly reports, 16 quarterly reports, 6 semiannual reports and 1 annual report which are regularly submitted to different departments of Bangladesh Bank. The BB officials let CRMS know if there is any discrepancy and CRMS also obtains clarification from the departments if there is any such requirement.

Chapter One

Introductory Discussion

1.1 Introduction

The importance of a sound credit management can hardly be over emphasized. The main source of revenue of a bank is interest revenue. This revenue is generally generated through loan disbursement. There may be other sources of revenues but loan disbursement is the most vital one. Therefore, the lending institutions must manage their credit or credit risk with utmost sincerity and care.

Lending is not static. The lending officer's prime adversary change is constant. The business environment is constantly changing and to cope with these continuous changes the banks are supposed to change their products. Strategies that brought past prosperity will not necessarily work in the coming years.

In today's volatile economy, businesses are under extra pressure. Some borrowers with a history of stability and high profitability are moving toward instability and marginal profitability. The global marketplace has not only put pressure on lending margins but a rising number of borrowers have also faced severe liquidity strains. The new energy economics and especially the new technology are altering the environment, our lives and our thinking. To make sound decisions, lenders must be alert to these changes. Success can be slippery and size alone has proven no assurance of either prosperity or survival. Next to the pervasive influence of the business cycle, management and its ability to adjust and prosper, to cope successfully with adversity as well as prosperity are most critical. Technology and consumer tastes aside, companies are tremendously influenced-for the good or bad- by management behavior and competence.

Further, the intrinsic of a credit, its industry and competitive position, management and external factors – including the business cycle – are all impacting elements over the periods of the bank's exposure and are constantly interacting. The ability of a business is to adjust to changes and renew itself is the key. The secret is to know and understand the risks and then getting protection against them. The lending officer is not only making a present judgment about future willingness and ability to repay, but also about future conditions.

1.2 Objectives

1.2.1 Broad Objective

To discuss the overall activities performed in Credit Risk Management in comparison to the guidelines prescribed by Bangladesh Bank.

1.2.2 Specific Objectives

- Credit Risk Management Practice at Citibank, N.A.: To have better orientation on credit management activities specially credit policy and practices, credit appraisal, credit-processing steps, credit management, risk grading, classification method and practices of Citibank, N.A.
- To compare the functions performed in CRMS of Citibank, N.A. with the CRM policy formulated by Bangladesh Bank
- To identify and suggest scopes of improvement in credit management of Citibank, N.A.

1.3 Scope of the Report

This report details the CRM functions performed by the CRMS department of Citibank N.A. Credit Risk Management is a process that requires collaboration from various other departments. Due to my involvement with the CRMS department, this report is solely based on the processes followed by the department to manage credit risk. All these processes have been compared with the credit risk guidelines provided by Bangladesh bank.

Therefore, this report will help reader to know what the CRM practice in Citibank, N.A. is. The report contains details of the Credit Risk Management guidelines of Bangladesh Bank. Not only knowing the CRMS practice in Citibank but also understanding how accurately it is following the guidelines of Bangladesh Bank, will help the reader to obtain clear information on CRMS.

Further it will help the reader to compare the CRM practice with that of other banks. In this report I have mentioned few recommendations on the limitations of the CRMS department, which will be beneficiary for its future development.

1.4 Data Types

For the research work, mainly two types of data have been collected. They are:

1.4.1 Primary Data

Primary Data was gathered mainly through observation of the CRM activities performed at Citibank N.A. As an intern, I was exposed to several processes regarding CRM and details of the activities have been in the descriptive part of the report based on my observations on those. Moreover, various process notes have been provided to me for gathering knowledge of various CRM functions and applications. Besides, employees of CRMS department have been asked questions about the processes and their principles and their responses have been included in the respective parts of the report. After completion of all these discussions and data collection, they were arranged and summarized in full report format.

1.4.2 Secondary Data

Secondary data was collected from books, journals, articles, research papers and the World Wide Web. Some secondary data was collected from the official website of Citibank,N.A., Bangladesh.

1.5 Methodology

An organized step-by-step procedure has been followed to prepare the report. Considering the time limitations the objectives and scope of the research was determined first. Then a structured work plan was made to make the research possible. Collection of data was mainly accumulated from the secondary sources. A Data Summary was prepared. Then the data was analyzed critically in a balanced manner so as to reach the conclusion in a proactive way.

A detailed planning was done before the staring of the work. First, the boundaries of the study were identified. The sector associated with the work was selected. As I have worked at Credit Risk Management Services department I chose a related topic.

For the purpose of the survey, the category was selected. A questionnaire was developed. Officials of the Citibank, N.A., and Bangladesh Bank were knocked for the purpose of interview.

Experience was gained through working at Citibank, N.A.. Understanding was obtained from the officials and interviews were taken on the scheduled time. Other data were collected from books and journals. The relevant data from the websites were extracted. All the data were summarized and documented.

From the summarized results the conclusion is drawn regarding the Credit management practice at Citibank N. A. Appropriate recommendations were made. All significant aspects and issues were properly resolved. The results and findings were summarized. A draft copy of the report was organized and prepared.

1.6 Consultation and Review

The draft copy of the report was submitted to the respected supervisor Ms. Kulsum Popy for modifications and corrections. Her valuable remarks were noted and the report was reviewed accordingly. After final consultation with her, the final copy of the report was prepared.

1.7 Limitations

- This Report confines itself within the periphery of the functions of CRMS department of Citibank N.A.
- This report only contains the details of those functions to which I was introduced and well informed.
- Sharing of financial and confidential information has been kept limited for maintaining information security.
- As an intern, I was placed in CRMS for 4 months. So, it was not possible to outline all the CRM functions in detail.

Chapter Two

Credit Risk Management: Theoretical Framework

2.1 History of Credit

Credit is much older than writing. The exact timing of credit inauguration is not found in the history. Many people say that the history of credit inaugurated more than four thousand years ago. Definitely, there were no such formalities as we are having now but there was punishment for making default. Failure to pay a debt was considered to be a crime that was treated identically to theft and fraud. Due to such crime, a defaulter could be seized by his creditors and sold into slavery and his wife and children could be sold for a three-year term. (Aaron Brown, vice president, Morgan Stanley).

From this anecdote it can be said that the history of credit is very old as it mentioned that credit is much older than writing. It can also be inferred that during that time there were no written formalities, guidelines or policies as we have now-a-days. The defaults made by the borrowers actually contributed to the imposition and implementation of formalities.

2.2 Definition of Credit

Credit is a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some later date. When a consumer purchases something using a credit card, they are buying on credit (receiving the item at that time, and paying back the credit card company month by month). Any time when an individual finances something with a loan (such as an automobile or a house), they are using credit in that situation as well. In banking terms credit refers to the loans and advances made by the bank to its customers or borrowers. Bank credit is a credit by which a person who has given the required security to a bank has liberty to draw to a certain extent agreed upon. It is an arrangement for deferred payment of a loan or purchase.

In other words, credit means a provision of, or commitment to provide, funds or substitutes for funds, to a borrower, including off-balance sheet transactions, customers' lines of credit, overdrafts, bills purchased and discounted, and finance leases. (Mauritius, 2010)

2.3 Definition of Credit Risk

Credit risk refers to the risk that a borrower will fail to make the payments which it is obligated to do. Such an event is called a default. The risk is primarily that of the lender and includes lost principal and interest, decreased cash flow, and increased collection costs. The loss may be complete or partial and can arise in a number of circumstances.

For example:

a) A consumer fails to make a payment due on a mortgage loan, credit card, line of credit, or other loan

b) A company is unable to repay amounts secured by a fixed or floating charge over the assets of the company

c) A business or consumer does not pay a trade invoice when due

d) A business does not pay an employee's earned wages when due

e) A business or government bond issuer does not make a payment on a coupon or principal payment when due

f) An insolvent insurance company does not pay a policy obligation

g) An insolvent bank does not return funds to a depositor

h) A government grants bankruptcy protection to an insolvent consumer or business

Risk means the exposure to a chance of loss or damage. Risk is the element of uncertainty or possibility of loss that exist in any business transaction. Credit risk is the likelihood that a borrower or counter party will be unsuccessful to meet its obligation in accordance with agreed terms and conditions.

Credit risk means the risk of credit loss which results from the failure of a borrower to honor the borrower’s credit obligation to the financial institution (Mauritius, 2010)

Credit risk is most simply defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms (Basel Committee on Banking Supervision, 2000).

2.4 Importance of Managing Credit Risk

Credit risk management is a very important area for the banking sector. There are wide prospects of growth and other financial institutions also face problems which are financial in nature. Also, banking professionals have to maintain a balance between the risks and the returns. For a large customer base banks need to have a variety of loan products which will secure the overall loan portfolio of the bank both in short and long run. If bank lowers the interest rates for the loans it offers, it will suffer as the return will be lower and the opposite happens when the interest rate is increased. (Ajeet Kumar Singh, 2011)

In terms of equity, a bank must have substantial amount of capital on its reserve, but not too much that it misses the investment revenue and effective opportunities of fruitful investment, and not too little that it leads itself to financial instability and to the risk of regulatory non-compliance.

Credit risk management is risk assessment that comes in an investment. Risk often comes in investing and in the allocation of capital. The risks must be assessed so as to derive a sound investment decision. And decisions should be made by balancing the risks and returns. The ultimate gains are after all a trade between the cost of fund provided to borrowers and the returns achieved from them.

Giving loans is, sometimes, a risky affair for bank and certain risks may also come when banks offer securities and other forms of investments. The risk of losses that result in the default of payment of the debtors is a kind of risk that must be expected. A bank has to keep substantial amount of capital to protect its solvency and to maintain its economic stability. The greater the bank is exposed to risks, the greater the amount of capital must be when it comes to its reserves, so as to maintain its solvency and stability. Credit risk management must play its role to help banks be in compliance with Basel II Accord and other regulatory bodies.

For assessing the risk, banks should plan certain estimates, conduct monitoring and perform reviews of the performance of the bank. They should also do loan reviews and portfolio analysis in order to determine risk involved. Banks must be active in managing the risks in various securities and derivatives. Still progress has to be made for analyzing the credits and determining the probability of defaults and risks of losses.

So, undoubtedly credit risk management becomes a very important activity for the banks to survive in the long run as well as ensuring profitability for more expansion.

2.5 Organizations Supervising Credit Risk Management

There are several organizations worldwide which are currently involved in formulating ways of sound credit risk management as well as monitoring of the activities performed by financial institutions worldwide. Central banks of respective countries have established policies and directives in place for the financial institutions and they have to comply with those policies and directives. For central banks worldwide there is an alliance named as ‘Bank for International Settlements’ or BIS in short form. BIS provides policies and formulates regulations to help central banks have a dedicated guideline for adequate coverage over Credit Risk.

2.5.1 The Bank for International Settlement (BIS)

The Bank for International Settlements (or BIS) is an international organization of central banks which exists to "foster cooperation among central banks and other agencies in pursuit of monetary and financial stability". It carries out its work through subcommittees, the secretariats it hosts, and through its annual General Meeting of all members. The BIS also provides banking services, but only to central banks, or to international organizations like itself. Based on Basel, Switzerland, the BIS was established by the Hague agreements of 1930. As an organization of central banks, the BIS seeks to make monetary policy more predictable and transparent among its 55 member central banks. While monetary policy is determined by each sovereign nation, it is subject to central and private banking scrutiny and potentially to speculation that affects foreign exchange rates and especially the fate of export economies. Two aspects of monetary policy have proven to be particularly sensitive, and the BIS therefore has two specific goals: to regulate capital adequacy and make reserve requirements transparent.

2.5.1.1 Principles Formulated by the Bank of International Settlement (BIS)

The Bank of International Settlement (BIS) on November 28th 2005 in a press release issued a series of ten principles on Sound Credit Risk Assessment and Valuation for Loans:

Principle 1: The bank's board of directors and senior management are responsible for ensuring that the bank has appropriate credit risk assessment processes and effective internal controls to consistently determine provisions for loan losses in accordance with the bank's stated policies and procedures, the applicable accounting framework and supervisory guidance commensurate with the size, nature and complexity of the bank's lending operations.

Principle 2: Banks should have a system in place to reliably classify loans on the basis of credit risk.

Principle 3: A bank's policies should appropriately address validation of any internal credit risk assessment models.

Principle 4: A bank should adopt and document a sound loan loss methodology, which addresses risk assessment policies, procedures and controls, for assessing credit risk, identifying problem loans and determining loan provisions in a timely manner.

Principle 5: A bank's aggregate amount of individual and collectively assessed loan provisions should be adequate to absorb estimated credit losses in the loan portfolio.

Principle 6: A bank's use of experienced credit judgment and reasonable estimates are an essential part of the recognition and measurement of loan losses.

Principle 7: A bank's credit risk assessment process for loans should provide the bank with the necessary tools, procedures and observable data to use for credit risk assessment purposes, account for impairment of loans and the determination of regulatory capital requirements.

Principle 8: Banking supervisors should periodically evaluate the effectiveness of a bank's credit risk policies and practices for assessing loan quality.

Principle 9: Banking supervisors should be satisfied that the methods employed by a bank to calculate loan loss provisions produce a reasonable and prudent measurement of estimated credit losses in the loan portfolio that are recognized in a timely manner.

Principle 10: Banking supervisors should consider credit risk assessment and valuation practices when assessing a bank's capital adequacy. (Settlement, 2011)

2.5.2 Bangladesh Bank- as Local Regulator of the Banks

The role of the Central Bank as regulator has been the focus of much public attention and debate, particularly in light of the increased pressure that the transformation of the financial services industry poses to the Supervisory Authority in achieving its goals of safety and soundness whilst facilitating market efficiency and effectiveness. The rationale for bank supervision is double-pronged. The first is the promotion of the safety and soundness of financial institutions so that they do not become a source of systemic risk and pose a threat to the payment system. The second is the promotion of an efficient and effective banking system that finances economic growth, allocates credit and meets the needs of the customers and communities they serve.

As Regulator central banks have to be proactive in monitoring the lending processes followed by banks and also make sure that utmost compliance and due diligence is performed by them. Creditworthiness of institutions is of significant importance and credit approvals or extensions have to be based on the financial capability of the borrower and its extent of exposure to risk. Bangladesh bank has formed several departments to supervise and monitor the credit risk management activities of the scheduled banks existing in our country. The involved departments of Bangladesh Bank are:

a) Banking Regulation and Policy Department

b) Credit Information Bureau

c) Agricultural Credit and Financial Inclusion Department

d) Debt Management Department

e) Department of Off-Site Supervision

f) Statistics Department

g) Department of Banking Inspection

All these departments are well aware of the activities of the scheduled banks of Bangladesh and banks have to submit several reports on monthly, quarterly, half yearly, yearly and in ad-hoc basis to comply with the regulations formulated by the respective departments of Bangladesh Bank. Through these reports the departments and their respective officials get a picture of Credit Risk Management activities. Moreover, the offsite supervision and banking inspection team execute inspection in the banks on a routine basis to monitor whether proper scenario in accordance with the submitted data is really in place or not. They also publish several circulars and directives/guidelines time to time to impose new restrictions or suggestions to comply with the policies already set by the central bank to ensure smooth and risk mitigated banking system.

2.6 Credit Rating

Credit rating of the borrower is an important consideration for making lending decision. Though the rating system is not beyond criticism, still it gets some importance. In the last couple of years few renowned financial institutions became bankrupt. Unfortunately, the rating could not identify their loopholes. A brief description about various rating is given below:

a) Individual Credit Rating: A credit rating assesses the credit worthiness of an individual. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the subject being able to pay back a loan.

b) Corporate credit ratings: The credit rating of a corporation is a financial indicator to potential investors of debt securities such as bonds. These are assigned by credit rating agencies such as Standard & Poor's, Moody's or Fitch Ratings and have letter designations such as AAA, B, CC.

c) A sovereign credit rating is the credit rating of a sovereign entity. The sovereign credit rating indicates the risk level of the investing environment of a country and is used by investors looking to invest abroad. It takes political risk into account.

2.7 Single Borrower Exposure Limit

As a prudential measure intended for ensuring improved risk management through restriction on credit concentration, Bangladesh Bank has from time to time advised the scheduled banks in Bangladesh to fix limits on their large credit exposures and their exposures to single and group borrowers.

In general, and as practiced internationally, exposure ceiling is derived from a bank's total capital as defined under capital adequacy standards (Tier I and Tier II Capital). Following the same practice, Bangladesh Bank issued a circular (BRPD Circular No.08) on March 18, 2003, recommending uniform exposure limits for both local and foreign banks.

In order to enable the banks to improve their credit risk management further, Bangladesh Bank is issuing this **Master Circular** by consolidating all the instructions issued so far and incorporating some amendments to the previous circulars.

As a result of increase in capital of almost all the banks, now it has been decided to reduce the single borrower exposure limit from 50% to 35%. Thus-

(a) The total outstanding financing facilities by a bank to any single person or enterprise or organization of a group shall not at any point of time exceed 35% of the bank's total capital subject to the condition that the maximum outstanding against fund based financing facilities (funded facilities) do not exceed 15% of the total capital. In this case total capital shall mean the capital held by banks as per section-13 of the Bank Company Act, 1991.

(b) Non-funded credit facilities, e.g. letter of credit, guarantee etc. can be provided to a single large borrower. But under no circumstances, the total amount of the funded and non-funded credit facilities shall exceed 35% of a bank's total capital.

However, in case of export sector single borrower exposure limit shall remain unchanged at 50% of the bank's total capital. But funded facilities in case of export credit shall also not exceed 15% of the total capital. In addition, the banks shall follow the following prudential norms, where applicable:

- Loan sanctioned to any individual or enterprise or any organization of a group amounting to 10% or more of a bank's total capital shall be considered as large loan.

- The banks will be able to sanction large loans as per the following limits set against their respective classified loans:

Rate of Net Classified Loans	Highest rate for Large Loan against Bank’s Total Loans & Advance
Up to 5%	56%
More than 5% but up to 10%	52%
More than 10% but up to 15%	48%
More than 15% but up to 20%	44%
More than 20%	40%

- In order to determine the above maximum rates of large loans, all non-funded credit facilities e.g. letter of credit, guarantee, etc., included in the loan shall be considered as 50% credit equivalent. However, the entire amount of non-funded credit facilities shall be included in determining the total credit facilities provided to an individual or enterprise or an organization of a group.
- A public Limited company, which has 50% or more public shareholdings, shall not be considered an enterprise/organization of any group.
- In the cases of credit facilities provided against government guarantees, the aforementioned restrictions shall not be applicable.
- In the cases of loans backed by cash and cashable securities (e.g.FDR), the actual lending facilities shall be determined by deducting the amount of such securities from the outstanding balance of the loans.
- Banks should collect the large loan information on their borrowers from Credit Information Bureau (CIB) of Bangladesh Bank before sanctioning, renewing or rescheduling large loans in order to ensure that credit facilities are not being provided to defaulters.
- Banks must perform Lending Risk Analysis (LRA) before sanctioning or renewing large loans. If the rating of an LRA turns out to be "marginal"; a bank shall not sanction the large loan, but it can consider renewal of an existing large loan taking into account other favorable conditions and factors. However, if the LRA score of the borrower is unsatisfactory, neither sanction nor the renewal of the loan can be considered.
- While sanctioning or renewing of large loan, a bank should judge its borrower's overall debt repayment capacity taking into consideration the borrower's liabilities with other banks and financial institutions.
- A bank shall examine its borrower's Cash Flow Statement, Audited Balance Sheet, Income Statement and other financial statements to make sure that its borrower has the ability to repay the loan.
- Sanctioning, renewing or rescheduling of large loans should be approved by the Board of Directors in case of local banks. Such decisions should be taken by the Chief Executives

in case of foreign banks. However, while approving proposals of large loans, among other things, compliance with the above guidelines must be ensured.

- For the loans that have already been disbursed with the approval of Bangladesh Bank, and that have exceeded the limit as stipulated in Section 01 (mentioned above), banks shall take necessary steps to bring down the loan amounts within the specified limit. In order to accomplish this condition, banks may, if necessary, arrange partaking with other banks. However, for continuous loans, the limit has to be brought down as per Section 02 within June 30, 2005. For term loans, the deadline is June, 2006.
- Banks shall submit the quarterly statement of large loan in the specified format (Form L) to Department of Off-site Supervision of Bangladesh Bank within 10 days after the end of respective quarter.
- This circular is issued by Bangladesh Bank in exercise of its power conferred to it by section 45 of the Bank Company Act, 1991. This circular shall be effective immediately. The chief executives of all the banks are advised to place this circular in their next board meetings.

Credit Risk Management Guidelines by Bangladesh Bank

2.8 Lending Guidelines

All Financial Institutions should have established “Lending Guidelines” that clearly outline the senior management’s view of business development priorities and the terms and conditions that should be adhered to in order for facilities to be approved. The Lending Guidelines should be updated at least annually to reflect changes in the economic outlook and the evolution of the Financial Institution’s (FI’s) facility portfolio, and be distributed to all lending/marketing officers. The Lending Guidelines should be approved by the Managing Director / CEO & Board of Directors of the FI based on the endorsement of the FI’s Head of Credit Risk Management and the Head of Business Units.

Any departure or deviation from the Lending Guidelines should be explicitly identified in credit applications and a justification for approval provided. Approval of facilities that do not comply with Lending Guidelines should be restricted to the FI’s Head of Credit or Managing Director/CEO or Board of Directors. The Lending Guidelines should provide the key foundations for account officers / Relationship Managers (RM) to formulate their recommendations for approval and should include the following:

Industry and Business Segment Focus

The Lending Guidelines should clearly identify the business / industry sectors that should constitute the majority of the FI’s facility portfolio. For each sector, a clear indication of the FI’s appetite for growth should be indicated. This will provide necessary direction to the FI’s marketing staff.

Types of Facilities

The type of facilities that are permitted should be clearly indicated, such as Lease, Term Loan, Home Loan and Working Capital etc.

Single Borrower/Group Limits/Syndication

Details of the FI’s Single Borrower/Group limits should be included as per Bangladesh Bank guidelines. Financial Institutions may wish to establish more conservative criteria in this regard.

Sector Lending Caps

An important element of credit risk management is to establish exposure limits for single obligors and group of connected obligors. Financial Institutions are expected to develop their own limit structure while remaining within the exposure limits set by Bangladesh Bank. The size of the limits should be based on the credit strength of the obligor, genuine requirement of credit, economic conditions and the institution’s risk tolerance. Appropriate limits should be set for respective products and activities. Financial Institutions may establish limits for a specific industry, economic sector or geographic regions to avoid concentration risk.

Product Lending Caps

Financial Institutions should establish a specific product exposure cap to avoid over concentration in any one product.

Discouraged Business Types

Financial Institutions should outline industries or lending activities that are discouraged. The FI may have segregated sectors to be discouraged based on the following:

Government Specified	**Best Practice**	**Company Specific**
• Military equipment / Weapons Finance • Lending to companies listed on CIB black list or known defaulters	• Highly Leveraged Transactions • Logging, Mineral Extraction/Mining, or other activity that is Ethically or Environmentally Sensitive • Counter parties in countries subject to UN sanctions	• Finance of Speculative Investments • Share Lending • Taking an Equity Stake in Borrowers • Lending to Holding Companies • Bridge Loans relying on equity/debt issuance as a source of repayment

Facility Parameters

Facility parameters (e.g., maximum size, maximum tenor, and covenant and security requirements) should be clearly stated. As a minimum, the following parameters should be adopted:

- Banks should not grant facilities where the bank's security position is inferior to that of any other financial institution.
- Assets pledged as security should be properly insured.
- Valuations of property taken as security should be performed prior to facilities being granted. A recognized 3rd party professional valuation firm should be appointed to conduct valuations.

2.9 Credit Assessment & Risk Grading

2.9.1 Credit Assessment

A thorough credit and risk assessment should be conducted prior to the granting of a facility, and at least annually thereafter for all facilities. The results of this assessment should be presented in a Credit Application that originates from the relationship manager/account officer ("RM"), and is reviewed by Credit Risk Management (CRM) for identification and probable mitigation of risks. The RM should be the owner of the customer relationship and must be held responsible to ensure the accuracy of the entire credit application submitted for approval. RMs must be familiar with the FI's Lending Guidelines and should conduct due diligence on new borrowers, principals, and guarantors. It is essential that RMs know their customers and conduct due diligence on new borrowers, principals, and guarantors to ensure such parties are in fact who they represent themselves to be. All Financial Institutions should have established Know Your Customer (KYC) and Money Laundering guidelines which should be adhered to at all times. Credit Applications should summarize the results of the RMs risk assessment and include, as a minimum, the following details:

- Amount and type of facility(s) proposed
- Purpose of facilities

- Facility Structure (Tenor, Covenants, Repayment Schedule, Interest)
- Security Arrangements
- Government and Regulatory Policies
- Economic Risks

In addition, the following risk areas should be addressed:

- Borrower Analysis: The majority shareholders, management team and group or affiliate companies should be assessed. Any issues regarding lack of management depth, complicated ownership structures or inter-group transactions should be addressed, and risks mitigated.

- Industry Analysis: The key risk factors of the borrower's industry should be assessed. Any issues regarding the borrower's position in the industry, overall industry concerns or competitive forces should be addressed and the strengths and weaknesses of the borrower relative to its competition should be identified.

- Supplier/Buyer Analysis: Any customer or supplier concentration should be addressed, as these could have a significant impact on the future viability of the borrower.

- Historical Financial Analysis: Preferably an analysis of a minimum of 3 years historical financial statements of the borrower should be presented. Where reliance is placed on a corporate guarantor, guarantor financial statements should also be analyzed. The analysis should address the quality and sustainability of earnings, cash flow and the strength of the borrower's balance sheet. Specifically, cash flow, leverage and profitability must be analyzed.

- Projected Financial Performance: Where term facilities (tenor > 1 year) are being proposed, a projection of the borrower's future financial performance should be provided, indicating an analysis of the sufficiency of cash flow to service debt repayments. Facilities should not be granted if projected cash flow is insufficient to repay debts.

- Credit Background: Credit application should clearly state the status of the borrower in the CIB (Credit Information Bureau) report. The application should also contain liability status with other Banks and FI's and also should obtain their opinion of past credit behavior.

- Account Conduct: For existing borrowers, the historic performance in meeting repayment obligations (trade payments, cheque, interest and principal payments, etc.) should be assessed.

- Adherence to Lending Guidelines: Credit Applications should clearly state whether or not the proposed application is in compliance with the FI's Lending Guidelines. The FI's Head of Credit or Managing Director/CEO or Board should approve Credit Applications that do not adhere to the FI's Lending Guidelines.

- Mitigating Factors: Mitigating factors for risks identified in the credit assessment should be identified. Possible risks include, but are not limited to: margin sustainability and/or volatility, high debt load (leverage/gearing), overstocking or debtor issues; rapid growth, acquisition or expansion; new business line/product expansion; management changes or succession issues; customer or supplier concentrations; and lack of transparency or industry issues.

- Facility Structure: The amounts and tenors of financing proposed should be justified based on the projected repayment ability and facility purpose. Excessive tenor or amount relative to business needs increases the risk of fund diversion and may adversely impact the borrower's repayment ability.

- Purpose of Credit: Financial Institutions have to make sure that the credit is used for the purpose it was borrowed. Where the obligor has utilized funds for purposes not shown in the original proposal, Financial Institutions should take steps to determine the implications on creditworthiness. In case of corporate facilities where borrower own group of companies such diligence becomes more important. Financial Institutions should classify such connected companies and conduct credit assessment on consolidated/group basis.

- Project Implementation: In case of a large expansion, which constitutes investment of more than 30% of total capital of a company or for a green field project, project implementation risk should be thoroughly assessed. Project implementation risk may involve construction risk (Gestation period, regulatory and technical clearances, technology to be adopted, availability of infrastructure facilities) funding risk, and post project business, financial, and management risks.

- Foreign Currency Fluctuation: Credit application should clearly state the assessment of foreign currency risk of the applicant and identify the mitigating factors for its exposure to foreign currency.

- Security: A current valuation of collateral should be obtained and the quality and priority of security being proposed should be assessed internally and preferably by a third party valuer. Facilities should not be granted based solely on security. Adequacy and the extent of the insurance coverage should be assessed.

- Type of Control on Cash Flow: The credit application should contain and assess if there is any control on the borrowers cash flow for securing the repayment. This may include payment assignment from export proceed, payment assignment from customers of the borrower etc.

2.9.2 Risk Grading

The Credit Risk Grading (CRG) is a collective definition based on the pre-specified scale and reflects the underlying credit-risk for a given exposure. A Credit Risk Grading deploys a number/alphabet/symbol as a primary summary indicator of risks associated with a credit exposure. Credit Risk Grading is the basic module for developing a Credit Risk Management system. Credit risk grading is an important tool for credit risk management as it helps the Financial Institutions to understand various dimensions of risk involved in different credit transactions.

The aggregation of such grading across the borrowers, activities and the lines of business can provide better assessment of the quality of credit portfolio of a FI. The credit risk grading system is vital to take decisions both at the pre-sanction stage as well as post-sanction stage.

At the pre-sanction stage, credit grading helps the sanctioning authority to decide whether to lend or not to lend, what should be the lending price, what should be the extent of exposure, what should be the appropriate credit facility, what are the various facilities, what are the various risk mitigation tools to put a cap on the risk level. At the post-sanction stage, the FI can decide about the depth of the review or renewal, frequency of review, periodicity of the grading, and other precautions to be taken. Risk grading should be assigned at the inception of lending, and updated at least annually. Financial Institutions should, however, review grading as and when adverse events occur.

Chapter Three

Organizational Details

3.1 Citigroup in Brief

Citigroup Inc., known widely as Citi is a major American financial services company based in New York, United States of America. Citigroup was formed from one of the world's largest mergers in history by combining the banking giant Citicorp and Financial Conglomerate Travelers Group in 1998. Citigroup Inc. has the largest financial services network, spanning 160 countries with approximately 12,500 offices worldwide. The company employed almost 300,000 staff around the globe. It holds over 220 million customers in more than 160 countries. It is the world's largest bank by revenues as of 2010 and 96% of the world's Fortune 500 Companies are now served by Citigroup. All over the world 1.65 million families got benefitted from Citi-funded programs. Citigroup suffered a major loss during the global financial crisis back in 2008 and rescued in November 2008 by a massive bailout by the US government. The largest shareholders of Citi are mainly from funds from Middle East and Singapore.

3.2 History of Citibank

Founded in 1812, Citibank is one of the oldest banks of the world. City Bank of New York came into existence on June 16, 1812. In 1865 City Bank received US government's charter and joined US National Banking System. The bank was then renamed as "National City Bank of New York". National City Bank of New York became the largest bank in the city of New York with \$34.4 million in deposits and assets worth \$38.9 million in 1893. Only a year later it also became the largest bank in the US. National City became the government depository. In 1906 National City took a historical step into international banking, a pioneering step in America's Financial Services. It began by financing the construction of a railroad from La Paz, Bolivia to the port of Antofagasta, Chile. In 1913 The Federal Reserve Act permitted national banks to open offices abroad. In 1916 the bank opened branches in Brazil, Santiago, Valparaiso and Genoa. In 1919 it became the first US bank with \$ 1 billion assets. In 1929 the great depression began. More than one third of the American banks failed. National City bank survived by maintaining its policy of ready money, although it had to write off \$86 million in loans. Business in China however generated enough income to maintain the annual corporate dividend. By 1930 it had 94 overseas offices in operation. In 1946 the bank began to open its business in the Far East and Europe. In 1955 it merged with the old First National Bank and changed its name to First National City Bank of New York. In 1959 the bank had 83 branches in 28 countries of the world. The bank marked its 150th anniversary by shortening its name to First National City Bank in 1962. In 1965 the bank entered into the credit card business and became involved in micro-credit. It introduced Citibank's first credit card- the "First National City Charge Service"- popularly known as "Everything" card in 1967, which converted to Master Charge (today's MasterCard) in 1969. In 1974 the bank had a presence in 103 countries with 252 branches, 487 affiliate offices, 308 26

Banking subsidiary and representative offices and 34 subsidiary offices. In 1976 First National City Bank became Citibank N.A. with a vision "starting with a dedication to the consumer and the proposition that we can offer a set of services that will substantially satisfy a family's financial needs, ear the shareholders an adequate profit while creating a positive and straightforward relationship with the customers". In 1977 Citi pioneered round the clock banking with the 1st 24/7 ATM. In 1977 its assets topped $ 100 billion. In 1992 Citibank N.A became the largest bank in the US and its name became synonymous with innovative banking. In 1998 Citicorp merged with Travelers Group to form Citigroup. In 2007 the company was rebranded as Citi across the globe.
(Citigroup, 2012)

3.3 Citi Brand and its Core Message

3.3.1 Driving Success

We are relentless in driving winning performance for our clients and our franchise- anytime, anywhere. Our employees share in our success and are committed to making a difference in the lives of people, organizations and communities around the world. The core message of Citi's brand focuses on the following:

Citi's Existence across the Globe

- Serve our Clients with distinction
- Build a great team
- Produce results with integrity
- Lead through innovation

3.4 Citi's Mission Statement and Principles

Citi works tirelessly to serve individuals, communities, institutions and nations. With 200 years of experience in meeting the world's toughest challenges and seizing the greatest opportunities, we strive to create the best outcomes for our clients and customers with financial solutions that are simple, creative and responsible. An institution connecting over 1000 cities, 160 countries and millions of people, we are your global bank; we are Citi.

The four key principles-the values that guide us as we perform our mission-are:

Common Purpose: One team, with one goal; serving our clients and stakeholders

Responsible Finance: Conduct that is transparent, prudent and dependable.

Ingenuity: Enhancing our clients' lives through innovation that harnesses the breadth and depth of our information, global network, and world-class products.

Leadership: Trained people who thrive in a diverse meritocracy that demands excellence, initiative and courage.

3.5 Businesses of Citi

The overall business of Citi comprises of

- Institutional Clients Group (ICG)
- Consumer Banking
- Citi Holdings

Institutional Clients Group (ICG)

Citi's Institutional Clients Group is comprised of diverse talented professionals globally located in over 100 countries and territories and collectively represents an unparalleled international network of financial skills and capabilities serving targeted clients. Its clients are top corporations, financial institutions and government's ion countries around the world, and our mission is to help them achieve their goals. We do so by providing strategic financing and operational insights and executing tailored products/ service solutions, both cross-border and domestically.

The ICG responds to clients' changing needs through its long established relationship coverage approach that provides client solutions utilizing all of Citi's relevant capabilities, including the broadest possible access to financial markets globally. No other institution can match its combination of Global insights, client relationship management services, geographic reach and local and cross border product expertise. (Citigroup, Citi History, 2012)

The ICG is organized into 5 groups:

- Global Banking
- Global Markets
- Global Transaction Services
- Citi Capital Advisors
- Citi Private Bank

3.6 Citi in Bangladesh

Citi's Trajectory in Bangladesh is almost 25 years today. Citi opened a representative office in Bangladesh in 1987 and its first full service branch in Motijheel in 1995. The inauguration of the offshore banking units in Dhaka and Chittagong has increased the total number of service outlets to 8. In this timeframe, Citi has built a strong franchise in Bangladesh and is expanding the depth of services offered to its clientele at a rapid pace.

Citibank provides a wide range of services including treasury and trade solutions, agency and trust services, foreign exchange and structured finance to corporate clients, governments and financial institutions. Citibank has increased its commitment to Bangladesh launching investment banking services and leading the largest M&A transaction and the first private placement bond in the country.

3.6.1 Citibank Bangladesh Businesses

Citi's Global Corporate and Commercial Banking (GCCB) comprises of Commercial Banking Group (CBG) which supports emerging local corporate, Network Relationship banking (NRB) which caters to the multinational companies and their subsidiaries in Bangladesh. And Financial Institutions Group (FIG) which caters to the banking needs of Banks and on bank financial institutions.

Citi Transaction Services is the product of Citi and provides customized solutions to each involving cash management, trade products, fund management and agency services.

Fixed Income, Currency and Commodities (FICC), better known as Treasury, leads the market with innovative products and cutting edge technology designed to provide customized solutions for clients. Citi's Treasury provides first class Foreign Exchange (FX) advisory and execution services to high volume FX customers along with Strategic derivative structures to hedge both the exchange rate risks and interest rate risks.

Over the past decades Citi's Structured Finance unit has been working closely with regulatory agencies and the Government of Bangladesh to promote key infrastructure related projects in the country.

In 2007 Citi became the first foreign bank in Bangladesh to be awarded a merchant banking license.

Citi Transaction Services	Fixed income, Currencies and Commodities	Global Corporate and Commercial Bank	Citi Global Markets
•Pioneer is Cash Management Solution In Bangladesh •Awarded Best Bank in Cash Managemet •Pioneered in Electronic Banking •Pioneer in Host to Host Solution •Direct Custody and Clearing Solutiomns •Largest Agency Service Provider •Pioneered in Structured Trade Deals •Awarded as the best Internet bank by Global Finance •First forign bank to introduce Insurance Scheme for Remitters of KSA •Largest foreign bank payment network	•Pioneer in Derivative based solution in the coun try •Expetise in Structured Finance in Bangldesh •Proven track record with bi/multilateral agenscies: Citi leads the field in aranging funding both in foreign and local currecny in association with export credit agencies and mulilateral agencies such as OPIC (Overseas Private investment Corporations)	•A leading corporate bank serving corporate and financial Institutions •Dominant corprate in the industry	•Arranged the largest IPO Deal in Bangladesh

Business Segments of Citibank and their Features

3.7 Corporate Social Responsibility

Citi is committed to Bangladesh through its core business activities, philanthropy, diversity efforts, volunteerism and public engagement as well as philanthropic initiatives starting from supporting and facilitating microfinance initiatives aimed at reducing poverty, standing right next to our people at a time when they need us the client base most. Such activities are carried out by Citi, Bangladesh under the umbrella of Citi Foundation. With the help of the grants received from Citi Foundation, Citi Bangladesh is able to act in a way, which benefits the different underprivileged groups as well as enhancing certain sector of the economy that contribute to the prosperity of Bangladesh, e.g. financial education, microfinance, social development. The main areas of focus for Bangladesh are: microfinance, financial education, educating the next generation and disaster management response. Citi Bangladesh has been continuing few programs for the last few years. These are:-

- Citi Micro Entrepreneur Awards (Started in 2005)
- Citi Financial Quiz Competition (Started in 2008)
- Fund Raising for Disaster Affected People (2007)
- Citi Financial IT Project Competition (Started in 2007)
- Citi Shahittyo Puroshkar (Started in 2011)
- Citi Fund Raising for Rural Child Education

Besides, Citi has been arranging Global Community Day each year to mark its start in global economy. This year was a special one as Citi celebrated its 200 years anniversary in grand style showing and proving its commitment towards mankind. Citi launched 3 projects on three different days this year. Firstly, 200 underprivileged school children were taken to a movie show. Secondly, Citibankers all over the country donated 200 bags of blood to Red Crescent. Thirdly, Citi Bangladesh planted 200 trees at the premises of Dhaka Residential Model College to mark its 200 years on the 16th June.

3.8 Citibank N.A. Bangladesh Team

Citi, one of the existing 9 foreign banks in Bangladesh, entered into the banking landscape of the country in 1987 as a representative office and it was not until June 25, 1995 that a full-fledged branch was opened with 6 employees serving a handful of clients. However, a huge change has come over time. Citi family has grown in more than 220 members with 5 branches and 3 OBU booths at the heart of the economic activity Export processing Zones facilitating economic transactions valued at more than 7% of the country’s GDP. Ever Since 1995, it was no looking back for Citi. Citi increased its footprint in Bangladesh by opening its 2nd branch in 2000 in the port city of Chittagong and three more branches were added in Dhaka by 2009. Apart from the big two cities Citi has also extended its banking services to the realms of EPZ. Citi has presence in the three EPZs of the country.

Citi's operations encompasses primarily on commercial banking services providing a comprehensive range of financial services including Treasury Management, Transaction Services, Foreign Exchange and Structured Finance to corporate clients.

Over the years Citi has experienced an exciting journey in Bangladesh where we have witnessed remarkable growth in terms of revenue, portfolio size, client base, coverage and employee growth.

Chapter Four

Findings & Analysis

This section explains the combined findings of Credit Risk Management Practices at Citibank as per the CRM guidelines of Bangladesh Bank.

4.1 Credit Criteria

4.1.1 General Consideration

4.1.1.1 Pre- Sanction Stage

Credit criterion is employed by banks and financial institutions to determine a borrower's creditworthiness in servicing its debt. For granting or extending credit the following things should be considered.

- **Project Profile**

The lender should try to understand the purpose of taking the loan. The lender should identify whether the loan is for productive purpose or for non-productive purpose. It should be mentioned here that the lender should discourage loans for non-productive or speculative purposes. Even if it is for productive purpose the bank or financial institution should scrutinize the potential project. As part of the scrutiny the lender should consider the following issues.

- **Ratio Analysis**

The lender should calculate various ratios (example- Liquidity Ratio, Profitability Ratio, Solvency Ratios etc.) of the existing and the projected business for which the loan has been asked. These ratios will give the lender a basis for predicting the future about the borrower and its performance.

- **Financial Statements Analysis**

The lender should analyze the potential borrower's audited financial statements. The opinion of the auditors and the reputation of the audit firm which performed the auditing should be considered. The financial statements, along with the notes to the financial statements should be noticed with utmost care and prudence. In this regard professional suggestion may be taken.

The profit, its trend, dividend pay-out ratio, the amount and the nature of resources, the obligation to its creditor must be noticed with utmost care. Any negligence or non-competence, in this regard, may result in huge loss.

The amount, nature and the tenor of all debts should be watched with great care. The lender should know whether the potential borrower has taken any loan from any other source, and if the answer is "yes", the lender should analyze whether the borrower has adequate capacity to bear the interest and to repay the debt accordingly. The lender should also seek an undertaking from the borrower explaining that the borrower has not taken any loan from any other source or it has not taken loan from any source other than the mentioned one(s). This type of analysis will help the lender to calculate the rate of interest, tenor of the facility and the maximum limit of the borrower.

The statement of cash flow should be scrutinized carefully as this statement gives a basis to the user of financial statements to surmise about the future cash flow of the borrower. It is expected that the borrower will pay the interest and the principal from its operating cash flow.

- **Management**

The lender should have a good idea about the tone, quality and the reputation of the management. The banks or financial institutions should not believe everything what the potential or existing borrower says. They should exercise their judgments. The lender shall have to be skeptic and prudent. The lender shall have to outsmart the management of the borrower.

- **Collateral**

Collateral is the asset that gives the lender some sort of safety, if the debt becomes bad. It should be clearly mentioned here that no lender expects to realize the disbursed money by disposing the collateral. Still the traditional banks or financial institutions usually keep collateral for safety purpose. Regarding collateral, the following issues need to be considered:

- The market value of asset must be realistically appraised by knowledgeable person. If collateral is required it should be taken immediately.

- Three important factors must be considered in evaluating collateral: control, marketability and margin.
- The lender should verify the authenticity of title of the collateral. The lender should take expert opinion from its legal adviser.
- The lender should check whether the collateral is insured or not. If it is insured, the validity of the policy should be checked. Even if the collateral is insured and its validity is okay, the insurance policy should be reviewed on a regular basis.
- The security shall give the bank a privileged position but at the same time the lender should not consider the collateral as a substitute for repayment. Loans must be repaid from the flow of cash. Collateral can, however, provide incremental protection.

- **External Issues**

It has already been mentioned that the economy is constantly changing. Considering these unforeseen situations the financial institutions shall have to take decision. The lending officers shall have to be pro-active, rather than re-active. An example of Citibank should be mentioned here. Sensing the recent recession in advance, it has cut its loans and advances by more than 30 percent. The lending officer needs to think beyond the tip of his nose. Of course the lender should also have some emergent strategies to acclimatize with the changed situation. Otherwise, the banks or financial institutions may have to face difficulties.

The lender should have a clear idea about the industry in which the potential borrower belongs to. The borrower's position in the industry should be noticed. The growth of the industry, potential opportunities and threats shall have to be analyzed too. The rate of inflation, interest and exchange, government's fiscal and monetary policies, in short, the over-all macro-economic scenario must have to be considered for making judicious and informed decision.

- **Documentation**

As per ICG Policy, no advance or drawdown is permitted until all documentation is completed, executed, delivered and registered (if necessary) and all conditions precedent have been met. Certain activities may be exempt from these requirements, if they are covered under the approved credit programs that establish the specific alternative documentation requirements. (Management, 2002)

The responsibility for the completeness and content of the legal documentation, and for obtaining waivers and deferrals lies with the sponsoring officer.

Required Credit Documentation for Credit Facilities

Documents required for various credit facilities are listed below:

<u>Overdraft and Short Term Loan</u>

i. Offer letter signed by a vice president or higher who is also a Credit Officer, and accepted by authorized signatory/signatories of the borrower

ii. Board resolution approving the offered credit facility

iii. Certified true copy of Memorandum and Articles of Association of the borrowing concern

iv. Overdraft Agreement

v. Short Term Loan Agreement

vi. Demand Promissory Note

vii. Letter of Continuity

<u>Term Loan Facility</u>

i. Offer letter signed by a vice president or higher who is also a Credit Officer, and accepted by authorized signatory/signatories of the borrower

ii. Board resolution approving the offered credit facility

iii. Certified true copy of Memorandum and Articles of Association of the borrowing concern

iv. Term Loan Agreement

v. Demand Promissory Note

vi. Letter of Continuity

Trade Facilities

i. Offer letter signed by a vice president or higher who is also a Credit Officer, and accepted by authorized signatory/signatories of the borrower

ii. Board resolution approving the offered credit facility

iii. Certified true copy of Memorandum and Articles of Association of the borrowing concern

iv. Import Documents

a. Continuing Agreement cum Indemnity for Documentary Letters of Credit

b. Trust Receipt Document (for loan against LC)

c. Short Term Loan Agreement

v. Export Documents

a. Deed of Assignment

vii. Demand Promissory Note

viii. Letter of Continuity

FX and Derivatives

a. Offer letter signed by a vice president or higher who is also a Credit Officer, and accepted by authorized signatory/signatories of the borrower

b. Board resolution approving the offered credit facility

c. Certified true copy of Memorandum and Articles of Association of the borrowing concern

d. Exchange of Trade level confirmations

Documentation for Secured Facilities

i. Deed of Hypothecation: For hypothecation over plant and machinery

ii. Deed of Hypothecation: For hypothecation over stock and book debts

iii. Certificate of charge creation or money receipt of filing of charge issued by Register of Joint Stock Companies

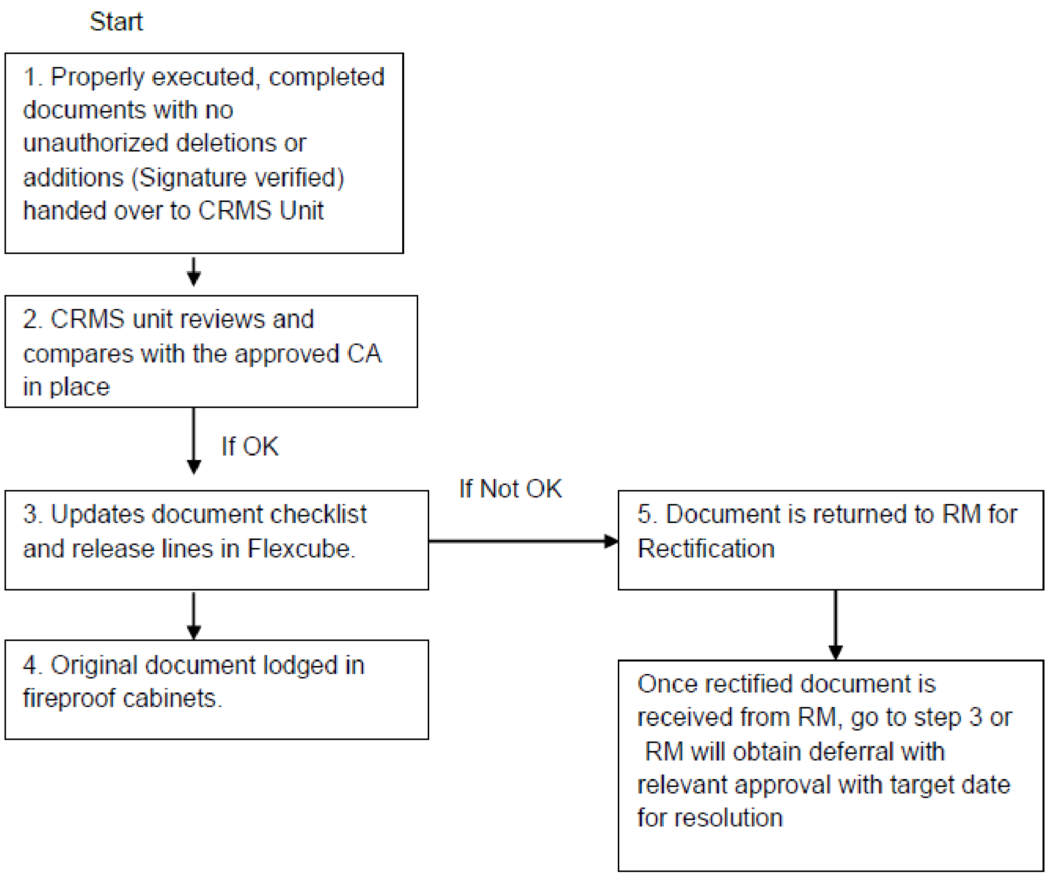
iv. Lenders' Pari Passu Security Sharing Agreement

v. Set-off document for cash collateral

Operational Process of Documentation

CRMS Unit ensures that the required documents are in place (or deferral has been obtained) prior to releasing lines of the system. Facilities will be released only to the extent completed and duly executed documentation is available (or approved deferral in place). For credit facilities where deferral exists, lines will be set to expire along with the expiry of the deferral.

Figure 1: Process flow after a document is received from the Relationship Manager.



<u>Tracking of Document Expiry</u>

The documents which are subject to expiry after a certain period need to be tracked. Of the documents collected for extension of credit in Bangladesh, only Demand Promissory Note and Letter of Continuity expire after a certain period. The expiry of these documents for all the clients is tracked and RMs are informed about the validity status of these documents on a monthly basis as part of the monthly credit tracker.

Storage of Documents

All legal documentation relating to extension of Credit are kept in fire proof cabinets. The keys of the fireproof cabinet for safekeeping of credit documents are kept under dual custody. There are two different custodians for the two sets of keys and each of the custodians or his back up must be present while opening or closing the cabinet. Transactional level documents will be held at the respective processing unit.

Original documents of the clients of Chittagong are kept in the fireproof cabinet of the vault of Chittagong branch. The photocopies or the scanned copies of the documents are sent to CRMS for reviewing and line upload.

4.1.1.2 Post Sanction Stage

Selling a credit is not the only objective of a bank or a financial institution. Here is the main difference between selling other products and selling credit, because the lender expects the principal back with interest. The main objective of a commercial bank is to maximize the wealth through the maximization of profit. And for a commercial bank, one of the vital ways of maximizing profit is to maximize interest revenue which comes as a consequence of loan disbursement. So the lenders have to be cautious both in the pre-sanction and post- sanction stage. The issues that need to be considered in the post-sanction stage are described below:

Loan Monitoring

Extension of credit facilities to different classes of borrowers for various productive purposes involves certain procedures, formalities and precautions at different stages of which the most crucial stage is “supervision and follow up”. A banker should ensure that the credit facility is allowed to the genuine borrowers, for genuine economic purposes, money lent is properly used for generation of income through increased economic activities and the borrowed money is repaid in time. All these can be ensured through an effective supervision and follow up system of advances, particularly, the purpose, end use, borrower and security.

Previously, advances were security oriented and were allowed in the traditional sectors. The bankers were security conscious and little emphasis was given to the purpose and use of credit.

With the changed circumstances, the advances portfolio of banks has been enlarged. It now covers a wide range of economic activities both in traditional and non-traditional sectors and both in urban and rural areas. Many of the borrowers do not have asset holding to meet the so called security. It, therefore, logically follows that in the absence of traditional security an effective system of supervision and follow-up can be ensured. If effective supervision and follow-up can be ensured, no advance is likely to stick up and even the most conservative banker need not have any anxiety for the recovery of the money lent.
(Supervision, 2012, pp. 28-41)

Scope of Loan Monitoring:

The loan monitoring may be done in the following ways:

a) Supervision

b) Follow-up

a) Supervision

Supervision puts more emphasis on proper end use. Supervision keeps track of the end use of fund lent. It includes adequate arrangements by bank for maintaining close contact with the borrower and his activities in order to remain well informed about the position and progress of the purpose and to offer appropriate guidance to the borrower, where necessary.

Common Methods of Supervision

- ✓ Monitoring over the utilization of money disbursed to ensure that the money is properly utilized for the purpose(s) for which it was allowed.
- ✓ Keep watching over the purchase and use of inputs and materials.
- ✓ Keep watching over the outputs and sales.
- ✓ Keep watching over the in-flow and out-flow of fund.
- ✓ Keep watching over the maintenance of security offered.

- ✓ Visits to the projects/activities finances at different stages starting from the stage of appraisal up to the recovery of the money lent.

b) Follow-up

Follow-up puts more emphasis on timely recovery of advances. Follow-up includes effort to ensure that the terms and conditions of the advance at pre disbursement, post disbursement and recovery stages are complied with and money lent is repaid as per schedule of repayment. It also includes efforts to regularize the irregular advances. Recovery of advances largely depends on effective follow-up.

Common Methods of Follow-up

- ✓ Ensure that the advances have been sanctioned and disbursed as per norms and procedures prescribed by the central bank and as per practice, procedures and norms of the bank. If there is any deviation, proper steps should be taken to regularize.
- ✓ Check the documents and ensure that the documents have been obtained as per terms of sanction and as per procedure for such type of advance. If not, steps should be taken to get those documents.
- ✓ Ensure that the security/collateral has been obtained as per terms of sanction and valuation has been performed correctly and the security is maintained properly.
- ✓ Ensure that the security has been properly insured.
- ✓ Ensure that the disbursements are made as per procedure and terms of sanction.
- ✓ Ensure collection of periodical reports, returns and information about the borrower and the activities / projects financed.
- ✓ Issuance of letters and reminders to regularize the irregularities, if any, and to repay the advance as per schedule.
- ✓ Continue efforts for recovery of the advance.
- ✓ Arrange settlement of the account in time.

The above mentioned points have been mentioned as some of the common methods as guidelines for supervision and follow-up of advances. These are not the only and exclusive methods banks are supposed to follow. Depending on the situation the banks may have to take different actions. Supervision and follow-up of advances are the direct responsibilities of the branch. Branch is the unit from where the proposal is made for any advance disbursement.

Post Loan Review

- ✓ Banks make advances from the funds deposited by or collected from the depositors and money borrowed from other banks including central bank of the country. Depositors' money and borrowed funds are repayable as and when demanded. Therefore, advances made by the banks must be recovered to meet the demands of the depositors, lenders and also to continue and expand the credit operations of the banks. It has been mentioned that effective supervision and follow-up are essential to ensure recovery of advances as per schedule of payment and also for recovery of overdue and stuck-up advances. This can only be achieved if proper post loan review is done.
- ✓ However the following steps may be taken in order to facilitate the recovery in addition to the common methods already mentioned earlier in respect of supervision and follow-up of advances. We may add the following points for post loan review.
- ✓ Due date diary must be maintained for each and every borrower.
- ✓ Written notice must be issued well ahead of due date of the repayment of installments or due date of repayment, if repayable at a time.
- ✓ Written remainders to be issued at regular intervals till recovery is completed.
- ✓ Arrangements should be made to ensure personal contacts with the borrower for recovery purposes
- ✓ Advances not repaid within due date may be grouped as Overdue advances, Default Advances, Classified Advances (Sub-Standard, Doubtful, Bad & Loss), Advances under legal process for recovery.
- ✓ Examining the loan papers and documents to ascertain the correct position.
- ✓ Ascertaining the condition of security and its value.

4.1.2 Mandatory Consideration

4.1.2.1 Bangladesh Bank Directives

Bangladesh Bank (BB) from time to time prescribes guidelines or suggestions to the banks operating banking business within the territory of Bangladesh. Some of these guidelines are mandatory and some are suggestive. Among the guidelines two relevant guidelines - "Single Borrower Exposure Limit" and "Credit Risk Management" have already been discussed in chapter two. These guidelines (whether suggestive or mandatory) help protect the interest of the depositors and the shareholders. Because if a bank disburses a substantial amount of its entire fund and if the borrower becomes bankrupt, the bank will be in serious trouble. This bankruptcy will not only hamper the condition of the respective bank but also it may have a serious impact on the overall economy. This was one of the major reasons of the previous recession (2007-08) in the world economy. Even the US government had to declare bailout packages to reduce the intensity of the recession. Another major reason of that world-wide economic debacle was to disburse substantial number of loans to non-productive sector. People started consuming taking loan from banks.

If there had not been such aggressive banking activities, we might not have had the recession. That is why the central banks all over the world give direction to protect and stabilize the economy. So the directives should be followed properly sacrificing the short term greed for the long term survival and growth.

4.1.2.2 Credit Information Bureau (CIB) Report

The main aim of the CIB is to provide service to the participants (banks/financial institutions) that need to assess lending risk when granting credit. To this end, these banks/ financial institutions have access to the total liabilities of each borrower in the CIB database. In addition, the following services are also furnished:

a. Providing CIB reports to

I. Board of Investment (BOI) to assess risk of a domestic company/Joint Venture before getting permission for foreign loan,

II. BRPD and DFIM for selection of director for different banks, for loan processing and issuing license to FIs respectfully.

III. Different departments of Bangladesh Bank.

Obtaining CIB reports from Bangladesh Bank (BB) about the potential borrowers is a mandatory requirement. CIB report is now available on the CIB website. Every bank has been provided login ID and passwords so that respective bank officials enter the database of CIB and collect the CIB reports of respective borrowers. Citibank CRMS strictly maintains the practice of collecting updated CIB reports to makes sure that no drawdown of loan is provided to any bad or default customer. From CIB report past history of a borrower can be known. In case of companies CIB report of the directors of the respective company is required. CRMS collects the Director names of respective corporate borrowers in a specific form known as CIB undertaking form where the companies disclose the details of the Directors.

4.1.3 Organization Specific Policies

Every organization has its own policies and procedure irrespective of its size and nature. The lending officer should respect the policies of his organization. For example Citibank has a policy of "Right to reject" which means it does not offer loan to everybody. Only the top ranked big corporate houses of the respective industry are entitled to get credit. So, the lending officer should consider his organizational policy too while sectioning credit.

Citibank has a rigorous process and policy in place to monitor the status of the credit customers on an ongoing basis. The status of customers reported to top management is live and up to date. ICG Risk Policy is strictly followed to make sure that risk is mitigated and kept within a tolerable range.

4.2 Analysis of banking practice done by Citibank, N.A.

4.2.1 Principles Formulated by the Bank of International Settlement (BIS) and the methods followed in Citibank, N. A.

Citibank follows BIS principles for Sound Credit Risk Assessment and Valuation for loans.

Principles of Bank of International Settlement (BIS)	Policy/Method followed in Citibank, N. A.
Principle 1: The bank's board of directors and senior management are responsible for ensuring that the bank has appropriate credit risk assessment processes and effective internal controls to consistently determine provisions for loan losses in accordance with the bank's stated policies and procedures, the applicable accounting framework and supervisory guidance commensurate with the size, nature and complexity of the bank's lending operations.	1. In Citibank, N. A. a thorough credit risk assessment is conducted prior to the granting of a facility. This assessment of risk is mainly done by RMs. The result of this assessment is presented in a Credit Application to Credit Risk Management (CRM) for review of any problem.
Principle 2: Banks should have a system in place to reliably classify loans on the basis of credit risk. Principle 3: A bank's policies should appropriately address validation of any internal credit risk assessment models.	2. Citibank classifies its in the credit customers in the following manner: ➢ Unclassified (UC)- Pays installment on time ➢ Special Mention Account (SMA)- Loan payment overdue for 90 days ➢ Sub-standard (SS)- Overdue for more than 3 months but less than 6 months ➢ Doubtful (DF)- Overdue for more than 6 months but less than 9 months ➢ Bad/Loss (BL)- Overdue for 9 months to 5 years ➢ Bad Loss Written off (BLW)- Will not pay at all The guideline is prescribed by BB.
Principle 4: A bank should adopt and document a sound loan loss methodology, which addresses risk assessment policies, procedures and controls, for assessing credit risk, identifying problem loans and determining loan provisions in a timely manner.	3. Citibank CRMS strictly maintains the practice of collecting updated CIB reports to makes sure that no drawdown of loan is provided to any bad or default customer. However, this CIB report can easily be downloaded from CIB website.
Principle 5: A bank's aggregate amount of individual and collectively assessed loan provisions should be adequate to absorb	4. Citibank has a policy of "Right to reject" which means it does not offer loan to everybody. Only the top ranked big

estimated credit losses in the loan portfolio. Principle 6: A bank's use of experienced credit judgment and reasonable estimates are an essential part of the recognition and measurement of loan losses. Principle 7: A bank's credit risk assessment process for loans should provide the bank with the necessary tools, procedures and observable data to use for credit risk assessment purposes, account for impairment of loans and the determination of regulatory capital requirements. Principle 8: Banking supervisors should periodically evaluate the effectiveness of a bank's credit risk policies and practices for assessing loan quality. Principle 9: Banking supervisors should be satisfied that the methods employed by a bank to calculate loan loss provisions produce a reasonable and prudent measurement of estimated credit losses in the loan portfolio that are recognized in a timely manner. Principle 10: Banking supervisors should consider credit risk assessment and valuation practices when assessing a bank's capital adequacy.	corporate houses of the respective industry are entitled to get credit. So, the lending officer should consider his organizational policy too while sectioning credit. 5. Credit Risk Assessment is done by the relationship managers in Citibank. 6. Credit Criteria of Citibank, N.A. In Pre-Sanction Stage ➢ Project Profile ➢ Ratio Analysis ➢ Financial Statement Analysis ➢ Management ➢ Collateral ➢ External Issues ➢ Documentation In Post-Sanction Stage ➢ Loan Monitoring: Supervision and Follow-up ➢ Post Loan Review 7. Perfection of Citibank, N.A. in managing the credit portfolio: Non-Performing Loan is below 2%.

4.2.2 Credit Risk Management technique followed by Citibank, N.A. as per Bangladesh Bank Guidelines

<table>
<tr><th>Criteria</th><th>Credit Risk Management Guidelines by Bangladesh Bank</th><th>Credit Risk Management followed by Citibank NA</th></tr>
<tr><td rowspan="2">Lending Guidelines:

Industry and Business Segment Focus – As per internal policy of Citibank, N. A.</td><td>The Lending Guidelines should be approved by the Managing Director / CEO & Board of Directors of the FI based on the endorsement of the FI’s Head of Credit Risk Management and the Head of Business Units.</td><td rowspan="4">✓ Lending guidelines prior to facility approval in Citibank, N. A. are:-

Project profile- Bank identifies whether the loan is for productive purpose or for non-productive purpose.

Ratio Analysis- Evaluating the future performance of the borrower.

Financial Statement Analysis- Evaluation of the borrowers present performance

Management- Citibank outsmarts the management to borrowers

Collateral- Security asset of the borrower should be closely monitored

External Issues- Tackling the unforeseen situation. Citibank Sensing the recent recession in advance, it has cut its loans and advances by more than 30 percent.

Documentation- CRMS Unit ensures that the required documents are in place (or deferral has been obtained) prior to releasing lines of the system. Facilities will be released only to the extent completed and duly</td></tr>
<tr><td>The Lending Guidelines should clearly identify the business / industry sectors that should constitute the majority of the FI’s facility portfolio. For each sector, a clear indication of the FI’s appetite for growth should be indicated</td></tr>
<tr><td>Types of Facilities</td><td>The type of facilities that are permitted should be clearly indicated, such as Lease, Term Loan, Home Loan, and Working Capital etc</td></tr>
<tr><td>Single Borrower/Group Limits/Syndication – Done by FI</td><td>Details of the FI’s Single Borrower/Group limits should be included as per Bangladesh Bank guidelines. Financial Institutions may wish to establish more conservative criteria in this regard.</td></tr>
</table>

<table>
<tr><td></td><td></td><td rowspan="4">executed documentation is available (or approved deferral in place).

✓ Facility Parameters, Credit Assessment and Risk Grading is done by relationship officers (RMs) in Citibank.

✓ Bangladesh Bank issues Master Circular, as per the circular Citibank determines the Product Lending Caps.

Maximum 35% of the banks total capital can be disbursed to a single borrower.
15% for Funded Facility
20% for Non-Funded Facility

Credit Risk Management steps followed by Citibank, N.A.

Step 1- RMs evaluate a clients credit worthiness. Facility Parameters, Credit Assessment and Risk Grading are prepared. And after that sent to CRMS.
Step-2- CRMS uploads it to the System (bank's internal system)
Step 3- A system generated Credit Approval (CA) is prepared. And send back to the RM.
Step 4- RM sends it to Risk Chain which is situated in India for approval.
Step 5- After receiving approval from India, Offer Letter is Issued to the respective client. Demanding required documentation and legal papers.</td></tr>
<tr><td>Product Lending Caps – Evaluated by Finance Dept. & Internal policy)</td><td>Financial Institutions should establish a specific product exposure cap to avoid over concentration in any one product</td></tr>
<tr><td>Facility Parameters – Evaluated by RM</td><td>Facility parameters (e.g., maximum size, maximum tenor, and covenant and security requirements) should be clearly stated. As a minimum, the following parameters should be adopted:
- Financial Institutions should not grant facilities where the FI's security position is inferior to that of any other financial institution.
- Assets pledged as security should be properly insured.
- Valuations of property taken as security should be performed prior to facilities being granted. A recognized 3rd party professional valuation firm should be appointed to conduct valuations.</td></tr>
<tr><td>Credit Assessment – Evaluated by RM</td><td>A thorough credit and risk assessment should be conducted prior to the granting of a facility, and at least annually thereafter for all facilities. The results of this assessment should be presented in a Credit Application that originates</td></tr>
</table>

	from the relationship manager/account officer ("RM"), and is reviewed by Credit Risk Management (CRM) for identification and probable mitigation of risks	**Step 6-** Client provides the bank with the required legal documents. **Step 7-** After receiving the documents facility is uploaded in the system and finally disbursed to client. (this step is done by CRMS)
Risk Grading – Evaluated by RM	The Credit Risk Grading (CRG) is a collective definition based on the pre-specified scale and reflects the underlying credit-risk for a given exposure. The aggregation of such grading across the borrowers, activities and the lines of business can provide better assessment of the quality of credit portfolio of a FI.	

Chapter Five

Suggestions, Recommendations & Conclusion

5.1 Suggestions & Recommendations

Citibank N.A. being a Foreign Bank operating for two hundred years has all the systems in place to cope with the risks associated with its business. Its policies and regulations are robust and much strict when it comes to the point of Credit Risk. The ICG risk manual completely outlines the overall process of CRM from the starting point to the end. It has described the roles of every single person associated to the process of CRM. There is a separate group of employees who act as Risk Officers and assess the risk vulnerability of the credits. So, one must say that the risk mitigation is in place from the very beginning of the credit approval process. In Citibank the credit approval stage is very much in line with the global policy. But there are some irregularities in the case of loan monitoring. The creditworthiness and changing financial abilities of the borrowers should be much more strictly monitored by RMs as well as other officials to minimize the percentage of Non-Performing Loans (NPL) and default. CIB reports should be more intensely checked on a regular basis so that there is no compromise with the classified borrowers. In Bangladesh the Credit Information Bureau has come up to gather and provide all borrowing customer related information. CIB is yet to provide reliable data as its database is solely dependent on the reports provided by scheduled banks. All these banks submit a regulatory report named 'Monthly CIB Online Report' which details the existing outstanding of the borrowers with those banks. But the banks are not submitting the report prudently with accurate data. As a result the actual scenario is not perfectly reflected in the CIB reports of the borrowers. So, there is a gap between actual creditworthiness of the borrower and the findings from the report about the borrowers.

As far as I have seen and experienced the documentation process for credit facilities is quite satisfactory and these documents are held properly as recommended by Bangladesh Bank. There are some irregularities in collecting the supporting documents like Stock Reports, insurance Cover Notes which are required for the asset backed credit facilities. CRMS should more regularly follow up with the RMs so that the process is much more regularized than it is now. Checklists for Documentations should be more closely monitored so that expired documents can be renewed prior to the expiry of those.

Credit lines of the borrowers are maintained in Flexcube which is the centrally structured software used for transactions. CRMS must be stricter in restricting the credit lines upon deterioration of the classification status of the customers. Risk officers should also be more watchful of the limit utilized by borrowers and the re-payment frequencies of them. Although the percentage of NPL at Citibank N.A. is very low, the process can be made much more robust to keep that within a minimum.

In case of classified customers the credit lines can be restricted to a lower amount as the deterioration of the classification status may subsequently lead to non-performance and non-repayment of the credit facilities.

5.2 Conclusion

It was a good four months of time at Citibank N.A. where I learnt the process of Credit Risk Management in brief. CRMS functions are limited and some of the credit functions are performed by Credit Administration team and Risk Chain incorporated in India. CRMS does all the functions proactively and regularly monitors the conditions of borrowers. Ad hoc monitoring is also performed upon request of the Risk Chain and deterioration of the risk grading of the borrowers. CRMS also reports internally to the higher management and CRMC to let them know about the current status of credit process. The single borrower exposure limit is closely monitored on a daily basis as it has been highly prioritized by Bangladesh Bank's Offsite Supervision Department. Large Loan reporting is strictly prepare and submitted on time to let the central bank know about the large loan customers. Repotting to CIB is also another prime concerns as CIB officials has recently emphasized on correct and timely reporting about the relevant information of the all customers. Other processes like documentation, review of documentation and up-gradation are thoroughly performed by CRMS. But there is a bit more hard work required by CRMS to regularize all these processes. The existing system in place is quite perfect for risk mitigation and a full compliance of the policies are required to maintain a secured credit portfolio in Citibank N.A. Despite all of these the current situation quite satisfactory and recent Bangladesh Bank inspection team has provided a satisfactory score to Citibank in the aspect of Credit Risk Management.

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