



INTERNSHIP REPORT

ON

“Credit risk management in Sonali Bank Ltd.”

Submitted By

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Major in Finance

Submitted To

Supervisor

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BRAC Business School

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## Letter of Transmittal

September 14, 2014

To,  
Mr. Riyashad Ahmed  
Assistant Professor  
BRAC Business School,  
BRAC University, Bangladesh.

**Subject: Submission of internship report**

Dear Sir,

It is my pleasure to submit my internship report titled “Credit Risk Management of Sonali Bank Limited” that has been prepared to fulfill my degree requirement. I put my best effort to follow the instructions of you in preparing this report. The internship program was very much valuable to me as it helped me to gain experience from practical field. While preparing this report I went through extensive literature survey and interviewed with the bank officials and customers. It was a great learning experience for me. I tried to the maximum competence to meet all the dimensions required from this report.

I am, therefore, grateful to you for your kind cooperation in this report. I hope the report will satisfy you.

Sincerely yours,

Anamica Chowdhury.  
ID-12164035  
MBA

## **Acknowledgement**

First of all, I would like to express my deep gratitude to Almighty Allah for preparing this Internship Report.

I would like to thank Md Yakub Mazumder, Manager of Court Hill Branch, Chittagong for giving me the permission to do the internship at Sonali Bank Limited. I also like to thank him for supervising and giving me the guidance through out the internship period and the knowledge about his organization as much as possible.

This Internship Report has been prepared as the part of MBA program under BRAC Business School Department of BRAC University. I would also like to thank Mr. Riyashad Ahmed Assistant Professor BRAC Business School for giving us her precious time and sincere guidance by pointing out the flows of my Internship Report and by providing me the right direction.

Last but not the least thanks goes to my parents for bearing the tension, frustration and all the hard work along with me through the entire BBA program.

## **Executive Summary**

Sonali Bank Ltd. is the largest state owned commercial bank in Bangladesh with a total of 1203 branches. Total of 858 branch in rural and 343 branch in urban area. The functions of the bank covered a wide range of banking and functional activities to individual, firms, corporate bodies, Multinational agencies and the rural area. The bank provides more than 21 types of free services on behalf of the government of Bangladesh through its rural and urban branches as part of their commitment to society.

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

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

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

Sonali bank Ltd. Court Hill branch, Chittagong is where I did my internship. Loan and advances are sanctioned according standard procedure. In this particular branch consumer loan and SHBL are most popular. Credit risk is relatively low. Recovery rate is 100% in consumer loans and SHBL. Performance of other loans is also good. As most of its credits are related only to two kinds of loans, its credits are not well diversified. So it faces credit concentration risk. As it is a rural branch opportunity for sanctioning large scale or industry loan is very limited. Most of the deposits are added to Sonali bank general account.

## **Introduction**

Each MBA degree needs practical knowledge of the respective field of discipline to be fruitful. Our MBA program also has an internship program, relating to the exchange of theoretical knowledge into the real life practical situation.

Internship Report prepared as a requirement for the completion of the MBA program of the BRAC University, Bangladesh. The primary goal of internship is to provide an on the job exposure to the student and an opportunity for translation of theoretical conceptions in real life situation. Students are placed in enterprises, organizations, financial institutions, research institutions as well as development projects. The program covers a period of 2 months organizational attachment.

It was great opportunity for me to complete my internship program in the largest commercial bank "Sonali Bank Ltd." This internship study was assigned as a part of the course requirement in order to complete my MBA degree program.

### **A Brief Overview of Sonali bank Limited**

Sonali Bank is a state-owned commercial bank in Bangladesh. It is the largest bank of the country.[A fully state-owned enterprise, the bank has been discharging its nation-building responsibilities by undertaking government entrusted different socio-economic schemes as well as money market activities of its own volition, covering all spheres of the economy. Sonali Bank Limited singularly enjoys the prestige of being the agent of the Central Bank of Bangladesh in such places where the guardian of the money market has chosen not to act by itself.

Sonali Bank was established in 1972 under the Bangladesh Banks (Nationalization) Order, through the amalgamation and nationalization of the branches of National Bank of Pakistan, Bank of Bhowalpur and Premier Bank branches located in East Pakistan until the 1971 Bangladesh Liberation War. When it was established, Sonali Bank had a paid up capital of 30 million taka. In 2001, it's authorized and paid up capital were Tk. 10 billion and Tk. 3.272 billion respectively. The bank's reserve funds were Tk. 60 million in 1979 and Tk. 2.050 billion on 30 June 2000.

The management of Sonali Bank is vested in a 7-member board of directors appointed by the government. The managing director is the chief executive. He is assisted by a deputy managing director, six general managers, and other senior executives. The general managers are in charge of the bank's branches in the headquarters of the six administrative divisions of the country namely, Dhaka, Chittagong, Rajshahi, Khulna, Sylhet and Barisal. The bank has 32 departments at its head office including a training institute in Dhaka. On 30 June 2000, the total number of employees of the bank was 26,085.

Sonali Bank Limited was incorporated in Bangladesh on 03 June 2007 as a Public Limited Company under Companies Act 1994. Formally this bank was incorporated as a nationalized commercial bank named as Sonali Bank established by The Bangladesh Bank Order 1972 (Presidential Order no. 26 of 1972) and was fully owned by the Government of the People's Republic of Bangladesh. After incorporation dated 15 November 2007 Sonali Bank Ltd. has taken over the undertaking and business of Sonali Bank. The Bank has total of 1203 branches throughout the country including two overseas branches at Kolkata and Siliguri in India as on 13 November 2013.

## **Nature of Business/Core Business**

The Principle activities of the bank include providing of all kinds of commercial banking services to its customers. The activities can be classified in the following ways:

### **Core Business:**

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

### **Other Business/Services:**

- Government Treasury Bonds
- Locker Service
- A.T.M. Card
- Utility Bills Collection
- Ancillary Services
- Merchant Banking

## **Islamic Banking Services:**

### ***Deposit Products:***

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

### ***Investment Products:***

- Bai-Murabaha
- Bai-Muajjal
- Bai-Salam
- Bai-Istisna
- Hire Purchase Under Shirkatul Melk(HPSM)

## **Sonali Bank's Vision:**

Socially committed leading banking institution with global presence.

## **Sonali Bank's Mission:**

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

## **Sonali Bank's Slogan:**

Your trusted partner in innovating banking.

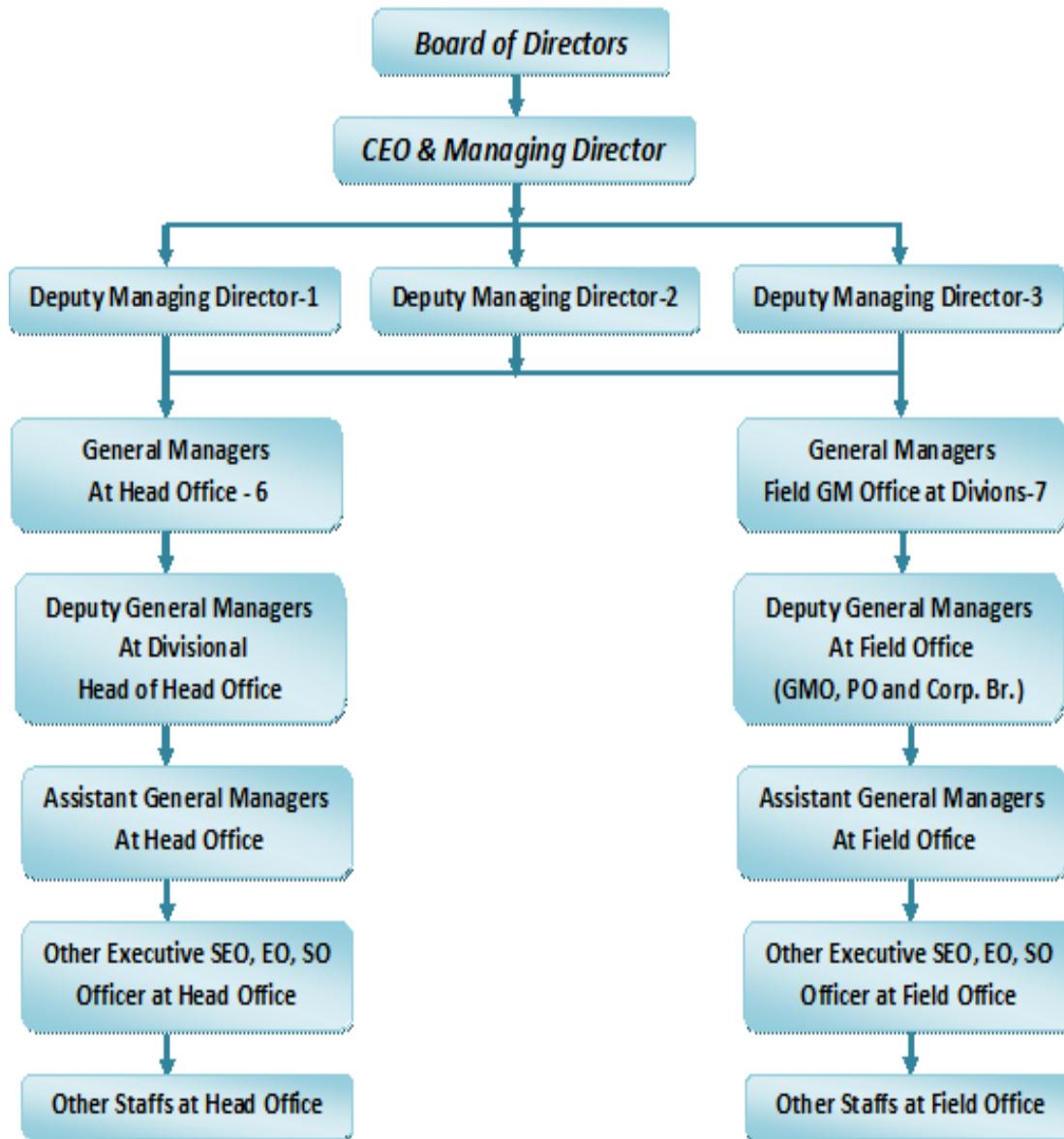


## Corporate Profile of Sonali Bank Limited

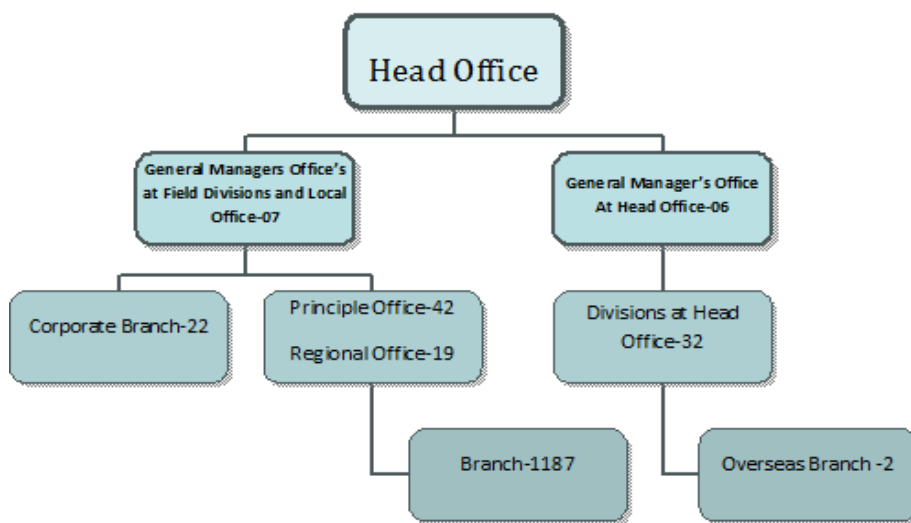
<b>Name of the Company</b>	: <b>Sonali Bank Limited</b>
<b>Chairman</b>	: Quazi Baharul Islam
<b>CEO and Managing Director</b>	: Md. Humayun Kabir
<b>Company Secretary</b>	: Zaheed Hossain
<b>Legal Status</b>	: Public Limited Company
<b>Genesis</b>	: Emerged as Nationalized Commercial Bank in 1972, following the Bangladesh Bank (Nationalization) Order No. 1972(PO No.26 of 1972)
<b>Date of Incorporation</b>	: 03 June, 2007
<b>Date of Vendor's Agreement</b>	: 15 November, 2007
<b>Registered Office</b>	: 35-42, 44 Motijheel Commercial Area, Dhaka, Bangladesh
<b>Authorized Capital</b>	: Taka 10.00 billion
<b>Paid-up Capital</b>	: Taka 09.00 billion
<b>Number of Employee</b>	: 21,839
<b>Number of Branches</b>	: 1184
<b>Phone-PABX</b>	: 9550426-31, 33, 34, 9552924
<b>FAX</b>	: 88-02-9561410, 9552007
<b>SWIFT</b>	: BSONBDDH
<b>Website</b>	: <a href="http://www.sonalibank.com.bd">www.sonalibank.com.bd</a>

*Figure 1: Corporate Profile of Sonali Bank Limited*

## Operational network organogram



*Figure-2: Organogram of Sonali Bank Limited (position wise)*



## Board of Directors

Sl. No.	Name	Designation
1.	Mr. Quazi Baharul Islam	Chairman
2.	Mr. Md. Shahid Ulla Mia	Director
3.	Dr. Nasreen Khundker	Director
4.	Mr. A.S.M. Nayem, FCA, FCCA	Director
5.	Mr. M. Lutfur Rahman Khan	Director
6.	Mr. K.M. Zaman Romel	Director
7.	Mr. Kashem Humayun	Director
8.	Mr. Shaimum Sarwar Kamal	Director
9.	Advocate Sattayendra Chandra Bhakta	Director
10.	Mrs. Jannat Ara Henry	Director
11.	Mr. Suvas Singho Roy	Director
12.	Mr. Md. Anwar Shahid	Director
13.	Mr. Md. Humayun Kabir	CEO & MD

## **Future Plan:**

SBL will continue to patronize sports and culture at home and abroad. Arrangements will be made for rendering better social services to the community apart from core banking activities. Specific action plans will be initiated to expand CSR programs in line with the guidelines of Bangladesh Bank and Securities & Exchange Commission (SEC).

## **Job Description**

### **Duties Performed in the General Banking:**

General banking is the one of the most important department of every banking transaction.

During the internship period I learn most this section. I did my work in the following section under general banking Division.

1. Account opening.
2. Account closing.
3. Cheque Issue.
4. Clearing House Section.

### **General Banking Functions**

A financial institution intermediary that mediates or stands between ultimate borrowers and ultimate lenders is known as banking financial institution. Banks perform this function in two ways- taking deposits from various areas in different forms and lending that accumulated amount of money to the potential investors in other different forms. General banking department aids in taking deposits and simultaneously provides some ancillary services. General banking is the front-side banking service department. It provides those customers who come frequently and those customers who come one time in banking for enjoying ancillary services. In some general banking activities, there is no relation between banker and customers who will take only one service form bank. On the other hand, there are some customers with whom banks are doing its business frequently. It is an important department for all banks because it provides day-to-day service to the customers. Front Desk is the important for general banking. Customers give their deposits and meet their demand for cash by honoring cheques. Besides this a customer opens new accounts, remit funds, issues bank drafts and pay orders etc. There are various sections in this department, which are as follows: -

- Cash Section
- Accounts Opening Section
- Cheque Clearing Section

### **Cash Section**

The most vital and important section of the branch is Cash Department. It deals with all kinds of cash transactions. This department starts the day with cash in vault. Each day some cash that is opening cash balance are transferred to the cash officers from the cash vault. Opening cash balance is adjusted by cash receipts and payments. This figure is called closing balance. This balance is then added to the vault. This is the final cash balance figure for the bank at the end of any particular day. There is an important clause and duty practiced by the branch is to refund the principal amount that exceeds more than Tk. 1 core at the principle branch of the bank.

#### Books Maintained By This Section

Vault Register: It keeps account of cash balance in vault in the bank.

Cash Receipt Register: Cash receipt in whole of the day is recorded here.

Cash Payment Register: Cash payments are made in a day are entered here.

Rough Vault Register: Cash calculation for final entry in vault register is done here as any error and correction here is not acceptable

Cash Balance Book: Balance here is compared with vault register. If no difference is Found, indicates no error.

#### Functions of Cash Department

##### Cash payment

1. Cash payment is made only against cheque
2. This is the unique function of the banking system, which is known as — payment on demand ||
3. It makes payment only against its printed valid cheque.

##### Cash receive

1. It receives deposits in form of cash
2. It collects money only its receipts forms.

#### Cheque Cancellation or Cash Payment Process:

##### Step 1

- Receiving Cheque by the employee in the cash counter
- Verification of the followings by the cash Officer in the computer section

##### Step 2

- Date of the Cheque (present within 6 months from issue date)
- Issued from this branch
- Amounts in figure and sentence written does not differ
- Signature of the drawer does not differ
- Cheque is not torn or mutilated

### Step 3

- Gives pay cash seal and sends to the payment counter

### Step 4

- Payment officers make payment

## **Account Opening Section**

Account opening section is an important factor for banks because customer is the main source of bank. Selection of customer is another important factor. Bank's success and failure largely depends on their customers. If customer is not good then may create fraud and other problems by their account with bank and thus destroy goodwill of banks. Therefore, bank must be conscious in selecting its customer. For this reason Sonali Bank Ltd. keep key information system.

### Accounts Opening Process

Recently, Bangladesh Bank has been declared, designed and enforced a unique format of form for every banks. This format should hold the important document in a same manner and process respectively for different kind of accounts. Sonali Bank Ltd. is not different from this practice. Accounts opening process can be as follows:

### Step 1

- Receiving filled up application in bank's prescribed form mentioning what type of account is desired to be opened.
- The form is filled up by the applicant himself/ herself
- Two copies of passport size photographs from individual are taken and in case of firms photographs of all partners are taken
- Officer are taken information from customer by key information system

### Step 2

- Applications must submit required documents
- Applications must sign specimen signature sheet and give mandate
- Introducer's signature and accounts number-verified by legal officer

### Step 3

- Filling & signing up KYC or Know Your Customer Form
- Filling & signing up Owner Information Form

### Step 4

- Authorized Officer accepts the application

#### Step 5

- Minimum balance is deposited-only cash is accepted

#### Step 6

- Account is opened and a chequer book and pay-in-slip book is given

#### Transfer of Account

An account can be transferred from branch to branch and only from the same bank. Following steps are considered for this purpose:

- Application in written to the Manager of the account maintaining branch
- Manager sends a request to the manager of the desired branch of depositors
- Sends original Account opening application and specimen signature sheet with the balance remained in the account at the sent Manager's request
- New account is opened at desired branch

#### Clearing Department

Cheques clearing section of Sonali Bank Ltd. receives cheque, demand drafts and pay orders of their clients. Upon the receipt of the instrument the cheque clearing section examines three types of payment modules.

Whether the Paying Bank within Dhaka City: The cheques clearing section of Sonali Bank Ltd., Dhanmondi Branch sends Inter Branch Debit Advice (IBDA) to the head office on the receiving day of the instruments. The main branch takes those instruments to the clearing house on the following day. If the instruments are dishonored, Head Office of Sonali Bank Ltd. sends IBDA to the Sonali Bank Ltd., Dhanmondi Branch.

Whether the Paying Bank of their own branch: The cheque clearing section of Sonali Bank Ltd., Dhanmondi Branch sends Outward Bills for Collection (OBC) to the concerned paying branch to get Inter Branch Credit Advice (IBCA) from the paying branch. If the paying branch dishonors the instrument, the paying branch returns it to the Sonali Bank Ltd., Dhanmondi Branch describing why the instrument is dishonored.

Types of Cheque Collected by Clearing Department:

Local Bills Collection Cheques (LBC): Local bills collection cheques are those cheques, which are collected and paid by two different branches of a bank situated in the same city.

Outward Bills Collection Cheque (OBC): OBC cheques are those cheques, which are collected and paid by two different branches of same or different bank situated in the outstation.

General Banking Functions under Sonali Bank Ltd

Transfer Cheque: Transfer Cheques are those cheques, which are collected and paid by the same branch of Sonali Bank Ltd.

### Clearing House

Clearing House is an arrangement under which member banks agree to meet, through their representatives, at an appointed time and place to deliver instruments drawn on the other and in exchange, to receive instruments drawn on them. The net amount payable or receivable as the case may be, is settled through an account kept with the controlling bank.

### Types of Clearing

Outward Clearing: Outward clearing means when a particular branch receives instruments drawn on the other bank within the clearing zone and those instruments for collection through the clearing arrangement is considered as outward clearing for that particular branch.

Inward Clearing: When a particular branch receives instruments, which are drawn on them and sent by other member bank for collection are treated as inward clearing.

## **Background of the Report**

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

## **Title of the study**

Title of the study is: "Credit risk management in Sonali Bank Ltd."

## **Description of Project**

In this report I tried to give an overview about all kinds of credit risk management practices in Sonali Bank Ltd. So I tried to find the answer of the following questions:

1. What's the idea of credit?
2. What's the idea of risk management?
3. What are the guidelines of Bangladesh Bank concerning CRM?



4. What are the Basic Activities of the Bank of Sonali bank Ltd.?
5. What are the rules and regulation followed by Sonali bank Ltd.?
6. What are the sources used for Credit risk investigation?
7. How risk assessment is done?
9. How is its documentation process?
10. How they deal with non-performing loans?
11. How to arrange the criteria of lending before sanctioning?
12. What sectors the bank has to give emphasis on providing loans and advanced?
13. Types of credit facilities of the bank.
14. What are the basis on loan classification and provisioning?

### **Objectives of the study**

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

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

### **Methodology of the study**

The following methodology was used for the study:

Both primary and secondary data sources are used to generate this report. Primary data sources are scheduled survey, informal discussion with professionals and observation while working in different desks. The secondary data sources are annual reports, manuals, and brochures of Sonali Bank Ltd. and different publications of Bangladesh Bank.

To identify the implementation, supervision and monitoring practices interview with the employee and extensive study of the existing file and practical case observation was done.

## **Sources of data**

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

### ***Primary Sources:***

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

### ***Secondary Sources:***

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

## **Limitation of the study**

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

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

And as it was my first work and inexperience was a problem. So there may be some personal mistake in the report.

# LITERATURE REVIEW

## Part A: Theoretical Framework

### *What is credit?*

Credit is usually defined in terms of the borrowing and lending of money. The most basic form is a loan granted to a borrower, who may be a consumer or a company. Credit can also take the form of a financial instrument that entails fixed payments determined up front and made over a set time period. (Hong Kong Institute of Bankers, 2012)

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. (Bank of Mauritius, December 2003)

In banking terminology, credit refers to the loans and advances made by the bank to its customers or borrowers.

### *What is credit risk?*

Credit risk arises from the potential that a bank's borrower will fail to meet its obligations in accordance with agreed terms. Credit risk also refers the risk of negative effects on the financial result and capital of the bank caused by borrower's default on its obligations to the bank (Bangladesh Bank, 2012).

The risk that a borrower or counterparty may fail to fulfill an obligation. The assessment of credit risk involves evaluating both the probability of default by the counterparty, obligator, or issuer and the exposure or financial impact on the authorized institution in the event of default (Hong Kong Monetary Authority, 2001).

### *What is credit risk management?*

Risk management contains

- Identification,
- Measurement,
- Aggregation,
- Planning and management,
- As well as monitoring of the risks arising in a bank's overall business (Oesterreichische National bank, 2005).

### *Why manage credit risk?*

The reasons behind managing credit risks are as follows:

- a) Increase shareholder value
  - Value creation
  - Value preservation
  - Capital optimization
- b) Instill confidence in the market place
- c) Alleviate regulatory constraints and distortions thereof (Bhargara, 2004).

***What is credit Risk Management process?***

Credit risk management process should cover the entire credit cycle starting from the origination of the credit in a financial institution's books to the point the credit is extinguished from the books. It should provide for sound practices in:

- Credit processing/appraisal
- Credit approval/sanction
- Credit documentation
- Credit administration
- Disbursement
- Monitoring and control of individual credits
- Monitoring the overall credit portfolio (stress testing)
- Managing problem credits/recovery (Bank of Mauritius, December 2003)

**Part B: Guidelines for CRM by Bangladesh Bank & Sonali Bank's Practice**

In February 2013 Department of Off-site Supervision of Bangladesh Bank issued "Risk Management guidelines for Banks" (Bangladesh Bank, 2013) for all scheduled banks in Bangladesh. These guidelines are issued by Bangladesh Bank under section 45 of 'ব্যাংক কোম্পানি আইন, ১৯৯১' and introduced to provide a structured way of identifying and analyzing potential risks, and devising and implementing responses appropriate to their impact. Summary of Some of the important CRM guideline are presented here.

Credit risk management framework

A typical credit risk management framework in a bank may be broadly categorized into following main components:

- a) Board oversight
- b) Senior management's oversight

- c) Organizational structure
- d) Systems and procedures for identification, acceptance, measurement of risks
- e) Monitoring and control of risk

### Credit administration

The credit administration function is basically a back office activity that supports and controls extension and maintenance of credit. While developing credit administration areas, banks must ensure:

The efficiency and effectiveness of credit administration operations, including monitoring documentation, contractual requirements, legal covenants, collateral, etc. The accuracy and timeliness of information provided to management information systems; the adequacy of control over all "back office" procedures; and compliance with prescribed management policies and procedures as well as applicable laws and regulations.

Banks need to enunciate a system that enables them to monitor quality of the credit portfolio on day-to-day basis and take remedial measures as and when any deterioration occurs. Such a system would enable a bank to ascertain whether loans are being serviced as per facility terms, confirm the adequacy of provisions, and establish that the overall risk profile is within limits established by management and compliance of regulatory limits. Monitoring procedures and systems should be in place so as to provide an early signal of the deteriorating financial health of a borrower.

A typical credit administration unit performs the following functions:

- Documentation
- Credit disbursement
- Credit monitoring
- Credit repayment
- Maintenance of credit files
- Collateral and security documents

### Measuring credit risk

The measurement of credit risk is a vital part of credit risk management. To start with, banks should establish a credit risk rating framework across all type of credit activities. Among other things, the rating framework may, incorporate:

Business risk

- Industry characteristics
- Competitive position (e.g. marketing/technological edge)
- Management

- Financial risk
- Financial condition
- Profitability
- Capital structure
- Present and future cash flows

### Credit risk monitoring and control

Banks need to develop and implement comprehensive procedures and information systems to monitor the condition of each individual credit across various portfolios. Banks need to enunciate a system that enables them to monitor quality of the credit portfolio on a day-to-day basis and take remedial measures as and when any deterioration occurs. These procedures need to define criteria for identifying and reporting potential problem credits and other transactions to ensure that they are subject to more frequent monitoring as well as possible corrective action, classification and/or provisioning. Establishing an efficient and effective credit monitoring system would help senior management to monitor the overall quality of the total credit portfolio and its trends and helps to reassess credit strategy/policy accordingly before encountering any major setback.

The banks credit policy should explicitly provide procedural guideline relating to credit risk monitoring. At the minimum it should lay down procedure relating to:

The roles and responsibilities of individuals responsible for credit risk monitoring;  
The assessment procedures and analysis techniques (for individual loans & overall portfolio)

- The frequency of monitoring;
- The periodic examination of collaterals and credit covenants;
- The frequency of site visits; and
- The identification of deterioration in any credit;

### Managing credit concentration risk

Concentration risk generally designates the risk arising from an uneven distribution of counterparties in credit or any other business relationships or from a concentration in business sectors or geographical regions which is capable of generating losses large enough to jeopardize an institution's solvency.

Credit concentrations of a bank may be pre-planned and part of its business philosophy. However, banks should make greater efforts to identify and limit concentration risk or to demand appropriate risk premiums. Each bank should have effective internal policies, systems and controls to identify, measure, monitor and control credit risk concentrations (CCR). Banks should minimize concentration risk possibilities rather than providing

capital cover. However, BB reserves the right to require higher levels of capital for individual banks with excessive concentration risk.

### Credit Risk Management

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

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

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

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

### Implementation of BASEL-II

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

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

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

Along with the existing capital adequacy rules and reporting Bangladesh Bank (ref. BRPD Circular no.10 dated 25.11.2002) Banks will start quarterly reporting as per the set

of the reporting formats provided by Bangladesh Bank. Sonali Bank Ltd. Management is aware about guideline of Bangladesh Bank and prepared for implementing new capital Accord BASEL-II.

Credit Rating of the Bank

As per the BRPD instruction circular No.6 dated July 5, 2006, the bank has done its credit rating by Credit Rating Information and Services Limited (CRISL) based on the financial statements dated 31 December 2013.

Credit Rating Report (Surveillance Rating)

<b>Surveillance Rating-2011</b>	<b>Long Term</b>	<b>Short Term</b>
As Government Supported Entity	AAA	ST-1
As Private Commercial Bank	A-	ST-2
Outlook	Stable	
Date of Rating	16 October, 2013	

CRISL's Definition of Rating

<b>Rating</b>	<b>Definition</b>
AAA Triple-A ( Highest Safety)	Banks rated in this category are adjudged to be of best quality, offer highest safety and have highest credit quality. Risk factors are negligible and risk free, nearest to risk free Government bonds and securities. Changing economic circumstances are unlikely to have any serious impact on this category of banks.
<b>ST - 1</b>	Highest certainty of timely payment. Short-term liquidity including internal fund generation is very strong and access to alternative sources of funds is outstanding, Safety is almost like risk free Government short-term obligations.



<b>A-</b> <b>Single-A</b> (Adequate safety)	Banks rated in this category are adjudged to offer adequate safety for timely repayment of financial obligations. This level of rating indicates a corporate entity with an adequate credit profile. Risk factors are more variable and greater in periods of economic stress than those rated in the higher categories.
<b>ST - 2</b>	High certainty of timely payment. Liquidity factors are strong and supported by good fundamental protection factors. Risk factors are very small.

## **Preclude**

The bank has put in place a robust risk management architecture with due focus not only on capital optimization, but also to do maximum welfare to people of Bangladesh and carry out government projects.

Bank is benchmarking on globally accepted sound risk management system, conforming to BASEL II framework, enabling a more efficient equitable and prudent allocation of resources.

Sonali Bank Ltd. has established Asset-Liability Management Committee (ALCO) to screen out the banks/financial institutions and determine the maximum risk exposure on each of them. ALCO also assesses recommends and controls cross border/country risk. Sensitivity analysis is conducted on the movement of Capital Adequacy Ratio, considering the projected growth in advances, investments in Subsidiaries/ Joint Ventures and the impact of Basel II framework etc. The Committee takes into consideration various options available for capital augmentation in tune with business growth and realignment of Capital structure duly undertaking the scenario analysis for capital optimization.

### **Capital structure (Disclosure on Risk Based Capital, Dec 2013)**

#### **Qualitative Disclosures**

Core capital of Sonali Bank Limited comprises of fully paid up capital against ordinary shares, statutory reserve and general reserve created out of profit, retained earning etc,

and supplementary capital include General provision & assets revaluation reserve. Eligible Capital of Sonali Bank Limited on the basis of Audited Balance Sheet of 31st December 2012 has been calculated as per Basel-II guidelines as shown below.

**Quantitative Disclosures**

	Eligible Capital	(Tk. in Crore)
	Tier-1 Capital:	
	(I) Paid up Capital	1125.00
(b)	(II) Statutory Reserve	592.49
	(III) General Reserve	4.70
	(IV) Retained Earnings	-1873.85
	Total Tier-1 Capital	-151.66
(c)	Total Tier-2 Capital.	1473.93
(d)	Deductions from Capital.	182.85
(e)	Total eligible Capital.(b-d)	-334.51

**Capital Adequacy (Disclosure on Risk Based Capital, Dec 2013)**

**Qualitative Disclosures**

Sonali Bank Limited is very much aware of maintaining Capital to support its current and future activities. A three year capital growth plan up to 2015 has also been prepared. The

government (owner of the bank) has been approach to provide additional capital amounting to Tk. 3375.00 crore to meet the capital requirement of the bank.

Quantitative Disclosures

(Tk. in Crore)

Capital Requirement for Credit Risk	2823.11
Capital Requirement for Market Risk	287.02
Capital Requirement for Operational Risk	430.53
Capital Adequacy Ratio (CAR)	-0.94
Tier-1 Capital to RWA	-0.94

**Credit Risk (Disclosure on Risk Based Capital, Dec 2013)**

**Quantitative Disclosures**

Sonali Bank Limited has its own Credit Risk Management guideline in terms of Core Risks Management guidelines of Bangladesh Bank. The Bank also follows other instructions/guidelines of Bangladesh Bank in this regard.

Sonali Bank Limited constantly monitors, reviews and analyses its credit portfolio with a view to improving ability of credit portfolio, minimizing potential losses and ensuring efficient credit process.

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

**Quantitative Disclosures**

Total gross credit risk exposures broken down by major types of credit exposure.	BDT (in Crore)
<b>Balance Sheet Exposures</b> (as per Audited Balance Sheet)	
1) Cash	602.15
2) Claims on Bangladesh Government and BB	11964.18
3) Claims on Public Sector Entities (Other than Government) in Bangladesh	7405.36
4) Claims on Banks & NBFIs	4149.55
5) Claims on Corporate	5861.48
6) Claims under Credit Risk Mitigation	1268.21
7) Claims categorized as retail portfolio & SME	3734.29
8) Consumer Finance	402.76
9) Claims fully secured by residential property	32.54
10) Past Due Claims (Risk weights are to be assigned net of specific provision)	5822.42
11) Unlisted equity investments and regulatory capital instruments issued by other banks (other than those deducted from capital) held in banking book	558.37
12) Investments in premises, plant and equipment and all other fixed	2312.24

assets	
13) All other assets	17828.47
<b>Off-Balance Sheet Exposure</b>	
1) Claims on Bangladesh Government and Bangladesh Bank	855.60
2) Claims on Public Sector Entities ( Other than Government) in Bangladesh	2910.40
3) Claims on Banks & NBFIs	24.00
4) Claims on Corporate	223.80
5) Claims against retail portfolio & SME	425.03
Industry or counterparty type distribution of exposures, broken down by major types of credit exposure.	
1) Agricultural / Rural Credit	2927.90
2) Micro Credit	982.04
3) Industrial Credit	8221.52
4) Agro-based Industrial Credit	2344.69
5) International Trade	14004.37
6) SME Finance	293.09

7) General Advance & Others	9041.10
Residual contractual maturity breakdown of the whole portfolio, broken down by major types of credit exposure.	
<b>Loans and Advances</b>	
On demand	3530.92
Not more than 3 months	902.02
More than 3 months but not more than 1 year	15117.01
More than 1 year but not more than 5 years	4060.72
More than 5 years	10222.66
<b>Bills purchased and discounted</b>	
Not more than 1 month	3056.50
More than 1 month but not more than 3 months	266.31
More than 3 months but not more than 6 months	426.15
More than 6 months	232.42
Gross Non Performing Assets (NPAs)	
Non-Performing Assets (NPAs) to Outstanding Loans & advances	
<b>Movement of Non-Performing Assets (NPAs) (Loans &amp; advances)</b>	

Opening balance	6607.53
Additions	7459.81
Reductions	846.84
Closing balance	13220.50

<b>Movement of specific provisions for NPAs (Loans &amp; advances)</b>	<b>BDT (in Crore)</b>
Opening balance	3756.77
Less: Loans written off which fully Provided for	90.92
Add: Recovery Loans which was written off earlier	-
Add: Specific Provisions made during the year	3701.67
Closing balance	7367.52

### **Sources of Credit Investigation**

The following are the sources of credit information

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

- Other sources, i.e.
- Income tax statement
- Registration office
- Press report
- Revenue and municipal rent receipt register of Joint Stock Company
- VAT return
- Confidential report from fellow banks.

**For investigation the manager have to enquiry about**

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

**Credit Risk Assessment**

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

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

*1. Borrower Analysis:*

- a. Share holding
- b. Reputation



- c. Education
  - d. Experience – success history
  - e. Net worth
  - f. Age etc.
2. *Industry Analysis:*
    - a. Industry Position/Threat/Prospect.
    - b. Risk factors pertaining to the industry.
    - c. Borrower's position / share in the industry.
    - d. Strength, weakness of the borrower compared to the competitors etc.
  3. Supplier/ Buyer Risk Analysis
    - Concentration on single/few buyer/supplier is addressed.
  4. Demand Supply position
  5. Technical feasibilities / Infrastructural facilities
  6. Management Teams Competence
  7. Seasonality of demand
  8. Debt to equity Ratio
  9. Historical financial analysis:
    - a. An analysis of 3 years historical financial statements.
    - b. Earning – its sustainability.
    - c. Cash flow
    - d. Leverage
    - e. Profitability
    - f. Strength and reliability of Balance Sheet etc.

10. Projected Financials:

- a. Sufficiency of cash flows to service debt repayment.
- b. Debt Service Coverage Ratio.

11. Trade Checking:

12. Account conduct:

- a. For existing customer the repayment history, credit turnover, study of account statement
- b. If the customer is proposed to be migrated from other Bank, statement of account from present Banker is required
  - Allied deposit with our Bank.
  - Other business with our Bank.

13. Security:

- a. A current valuation of collateral security by Professional Enlisted Surveyor be obtained with photograph and site map. Collaterals within command area of the respective branch location are preferred. Third Party property and vacant land should be discouraged.
- b. Loans should not be considered based solely on collateral.
- c. Adequacy and extent of Insurance coverage should be assessed. Insurance Policy should be obtained from approved Insurance Company. Premium should be paid through Bank, duly stamped money receipt be obtained. Insurance Policy be held by the Bank. The Policy is renewed in time. Letter of authority be obtained from the customer to debit account to pay premium for renewal/enhancement of the policy.

14. Succession issue:

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

15. Adherence to credit guidelines:

- a. It should be clarified whether the customer is agreeable to comply with guidelines in respect of regulatory requirement and Bank's policy requirement.
- b. Any deviation be clearly identified and maintained.

16. Mitigating Factors:

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

17. Environmental factor.

18. Employment generation and contribution to the national economy.

### **Preparation of credit report**

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

After preparing credit report banks ask for loan documentation.

### **Loan documentation**

#### ***What is documentation?***

As other commercial banks one of the main functions of Sonali bank is to extend credit facilities of its valued customers. The credit facilities are given against varies types of securities. These are mainly:

- Personal i.e. credit worthiness of the proposed borrower and guarantor.
- Moveable i.e. FDR, shanchaypattra goods and commodities balance of deposit A/C etc.

Immoveable i.e. land building etc.

Before rendering credit facilities bank has to create charge over the securities through a number of agreements .papers etc. which are called documents.

#### ***Purpose of document***

The entire purpose of the document is that reliance can be place up on the truth of the statement contains in them. Mainly three questions may be examined when document is produced in the court. These are:

- Is the document genuine?
- What is it's contain?
- Are the statements in the document true?

The documents should correctly be taken by the bank in order to crate required charges on the securities defectively in favor of the bank the proper and correct documentation is essential from the point of view of the safety of the banks interest.

### ***Steps of the documentation***

For proper and correct documentation a banker has to go through the following steps:

- 1) Prepare a list of require document
- 2) Verify the legal capacity of the executor
- 3) Affix properly valued adhesive stamp or type on a duly stamped paper
- 4) Execution
  - Ø In presence of manager
  - Ø In one sitting and with indelible ink
  - Ø Any correction altercation etc. must be authenticated with full signature
  - Ø Correctly dated
  - Ø If several pages execution must put their full signature in all pages
  - Ø Witness
- 5) Registration.

### ***Loan classification***

Monitoring can be done through loan classification. Loan is mainly classified to understand that which loan account are performing well (regularly interest payment, timely repayment, and timely renewal etc.) and which are not. In classifying the loan and advance there are two classes in the loan review practiced in SBL. They are as follows as the table.

#### ***Unclassified***

The loan account is performing satisfactory in the terms if its installment and no overdue is occurred.

#### ***Classified***

The loan account is not performing satisfactory in the terms of installments and overdue is occurred. These types of loan need close monitoring to stop the deteriorating position.

- A) Substandard

The main criteria for a substandard advance are that despite these technicalities or irregularities no loss is expected to be arise for the bank. These accounts will require close supervision by management to ensure that he situation does not deteriorate further.

**B) Doubtful**

This classification contains where doubt exists on the fully recovery of the loan or advance but cannot quantifiable at this stage.

**C) Bad & Loss**

A particular loan or advance fall in this class when it seems that this loan or advance is not collectable or worthless even after all security has been exhausted.

In the following table the criteria to be fall in classified category are summarized:

Substandard	Doubtful	Bad & Loss
3 months and above but less than 6 month.	6 month and above but less than 12 month.	Not recover within more than 12 months.

Chapter CRM in Court Hill branch, Chittagong

## **ANALYSIS AND FINDINGS**

### **Part A: Analysis**

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

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

#### **Processes and practices of credit risk management**

Ø Credit risk in the Sonali Bank Ltd.'s portfolio is monitored, reviewed and analysed by the Credit Risk Management (CRM) to minimize potential losses and ensuring efficient credit process.

Ø They have identified the types of risks and disclosed in the BASEL II disclosures according to the BRPD Circular no-09 dated 31st December 2008.

Ø Credit risk faced by the bank is properly identified which includes the following:

- The gross credit risk exposure has grown to BDT 37,814.44 crore as of December 2013.
- Credit quality is standard due to their sound credit risk management system.
- They have made sufficient provisions for NPAs, NPIs and depreciation.
- Volume of off-balance sheet exposures is BDT 4,438.83 crore.

Ø The bank decides on how much risk to take based on their risk appetite as well as government guidelines.

Ø Sonali Bank Ltd. has its own Credit Risk Management guidelines in terms of Core Risks Management guidelines of Bangladesh Bank. The Bank also follows other instructions/guidelines of Bangladesh Bank in this regard.

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

### **The credit risk faced by the bank**

The Movement of Non-Performing Assets (NPL) as disclosed in Basel II shows increase in outstanding Loans & advances. Closing balance of non-Performing loan of December 31, 2013 was BDT 13220.50 crore whereas opening balance was BDT 6607.53 core. Reductions in outstanding amount of that year were BDT 846.84 whereas additions were about BDT 7459.81 crore.

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

### **Methods used to mitigate credit risk.**

- Based on the policies strategies are developed by the bank to mitigate credit risk.
- Credit risk is mitigated by appropriate credit appraisal systems before lending and proper collateral or guarantees are taken to hedge the risk.
- Risk management system is put in place for better management of credit risk and a risk rating is installed which is in compliance with BB guidelines.
- The risk management function is reviewed periodically usually every quarter.
- The rating system for term loans is annual.
- Investment is made in different sectors to diversify risk. Disclosure on Risk Based Capital (Basel-II)" (December 2013) shows Industry or counterparty type distribution of exposures:

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

## **Part B: Findings**

### **Outcome of the Study**

The findings of this study are summarized below:

- The credit risk management process of Sonali Bank Ltd. is quite commendable. Systematic and timely monitoring and appropriate documentation are tried to be maintained.
- Customer satisfaction level is quite good. Informal conversation with some customers reveals that they approve the credit evaluation and management process of Sonali Bank Ltd.
- Governments orders like account opening for 10 taka, etc. increases cost. SME loans for farmers without collateral not only increases credit risk but also costly for banks But return on these services are low.
- Hall-Mark scam exposed major weakness in top management.
- Filing procedure is not maintained in a definite and clear manner. It is difficult to locate the documents in a chronological and sequential manner. A definite practice, though mentioned in the credit policy is not always maintained by the credit officials.
- The credit sanction and disbursement procedure is quite lengthy.
- All branches are not online and Networking system in Sonali Bank Ltd. has to be improved.
- It uses software like RMS+, and Baxibank 5000 that runs on windows XP which is quite out dated and security system appears vulnerable to cyber-attacks.

## **Recommendations**

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

- The credit sanction procedure should be made quicker since competition is very hard in today's business world. People do not want to wait for three to four weeks on an average to get a loan which is even protected by security.
- Decision making process can be made more decentralized.

- The bank should emphasize on reducing the classified and non-performing credits by concerted efforts.
- In the credit department, strict supervision is necessary to avoid loan defaulters. Bank official should do regular visit to the projects.
- Central monitoring system should be more active to maintain classified loan to a minimum level.
- Filing is a very important component of proper documentation. It has to be dealt with importance.
- Salary scale should be increased to motivate extremely dissatisfied employees and to reduce misconduct.
- Vaults security should be increased.
- To attract more clients should sought new marketing strategy.
- An uninterrupted network system has to be ensured. It will save the officials from much hassle and will save time.
- Politically influenced Lending or project finance should be check.

## **Conclusion**

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

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

In recent years, the bank has been exposed to credit risk due large scale loan defaults. Top managements malpractice and mismanagement caused less return on investment. Recovery from top 20 loan defaulters in 2013 was only 37 percent. As for non-performing loans recovery, Sonali bank Ltd. achieved 50 percent of the target. (The Daily Star, March 27, 2014)

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

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