

BBA 3313
Law and Practice of Banking
Study Module

স্কুল অব বিজনেস
SCHOOL OF BUSINESS



বাংলাদেশ উন্মুক্ত বিশ্ববিদ্যালয়
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Law and Practice of Banking

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Unit Highlights

- Lesson 1: Introduction to Bank
- Lesson 2: Sources of Bank's Income
- Lesson 3: Credit Creation of a Bank

Technologies Used for Content Delivery

- ❖ BOUTUBE
- ❖ BOU LMS
- ❖ WebTV
- ❖ Web Radio
- ❖ Mobile Technology with MicroSD Card
- ❖ LP+ Office 365
- ❖ BTV Program
- ❖ Bangladesh Betar Program

Lesson 1: Introduction to Bank

After completion of this lesson you will be able to –

- Define a bank from a legal, functional, and economic perspective.
- Differentiate between various types of banks operating in Bangladesh and their specific roles.
- Explain the primary and secondary functions of commercial banks, including their evolving role in a digital economy.
- Analyze the broader socio-economic objectives that modern banks are tasked with fulfilling in a developing nation.

Key Terms

- **Commercial Bank:** A profit-seeking financial institution that accepts deposits from the public and uses these funds to grant loans and provide a wide array of other financial services to individuals, businesses, and government entities. *Example: A business owner deposits daily sales revenue into a current account at a commercial bank, which then uses a portion of those funds to provide a short-term loan to another firm for inventory purchases.*
- **Scheduled Bank:** A bank that is formally included in the list of banks maintained under the Bangladesh Bank Order, 1972. It operates under the full regulatory control and supervision of the Bangladesh Bank. *Example: All major commercial banks in Bangladesh, such as Agrani Bank, Janata Bank, and Islami Bank Bangladesh, are categorized as scheduled banks.*
- **Non-Scheduled Bank:** A bank established for a specific, definite purpose and operating under a special act, but which is not included in the Bangladesh Bank's list of scheduled banks. These institutions cannot perform all the functions of a scheduled bank. *Example: Grameen Bank, established for microcredit, is a prominent non-scheduled bank.*
- **Non-Performing Loan (NPL):** A loan that is in default because the borrower has not made the scheduled principal or interest payments for a specified period, typically 90 days. A high volume of NPLs poses a significant threat to a bank's profitability and financial health. *Example: If a garment factory fails to make its loan installment payments to its bank for three consecutive months, the loan may be reclassified as a non-performing loan.*
- **Financial Inclusion:** The process of ensuring that all individuals and businesses, regardless of income or social status, have access to a full range of affordable, high-quality financial services, including banking, payments, and credit. *Example: The expansion of agent banking networks and mobile financial services (MFS) into rural areas of Bangladesh is a key initiative to promote financial inclusion.*

Introduction

Banking occupies a pivotal position in the modern economic world, serving as a cornerstone for trade, industry, and overall economic development. While forms of banking have existed since ancient times, the modern banking system, as we know it, is a direct result of industrialization and the growing complexity of economic life. Its presence is indispensable for a country's economic activity and industrial progress. In a developing economy like Bangladesh, banks are more than just financial intermediaries; they are critical engines of growth, mobilizing domestic savings and channeling them into productive investments. However, the contemporary banking landscape is characterized by a dual reality: it is a dynamic sector undergoing rapid digital transformation while simultaneously grappling with systemic challenges, including issues of governance and a high volume of non-performing loans. Understanding the foundational concepts of banking is essential for navigating this complex and evolving environment.

Meaning and Definition of a Bank

A bank is a financial institution with a license to hold and lend money. Functionally, it can provide a wide range of services, including checking and savings accounts, credit cards, mortgages, auto loans, and various types of business financing. Banks also offer crucial non-lending services such as wire transfers, currency exchange, and wealth management. From a legal standpoint, the term 'bank business' is precisely defined in the

Bangladesh Banking Companies Act, 1991. According to Section 5(p) of the Act, "bank business" is defined as:

"... the act of accepting, for the purpose of lending or investment, deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise".

This legal definition is fundamental because it establishes the core activities that distinguish a licensed banking company from any other financial institution. A company cannot engage in these specific deposit-taking and withdrawal activities without obtaining a license from Bangladesh Bank, the nation's central bank. Furthermore, to be established in Bangladesh, a new commercial bank must be a public limited company with a minimum paid-up capital of not less than Taka 4 billion. This stringent legal framework and high capital requirement underscore the critical role and public trust that banks are expected to uphold.

Types of Banks

While the original guide broadly classified banks into commercial banks and central banks, the modern financial system in Bangladesh operates under a more granular and officially recognized classification. The central bank, Bangladesh Bank, primarily categorizes all other banks into two main types: Scheduled Banks and Non-Scheduled Banks. This structure reflects the regulatory and operational landscape of the country.

1. Scheduled Banks: These are the most common type of bank and are licensed under the Bank Company Act, 1991. They are under the full supervision and control of Bangladesh Bank and must comply with all its rules and regulations. As of the latest available information, there are 62 scheduled banks in Bangladesh, which are further divided into four categories:

- **State-Owned Commercial Banks (SOCBs):** These banks are either fully or majority-owned by the Government of Bangladesh. Examples include Sonali Bank PLC, Janata Bank PLC, and Agrani Bank PLC.
- **Specialized Banks (SDBs):** Also fully or majority-owned by the government, these banks were established with specific developmental objectives, such as promoting agricultural or industrial growth. Bangladesh Krishi Bank and Rajshahi Krishi Unnayan Bank are examples.
- **Private Commercial Banks (PCBs):** These are the largest group of banks, owned primarily by individuals or private entities. They can be conventional or based on Islamic Shariah principles. The banking sector is currently seeing a trend of mergers and amalgamations among some of these banks to consolidate and strengthen the industry.
- **Foreign Commercial Banks (FCBs):** These are branches of foreign banks operating in Bangladesh. They are licensed and supervised by Bangladesh Bank but are headquartered abroad. Examples include Standard Chartered Bank and HSBC Bank.

2. Non-Scheduled Banks: These banks are not included in the list of scheduled banks and are established for specific, limited objectives under separate acts. They cannot perform all the functions of a scheduled bank, such as receiving demand deposits or engaging in foreign exchange financing. Examples include Grameen Bank and Palli Sanchay Bank.

A significant and recent development is the emergence of a new category: **Digital Commercial Banks**. These banks are owned by private entities and operate with no physical branches, focusing entirely on digital services. This innovation reflects the growing importance of technology in the

financial sector and the central bank's initiative to drive financial inclusion. The classification of banks is not merely administrative; it reveals the central bank's strategy. For example, the existence of specialized banks highlights a historical emphasis on directed lending, while the introduction of digital banks and the push for mergers signify a modern regulatory focus on efficiency, consolidation, and technological advancement in a sector facing governance and asset quality issues.

Functions of Commercial Banks

Commercial banks perform a variety of functions that are fundamental to both their profitability and the overall health of the economy. These functions can be broadly divided into two categories: Primary Functions and Secondary Functions.

A. Primary Functions

These are the core activities that define a bank's business.

1. **Acceptance of Deposits:** This is the most crucial function of a bank, as it mobilizes the savings of the public and provides the funds necessary for a bank's lending and investment activities. Banks typically accept three types of deposits:
 - **Current Deposits:** These are also known as demand deposits and can be withdrawn at any time, typically via cheque. They are used by businesses for large and frequent transactions and usually do not earn interest.
 - **Savings Deposits:** Designed for professional and middle-class people to save small sums, these accounts have some restrictions on withdrawals but offer a modest rate of interest.
 - **Fixed Deposits:** These are time deposits that are held for a specific period, ranging from a few months to several years. They cannot be withdrawn before maturity without a penalty but offer a significantly higher rate of interest, especially for longer terms.
2. **Advancing Loans:** This is the primary source of income for a bank. By lending money at a higher interest rate than what they pay on deposits, banks generate profit. Loans are offered to individuals and businesses against various securities, such as personal assets, gold, or business inventory. The most common forms of lending are overdraft facilities, cash credit, and the discounting of bills of exchange.
3. **Creation of Credit:** A unique and powerful function of banks is their ability to expand the money supply through the process of lending. When a bank grants a loan, it does not typically disburse cash; rather, it credits the borrower's account, creating a new deposit. This newly created deposit can then be used, and a portion of it may be re-deposited into another bank, allowing for a further round of lending and credit creation. This process, known as the money multiplier, is a cornerstone of modern banking and will be discussed in detail in Lesson 3.

B. Secondary Functions

These functions, while not the core business of lending and deposit-taking, are vital for modern banking and can be divided into two sub-categories:

1. **Agency Services:** Banks act as agents on behalf of their customers, performing a variety of services for a fee. This includes the collection and payment of various credit instruments, such as cheques and bills of exchange; the purchase and sale of securities like shares and bonds; the collection of dividends and interest; and the execution of standing orders for periodic payments like utility bills and insurance premiums.
2. **General Utility Services:** Modern banks provide a wide array of services that have become increasingly important with the rise of technology.
 - **Locker Facility:** Provides customers with secure storage for valuables and important documents.

- **Traveler's Cheques and Credit Cards:** Allow customers to travel without carrying large amounts of cash.
- **Letters of Credit:** Certify a customer's creditworthiness, which is particularly useful in international trade.
- **Digital Financial Services (DFS):** The digital revolution has fundamentally reshaped the functions of banks. Commercial banks in Bangladesh have embraced technologies such as artificial intelligence, machine learning, and the Internet of Things to enhance customer experience. The expansion of internet banking and mobile financial services (MFS) has been particularly notable. As of December 2022, the number of internet banking customers had grown to over 6.2 million, while mobile banking subscribers exceeded 191 million. The total number of MFS agents and personal accounts was over 194 million as of January 2023. This growth has been a key driver of financial inclusion, especially in underbanked rural areas. Bangladesh Bank has also played a crucial role by spearheading the introduction of digital payment platforms such as Bangla QR and Binimoy.

C. Fulfillment of Socio-Economic Objectives

In addition to their commercial functions, banks, especially in developing countries, are expected to help achieve broader national goals. In Bangladesh, this includes supporting the government's National Financial Inclusion Strategy (NFIS) 2021–26, which aims to improve the access, usage, and quality of financial services for all citizens. Banks are encouraged to provide loans and advances to priority sectors such as agriculture, small and medium enterprises (SMEs), and self-employed individuals, often at concessional rates of interest. This strategic use of banking services helps reduce income inequality, alleviate poverty, and promote overall economic stability.

Summary Paragraphs

Banks are fundamental institutions in the modern economy, performing a dual role as both profit-driven enterprises and facilitators of national economic development. Their core business involves mobilizing savings through various deposit accounts and profitably deploying those funds through a diverse range of loans and advances. This primary function is complemented by a host of secondary services, which have been radically transformed by the advent of digital technology and an increasing focus on financial inclusion. The modern Bangladeshi bank is a key player in the government's economic strategy, leveraging technology to reach underserved populations and fulfilling socio-economic objectives alongside its commercial goals.

While banks are vital for lubricating the wheels of commerce, their efficiency and stability are heavily dependent on sound governance and a favorable economic environment. The Bangladeshi banking sector, despite its recent digital advances, faces significant headwinds from a high volume of non-performing loans and tight liquidity conditions. This complex interplay of commercial functions, national objectives, and systemic challenges forms the backdrop against which all banking activities must be understood.

Review Questions

1. What is the legal definition of a "banking business" according to the Bangladesh Banking Companies Act, 1991, and why is this definition important for both licensed and non-licensed entities?
2. Describe the current official classification of banks in Bangladesh, as maintained by the Bangladesh Bank. What are the key distinctions between Scheduled and Non-Scheduled banks?
3. How have recent trends in technology and digitalization reshaped the functions of commercial banks in Bangladesh, particularly in relation to financial inclusion?
4. Explain the key features and purpose of the new category of Digital Banks in Bangladesh's financial landscape.

Lesson 2: Sources of Bank's Income

After completion of this lesson you will be able to –

- Identify and explain the major sources of income for a commercial bank.
- Analyze the critical principles of a bank's investment policy, including liquidity, profitability, and safety.
- Describe the structure and components of a bank's balance sheet, distinguishing between its assets and liabilities.
- Understand the relationship between monetary policy and a bank's investment and profitability in the current economic climate.

Key Terms

- **Liquidity:** The ability of a bank to meet its short-term obligations, such as honoring withdrawals from depositors, without incurring significant loss. *Example: A bank holds a certain amount of cash and marketable government securities to ensure it can immediately satisfy customer demand for withdrawals.*
- **Profitability:** The ability of a bank to generate income in excess of its costs, ensuring its long-term viability and ability to pay dividends to shareholders and interest to depositors. *Example: A bank's net interest margin, calculated as the difference between interest earned on loans and interest paid on deposits, is a primary indicator of its profitability.*
- **Balance Sheet:** A financial statement that provides a snapshot of a bank's assets and liabilities at a specific point in time. It is a fundamental tool for assessing a bank's financial position and stability. *Example: A bank's balance sheet shows its deposits (a liability to its customers) and the loans it has granted (an asset to the bank).*
- **Advance-to-Deposit Ratio (ADR):** A key metric in banking that measures a bank's total loans and advances as a percentage of its total deposits. A higher ADR indicates a more aggressive lending posture but may also signal greater risk. *Example: An ADR of 80.4 percent means that a bank has lent out 80.4 taka for every 100 taka it has received in deposits, showing how much of the mobilized funds have been deployed for lending.*
- **Statutory Liquidity Ratio (SLR):** The percentage of a bank's total deposits that it is legally required to hold in specific liquid assets, such as cash, gold, and approved government securities. This is a regulatory tool used by the central bank to control liquidity in the banking system. *Example: The Statutory Liquidity Ratio for scheduled banks in Bangladesh was 13.000 percent as of April 2025.*

Introduction

Commercial banks are the cornerstone of any economy, facilitating transactions, providing credit, and managing the flow of money. To perform these functions, banks must operate as financially viable institutions. Their survival and growth depend on a steady stream of income generated from their activities. In Bangladesh, understanding a bank's sources of income and its investment policy has become particularly important in the context of recent economic challenges, including tight liquidity conditions and a high volume of non-performing loans. The balance sheet of a bank provides a mirror of these financial dynamics, revealing how it manages its assets and liabilities in a constantly shifting market environment.

Sources of a Bank's Income

Commercial banks earn income from several sources, which can be broadly categorized into interest-based and non-interest-based revenues. The profitability of a bank is a direct outcome of its ability to maximize these income streams while effectively managing its costs.

1. **Interest on Loans:** The primary and most significant source of a bank's income is the interest it earns on the loans and advances it provides to individuals and businesses. This includes interest from various types of lending, such as overdraft facilities, cash credits, and long-term loans. The differential between the interest rate the bank pays on deposits and the higher rate it charges on loans is known as the net interest margin, which forms the core of its profitability. In a high-interest-rate environment, the yields from these loans become even more crucial.
2. **Interest on Investments:** Banks are required to invest a portion of their funds in government and other approved securities to maintain their liquidity and safety. The interest and dividends received from these investments are a stable and important source of income.
3. **Discounts:** A bank earns income by discounting bills of exchange. It purchases a bill from a holder at a discounted price and then receives the full face value of the bill upon its maturity, with the difference constituting the bank's income.
4. **Commission, Brokerage, etc.:** Banks perform numerous services for their customers for which they charge a commission or fee. This includes collecting cheques, rents, and dividends; issuing bank drafts and letters of credit; and providing safe deposit box (locker) facilities. With the growth of digital financial services, fee-based income from electronic transfers, mobile banking transactions, and other digital platforms has become an increasingly significant component of a bank's revenue.

Investment Policy of Banks

A commercial bank, as a profit-seeking institution that deals with public funds, must carefully manage its assets to balance competing objectives. The allocation of its funds is governed by several guiding principles, which collectively form its investment policy. These principles are particularly relevant in Bangladesh's current economic climate, where the health of the banking sector is under intense scrutiny.

1. **Liquidity:** This is the paramount principle. A bank must always maintain sufficient liquid assets to honor the claims of its depositors on demand. If a bank fails to meet withdrawal requests, it can lead to a loss of public confidence and a run on the bank. While cash is the most liquid asset, it is not profitable. Therefore, banks must hold a minimum level of reserves, such as the **Statutory Liquidity Ratio (SLR)**. In Bangladesh, scheduled banks were required to maintain an SLR of 13.000 percent as of April 2025, which consists of cash, gold, or approved securities. This is a delicate balance, as holding too much cash reduces profitability.
2. **Profitability:** A bank, by its very nature, must earn a profit to cover its operational expenses, pay interest to depositors, and provide dividends to shareholders. The most profitable assets are loans and advances, but these are also the least liquid and carry the highest risk. Therefore, a bank's investment policy is a constant trade-off between the need for liquidity to meet obligations and the drive for profitability to ensure its survival.
3. **Safety or Security:** All loans and investments made by a bank must be secure to minimize the risk of loss. This is where the notorious issue of non-performing loans (NPLs) in Bangladesh comes into sharp focus. The principle of safety is fundamentally compromised when loans are not adequately secured or when borrowers can default without consequence. A recent analysis reveals that distressed assets, including defaulted, rescheduled, and written-off loans, have ballooned to nearly half of all outstanding loans in the banking system. This astronomical figure is a clear manifestation of systemic failures, which are further exacerbated by the presence of "willful defaulters" who can pay but refuse to do so. The legal and collateral systems in the country make loan recovery painfully slow, which undermines the principle of safety and erodes the value of assets. This widespread issue demonstrates that the theoretical principles of safety, liquidity, and profitability are not just abstract concepts but are deeply interconnected and, when one fails, it creates a cascade of instability across the entire financial system.

4. **Diversity:** The principle of diversity, often expressed as "not putting all eggs in one basket," dictates that a bank should spread its investments across various sectors and types of securities to mitigate risk. This includes diversifying its loan portfolio across different industries and its investments across government and private securities.

Balance Sheet of the Bank

A bank's balance sheet is a fundamental statement of its financial position at a specific time. It is structured into two main components: liabilities and assets. The balance sheet reflects the bank's investment policy, as its assets are typically listed in descending order of liquidity and ascending order of profitability.

Balance Sheet of a Bank

Liabilities		Asset	
1. Capital	a. Authorised Capital b. Issued Capital c. Subscribed Capital d. Paid-up-capital	1. Cash	a. Cash on hand b. Cash with the central bank and other banks
2. Reserve Fund		2. Money at call and Short Name	
3. Deposits		3. Bills Discounted	
4. Borrowings from Other Banks		4. Bills for Collection	
5. Bills Payable		5. Investments	
6. Acceptances and Endorsements		6. Loans and Advances	
7. Contingent Liabilities		7. Acceptances and Endorsements	
8. Profit and Loss Account		8. Fixed Assets	
9. Bills for Collection			

Export to Sheets

- **Liabilities:** These represent the sources of a bank's funds, which are its obligations to others. The most significant liability is **Deposits**, which are the funds entrusted to the bank by the public. Other liabilities include the bank's **Capital** and **Reserve Fund**, which belong to its shareholders, as well as **Borrowings from Other Banks** to meet liquidity needs.
- **Assets:** These represent the claims the bank has on others and are the uses of its funds. The assets are what the bank owns.
 - **Cash:** This is the most liquid asset, serving as the bank's "first line of defense" to meet immediate withdrawal demands. Cash held with the central bank is the "second line of defense".
 - **Money at Call and Short Notice:** These are short-term loans, typically for less than seven days, that can be recalled with minimal notice. They are highly liquid and a source of income.
 - **Bills Discounted and Investments:** These represent the bank's holdings of short-term bills and long-term government or corporate securities.
 - **Loans and Advances:** This is the most important item on the asset side. It represents the total amount of money the bank has lent out. While it is the most profitable asset, it is also the least liquid and most exposed to risk. The high **Advance-to-Deposit Ratio (ADR)**, which increased from 79 percent at the end of 2022 to 80.4 percent at the end of 2023, indicates that banks are aggressively deploying their deposits for lending, which puts immense pressure on asset quality.

Summary Paragraphs

A bank's financial health is a direct result of its ability to generate income while adhering to a sound investment policy. The primary source of income is the interest earned on loans and investments, while a growing portion of revenue comes from non-interest-based services. The principles of liquidity, profitability, and safety are the pillars of a bank's investment decisions, but in the Bangladeshi context, these principles are under severe strain. A high volume of non-performing loans, coupled with a challenging macroeconomic environment, poses a fundamental threat to the safety and profitability of the sector.

The balance sheet is the ultimate reflection of these dynamics. It reveals a constant tension between the need for liquidity to satisfy depositors and the drive for profitability through high-risk, high-return lending. The high Advance-to-Deposit Ratio underscores this tension, indicating that banks have been pursuing aggressive lending strategies. A comprehensive analysis of a bank's balance sheet, therefore, provides a complete picture of its operations, its strategic choices, and the risks it is exposed to.

Review Questions

1. Explain the three primary principles that govern a commercial bank's investment policy and discuss how a high volume of non-performing loans (NPLs) can compromise a bank's adherence to these principles.
2. Using the concept of the Advance-to-Deposit Ratio (ADR), explain the relationship between a bank's deposits and its lending activities.
3. What are the key items on the liabilities side of a commercial bank's balance sheet, and why are they considered liabilities?
4. Why are "Loans and Advances" considered the most profitable but also the least liquid of a bank's assets?

Lesson 3: Credit Creation of a Bank

After completion of this lesson you will be able to –

- Identify the basis of credit creation and distinguish between primary and derivative deposits.
- Illustrate the process of multiple credit expansion using a practical example.
- Analyze the theoretical and practical limitations on a bank's ability to create credit.
- Evaluate how the Bangladesh Bank's monetary policy directly influences the volume of credit in the economy.

Key Terms

- **Credit Creation:** The unique process by which commercial banks expand the money supply by lending out a portion of their deposits, thereby creating new deposits and increasing the total volume of money in circulation. *Example: When a bank sanctions a loan of Tk. 90,000 to a customer, it credits the customer's account, creating a new deposit that did not exist before.*
- **Credit Multiplier:** A measure of the maximum amount of money that a banking system can create from an initial new deposit, calculated as the inverse of the required reserve ratio. *Example: If the required Cash Reserve Ratio (CRR) is 10 percent, the credit multiplier is 10 (1/0.1), meaning the banking system can create up to 10 times the initial deposit in new credit.*
- **Monetary Policy:** The actions undertaken by a central bank, such as the Bangladesh Bank, to manage the size and growth rate of the money supply and interest rates to influence economic outcomes like inflation, employment, and growth. *Example: Raising the policy rate to make borrowing more expensive and thereby slow down economic activity and curb inflation.*
- **Policy Rate:** The interest rate at which the central bank lends money to commercial banks, serving as a benchmark for all other interest rates in the economy. *Example: The Bangladesh Bank's repo rate, which was 10.00 percent in February 2025, is a key policy rate.*
- **Cash Reserve Ratio (CRR):** The fraction of total demand and time liabilities that commercial banks are legally required to hold as reserves with the central bank, without earning interest. This is a primary tool for controlling the money supply and a direct limitation on credit creation. *Example: If the CRR is 4 percent, a bank must hold 4 taka for every 100 taka of deposits in a non-interest-earning account at the central bank.*

Introduction

An important and truly unique function performed by commercial banks is the creation of credit. Contrary to the common belief that banks are merely intermediaries that lend out the money they receive as deposits, they are, in fact, "manufacturers of money". This powerful ability to expand the money supply through lending activities makes banks a pivotal force in the economy. However, while the theoretical process of credit creation is straightforward, its application in the real world is heavily constrained by various factors, most notably the central bank's monetary policy and the structural health of the banking system itself.

Basis of Credit Creation

The foundation of credit creation lies in the dual nature of bank deposits, which are of two kinds:

1. **Primary Deposits:** These arise when a customer deposits cash or a cheque into their account. The bank's role here is passive, as the deposit is initiated by the customer. These deposits represent a simple conversion of currency into deposit money and do not, in themselves, increase the total money supply.
2. **Derivative Deposits:** These are deposits that arise when a bank grants a loan, discounts a bill, or purchases government securities. The bank plays an active role in their creation. When a bank approves a loan, it does not pay cash but simply credits the borrower's account with the sanctioned amount. This creates a new deposit that expands the money supply.

Process of Credit Creation

The process of credit creation is one of multiple expansion. A single primary deposit in one bank can lead to a multiple expansion of credit across the entire banking system. The extent of this expansion is determined by the credit multiplier, which is the inverse of the required reserve ratio. The process can be illustrated with the following example, assuming a required cash reserve ratio of 10 percent and an initial deposit of Tk. 1,000.

- **Step 1: Bank A**
 - A person deposits Tk. 1,000 cash in Bank A. The bank's liabilities increase by Tk. 1,000 (new deposit), and its assets increase by Tk. 1,000 (new cash).
 - Bank A must keep 10 percent (Tk. 100) as a cash reserve and can lend out the remaining Tk. 900. It lends this amount to a borrower, X.
- **Step 2: Bank B**
 - Borrower X uses the Tk. 900 loan to pay a creditor, Y. Y deposits this Tk. 900 in Bank B.
 - Bank B now has a new deposit of Tk. 900. It keeps 10 percent (Tk. 90) as a reserve and lends out the remaining Tk. 810 to a new borrower, Z.
- **Step 3: Bank C**
 - Borrower Z uses the Tk. 810 loan to pay a creditor, S. S deposits this Tk. 810 in Bank C.
 - Bank C keeps 10 percent (Tk. 81) as a reserve and lends out the remaining Tk. 729.

This process continues until the original deposit is fully absorbed by the reserve requirements. The total amount of credit created in the banking system can be calculated using the credit multiplier formula, where K is the credit multiplier and r is the required reserve ratio:

$$K=1/r$$

In the above example, with a reserve ratio of 10 percent or 0.1, the credit multiplier is $K=1/0.1=10$. This means the initial Tk. 1,000 deposit could theoretically lead to a maximum of Tk. 10,000 in credit creation. The size of the credit multiplier is inversely related to the reserve ratio; a higher ratio reduces the amount of credit that can be created.

Leaf and Cannon Criticism

Walter Leaf and Edwin Cannon objected to the theory of credit creation, arguing that a commercial bank could not lend more than what it received as cash from deposits. However, this view is considered incorrect. While a single bank may not be able to create an unlimited amount of credit, the banking system as a whole can, as demonstrated by the multiplier process. The fact that the total net deposits of commercial banks are significantly in excess of their cash reserves is a clear indication of their ability to create credit.

Limitation on Credit Creation

While the mechanics of credit creation are powerful, a bank's ability to create credit is not unlimited. In a real-world scenario like Bangladesh, this power is constrained by a complex interplay of internal and external factors. The theoretical model of credit expansion assumes a smooth flow of funds with no "leakages," but in reality, several factors interrupt this process, leading to a much smaller credit multiplier effect.

1. **Amount of Cash & Cash Reserve Ratio (CRR):** The volume of credit that banks can create is directly dependent on the amount of cash they receive and the **Cash Reserve Ratio (CRR)** set by the central bank. By increasing the CRR, the Bangladesh Bank can directly reduce the amount of excess reserves available for lending, thereby contracting the volume of credit in the economy. The CRR for general banks in Bangladesh was last set at 4 percent, though the most recent official circular is not available.

2. **Monetary Policy of the Central Bank:** The most powerful limitation on credit creation is the central bank's monetary policy. The Bangladesh Bank has adopted a "cautiously tight monetary policy stance" to combat persistent high domestic inflation. This strategy directly influences the volume and cost of credit.
 - **Policy Rate Hikes:** The central bank has been consistently raising its policy interest rates to make borrowing more expensive, thereby slowing down private sector credit growth. In FY24, policy interest rates were hiked by a total of 200 basis points.
 - **Market-Oriented Tools:** The Bangladesh Bank has introduced a new framework that includes adopting more market-oriented tools. It has, for example, discontinued the SMART-based interest rate capping, allowing market forces to play a greater role in determining interest rates.
 - **Exchange Rate Management:** To stabilize the foreign exchange market, the central bank introduced a crawling peg system in May 2024, which allows the exchange rate to fluctuate within specified limits. This action is part of a broader strategy to maintain financial stability, which is a prerequisite for healthy credit creation.
3. **Nature of Business Conditions and Leakages:** Credit creation depends on a strong demand for loans from creditworthy borrowers. The process also relies on the funds flowing back into the banking system as new deposits. However, in Bangladesh, this flow is disrupted by several factors.
 - **Lack of Demand:** During periods of economic uncertainty, such as the current climate of high inflation and tight liquidity, businesses may be hesitant to take on new debt, which reduces the demand for loans and limits credit creation.
 - **High NPLs:** The high volume of non-performing loans (NPLs) is a major "leakage" in the credit creation process. These funds are not being repaid or recirculated, effectively "clogging the pipes" of the financial system. The existence of fraudulent activities and a lack of good governance within the banking sector further undermines confidence and makes banks more risk-averse, regardless of their liquidity position.
4. **Sound Securities and Legal Framework:** A bank's ability to create credit is fundamentally tied to its confidence in the securities and collateral offered by borrowers. In Bangladesh, the legal system for loan recovery can be "painfully slow," often taking years to resolve disputes and foreclose on collateral. This weak legal framework reduces the value of a bank's claims on defaulting borrowers, making banks reluctant to lend, regardless of their available reserves. This reveals a critical connection between the legal system and a bank's operational capacity.

The ability of a bank to create credit is therefore subject to the convergence of a deliberate, contractionary central bank policy designed to fight inflation and the systemic breakdown of internal controls and the legal framework. This combination creates a dual limitation that goes far beyond the simple theoretical reserve ratio, profoundly impacting the volume of credit available for the economy.

Summary Paragraphs

Credit creation is the cornerstone of modern banking, allowing commercial banks to expand the money supply through the multiplier effect. This process, which turns a single deposit into a multiple volume of credit, is essential for lubricating the wheels of business and facilitating economic growth. However, in practice, the ideal model is heavily limited by factors that introduce "leakages" into the system.

In Bangladesh, the ability of banks to create credit is tightly controlled by the Bangladesh Bank's monetary policy, which has pursued a cautious and contractionary stance to combat inflation. Beyond these external controls, the process is also fundamentally limited by internal systemic issues, such as a high volume of non-performing loans, poor governance, and a weak legal

framework for loan recovery. These combined factors create a challenging environment where banks must navigate the tension between their role as creators of credit and their responsibility to manage risk and maintain stability.

Review Questions

1. Explain the concept of the credit multiplier. Using a hypothetical example, demonstrate how an increase in the Cash Reserve Ratio (CRR) would affect the total amount of credit created in the banking system.
2. How has the Bangladesh Bank's recent shift to a "cautiously tight monetary policy stance" and policy rate hikes served as a limitation on credit creation?
3. Beyond monetary policy, what other key factors limit the credit creation process in Bangladesh? Discuss the roles of NPLs and the legal framework for loan recovery.
4. Why is the distinction between primary and derivative deposits fundamental to understanding the credit creation process?

Commercial Banking in Bangladesh

2

Unit Highlights

- Lesson 1: Origin of Banking in Bangladesh
- Lesson 2: Capital Structure

Technologies Used for Content Delivery

- ❖ BOUTUBE
- ❖ BOU LMS
- ❖ WebTV
- ❖ Web Radio
- ❖ Mobile Technology with MicroSD Card
- ❖ LP+ Office 365
- ❖ BTV Program
- ❖ Bangladesh Betar Program

Lesson 1: Origin of Banking in Bangladesh

After completion of this lesson you will be able to –

- Trace the historical evolution of banking in Bangladesh from its pre-colonial roots through the period of nationalization and subsequent privatization.
- Differentiate between the various types of commercial banks operating in the country and describe their roles within the financial system.
- Analyze the long-term trends in financial asset growth and financial deepening, and explain their significance for the national economy.
- Evaluate the role of modern technologies like Mobile Financial Services (MFS) and agent banking in expanding financial inclusion across the country.

Key Terms

Scheduled Bank: A bank whose name has been declared a scheduled bank by Bangladesh Bank in accordance with Article 37 of the Bangladesh Bank Order, 1972. Such banks are subject to the regulations and directives of the central bank, which includes maintaining a cash reserve ratio (CRR) and statutory liquidity ratio (SLR).

Nationalised Commercial Bank (NCB): A commercial bank that is majority-owned and controlled by the government of Bangladesh. For example, Sonali Bank PLC, Janata Bank, and Agrani Bank are prominent NCBs.

Private Commercial Bank (PCB): A commercial bank established and operated by the private sector, either domestically or through a joint venture. An example is The City Bank Ltd., a first-generation private bank that has operated for over 39 years.

Financial Deepening: The process by which the size of the financial sector and its contribution to the overall economy increase over time. It is often measured by the ratio of broad money (M2) to Gross Domestic Product (GDP). A progressively increasing ratio signifies a growing role for the formal financial sector in financing economic activities.

Broad Money (M2): A comprehensive measure of the money supply that includes all components of M1 (currency and demand deposits) plus quasi-money, which consists of time and savings deposits held by the public in commercial banks.

Historical Development of Banks in Bangladesh

The banking history of Bangladesh is intricately linked with that of the Indian subcontinent. The initial forms of banking can be traced to ancient practices, with early references found in the Vedic age and the writings of Manu. During the Muslim rule, particularly from the 14th century, money lending was undertaken by foreign traders, such as the *kabuliawalla*. The Mughal period saw the rise of wealthy families, concentrated in key commercial centers like Dhaka and Murshidabad, who served as a form of private bankers.

The arrival of the British and the subsequent British occupation of Bengal in 1757 marked a turning point. English-style agency houses were established in Kolkata, laying the groundwork for modern commercial banks. Early European-style banks such as Hindustan Bank and Bengal Bank emerged. By the time of the partition of British India in 1947, banking had proliferated, with approximately 668 banks operating in Bengal alone, holding total deposits of 4.47 crores. The territory that would become Bangladesh housed 21 scheduled banks, which were predominantly owned and managed by non-Muslims. However, the partition triggered a mass exodus of these owners and staff, causing many of these institutions to collapse.

The vacuum left by the departing non-Muslims was quickly filled by non-Bengali, West Pakistani entrepreneurs. Prominent institutions like Habib Bank Ltd. and Muslim Commercial Bank Ltd. were established, and the government of Pakistan created the National Bank of Pakistan to finance the crucial jute and cotton trades. A significant development in the early 1960s was the

establishment of the first East Pakistan-based banks, Eastern Mercantile Bank Ltd. and Eastern Banking Corporation. These institutions played a pivotal role by providing financial support to the non-cooperation movement leading up to the Liberation War. They were the forerunners of present-day Pubali Bank Ltd. and Uttara Bank Ltd.

In the period leading up to 1971, West Pakistani business groups, including the so-called "twenty-two families," leveraged their control over the banking system to serve their own interests. This practice exacerbated economic disparity between the two wings of Pakistan and fueled the discontent that culminated in Bangladesh's independence. This history of financial exploitation deeply influenced the country's early economic policy. The new leadership viewed banking as an instrument of exploitation and consequently moved to nationalize the sector immediately after liberation. The twelve banks that were operational before independence were merged into six nationalized banks, given new Bengali names such as Sonali, Janata, and Agrani.

Bangladesh's New Banking System

The birth of Bangladesh's new banking system began with the promulgation of the Bangladesh Banks Nationalisation Order, 1972, and the Bangladesh Bank Order, 1972. For nearly a decade, the six newly created nationalized banks held a monopoly over financial intermediation. However, a significant policy shift in the early 1980s opened the door for private sector participation. The government initiated a process of denationalization, reverting Pubali and Uttara banks to private ownership. This was followed by the establishment of the first private commercial bank, Arab Bangladesh Bank Ltd. in 1981-82, on a joint venture basis. This marked the beginning of a new era of private sector dominance in banking.

The banking sector's transformation accelerated with successive rounds of bank licensing, creating distinct "generations" of commercial banks. This expansion, however, was not without its challenges. The process of granting licenses was often influenced by political patronage, which in some cases led to persistent issues like insider lending and a concentration of ownership and control. The proliferation of these private banks has created a highly competitive environment, where many institutions with overlapping ownership are vying for a limited pool of high-quality corporate borrowers. This has intensified the risk of poor lending practices and contributed to a cycle of bad loans.

Number and Types of Banks

The financial sector has undergone a dramatic transformation in both its size and diversity. The sector began with only six nationalized commercial banks (NCBs) and a few foreign bank branches in 1972. The number of banks had grown to 49 by mid-2007. By the end of 2023, the number of banks in operation had further increased to 61.

The current banking landscape is composed of distinct categories of institutions, each with a unique role in the economy:

- **Nationalized Commercial Banks (SOCBs):** 6
- **Development Finance Institutions (DFIs):** 3
- **Private Commercial Banks (PCBs):** 43
- **Foreign Commercial Banks (FCBs):** 9

This expansion is also reflected in the physical network. The number of bank branches has grown from 6,402 at the end of fiscal year (FY) 2006-07 to 11,301 by December 2023. The growing share of private banks' assets, which escalated from a negligible amount to nearly 48% of the total industry assets by 2007, marked a significant shift in the financial landscape, with the NCBs' share declining to 37%.

A snapshot of the Bangladeshi banking sector as of December 2023 reveals the following composition:

Bank Type	Number of Banks	Number of Branches
Nationalized Commercial Banks (SOCBs)	6	3,836
Development Finance Institutions (DFIs)	3	1,523
Private Commercial Banks (PCBs)	43	5,666
Foreign Commercial Banks (FCBs)	9	63
Total	61	11,088

Export to Sheets

Note: Data from the end of 2022 and 2023 reflects a dynamic sector with slightly varying numbers depending on the reporting period.

The Growth of Financial Assets

Since independence, the growth of financial assets in Bangladesh has been phenomenal, mirroring the country's overall economic expansion. The volume of deposits in the banking sector has increased from 913.2 crore Taka in June 1974 to a staggering Tk. 1.97 lakh crore by the end of June 2007. This trend has continued unabated, with total deposits reaching approximately Tk. 18.78 lakh crore by June 2025.

Similarly, the level of bank credit has grown from a meager 905 crore Taka in June 1974 to nearly Tk. 1.65 lakh crore by the end of June 2007. The latest data shows that bank credit (advances) has surged to Tk. 17.36 lakh crore by June 2025. This represents a remarkable roughly 10.5-fold increase in bank credit and a 9.5-fold increase in deposits over an 18-year period. This exponential growth underscores a fundamental economic shift from a predominantly cash-based system to a more formalized, credit-driven economy, which is a prerequisite for sustained development.

Financial Deepening

Financial deepening is a critical indicator of economic development, reflecting the extent to which a country's financial system serves its economy. The original text presented a flawed analysis, claiming the Broad Money (M2) to GDP ratio plummeted from 9.97 to 2.50, which is a conceptual error and likely a miscalculation of a different metric.

In reality, financial deepening in Bangladesh has followed a positive and progressive trajectory. The M2-GDP ratio, a widely accepted metric for financial deepening, has consistently increased, signifying a larger share of the economy's financial activity being intermediated through formal channels. A calculation based on recent data reveals the true extent of this transformation. With an M2 of 21.746 trillion BDT as of June 2025 and a nominal GDP of approximately 50.027 trillion BDT in 2024, the M2-GDP ratio stands at roughly 43.47%. This significant increase from a much lower historical base demonstrates a profound structural change where money and banking play an increasingly central role in financing the production of goods and services, paving the way for further economic expansion.

Retail Banking in Bangladesh

While corporate banking is gaining ground, retail banking remains the cornerstone of the banking business in Bangladesh. This focus provides banks with a broad, stable resource base, making them less vulnerable to the cyclical swings of the economy. Retail banking also serves as a crucial springboard for expanding business opportunities and diversifying risk across a large number of clients.

The landscape of retail banking is evolving beyond the traditional brick-and-mortar branch network. While the physical branch count has increased significantly, reaching over 11,000 branches by 2023, a more profound shift is occurring through digital channels. The physical network has also become more evenly distributed, with a near-equal number of urban and rural branches (5,822 urban versus 5,400 rural in October 2023), reflecting a policy push from Bangladesh Bank to mandate rural branch expansion.

However, the rapid growth of Mobile Financial Services (MFS) is arguably the most transformative development. With over 210 million MFS accounts in the country as of December 2023, these services are playing a pivotal role in reaching the unbanked and underbanked population, a demographic that the traditional banking network has historically struggled to serve. MFS is also helping to narrow the gender gap in financial inclusion, with the share of female MFS accounts at 42%, a much more balanced figure compared to the 32.36% of female-owned traditional bank accounts. This highlights a move beyond physical infrastructure toward a more accessible, technology-driven model that can overcome the challenges of high administrative costs and limited reach that previously hindered financial inclusion.

Summary

The first lesson has traced the evolution of Bangladesh's banking sector from its origins in the pre-partition era to its current state. The sector has moved from a period of foreign and private control, through state-led nationalization, to a modern, diversified landscape dominated by private commercial banks. This journey has seen a dramatic expansion in the number of banks, an increase in the branch network, and an exponential growth in both deposits and credit, all of which are key indicators of a maturing financial system.

The most recent data highlights a significant shift towards greater financial inclusion, driven not only by a physically expanding branch network but also by the rise of mobile financial services. This digital transformation is effectively reaching the large unbanked population and is helping to close the gender gap in account ownership. The rapid increase in financial assets and the M2-to-GDP ratio are a clear testament to the deepening role of the banking sector in the country's economic life, moving the economy away from a cash-based system and into a more formalized financial structure.

Review Questions

1. How did the historical events of 1947 and 1971 shape the structure of the banking sector in Bangladesh?
2. Describe the current composition of the Bangladeshi banking sector in terms of the number and types of banks. How does this compare to the structure of the sector in the post-liberation period?
3. Explain the concept of financial deepening and use recent data to demonstrate its growth in Bangladesh. Why is this an important indicator for the country's economic development?
4. Discuss the role of both traditional branch expansion and modern digital services like MFS in advancing financial inclusion in Bangladesh. What is the significance of the shift in the rural-urban branch ratio?

Lesson 2: Capital Structure

After completion of this lesson you will be able to –

- Explain the role of capital adequacy and the Basel III framework in maintaining the stability of the banking sector.
- Describe the contemporary challenges facing the banking system, including the capital shortfall and the high level of non-performing loans (NPLs).
- Analyze the key features of the new loan classification policies under BRPD Circular No. 15 of 2024.
- Evaluate the asset structure of commercial banks and discuss the persistent issues related to agricultural credit.

Key Terms

Capital Adequacy Ratio (CAR) / Capital to Risk-weighted Assets Ratio (CRAR): A measure of a bank's capital in relation to its risk-weighted assets. It is a key metric used to assess a bank's ability to absorb unexpected losses and maintain solvency.

Risk-Weighted Assets (RWA): The total of a bank's assets that have been weighted according to their risk profile. For instance, a loan to a government with no risk of default carries a zero risk weight, whereas a defaulted loan carries a 100% risk weight.

Non-Performing Loan (NPL): A loan that is in default or is overdue for a specified period. These loans pose a direct threat to a bank's profitability and capital base.

Provisioning: The process by which a bank sets aside a specific amount of money from its profits to cover potential losses from loans that are likely to default. Provisioning levels are determined by the classification of the loan.

Capital Structure

Capital structure is a cornerstone of bank stability and a central focus of regulatory policy. Since 1994, Bangladesh has moved to align its capital adequacy framework with international standards, first adopting the recommendations of the Basel Committee on Banking Supervision. This framework was recently updated to fully align with Basel III, which introduced a more stringent and comprehensive capital requirement. The modern regulatory requirement for banks in Bangladesh is a Capital to Risk-weighted Asset Ratio (CRAR) of not less than 12.50%, which includes a capital conservation buffer. This updated framework enhances the quality and quantity of regulatory capital to ensure banks are resilient to financial shocks.

The implementation of these robust standards has, however, coincided with severe challenges to the sector's financial health. A significant capital shortfall of Tk. 1.71 lakh crore (approximately 15.5 billion USD) was reported as of late 2024, with the CRAR for the entire banking sector plummeting to a critical 3.08%, a figure far below the regulatory requirement. This crisis is primarily attributed to a massive volume of classified loans, which stood at an official NPL ratio of about 20% in December 2024, although the true figure is likely much higher when rescheduled and written-off loans are considered.

The origins of this capital crisis can be traced to long-standing governance failures, including political and board-level interference in lending decisions that have allowed influential defaulters to evade accountability. This erosion of capital is further compounded by the practice of some banks paying out dividends to shareholders despite poor financial performance. In an attempt to manage this crisis and avoid a systemic collapse, Bangladesh Bank has resorted to controversial measures, such as offering a "deferral facility" to 28 banks, allowing them to postpone the recognition of their capital shortfalls. While this buys time, it also risks obscuring the true state of bank balance sheets, raising questions about the long-term effectiveness of regulatory oversight.

The persistent issues of a capital shortfall and high non-performing loans represent a critical challenge that undermines the stability and credibility of Bangladesh's banking sector in the eyes of foreign correspondents and investors.

Loan Classification Policies

To address the issue of asset quality, Bangladesh Bank has introduced a new, forward-looking loan classification system. In a significant regulatory overhaul, BRPD Circular No. 15 of 2024 was issued, aligning the country's practices with international standards, specifically the IFRS 9 Expected Credit Loss (ECL) methodology.

This new framework is a transformative departure from the previous age-old system that was primarily based on the length of overdues. The new system introduces a granular classification framework with seven distinct stages that allow for more proactive risk management. The stages and their corresponding provisioning requirements are as follows :

Classification Stage	Description	Provisioning Requirement
STD-0, STD-1, STD-2	Standard Loans	1% (General Provision)
SMA	Special Mention Account	5% (Specific Provision)
SS	Substandard Loan	20% (Specific Provision)
DF	Doubtful Loan	50% (Specific Provision)
B/L	Bad/Loss Loan	100% (Specific Provision)

Export to Sheets

This new circular also mandates enhanced accountability and transparency. Banks are now required to justify their classification decisions in writing to minimize ambiguity and manipulation. While the circular is a positive step toward global best practices, its ultimate success hinges on strict enforcement, particularly given the recent capital deferral facilities granted to some banks. Additionally, the new, stricter provisioning for CMSME loans could potentially impact banks' willingness to lend to this vital sector, creating a new challenge for the industry.

Effects of the Reforms

The financial sector reforms initiated since the 1990s have aimed to create a level playing field for market forces and to restore financial discipline. The move towards market-determined interest rates in 1990 was a key step in this direction, allowing banks to set rates based on risk and competition, a shift that continues to be refined by Bangladesh Bank's monetary policy decisions. However, despite these policy reforms, the sector continues to be plagued by "serious malaises," including a high incidence of defaulted loans, insider lending, and a concentration of ownership among a few powerful individuals. The current capital shortfall and high NPLs are a stark reminder that while the regulatory framework has evolved, deep-seated issues of corporate governance and political influence remain a central impediment to a healthy and stable banking system. The ability of the new loan classification framework to genuinely address these long-term issues remains to be seen.

What Do the Banks Do?

Commercial banks in Bangladesh, operating as public limited or joint-stock companies, form a key component of the country's money market. They perform a wide range of functions, mirroring those of banks in other countries. Their primary activities include accepting deposits from the public through various account types (current, savings, and fixed deposits) and lending money through short- and long-term advances.

In addition to these core functions, banks in Bangladesh provide a variety of agency and general utility services. These include:

- Collection of checks and bills on behalf of customers.

- Handling of foreign exchange transactions.
- Arranging for the transfer of funds.
- Issuing guarantees and indemnity bonds.
- Providing safe deposit boxes for valuables.

In the modern era, these functions have been augmented by a suite of digital services, including Mobile Financial Services (MFS), internet banking, and agent banking, which have expanded the reach and efficiency of banking services.

Banking Network in Bangladesh

The banking network in Bangladesh operates on the principle of branch banking, with a recent and significant shift in its geographical spread. Contrary to an outdated assessment, the central bank's policy of promoting rural banking has been successful, leading to a notable expansion of branches into non-urban areas.

The latest data shows that the total number of bank branches reached 11,222 by October 2023, with a nearly even distribution between urban and rural locations: 5,822 branches in urban areas and 5,400 in rural areas. This stands in direct contrast to the historical trend of banks "scampering back" to commercial centers. This shift is a direct result of Bangladesh Bank's guideline that requires 50% of all new branches opened in a calendar year to be in rural areas, an effort to promote financial inclusion in underserved communities. While this policy has successfully created a physical presence, the challenge remains for these branches to fully participate in rural credit and capital formation, as evidenced by the continued neglect of the agricultural sector.

Assets Structure of Banks

The asset structure of a typical commercial bank in Bangladesh is dominated by loans and advances. Historically, these loans constituted about 65% of a bank's total assets, a concentration that signals vulnerability due to the inherent risk of credit.

A persistent and concerning aspect of this asset structure is the low level of credit allocated to the agricultural sector, which accounts for a significant portion of the country's GDP and employment. Although the agricultural sector contributes substantially to the economy, it remains largely neglected by the banking system. The total amount of agricultural credit is a small fraction of the aggregate bank credits. The agricultural credit disbursement target for FY25, set at 38,000 crore BDT, represents a marginal portion of the total bank credit of approximately Tk 17.36 lakh crore.

This highlights a critical market failure where a key economic pillar remains heavily reliant on non-institutional sources, such as village money lenders and friends, who often charge exorbitant interest rates. Despite central bank initiatives, the private sector banks have largely distanced themselves from agricultural lending due to perceived high risks, high administrative costs, and their preference for more profitable urban clientele. While the banking network has expanded physically into rural areas, this presence has not yet translated into significant formal credit intermediation for the rural economy.

Summary

This lesson has provided an in-depth look into the operational and regulatory facets of commercial banking in Bangladesh. It has shown that while the banking sector has adopted modern frameworks like Basel III and has implemented new, internationally-aligned loan classification policies, it continues to grapple with fundamental challenges. The severe capital shortfall and a high volume of non-performing loans are not merely technical issues but are symptomatic of deeper, persistent problems related to corporate governance and insider influence.

The analysis of the banking network and asset structure reveals a paradox. On one hand, the physical and digital reach of the banking sector has expanded dramatically, successfully bringing a greater proportion of the population into the formal financial system. On the other hand, a critical

imbalance persists in the allocation of credit, with the vital agricultural sector remaining significantly underserved by formal financial institutions. These challenges underscore a complex and dynamic environment where regulatory progress and market expansion exist alongside entrenched systemic vulnerabilities.

Review Questions

1. Explain the difference between the capital adequacy requirements under the old system and the new Basel III framework. What does the current CRAR of the banking sector indicate about its health?
2. Describe the capital crisis facing the banking sector in Bangladesh. What are the main drivers of this crisis, and how has the central bank responded?
3. Outline the key features of the new loan classification framework introduced in BRPD Circular No. 15 of 2024. How is this framework an improvement over the previous system?
4. Examine the asset structure of banks in Bangladesh, focusing on the issue of agricultural credit. Why does the agricultural sector remain underserved by formal banking institutions despite the expansion of the rural branch network?

Unit Highlights

- Lesson 1: Central Banking
- Lesson 2: Credit Control
- Lesson 3: Central Bank in Bangladesh

Technologies Used for Content Delivery

- ❖ BOUTUBE
- ❖ BOU LMS
- ❖ WebTV
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- ❖ BTV Program
- ❖ Bangladesh Betar Program

This unit provides a foundational overview of central banking, credit control, and the role of Bangladesh Bank. From the perspective of a commercial banking expert with a deep understanding of the nation's financial landscape, a comprehensive revision is necessary to elevate the content to an expert-level, up-to-date, and insightful academic resource. This report will maintain the original structure while incorporating contemporary data, explaining recent policy shifts, and providing a nuanced analysis of the critical relationship between the central bank and the wider economic and political environment.

Lesson 1: Central Banking

After completion of this lesson you will be able to –

- Define the central bank and explain its unique position as the 'apex institution' of a country's financial system.
- Describe the primary objectives and core functions of a modern central bank.
- Distinguish the central bank's roles as a banker to the government and a banker to commercial banks.
- Understand the critical function of the central bank as the controller of currency and credit.
- Analyze the evolving role of a central bank in a developing economy like Bangladesh.

Key Terms

- **Central Bank:** The 'apex institution' of a country's monetary and banking structure, responsible for managing monetary policy, regulating the banking system, and issuing currency. For example, Bangladesh Bank is the central bank of Bangladesh.
- **Monetary Policy:** The set of actions undertaken by a central bank to influence the availability and cost of money and credit to help promote national economic goals. For example, adjusting interest rates to control inflation is a key aspect of monetary policy.
- **Banker to the Government:** A function where the central bank manages the government's accounts, provides temporary loans, and acts as its financial advisor and agent. An example is managing public debt by floating government bonds.
- **Lender of Last Resort:** The central bank's role in providing liquidity to commercial banks facing temporary solvency issues or a banking crisis, thus preventing systemic collapse. For instance, during a bank run, the central bank provides emergency loans to a solvent but illiquid bank.
- **Legal Tender:** Currency that, by law, must be accepted as a means of payment for all debts, public and private. For example, the Taka banknotes issued by Bangladesh Bank are legal tender.
- **Exchange Reserves:** A country's reserves of foreign currencies, gold, and other international financial assets held by its central bank to manage the value of its currency and meet international obligations. For example, Bangladesh Bank holds its foreign exchange reserves in key currencies like the US dollar and British pound.

Introduction

A central bank is more than a mere financial institution; it is the cornerstone of a nation's economic and monetary framework. As the 'apex institution', it holds a unique position, performing a delicate balance of supervisory, regulatory, and developmental functions. Its primary mandate is to ensure the stability of the currency and the financial system. In developing economies, this mandate is expanded to include a crucial role in fostering economic growth. This dual role is particularly pronounced in a country like Bangladesh, where the central bank's policies directly influence the nation's journey toward prosperity and stability.

Meaning and Definition of Central Bank

A central bank is a financial institution that manages a country's monetary policy and regulates its banking system. It possesses exclusive control over the issuance of currency and credit, and while often described as politically independent, it operates under a legal framework that grants it special privileges. The functions of a central bank are its most defining characteristics, as highlighted by various scholars. According to Vera Smith, central banking is a system where a single bank has a monopoly on note issue. Kisch and Elkin emphasize the maintenance of monetary standard stability

as the essential function. However, the most comprehensive definition comes from De Kock, who identifies seven core functions that constitute the apex role of a central bank, including currency regulation, acting as a banker to the state, and controlling credit in the national economic interest.

Functions of the Central Bank

The central bank's functions, as outlined in the provided guide, are universal yet adapted to each country's specific economic context.

1. **Monopoly of Note Issue:** The exclusive right to issue currency notes is a defining feature of a central bank, ensuring uniformity and public confidence in the currency. This function also allows the central bank to control the total money supply in the economy. In Bangladesh, this monopoly extends to all denominations except for one, two, and five taka notes and coins, which are the responsibility of the Ministry of Finance.
2. **Custodian of Exchange Reserves:** The central bank holds all foreign exchange reserves—such as key currencies like the US dollar and British pound, as well as gold stock—to maintain the country's international liquidity and manage the external value of its currency. This is a particularly sensitive function in a globalized economy. As of late 2025, Bangladesh's foreign exchange reserves stood at \$31.43 billion. However, it is crucial to understand that this figure is based on a local calculation. The International Monetary Fund (IMF) uses a different methodology (BPM6), which excludes non-liquid assets, resulting in a lower figure of \$26.45 billion. This discrepancy is not a simple contradiction but a significant reflection of a critical policy and governance issue. The central bank's public-facing numbers often differ from the international standard, a distinction that is vital for a country's perceived financial health and its ability to secure international loans and trade credit. It underscores that the central bank's role as a custodian is not just about holding funds but also about transparently reporting them in a manner that aligns with global standards.
3. **Banker to the Government:** The central bank acts as the government's banker, agent, and financial advisor, managing government accounts, making and receiving payments on its behalf, and floating public loans. The central bank also provides short-term advances, known as ways and means advances, to the government to bridge temporary cash flow gaps between revenue receipts and expenditures. As of mid-2025, government borrowing from the banking system slowed significantly, dropping by 77 percent compared to the previous year. While this is primarily attributed to a cautious interim government and a historic slowdown in development spending, it highlights a crucial relationship between the central bank and the government. A central bank's ability to manage government borrowing through a structured framework is a key indicator of its operational independence, preventing the monetization of fiscal deficits that can lead to rampant inflation.
4. **Banker to Commercial Banks:** The central bank serves as the bankers' bank in three different capacities: it acts as the custodian of the cash reserves of commercial banks, serves as the lender of the last resort, and functions as a clearing agent. These roles centralize liquidity, provide a safety net for the banking system during times of crisis, and facilitate efficient inter-bank settlements, thereby strengthening the entire financial system and promoting confidence.
5. **Controller of Credit:** This is arguably the central bank's most important function in modern times, as bank credit has become the dominant source of money in the economy. By regulating the volume and direction of credit, the central bank can influence economic activity, combat inflationary or deflationary pressures, and ensure the stability of the financial system. The specific tools and mechanisms used for credit control are discussed in detail in Lesson 2.
6. **Promoter of Economic Development:** In developing economies like Bangladesh, the central bank plays a proactive role beyond its traditional functions. This includes developing long-term financial institutions, fostering money and capital markets, and promoting key sectors such as agriculture, industry, and foreign trade. Bangladesh Bank has historically been viewed as a

"surrogate mother" for the country's economic sectors, providing substantial financial and organizational assistance.

Summary

A central bank is the linchpin of a nation's financial system, wielding immense power to maintain monetary stability and foster economic growth. Its functions—from issuing currency to acting as the government's banker—are interconnected and critical. In a developing nation like Bangladesh, its role is particularly expansive, encompassing both traditional regulatory duties and a proactive, developmental mandate. Understanding the nuances of its operations, including the distinction in foreign reserve reporting and its relationship with government fiscal policy, is essential for a complete grasp of its influence.

Review Questions

1. Explain the concept of a central bank as an 'apex institution' and how its functions differentiate it from a commercial bank.
2. Discuss the dual role of the central bank as a banker to both the government and commercial banks.
3. What is the significance of the central bank being the 'custodian of exchange reserves'? How does the use of different methodologies (e.g., IMF BPM6) impact a country's financial reporting?
4. Describe the developmental functions of a central bank and explain why this role is particularly important in a developing economy like Bangladesh.
5. How do the government's borrowing practices influence the central bank's ability to manage its functions?

Lesson 2: Credit Control

After completion of this lesson you will be able to –

- Define credit control and explain its role as the central bank's primary tool for implementing monetary policy.
- Describe the key objectives of credit control in a modern economy.
- Differentiate between quantitative and qualitative methods of credit control.
- Explain the mechanics of the Interest Rate Corridor (IRC) framework and how it has replaced the traditional Bank Rate policy.
- Analyze the role of selective credit control in managing specific sectors of the economy.

Key Terms

- **Credit Control:** The regulation of the creation and contraction of bank credit by a central bank to influence economic activity. An example is increasing the Cash Reserve Ratio to reduce the amount of money banks can lend.
- **Quantitative Controls:** Monetary policy tools that regulate the *total volume* of credit in the economy, without targeting specific sectors. An example is Open Market Operations.
- **Qualitative (Selective) Controls:** Monetary policy tools that regulate the *flow* of credit to specific sectors or for specific purposes. An example is setting margin requirements for loans against certain securities.
- **Bank Rate:** The official minimum lending rate of the central bank, at which it advances loans to commercial banks. The historical bank rate has been replaced by the policy (repo) rate in Bangladesh's new framework.
- **Interest Rate Corridor (IRC):** A modern monetary policy framework that sets an upper bound (ceiling) and a lower bound (floor) for interbank interest rates, with the central bank's policy rate at the center. In Bangladesh, the IRC is defined by the Standing Lending Facility (SLF) as the ceiling and the Standing Deposit Facility (SDF) as the floor.
- **Open Market Operations (OMOs):** The central bank's purchase or sale of government securities in the open market to increase or decrease the money supply. An example is the sale of government bonds by Bangladesh Bank to absorb liquidity from the market during inflationary periods.

Introduction

In a credit-based economy, the central bank's power lies in its ability to manage the flow of credit. Credit control is the strategic function through which the central bank steers the economy toward its desired goals, such as price stability and sustainable growth. This lesson delves into the objectives and, most importantly, the evolving methods of credit control, with a focus on Bangladesh Bank's recent policy shifts.

Objectives of Credit Control

The central bank's credit control mechanisms are guided by several core objectives, all of which are essential for maintaining a healthy economic environment. These objectives include:

- **Stability of the Internal Price-level:** Credit creation by commercial banks can lead to an increase in the money supply and purchasing power, which may fuel inflation. The central bank uses credit control to ensure a proper balance between the supply of credit and the economy's needs, thereby helping to keep prices stable.
- **Checking Booms and Depressions:** By adjusting the volume of credit, the central bank can mitigate the uncertainties caused by trade cycles, promoting a more stable and predictable economic environment.

- **Promotion of Economic Development:** In a developing country, credit control can be used to direct funds towards productive sectors, fostering economic activities and employment.
- **Stability of the Money Market:** The central bank operates its credit control tools to neutralize seasonal variations in the demand for funds, liberalizing credit during periods of financial stringency to ensure market stability.
- **Stability in Exchange Rates:** Credit control measures can influence the domestic price level, which in turn affects a country's exports and imports, thus impacting foreign exchange rates. Measures are designed to prevent violent fluctuations in exchange rates.

Methods of Credit Control

The methods of credit control are broadly classified into two groups: quantitative controls and selective (qualitative) controls.

1. **Quantitative Methods:** These methods influence the overall supply and cost of credit in the economy. The provided guide's focus on the traditional Bank Rate is now outdated. The modern approach, as implemented by Bangladesh Bank, uses an **Interest Rate Corridor (IRC)** framework, which is a significant and fundamental shift in monetary policy. This framework establishes a corridor for interbank interest rates using three key rates:
 - **The Standing Lending Facility (SLF):** This rate serves as the ceiling or upper bound of the corridor. It is the rate at which commercial banks can borrow from the central bank as a last resort, thereby setting an upper limit for overnight lending rates in the interbank market.
 - **The Standing Deposit Facility (SDF):** This rate serves as the floor or lower bound of the corridor. It is the rate at which the central bank absorbs excess liquidity from commercial banks.
 - **The Policy (Repo) Rate:** This is the central rate within the corridor, at which the central bank conducts its main liquidity operations.

The frequent adjustments to these rates, such as the reduction of the SDF rate to 8 percent in July 2025, while keeping the policy rate at 10 percent and the SLF at 11.5 percent, are a sign of a central bank actively and dynamically managing a high-inflation environment. The shift to this framework allows for more nuanced control over money market liquidity. The IRC framework, along with

Open Market Operations (OMOs)—the central bank's purchase or sale of government securities to influence commercial banks' cash reserves and liquidity—and the **Cash Reserve Ratio (CRR)**, constitute the key quantitative tools for monetary management.

2. **Selective or Qualitative Methods:** These methods are used to regulate the use of credit for specific purposes, distinguishing between essential and non-essential uses. They are particularly effective in controlling inflationary pressure by targeting credit extended for speculative or non-productive purposes. Key measures include:
 - **Margin Requirements:** Adjusting the percentage of a loan required against the value of a security.
 - **Rationing of Credit:** Setting a limit on the amount of credit a bank can extend.
 - **Moral Suasion and Directives:** The central bank's use of persuasion and formal directives to guide banks' lending policies. The recent directives on loan classification and governance are prime examples of this.

Summary

Credit control is the engine of a central bank's monetary policy. The shift from a single, traditional Bank Rate to a modern Interest Rate Corridor framework represents a significant evolution in Bangladesh Bank's approach to managing money market liquidity. By combining these quantitative tools with targeted qualitative measures, the central bank works to manage inflation, stabilize the financial system, and promote planned economic development.

Review Questions

1. Explain the key objectives of credit control and provide examples of how Bangladesh Bank might use these controls to achieve them.
2. Differentiate between quantitative and qualitative methods of credit control, providing a specific example for each.
3. Describe the new Interest Rate Corridor (IRC) framework used by Bangladesh Bank. How does it differ from the traditional Bank Rate policy?
4. Why is the central bank's ability to engage in Open Market Operations essential for effective monetary policy?
5. In the context of a developing economy, why might selective credit control be as important as, or even more important than, quantitative controls?

Lesson 3: Central Bank in Bangladesh

After completion of this lesson you will be able to –

- Trace the history and evolution of Bangladesh Bank since its establishment in 1972.
- Describe the key functions of Bangladesh Bank as the country's central bank.
- Explain the role of Bangladesh Bank in the supervision and regulation of the financial sector.
- Analyze the significance of recent policy reforms, including the Interest Rate Corridor, the crawling peg, and Risk-Based Supervision.
- Discuss the critical issue of central bank autonomy in Bangladesh and its impact on financial stability.

Key Terms

- **Bangladesh Bank Order, 1972:** The legal framework that established Bangladesh Bank as the country's central bank. The Order defines the bank's functions, including its monopoly on note issue.
- **Risk-Based Supervision (RBS):** A modern regulatory approach that focuses supervisory resources on the banks and areas of banking that pose the greatest risk to the financial system. Bangladesh Bank's new RBS framework aims to monitor inherent risks like credit and operational exposures.
- **Crawling Peg:** A type of exchange rate system where a currency's value is pegged to another currency or a basket of currencies, but the peg is adjusted periodically to allow for gradual depreciation or appreciation. Bangladesh Bank's introduction of a crawling peg with a mid-rate of Tk. 117.00 per USD is a prime example.
- **Balance of Payments (BOP):** A statement of all transactions made between residents of one country and the rest of the world over a specified period. Bangladesh's BOP moved into a surplus due to increased remittance inflows and controlled imports.
- **Non-Performing Loans (NPLs):** Loans that are in default or close to being in default, a major challenge for the banking sector. Bangladesh Bank's reforms are aimed at addressing the alarming level of NPLs.
- **Financial Inclusion:** The process of ensuring access to financial services and credit for all segments of society, especially the rural and underserved population. Bangladesh Bank's promotion of mobile banking and nano-loans is a key initiative in this area.

Introduction

Bangladesh Bank, established in 1972, is more than just an institution; it is a pillar of the nation's economic sovereignty. This lesson explores its evolution, functions, and the ongoing challenges and reforms that define its contemporary role, providing a comprehensive understanding of how the central bank navigates the complexities of a dynamic, developing economy.

History and Evolution of Bangladesh Bank

Bangladesh Bank was established on December 16, 1972, under the Bangladesh Bank Order, 1972, to manage the country's financial system following its independence. In its early years, the bank focused on stabilizing the nascent economy, a task led by its first governor, Muhammad Ali, who helped establish the institution's credibility. The bank's operations expanded rapidly in the 1980s with the introduction of new banking laws and regulations. The original study guide mentions an outdated figure of 77 branches and a workforce of over 8,000 employees; however, the most recent public data available from the bank's website indicates it has ten offices and a total manpower of 5807 as of March 31, 2015. This highlights the importance of relying on the most current data available for a precise understanding of the institution.

Functions of Bangladesh Bank

Bangladesh Bank performs all the traditional central banking functions, but with specific applications and challenges relevant to the country. The report will detail the major functional areas:

- **Monetary and Credit Policies:** The bank's primary role is to formulate and implement monetary and credit policies to maintain price stability and foster economic growth.
- **Regulation and Supervision:** This function is being significantly updated to align with international standards. Bangladesh Bank is currently implementing a comprehensive **Risk-Based Supervision (RBS)** framework across all 61 scheduled banks. This new approach aims to enhance efficiency and oversight by developing a risk matrix to manage inherent exposures like credit, market, and operational risks. The goal is to enable real-time monitoring from a single, centralized platform, with full implementation expected by January 2026.
- **International Reserves Management:** An updated discussion, including the latest foreign exchange reserve figures and the distinction between the local and IMF methodologies, is crucial. As of late 2025, reserves stand at \$31.43 billion locally and \$26.45 billion under the IMF's BPM6 standard.
- **Payment Systems Regulation:** The bank plays a vital role in modernizing the financial infrastructure through initiatives like the Bangladesh Automated Clearing House (BACH), Electronic Fund Transfer (EFT), and the promotion of mobile banking and QR codes, which have facilitated financial inclusion for the underserved population.

Key Reforms and Contemporary Challenges

This new, crucial section will provide a detailed analysis of the recent, fundamental policy shifts that a modern study guide must address.

1. **The Interest Rate Corridor (IRC) Framework:** A comprehensive review of the new system, which moved from a monetary aggregate-based framework to an interest rate targeting one, is essential. The IRC, with its three key rates (SLF, policy repo, SDF), allows for more dynamic management of money market liquidity. The frequent adjustments to these rates, such as the reduction of the SDF rate to 8 percent, while keeping the policy rate at 10 percent and the SLF at 11.5 percent, are a direct response to a high-inflation environment. This reflects a central bank that is actively adjusting its tools to achieve its primary objective of price stability.
2. **The Crawling Peg Exchange Rate System:** This transitional measure, introduced on May 8, 2024, was necessary due to significant Taka depreciation and external sector challenges. The crawling peg links the Taka's value to a currency basket and aims to stabilize the exchange rate, reduce market volatility, and rebuild foreign reserves. The mid-rate was set at Tk. 117.00 per USD. This system demonstrates the central bank's shift towards a more flexible, market-based exchange rate regime.
3. **Governance and Autonomy:** The provided documents show a clear, step-by-step narrative of governance challenges. The Bank Company Act was amended multiple times during the previous regime, each time weakening the central bank's authority and strengthening the influence of family groups and political figures on bank boards. For example, amendments extended directors' terms from six to twelve years and increased the number of family members on boards, contributing to rampant loan scams and rising non-performing loans (NPLs). The current governor, Dr. Ahsan H. Mansur, has publicly stated that the banking sector was "right at the edge of the cliff" and is now pushing for major legal reforms. These reforms include extensive amendments to the Bank Companies Act to enhance the central bank's accountability and autonomy, adding asset recovery provisions to the Money Laundering Act, and allowing the central bank to take over any bank facing a liquidity crisis due to irregularities. This is not a

simple reform; it is a profound battle for institutional credibility and independence. The effectiveness of a central bank is not solely determined by its legal mandate but is a function of the political environment and its ability to resist external pressures.

Conclusions

Bangladesh Bank is a multifaceted institution at a critical juncture. Its evolution reflects the nation's own journey, from a state-run institution to a modern, market-oriented one. Recent reforms in monetary policy, exchange rate management, and banking supervision demonstrate a commitment to addressing fundamental macroeconomic challenges like inflation and NPLs. The implementation of the Interest Rate Corridor, the crawling peg system, and the Risk-Based Supervision framework are modern and necessary steps for a developing economy. However, the bank's ability to fully realize its potential is contingent on a deeper and more sustainable commitment to its institutional autonomy. The ongoing effort to reform the Bank Companies Act and insulate the central bank from political interference is the most critical factor for ensuring long-term financial stability and good governance in Bangladesh.

Unit Highlights

- Lesson 1: Introduction to Bank and Customer
- Lesson 2: The Banker and Customer Relationship
- Lesson 3: The Banker and Customer Relationship

Technologies Used for Content Delivery

- ❖ BOUTUBE
- ❖ BOU LMS
- ❖ WebTV
- ❖ Web Radio
- ❖ Mobile Technology with MicroSD Card
- ❖ LP+ Office 365
- ❖ BTV Program
- ❖ Bangladesh Betar Program

Lesson 1: Introduction to Bank and Customer

After completion of this lesson you will be able to –

- Define and differentiate between a "banker" and a "customer" from a legal and functional perspective in Bangladesh.
- Identify and categorize the special types of customers and understand the specific legal and procedural considerations for each.
- Explain the legal framework governing the guardianship of a minor's person and property in Bangladesh.

Key Terms and Definitions

- **Banker:** A person or company that carries on the business of banking, which is defined by the Bank Companies Act, 1991, as accepting deposits for lending or investment. These deposits are repayable on demand or otherwise and are withdrawable by various means, including cheques, drafts, or orders.
 - *Example:* A financial institution, such as a public limited company, that holds a license from the Bangladesh Bank to perform banking functions and that accepts deposits from the public for the purpose of lending.
- **Customer:** A person or entity that has a recognized account with a bank and engages in regular banking transactions. The relationship legally begins with the first transaction that initiates a banking relationship, such as the deposit of a first cheque, which legally establishes a debtor-creditor relationship.
 - *Example:* An individual who opens a savings account and makes an initial deposit, thereby establishing a formal banking relationship with the bank.
- **Minor:** A person who has not attained the age of majority, which is generally 18 years in Bangladesh, though this age can be extended to 21 years if a guardian is appointed by a court.
 - *Example:* A 16-year-old student for whom a savings account is opened and operated by their father as their natural guardian.
- **Lunatic/Insane Person:** An individual who is not of sound mind and is therefore legally incompetent to enter into any form of contract, as stipulated by the Contract Act, 1872.
 - *Example:* A person legally declared mentally incapacitated, for whom a court has appointed a guardian or committee to manage their financial affairs and property.

Introduction

The banking industry holds a central and vital position in a nation's economy. A bank is an indispensable institution in modern society, as the development of any nation is inextricably linked to the active assistance provided by its financial institutions. Banks are fundamental in financing trade, industry, and commerce, and modern businesses and entrepreneurs cannot carry on their commercial activities without the diverse financing methods offered by banks. In their capacity as financial institutions, banks provide essential services to individuals, companies, and the economy as a whole. Therefore, establishing and sustaining excellent customer relationships is crucial for any bank's success.

The role of a bank has expanded beyond traditional functions. The commercial role of banks in Bangladesh includes not only accepting deposits and lending but also processing payments via telegraphic transfer, internet banking, and other modern means. Banks also issue bank drafts and cheques, accept money on term deposits, provide various forms of credit, offer safekeeping of documents and valuables, facilitate currency exchange, and even act as a 'financial supermarket' by brokering financial products like insurance and mutual funds.

Meaning and Definition of a Banker

The term 'banker' is not a matter of general consensus among legal scholars, but it is defined by specific legal provisions. In Bangladesh, the definitive legal framework is provided by the Bank Companies Act, 1991, which governs the operations of all banks.

Under Section 5(p) of the Bank Companies Act, 1991, "banking" is defined as "the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise". A "banking company" is therefore any company that transacts the business of banking in Bangladesh. This definition is crucial as it establishes the core functions that distinguish a bank from other financial entities. A company that is primarily engaged in manufacturing or trade and accepts deposits solely to finance its own business is not considered a banking company under this Act.

A person or institution qualifies as a banker only if it meets specific conditions. First, it must accept deposits from the public, which may be of different types, such as current, savings, or fixed deposits. Second, these deposits must be withdrawable by the customer on demand or otherwise, through instruments like cheques, drafts, or other orders. Third, the money accepted as deposits must be for the purpose of lending or investment, and finally, the performance of this banking business must constitute the main activity of the company. The law also specifies, in Section 31 of the Bank Companies Act, 1991, that no person or company can conduct banking business in Bangladesh without a license from the Bangladesh Bank.

The principles of banking law in Bangladesh, while enshrined in its own specific legislation, share a common legal heritage with other common law jurisdictions, particularly England and India. The original document's references to the Indian Banking Regulation Act, 1949, and legal scholars like Sir John Paget are not without reason. The Bangladeshi legal framework, including the Bank Companies Act, 1991, and the Contract Act, 1872, is largely a localized and amended version of a legal lineage that can be traced back to British colonial rule. While the laws have evolved and been tailored to suit the national context, the foundational principles of banking, such as the relationship between a banker and customer, remain largely consistent.

Meaning and Definition of a Customer

The term 'customer' is not formally defined by statute in Bangladesh, or in England, but its meaning has been established through legal decisions and judicial precedents.

An older view, as espoused by Sir John Paget, required a "recognizable course or habit of dealing" or a "minimum of custom" for a person to be considered a customer. According to this view, a single transaction would not suffice to constitute a person a customer of a bank. This "duration theory" emphasized the need for a sustained relationship and regular banking transactions.

However, modern legal opinion has superseded this view. The more accepted legal position, established in the case of *Ladbroke Vs Todd* (1914), holds that the relationship between a banker and a customer begins as soon as the first cheque is paid in and accepted for collection. This "single transaction theory" means that neither the number of transactions nor the duration of the relationship is material in determining whether a person is a customer. The relationship is established as soon as a person opens an account and makes the initial deposit, even if they have not yet drawn any money.

To be considered a customer of a bank, a person must satisfy the following conditions:

1. They must have an account with the bank, which can be a savings, current, or fixed deposit account.
2. The transactions between the banker and the customer must be of a "banking nature." For example, a person who only uses the bank's safe deposit locker or purchases travellers cheques without holding an account is not considered a customer.
3. The frequency of transactions is not essential, although it is usually anticipated.

Special Types of Customers

Certain types of customers require special legal and procedural considerations from a bank. These customers are dealt with carefully, especially when opening and operating accounts.

- **Minors:** In Bangladesh, a minor is a person who has not completed 18 years of age, as stipulated by the Majority Act, 1875. However, the period of minority can be extended to 21 years if a guardian of their person or property has been appointed by a court. A bank can open an account for a minor, but it must exercise caution. Banks typically prefer to open savings accounts for minors rather than current accounts, as a minor cannot be held liable for an overdraft, and the bank would have no legal recourse to recover the debt. Banks also stipulate certain conditions for opening a minor's account, such as requiring the minor to be of a certain age (e.g., about 14 years old), capable of reading and writing, and properly introduced by a parent or guardian.
- **Legal Provisions Regarding Guardianship of a Minor:** The legal framework for guardianship in Bangladesh is based on the Guardians and Wards Act, 1890, and the Family Courts Ordinance, 1985. The law recognizes three types of guardians:
 1. **Natural Guardian:** As per the legal provisions, a father is the natural guardian of his children, and after him, the mother assumes this role. However, for a minor married girl, her husband is the natural guardian. In Bangladesh, the judiciary has taken a progressive approach, holding that the welfare of the child is the paramount consideration, often taking precedence over rigid personal laws in custody and guardianship matters.
 2. **Testamentary Guardian:** A guardian appointed by a natural guardian, typically a father, through a will.
 3. **Guardian Appointed by Court:** A court may appoint a guardian for a minor under the Guardians and Wards Act, 1890, especially if it is in the best interest of the child. The Family Courts Ordinance, 1985, gives Family Courts exclusive jurisdiction to handle suits related to the guardianship and custody of children. A critical procedural point for bankers is that when a minor attains the age of majority, the guardian's right to operate the account ceases, and the balance is held for and paid to the now-adult individual.
- **Lunatics and Drunkards:** Under the Contract Act, 1872, a lunatic or an insane person is legally incompetent to enter into any contract. A contract with such a person is not only invalid but also voidable at their option. Similarly, a contract with a person who is intoxicated to the point of losing their mental balance is considered invalid. A banker must exercise extreme caution when dealing with such individuals to avoid entering into a legally unenforceable agreement.
- **Married Women:** A married woman has the legal capacity to open an account, draw cheques, and provide valid discharges. In order to mitigate the risk of account misuse by her husband, a bank may request the name and occupation of the husband at the time of account opening. Similarly, for an unmarried woman, the bank may ask for details about her father.
- **Illiterate Persons:** An illiterate person is someone who cannot read or write. Banks in Bangladesh typically do not open current accounts for illiterate individuals. However, a savings account may be opened, provided specific precautions are taken. The bank is required to obtain the person's thumb impression on the account opening form in the presence of two witnesses known to both the bank and the depositor. Withdrawals from the account are permitted only after proper identification each time.
- **Joint Stock Company:** A joint stock company is a legal entity separate from its owners, with a perpetual succession, as defined in the Companies (Bangladesh) Act, 1994. When opening an account for a company, a banker must verify and obtain key documents, including the Memorandum of Association, the Articles of Association, the Certificate of Incorporation, and a copy of the Board Resolution appointing the bank as the company's banker. The Board

Resolution must also specify which officers are authorized to operate the account and must be signed by the chairman and secretary. The Companies (Bangladesh) Act, 1994, governs the establishment and operations of such entities.

- **Partnership Firm:** A partnership is a relationship between persons who have agreed to share the profits of a business, as defined by the Partnership Act, 1932. In Bangladesh, a partnership does not have a separate legal entity from its partners unless it is registered. Partners are subject to joint and several liability for the firm's debts. A bank must carefully examine the Partnership Deed to understand the firm's constitution and the borrowing powers of its partners. The bank must ensure that funds belonging to the firm are not credited to the partners' personal accounts.
- **Other Special Customers:** The report also notes specific procedures for dealing with Insolvents, Agents, Clubs, Associations, and Educational Institutions, and Trustees. In each case, the bank must conduct due diligence to ensure it is acting within the legal rights and obligations of the concerned parties. For example, for a Trust, the bank must examine the trust deed and ensure funds are not transferred to a trustee's personal account.

Summary of Lesson 1

This lesson has provided a foundational understanding of the legal and practical relationship between a banker and a customer in Bangladesh. The definition of a "banker" is governed by the Bank Companies Act, 1991, which establishes the core functions of accepting deposits for lending and investment. The concept of a "customer," while not statutorily defined, has evolved through common law to begin with the very first banking transaction, superseding the outdated "duration theory." This legal grounding is crucial for understanding the rights and obligations that govern the relationship.

The lesson has also highlighted the existence of "special types of customers," for whom banks must exercise particular caution and due diligence. This includes individuals like minors, lunatics, and illiterate persons, as well as legal entities like joint stock companies and partnership firms. The legal frameworks for these customers, such as the Guardians and Wards Act, 1890, and the Companies (Bangladesh) Act, 1994, provide the necessary guidelines. The overarching principle of "welfare of the minor," a core tenet of the Bangladeshi judiciary, exemplifies the deeper ethical considerations that guide legal practice in these matters.

Review Questions

1. What is the legal definition of "banking business" in Bangladesh, and which key piece of legislation governs it?
2. Discuss the evolution of the legal concept of a "customer" of a bank, explaining the "duration theory" and the "single transaction theory." Which theory is more relevant in modern banking practice in Bangladesh?
3. Explain the legal due diligence a banker must perform before opening an account for a Joint Stock Company and a Partnership Firm.
4. Describe the different types of guardians for a minor in Bangladesh. What is the paramount principle that a court considers when appointing a guardian?

Lesson 2: The Banker and Customer Relationship

After completion of this lesson you will be able to –

- Explain the primary and secondary relationships between a banker and a customer, and provide examples of each.
- Define and differentiate between the various special rights a banker can exercise, including the right of general lien, set-off, and Garnishee Order.
- Analyze the legal basis and practical application of each of the banker's rights within the context of Bangladeshi law.

Key Terms and Definitions

- **Debtor-Creditor Relationship:** The fundamental legal relationship where the bank is the debtor and the customer is the creditor for funds deposited, or vice-versa for loans and overdrafts. The bank owes the customer a debt and does not hold the physical currency in trust.
 - *Example:* When a customer deposits money into a savings account, the bank becomes a debtor to the customer, and the customer is the creditor for the balance.
- **Banker's General Lien:** A legal right of a banker, under the Contract Act, 1872, to retain any property of a customer that comes into the bank's possession until all debts owed by the customer have been paid. It is considered an implied pledge as it gives the bank the right to sell the property.
 - *Example:* A customer defaults on a loan, and the bank, having a general lien on the customer's shares lodged with it, can hold or sell those shares to recover the outstanding debt.
- **Right of Set-off:** A statutory and common law right of a bank to combine all accounts of a single customer and adjust the debit balance of one account against the credit balance of another.
 - *Example:* A customer has a BDT 50,000 credit balance in their savings account and a BDT 20,000 debit balance from a credit card. The bank can exercise its right of set-off to clear the card debt and leave a BDT 30,000 balance in the savings account.
- **Garnishee Order:** A legal order issued by a court that instructs a bank (the "garnishee") to freeze the funds of a judgment debtor and pay them directly to a judgment creditor to settle a debt.
 - *Example:* A court orders a bank to pay BDT 100,000 from a customer's account to a creditor who has won a lawsuit against that customer for an unpaid debt.

Introduction to the Banker and Customer Relationship

The relationship between a banker and a customer is fundamentally contractual, arising from a mutual agreement. This relationship is governed by various laws, including the Contract Act, 1872, and the Negotiable Instruments Act, 1881. The relationship is not static; it can take on different forms depending on the nature of the transaction. This dynamic is classified into two main types: the general relationship and the special relationship.

General Relationship

The general relationship between a banker and a customer is primarily that of a debtor and a creditor. When a customer deposits money into a bank, the money ceases to be the customer's property; it becomes a debt owed by the bank to the customer. The bank has the right to use this money as its own, and in return, it has an obligation to repay the debt upon demand. This is a crucial distinction: the bank is not a bailee or a trustee of the customer's funds, as the money is not held in

a separate physical form for the customer. Conversely, when a customer overdraws their account or takes a loan, the customer becomes the debtor, and the bank becomes the creditor.

This debtor-creditor relationship has specific legal characteristics. A customer, as the creditor, must make a formal demand for payment. A bank is not obliged to seek out its customer to repay the debt. The demand must be made at the proper place (the branch where the account is maintained) and in the proper form, typically through a cheque or a written order, as per the established banking practice. The landmark case of

Joachimson Vs Swiss Banking Corporation (1921) established the principle that a demand for repayment is a prerequisite for a bank's debt to become due.

Secondary Relationship

While the primary relationship is that of debtor and creditor, a bank can assume other roles depending on the services it provides. These are known as secondary relationships and include:

- **Banker as an Agent:** A bank acts as an agent for its customer when it performs services on the customer's behalf. Examples include collecting cheques, dividends, and interest on securities, making regular payments for bills and subscriptions, or buying and selling securities as instructed by the customer. In these instances, the bank-customer relationship is that of a principal and agent.
- **Banker as a Trustee:** A bank acts as a trustee when it holds and manages funds or assets for a specific purpose on behalf of a beneficiary. This occurs when a customer deposits an amount with the instruction that it be managed for a specific purpose or when the bank acts as a trustee for debenture holders. In these cases, the bank holds the property not as its own but for the benefit of another, and the relationship is that of a trustee and a beneficiary.
- **Banker as a Bailee:** A bank becomes a bailee when it takes physical possession of valuables for safekeeping on behalf of a customer, such as holding securities or jewellery in a safe deposit locker. In this capacity, the bank has a legal obligation to exercise reasonable care to protect the valuables. If the customer suffers a loss due to the bank's negligence, the bank can be held liable.

Special Relationship (Rights of the Banker)

The special relationship is defined by the rights that the banker can exercise with regard to a customer's account. These rights are crucial for the bank's ability to operate securely and efficiently.

- **Right of General Lien:** One of the most important rights a banker holds is the right of general lien. A lien is the right to retain a debtor's property until a debt has been discharged. Unlike a "particular lien," which is limited to a single transaction (e.g., a tailor holding a suit until tailoring charges are paid), a "general lien" allows a banker to retain any property of the customer for any general balance of accounts between the two parties. This right is codified in **Section 171 of the Contract Act, 1872**, which applies in Bangladesh. The banker's general lien is particularly powerful because it is considered an "implied pledge," giving the bank not only the right to retain the property but also the right to sell it to recover an outstanding debt, which is a right not typically associated with a standard lien. The bank cannot exercise its lien over items deposited for a specific, non-banking purpose, such as valuables in a safe deposit box or securities given for a particular loan.
- **Right of Set-off:** The right of set-off allows a bank to combine all accounts of a customer to adjust a debit balance in one account against a credit balance in another. This right is acknowledged in Bangladesh, as confirmed by a Bangladesh Bank FAQ, which states that "Banks have the right to set off their dues from the amount of deposits". The right of set-off can be established by common law or by a contractual agreement, often formalized through a "Letter of Lien and Set Off" signed by the customer. This allows the bank to automatically

combine a customer's accounts in the event of a default. However, this right is subject to specific conditions: the accounts must be in the same name and in the same right (e.g., a personal account cannot be set off against a trust account).

A key implication of the right of set-off is its precedence over a Garnishee Order. If a bank exercises its right of set-off before a Garnishee Order takes effect, it can reduce or extinguish the funds available in the customer's account. The Garnishee Order can only attach the funds that are genuinely owed by the bank to the customer at that specific moment, and a prior set-off legally reduces or eliminates that debt. This highlights a crucial legal priority rule for the bank.

- **Right Under Garnishee Order:** A Garnishee Order is a legal order issued by a court that compels a third party (the "garnishee"), typically a bank, to pay a judgment creditor the money it owes to a judgment debtor (the customer). This order is issued under

Order XXI, Rule 46 of the Code of Civil Procedure, 1908, in Bangladesh. The process involves two stages:

1. **Order Nisi:** An initial order from the court that warns the bank not to release any funds belonging to the judgment debtor until a further order is issued. The bank is required to freeze the customer's account and the customer is requested to appear before the court for a hearing.
2. **Order Absolute:** A final order issued after the court hearing that directs the bank to pay a specific amount from the customer's account to the judgment creditor.

A Garnishee Order is not applicable in several circumstances, such as when the judgment debtor's account is a joint account, when the funds are in a trust account, or when the account already has a debit balance.

Summary of Lesson 2

This lesson has detailed the complex and multifaceted relationship between a banker and a customer. The primary relationship is established as a legal debtor-creditor one, with the bank becoming a debtor for a credit balance and a creditor for a debit balance. Other, secondary relationships, such as agent, trustee, and bailee, exist for specific transactions but do not alter this fundamental legal reality. The lesson also explored the key legal rights a banker can exercise, including the right of general lien, the right of set-off, and the response to a Garnishee Order. These rights are critical for a bank's security and legal standing.

Review Questions

1. Discuss the various relationships that can exist between a banker and a customer, and explain why the debtor-creditor relationship is considered the primary one.
2. What is a banker's general lien? How does it differ from a particular lien, and why is it considered an "implied pledge" in a legal context?
3. Explain the legal principle of "right of set-off" and list the conditions under which a bank can exercise this right.
4. Define a Garnishee Order. Describe the two stages of the process (Order Nisi and Order Absolute) and the legal role of the bank (the "Garnishee") and the customer (the "Judgment Debtor").

Lesson 3: The Banker and Customer Relationship

After completion of this lesson you will be able to –

- Explain the banker's core legal obligations to the customer, specifically the obligation to honor cheques and maintain confidentiality.
- Analyze the legal implications of wrongful dishonour of a cheque by a bank and the consequences for the customer.
- Differentiate between the banker's obligations and the customer's corresponding duties.
- Summarize the conditions under which a banker-customer relationship can be terminated.

Key Terms and Definitions

- **Obligation to Honour Cheques:** A statutory duty of a bank, under Section 31 of the Negotiable Instruments Act, 1881, to pay a customer's cheque if there are sufficient funds and the cheque is in proper order.
 - *Example:* A customer with a BDT 50,000 balance in their account issues a cheque for BDT 20,000, and the bank is obligated to honor it upon proper presentment.
- **Wrongful Dishonour:** A mistake by a bank to refuse payment on a customer's cheque even when all conditions for payment are met, leading to a legal claim for damages by the customer.
 - *Example:* A bank's computer system fails to recognize an available balance, and it incorrectly returns a cheque with the remark "Insufficient Funds," damaging the customer's reputation.
- **Duty of Secrecy:** An implied contractual obligation of a bank to maintain the confidentiality of all information regarding a customer's financial affairs.
 - *Example:* A bank officer is prohibited from disclosing a customer's account balance to a third party without the customer's explicit consent or a legal directive.
- **Criminal Liability (Cheque Dishonour):** A legal consequence for a person who draws a cheque that is dishonoured due to insufficient funds, which can result in imprisonment and/or a fine, as per Section 138 of the Negotiable Instruments Act, 1881.
 - *Example:* A businessman writes a cheque to a supplier, but the cheque bounces. If he fails to pay the amount within 30 days of receiving a legal notice, he may face a criminal charge.

Introduction to Obligations

Just as a banker has certain rights over a customer's account, they also have specific legal obligations to fulfill while dealing with customers. These duties are crucial for maintaining the trust and integrity of the banking system. The two most fundamental obligations are the duty to honor cheques and the duty to maintain secrecy of a customer's account.

Obligation to Honour the Customer's Cheques

The bank's obligation to honour a customer's cheque is a statutory duty imposed by **Section 31 of the Negotiable Instruments Act, 1881**. The law states: "The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default".

For a banker to be legally bound to honour a cheque, several conditions must be met :

- **Sufficient Balance:** There must be enough clear, available funds in the customer's account to cover the amount of the cheque.

- **Proper Application of Funds:** The funds must be "properly applicable" to the payment. This means the funds must not be encumbered, held for a specific purpose, or be trust funds that cannot be used for the cheque's payment.
- **Duly Required to Pay:** The cheque must be presented to the bank in the proper manner, at the proper time, and within a reasonable period, which is typically six months from its issue date in Bangladesh.
- **Instrument in Proper Form:** The cheque must be complete and in proper order, with no legal restrictions on its payment, such as a Garnishee Order.

The Critical Distinction between Banker's Liability and Customer's Liability

The law makes a clear distinction between the consequences of a bank's error and a customer's failure. When a bank **wrongfully dishonours** a cheque, it is held responsible for the loss or damage caused to the customer. This is a civil liability, and the bank must compensate the customer for any monetary loss and for the injury to their reputation, especially if the customer is a trader.

In contrast, the **customer's liability** for a dishonoured cheque is a criminal matter in Bangladesh. The Negotiable Instruments Act, 1881, was amended to include

Section 138, which makes drawing a cheque that is returned unpaid due to insufficient funds a criminal offense. A person who issues a bad cheque can face imprisonment for up to one year, a fine of up to three times the cheque's amount, or both. This is a severe legal consequence that serves as a powerful deterrent. A civil suit for money recovery can also be filed.

The legal procedure for a customer's liability is specific: the payee must first present the cheque to the bank within six months of its date. If it is dishonoured, the payee must send a legal notice to the drawer within 30 days of receiving the dishonour memo, demanding payment. If the drawer fails to make the payment within another 30 days of receiving the notice, a legal case can be filed against them.

Obligation to Maintain Secrecy of Customer's Account

A banker has an implied contractual duty to maintain the confidentiality of all information related to a customer's account and financial affairs. This obligation stems from the common law and is a cornerstone of the banker-customer relationship. The duty extends to all information the bank obtains in the course of the banking relationship and continues even after the account is closed. The importance of this duty is reinforced by Bangladesh Bank regulations, which require a "Declaration of Secrecy" from key banking officials, such as the CEO, ensuring the principle is a matter of corporate governance and not just abstract legal theory.

The duty of secrecy is not absolute, and the landmark case of *Tournier v National Provincial and Union Bank of England (1924)* established four exceptions where disclosure is permissible :

1. **Where disclosure is compelled by law:** For example, in response to a Garnishee Order or a directive from the court.
2. **Where there is a public duty to disclose:** This includes situations involving national interest or criminal activities.
3. **Where the interests of the bank require disclosure:** For instance, when a bank needs to disclose information to a guarantor to protect its own interests.
4. **Where the customer gives express or implied consent to the disclosure:** This can be through a formal request or an established banking practice, such as providing a banker's reference.

Obligations of Customers

The relationship is not one-sided; customers also have obligations to the bank. These include:

- **Not to draw cheques without sufficient balance:** This is a crucial duty, as its breach carries criminal consequences in Bangladesh, as detailed under Section 138 of the Negotiable Instruments Act, 1881.
- **To draw cheques carefully:** Customers are responsible for drawing cheques in a manner that prevents forgery or alteration.
- **To pay reasonable charges for services rendered:** Customers must pay fees and interest as agreed upon for the services provided by the bank.
- **To make a formal demand for repayment:** The customer must make a formal demand for the repayment of their deposits, typically by cheque.

Conclusion

The relationship between a banker and a customer is fundamentally a legal one, governed by a reciprocal set of rights and obligations. Contrary to a common misconception, the relationship for a general deposit account is not that of a bailee and bailor but is primarily that of a **debtor and creditor**. The banker acts as a debtor for a credit balance and a creditor for a debit balance. Other relationships, such as agent, trustee, and bailee, are secondary roles that apply to specific transactions. This foundational legal analysis is what governs the rights and obligations of both parties. The relationship is a dynamic one that begins with the opening of an account and concludes with its closure.

Review Questions

1. What is a banker's obligation to honour cheques? List and explain the conditions under which a banker is legally bound to pay.
2. Under what circumstances can a bank be held liable for "wrongful dishonour"? What is the legal consequence for a customer who draws a cheque that is subsequently dishonoured for insufficient funds in Bangladesh?
3. Explain the legal principle of a banker's "duty of secrecy." What are the four recognized exceptions to this duty?
4. Discuss the importance of the Negotiable Instruments Act, 1881, as a legal framework that governs the relationship between a banker and a customer in Bangladesh.

Opening and Operating Bank Accounts

5

Unit Highlights

- Lesson 1: Opening and Operating Bank Accounts

Technologies Used for Content Delivery

- ❖ BOUTUBE
- ❖ BOU LMS
- ❖ WebTV
- ❖ Web Radio
- ❖ Mobile Technology with MicroSD Card
- ❖ LP+ Office 365
- ❖ BTV Program
- ❖ Bangladesh Betar Program

Lesson 1: Opening and Operating Bank Accounts

After completion of this lesson you will be able to –

- Distinguish between the different types of bank accounts available in Bangladesh and their primary uses.
- Articulate the legal and procedural requirements for opening a bank account, contrasting traditional methods with modern e-KYC processes.
- Explain the purpose and function of various forms, instruments, and legal documents used in the operation of bank accounts.
- Identify the legal and practical circumstances under which a bank account may be closed.
- Recognize the growing impact of technology and regulatory reforms on the banking sector's drive for financial inclusion.

Key Terms

- **Demand Deposit:** A non-interest-bearing bank account from which funds can be withdrawn at any time without prior notice. These accounts are also known as current accounts and are typically used by businesses for frequent transactions. For instance, a small retail business owner may use a Current Account to handle daily sales proceeds and payments to suppliers.
- **Time Deposit:** A type of bank deposit where money is held for a fixed, predetermined period, such as one, two, or five years. These accounts generally offer a higher interest rate than savings accounts, but the funds are not accessible until the maturity date. A Fixed Deposit Receipt (FDR) is a prime example of a time deposit.
- **e-KYC (Electronic Know Your Customer):** A digital process for verifying a customer's identity and other information electronically. This method uses biometric data and national identification information, such as the National ID (NID) card, to simplify and expedite the account opening process. A person can open a bank account from home by taking a selfie and scanning their NID card via a mobile app.
- **Introducer:** A person, typically an existing account holder of good standing, who vouches for and formally recommends a new customer to a bank. In the traditional banking system, a proper introduction was a mandatory prerequisite for opening certain types of accounts to mitigate risk and prevent fraud.
- **Garnishee Order:** A court order that directs a third party, such as a bank, to seize funds from a judgment debtor's account and pay them directly to a judgment creditor to satisfy a debt. For example, a court may issue a Garnishee Order to a bank, requiring it to transfer money from a customer's account to a person who has a legal claim against that customer.
- **Mobile Financial Services (MFS):** Branchless banking services that utilize mobile phones to facilitate financial transactions. These services, such as bKash, Nagad, and Rocket, are designed to extend banking access to unbanked and underbanked populations, particularly in rural and remote areas.
- **Non-Resident Bangladeshi (NRB) Account:** A bank account specifically designed for Bangladeshi citizens living abroad. These accounts facilitate the receipt and management of foreign currency remittances and are crucial for foreign exchange inflows into the country. An NRB working overseas can use such an account to send money home to family members.

Opening and Operating Bank Accounts

This Unit presents a comprehensive review and enhancement of the topic Opening and Operating Bank Accounts. The analysis updates the material to reflect the current legal, procedural, and technological landscape of banking in Bangladesh. It corrects outdated

information, incorporates modern practices like e-KYC, and provides a deeper, legally grounded context for the subject matter.

Technologies Used for Content Delivery

The Bangladesh Open University (BOU) employs a multi-faceted approach to content delivery, utilizing a range of modern and traditional technologies to reach a broad student body. These include BOUTUBE, the BOU LMS (Learning Management System), WebTV, Web Radio, Mobile Technology with MicroSD Cards, and dedicated programs on BTv and Bangladesh Betar.

Introduction

Bangladesh's economy is on a consistent and robust growth trajectory, which has been accompanied by a significant increase in its per capita income. As of 2024, the GDP per capita was recorded at \$1,941.28, a marked increase from previous years, reflecting the nation's emergence as a viable investment destination. This economic dynamism, characterized by a rapidly expanding middle class and one of the world's largest workforces, has created a substantial demand for modern and accessible banking services.

The financial sector has evolved to meet this demand, moving beyond traditional, paper-based systems to embrace a technology-driven, inclusive model. The country's banking laws and practices, governed by a robust legal framework that includes the Bangladesh Bank Order, 1972, and the Bank Companies Act, 1991, have adapted to support this transformation. The rise of mobile financial services (MFS) and digital banking solutions represents a strategic shift towards financial inclusion, allowing a larger segment of the population to participate in the formal economy. This unit will delve into the types of bank accounts available and the procedures for opening and operating them within this new and dynamic landscape.

Types of Accounts

Bank accounts in Bangladesh are broadly categorized based on their purpose, transaction frequency, and the target user. The original draft provided in the study guide contains outdated figures and references. The current banking environment operates under a flexible interest rate policy, with the Bangladesh Bank providing general guidance and oversight rather than setting specific rates. The primary account types are as follows:

1. **Current Account:** A current account is a transactional account designed for frequent and high-volume transactions, making it ideal for business entities, organizations, and institutions. This type of account is a demand deposit, meaning funds can be withdrawn at any time, and it does not typically earn interest on its credit balance. The minimum initial deposit varies by bank and can range from as low as Tk. 500 to Tk. 5,000. The key benefit of a current account is the flexibility it offers, with no restrictions on the number or amount of withdrawals. Banks may also extend overdraft facilities to current account holders, providing a crucial liquidity buffer for businesses.
2. **Savings Bank Account:** A savings account is designed for individuals who wish to save a portion of their income while having the flexibility to withdraw funds as needed. It is a popular account type due to its accessibility and the fact that it earns interest on the deposit balance. The minimum opening balance has been significantly reduced over the years to promote financial inclusion, with some banks allowing accounts to be opened with as little as Tk. 10. Banks offer various types of savings accounts, including premium and specialized products, with varying interest rates based on the average daily balance.
3. **Fixed Deposit Account (FDR):** Also known as a "time deposit," an FDR is an account where a lump sum of money is deposited for a fixed, predetermined period, such as one, three, or

twelve months, or even several years. The rate of interest is higher than that of a savings account and is determined by the duration of the deposit. Funds cannot be withdrawn before maturity without incurring a penalty, and a cheque book facility is not provided. However, banks may grant loans against the security of the FDR receipt, allowing customers to access liquidity without prematurely breaking their deposit.

4. **Recurring Deposit Account (DPS):** A recurring deposit, or Deposit Pension Scheme (DPS), is a savings scheme that has gained immense popularity in Bangladesh. Under this account, a depositor commits to depositing a fixed amount of money every month for a specific period, typically ranging from 12 months to 20 years. At the end of the term, the customer receives the total deposited amount plus cumulative interest. These accounts are a disciplined way for individuals to save for long-term goals such as a child's education or marriage. Bangladeshi banks offer a wide variety of such schemes, often with names like "Lakhpati Deposit Scheme" or "Millionaire Deposit Scheme".

For a clear comparison, the following table summarizes the key features of the primary bank account types.

Account Type	Interest Earned	Transaction Frequency	Purpose	Minimum Deposit (Tk.)	Target User
Current Account	No (typically)	Unlimited, high frequency	Daily business transactions	500 - 5,000	Businesses, organizations, institutions
Savings Account	Yes	Limited transactions	Savings and personal use	10 - 100,000	Individuals, students, employees
Fixed Deposit (FDR)	Yes (fixed, higher rate)	No withdrawals before maturity	Long-term savings, investment	Varies, can be substantial	Individuals with surplus funds
Recurring Deposit (DPS)	Yes (fixed rate)	Monthly deposits	Goal-oriented, disciplined saving	As low as 500/month	Individuals, salaried persons

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Procedure of Opening Current and Savings Accounts

The process of opening a bank account has undergone a major transformation in Bangladesh, driven by the central bank's focus on digital financial inclusion. There are now two distinct methods: the traditional, paper-based procedure and the modern, digital e-KYC process.

Traditional Account Opening Procedure

Traditionally, opening a bank account was a manual and document-intensive process. A prospective customer was required to visit a bank branch in person and complete a multi-step procedure to open an account. This process included:

1. **Presentation of Application:** The applicant had to fill out a prescribed hard-copy application form, which varied for individuals, joint accounts, and business entities. The form required personal details such as name, address, occupation, and a specimen signature.
2. **Introduction:** A critical step in the traditional process was the introduction. The bank would only open an account after a proper introduction by an existing customer who was considered a person of integrity and financial standing. This practice was a primary security measure to prevent fraud and ensure the identity and character of the new customer.
3. **Specimen Signature:** The customer's specimen signature was collected on a dedicated card, which would be used for manual verification of signatures on cheques and other instruments to prevent forgery.

4. **Cash Deposit:** After the formalities were completed, the customer had to make an initial cash deposit, the amount of which was determined by the bank and the type of account being opened.

Modern Digital Account Opening Procedure (e-KYC)

The traditional process, with its reliance on physical visits and manual verification, posed a significant barrier to financial inclusion for the large unbanked population. In response, Bangladesh Bank introduced e-KYC guidelines, which have revolutionized the account opening process. Using this new procedure, customers can open an account instantly from a smartphone or computer without visiting a branch or requiring an introducer.

Leading banks in Bangladesh have already implemented this technology, with services like EBL Insta Banking and City Bank's Ekhoni Account. The process is straightforward and typically involves:

1. **Downloading the App:** The customer downloads the bank's account opening app from an app store.
2. **Identity Verification:** The app prompts the user to take a photo of their National ID (NID) card and a selfie. The app's facial recognition and liveness testing technology verify the customer's identity by matching the selfie with the photo on the NID.
3. **Information Entry:** The customer fills in a few additional details electronically, such as their occupation, address, and nominee information.
4. **Document Uploads:** The customer may be required to upload photos of other documents, such as a utility bill for proof of address or an income proof document if the expected transaction volume is high. An e-TIN certificate is optional.
5. **Account Creation:** Once the information is verified, a customer ID and account number are created instantly, and the customer receives an immediate confirmation via email and SMS.

This shift from a paper-based to a digital process is not merely a technological upgrade but a strategic move to address the challenge of a large unbanked population. By simplifying and demystifying the account opening process, banks are actively contributing to the central bank's objective of promoting financial inclusion. This ease of access, combined with the rise of mobile financial services, is a primary driver of the growth of the formal financial system in Bangladesh. The following table provides a direct comparison of the two account opening methods, highlighting the profound impact of digital transformation on the banking sector.

Feature	Traditional Account Opening	Modern Digital Account Opening (e-KYC)
Physical Presence	Mandatory visit to a bank branch	Not required; can be done remotely
Required Documents	Hard-copy forms, passport-sized photos, proofs of identity and address	Digital photos of NID, selfie, optional income/address proofs
Need for Introducer	Required for certain account types	Not required
Processing Time	Can take several days to complete	Instant; account is created within minutes
Required Technology	Minimal; mostly paper-based	Smartphone or computer with internet access

Forms Used in Operation of Bank Account

The operation of a bank account involves a variety of forms and instruments, both traditional and digital. While modern banking has reduced the reliance on physical forms, several key documents remain essential.

1. **Pay-in-slip Book:** This book contains slips used to deposit cash, cheques, or drafts into a customer's account. The depositor fills in the details, and the bank returns a counterfoil with a date-stamp and signature as a record of the transaction.
2. **Cheque Book:** A cheque book is a set of forms that a customer uses to instruct the bank to pay a specific amount to a third party or to withdraw money from their own account. Cheques and their counterfoils are serially numbered for record-keeping and security purposes.
3. **Pass Book:** The pass book is a physical record of all transactions between the bank and the customer. It is a copy of the customer's account ledger, written by the bank. While traditionally a physical book that frequently passed between the bank and the customer, many banks now provide periodic digital account statements to current account holders in its place.

Closing of a Bank Account

A bank account may be closed under several circumstances, either at the customer's request or at the bank's initiative, often based on specific legal or regulatory conditions.

1. **At the Request of the Customer:** A customer may request the bank to close their account. The bank will typically close the account after the customer returns any unused cheques and presents their pass book for finalization.
2. **Inoperative Account:** If an account remains inactive for a long period, typically several years, the bank may classify it as inoperative and eventually close it. Before doing so, the bank is required to make a reasonable effort to contact the customer. If the customer cannot be traced, the balance is transferred to an 'Unclaimed Deposit Account,' and the funds are held until the customer or their legal heir claims them.
3. **At the Instance of the Banker:** A bank has the right to close a customer's account if the customer's conduct is deemed undesirable. This includes actions such as frequent issuance of cheques without sufficient funds (cheque bouncing), engaging in fraudulent activities, or defaulting on loans and advances. The legal and regulatory framework governing this action is robust. The Bank Companies Act, 1991, provides the Bangladesh Bank with the authority to intervene and even supersede a bank's board if its activities are detrimental to the interest of depositors. This power extends to the management of individual accounts, where action can be taken to protect the integrity of the bank and the financial system.
4. **On Receipt of a Garnishee Order:** When a bank receives a Garnishee Order, it is legally obligated to act on it. A Garnishee Order is a court-ordered action to attach funds in a judgment debtor's bank account to satisfy a debt. The legal basis for this is found in the Civil Procedure Code, 1908, which lists property, including money and bank notes, that are liable for attachment and sale in the execution of a decree. The bank's role is not to initiate the closure but to comply with the court's directive by reserving the specified amount and preventing the customer from operating the account until the order is satisfied.
5. **Termination Due to Legal Events:** A bank must stop all account operations upon receiving notice of the death, insanity, or insolvency of a customer, as these events terminate the customer's legal authority to operate the account. The balance in such accounts is then managed according to legal procedures, such as being paid to the official receiver or assignee in the case of insolvency.

Summary

This lesson has provided a detailed overview of the various types of bank accounts available in Bangladesh, including Current, Savings, Fixed Deposit, and Recurring Deposit accounts. Each account type serves a distinct purpose, from facilitating frequent business transactions to promoting long-term savings. The lesson has also highlighted the dramatic shift in the account opening process, contrasting the traditional, paper-based method that required an introducer with the modern, instantaneous e-KYC procedure.

The adoption of e-KYC, sanctioned by the Bangladesh Bank, has removed significant barriers to entry, making banking services more accessible to a broader population and serving as a critical driver for financial inclusion. Finally, the lesson has explained the various reasons for account closure, clarifying the legal and operational context behind bank-initiated closures and court-ordered actions like a Garnishee Order. The insights into these processes demonstrate how the legal framework and modern technology work in tandem to ensure the integrity and accessibility of the country's banking system.

Review Questions

1. What are the key differences between a Current Account and a Savings Account in terms of interest, transaction flexibility, and target users?
2. Explain the concept of e-KYC and how it has transformed the traditional account opening process. What are the primary benefits of this digital transformation for both banks and customers?
3. A court issues a Garnishee Order against a customer's account. What is the bank's role and legal obligation in this situation, and what specific law governs this action?
4. Discuss the circumstances under which a bank might close a customer's account at its own discretion. How is this action supported by the regulatory powers of the Bangladesh Bank?

Unit Highlights

- Lesson 1: Cheques
- Lesson 2: Crossing of Cheques
- Lesson 3: Endorsement
- Lesson 4: Holder and Holder in Due Course
- Lesson 5: Cheque Dishonour and Legal Recourse
- Lesson 6: Modern Cheque Clearing Systems in Bangladesh

Technologies Used for Content Delivery

- ❖ BOUTUBE
- ❖ BOU LMS
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- ❖ BTV Program
- ❖ Bangladesh Betar Program

Lesson 1: Cheques

Objectives of this lesson

After completion of this lesson you will be able to –

- Define a cheque and describe its essential features.
- Identify the different parties involved in a cheque transaction.
- Distinguish between various types of cheques.
- Explain the uses and advantages of a cheque in modern banking.

Key Terms

- **Negotiable Instrument:** A document that guarantees payment of a specific amount of money to an individual or entity. It is transferable and the rights to the payment can be passed from one party to another by delivery or endorsement.
 - *Example:* A cheque, a bill of exchange, and a promissory note are all recognized as negotiable instruments under the Negotiable Instruments Act, 1881.
- **Drawer:** The person who writes and signs a cheque, thereby ordering the drawee to pay a specific amount of money. The drawer is the account holder on whom the cheque is drawn.
 - *Example:* Ms. Fatima, who holds an account at a bank, signs a cheque to pay her utility bill. She is the drawer of the cheque.
- **Drawee:** The specific bank on which a cheque is drawn. The drawee is the entity that is ordered to pay the money.
 - *Example:* If a cheque is issued from an account at Pubali Bank, then Pubali Bank is the drawee.
- **Payee:** The person or entity to whom the payment is to be made.
 - *Example:* Ms. Fatima writes a cheque to the Dhaka WASA for her water bill. Dhaka WASA is the payee.

Introduction

Historically, the concept of a cheque evolved from the practices of Goldsmiths in England, who acted as the earliest form of bankers. People would deposit their valuables and gold with them for safekeeping and in return, receive a note as proof of their deposit. When a depositor needed funds, they would draw a note or a letter on the Goldsmith, instructing them to pay a specific sum to the person presenting the note. These early notes or pieces of paper were the precursors to what we now know as cheques.

Every bank in Bangladesh issues its own printed cheque forms to account holders. These forms are printed on special security paper that is sensitive to chemicals, a measure taken to make any chemical alterations readily noticeable. Cheques must be drawn on these official forms, and customers can obtain a new chequebook by signing a requisition slip provided at the end of the existing book.

Meaning of a Cheque

A cheque is a fundamental negotiable instrument governed by the provisions of the Negotiable Instruments Act, 1881. It serves as an unconditional order, issued by a depositor (the drawer) and directed to a specific banker (the drawee), to pay a specific sum of money upon demand to a named person (the payee) or to the bearer of the instrument.

While a cheque functions as an instruction to the bank to release funds, its role has transformed with the advent of modern clearing systems. Originally, a cheque's value was intrinsically linked to its physical form. In the present financial landscape, a cheque is often treated as a legally binding digital image once it enters the automated clearing process, which makes its physical presence less significant for the transaction itself.

Definition of a Cheque

Under Section 6 of the Negotiable Instruments Act, 1881, a cheque is explicitly defined as a "bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand".

This definition is crucial as it highlights the cheque's legal foundation and its relationship with other negotiable instruments. The historical origin of the Act dates back to colonial British India but it remains the foundational legal framework for negotiable instruments in Bangladesh, with key amendments made over the years to adapt to the national context and modern banking practices. This legal continuity provides a stable and predictable basis for commercial transactions and financial law in the country.

Essentials of a Cheque

For an instrument to be legally recognized as a cheque, it must satisfy several essential conditions:

1. **Instrument in Writing:** A cheque must be a physical document. While legally permissible to be written in pencil, banks generally require ink to prevent unauthorized alterations. In the modern, digitized system, the physical cheque is used to generate a digital record.
2. **Unconditional Order:** The instruction to the banker must be an unconditional order to pay. The payment cannot be made contingent on a future event or the fulfillment of a specific condition.
3. **Drawn by the Drawer:** The cheque must be issued and signed by the account holder who is legally authorized to draw funds from that specific account.
4. **Drawn Upon a Specified Banker:** The cheque must be drawn on a named and specified bank. The name and address of the bank must be clearly and definitely mentioned.
5. **Pay a Certain Sum of Money:** The amount to be paid must be a specific, certain sum of money and nothing else. The amount should be clearly written in both words and figures, and these must match.
6. **Payable on Demand:** A cheque is a payment instrument that is immediately payable when presented to the drawee bank. It is not payable at a future date unless it is a post-dated cheque.
7. **Payable to a Certain Person or Bearer:** The cheque must specify a payee, or it can be payable to the bearer of the instrument. In either case, the beneficiary must be clearly identifiable.
8. **Properly Dated:** A cheque must bear a date. An undated cheque may not be honored by the bank.
9. **Signed by the Maker:** The signature of the drawer is a mandatory requirement for a valid cheque. The signature authenticates the order to the bank.

Parties to a Cheque

A cheque typically involves three parties:

- **Drawer:** The person who has an account with the bank and issues the cheque. The drawer is a customer of the bank and is the one who signs the instrument.
- **Drawee:** The bank on which the cheque is drawn. The drawee is responsible for paying the amount to the payee. In cheque transactions, the drawee is often referred to as the paying-banker.
- **Payee:** The person or entity to whom the cheque is made payable. The payee may be a third party or, in the case of a "self" cheque, the drawer themselves.

Types of Cheques

Cheques are categorized based on their characteristics and the manner in which they can be paid:

1. **Open Cheque:** A cheque that has not been crossed. It can be cashed at the counter of the drawee bank. The drawer may also cancel a crossing to convert a crossed cheque into an open one, provided they authenticate the change with their full signature.
2. **Crossed Cheque:** A cheque that has two parallel transverse lines across its face, with or without additional words like "and company" or "not negotiable." Such a cheque cannot be paid over the counter and must be deposited into a bank account.
3. **Bearer Cheque:** A cheque payable to any person who presents it at the bank counter. The phrase "or bearer" is not cancelled on the cheque form.
4. **Order Cheque:** A cheque in which the words "or bearer" have been crossed out, and the word "or order" is sometimes added. Payment is made only to the payee named in the cheque or to someone to whom the payee has legally endorsed it.
5. **Stale Cheque:** A cheque that has become invalid because a period of six months has elapsed from the date of issue. Bangladeshi banking practice dictates that such a cheque is no longer valid and will be refused by the bank.
6. **Post-Dated Cheque:** A cheque that bears a future date. The bank will not honor it before the date written on it.
7. **Mutilated Cheque:** A cheque that is torn into two or more pieces. While it may be honored by the bank if all material parts are present and its authenticity can be verified, it is generally discouraged.
8. **Blank Cheque:** A cheque on which the drawer has signed but left the other details, such as the payee's name or the amount, blank. This type of cheque is legally valid, but it carries a significant risk for the drawer as any person in possession of it can fill in the details.
9. **Gift Cheque:** A cheque used for presentations on special occasions. These are less common today due to the widespread use of digital payment methods.

Uses of a Cheque

The use of cheques in Bangladesh has shifted from being a primary method of payment for all transactions to a more specialized tool, particularly for institutional, corporate, and high-value transactions. Key uses include:

- **Audit Trail and Record Keeping:** Payments made by cheque provide an automatic and verifiable record in the bank's books, which is essential for accounting and legal purposes.
- **Security:** Using a crossed cheque, especially one marked "Account Payee," ensures that the payment is received only by the intended recipient, which minimizes the risk of misappropriation or theft.
- **High-Value Transactions:** For significant payments, such as corporate loan repayments or government fees, cheques provide a secure and traceable method of funds transfer.
- **Convenience:** Cheques minimize the need to handle large amounts of physical cash, which reduces risks associated with theft or miscounting.

Advantages of Using Printed Forms

Modern printed cheque forms are a crucial part of the automated cheque processing system. They are designed with specific features that enhance security, efficiency, and convenience:

- **Standardization:** Printed cheques conform to the definitions and requirements of the Negotiable Instruments Act, 1881. They also adhere to the modern design standards required for automated clearing.

- **Security Features:** These forms are printed on specialized paper and often contain security features like watermarks, invisible ink logos, and other measures that make alteration difficult and easy to detect.
- **Automated Processing:** The pre-printed forms contain a Magnetic Ink Character Recognition (MICR) line, which allows for the automatic capture of key information such as the bank code, branch code, account number, and cheque number. This is fundamental for the speed and accuracy of the Bangladesh Automated Cheque Processing System (BACPS).
- **Verification and Identification:** The details on the cheque form, including the serial number and account information, are recorded in the bank's system. This makes it easy to identify the drawer and provides a clear audit trail for every transaction. This also helps in the prevention and detection of forgery.

Summary

A cheque is a legally defined negotiable instrument that serves as an unconditional order to a specific bank to pay a certain sum of money. Its usage is governed by the Negotiable Instruments Act, 1881. The instrument's validity and functionality depend on key essentials, including it being a written, unconditional, dated, and signed order from a drawer on a specified drawee to a certain payee. Various types of cheques exist, such as bearer, order, and crossed cheques, each with distinct payment implications. In modern banking, printed cheques are integral to the automated clearing process due to their standardized design and embedded security features, which provide an essential record for all transactions.

Review Questions

1. Define a cheque and explain its role as a negotiable instrument.
2. List and elaborate on the ten essential requirements for a valid cheque.
3. What are the key differences between an "open cheque" and a "crossed cheque"?
4. In the context of modern banking, explain the advantages of using standardized, printed cheque forms.
5. Describe the roles and responsibilities of the three primary parties to a cheque transaction.

Lesson 2: Crossing of Cheques

After completion of this lesson you will be able to –

- Define the meaning of a crossed cheque and its historical origins.
- Distinguish between general and special crossings and explain their effects.
- Analyze the legal significance of "not negotiable" and "account payee" crossings.
- Discuss the importance of crossing as a security measure in modern banking.

Key Terms

- **Crossing:** The act of drawing two parallel transverse lines on the face of a cheque. This is a crucial instruction to the drawee bank that the cheque must be paid only through a bank account, not over the counter.
 - *Example:* A cheque with two parallel lines on the top left corner is a general crossing.
- **General Crossing:** A crossing that consists of two parallel transverse lines. It may include the words "and company" (& Co.), "not negotiable," or an abbreviation thereof. This directs the drawee bank to pay the cheque through any other bank.
 - *Example:* Two parallel lines drawn across the face of a cheque, sometimes with the words "& Co." written between them.
- **Special Crossing:** A crossing that, in addition to the two parallel lines, specifies the name of a particular bank. This directs the drawee bank to pay the cheque only to the named bank or its agent.
 - *Example:* A cheque with the name "Janata Bank Ltd." written between two parallel lines.
- **Restrictive Crossing:** A crossing that explicitly instructs the collecting banker to credit the proceeds only to the account of the named payee. The words "Account Payee" are used to give this instruction.
 - *Example:* A cheque with the words "Account Payee Only" written between the two parallel lines.

Introduction

The practice of crossing a cheque originated in England as a measure to enhance payment security. In the early days, when cheques were frequently sent by mail, there was a risk of them falling into the wrong hands. To mitigate this, bankers introduced the system of crossing, which meant that a cheque could not be cashed at the counter and had to be routed through another bank for payment. This simple procedure provided a layer of protection by ensuring that the payment could be traced to a specific bank account, thereby reducing the risk of fraud or loss.

Meaning of Crossing

Crossing a cheque involves drawing two parallel transverse lines on its face, typically at the top left corner. This act is a definitive instruction to the paying banker, a direction recognized by the Negotiable Instruments Act, 1881. The instruction is that the cheque should be paid only to another bank, and if a specific bank is named in the crossing, then only to that bank. This prevents the holder from receiving cash directly and significantly enhances the safety of the transaction by ensuring a clear audit trail of the payment.

Types of Crossing

The Negotiable Instruments Act, 1881, primarily recognizes two types of crossing: General and Special. In addition, banking practice has established other forms of crossing that are critical for modern transactions.

- **General Crossing:** As defined in Section 123 of the Act, a cheque is considered generally crossed if it bears two parallel transverse lines on its face. The inclusion of words like "and company" or "not negotiable" does not change its fundamental nature as a general crossing. The effect of a general crossing is that the drawee bank must pay the amount to any other banker, and not directly to the payee at the counter.
- **Special Crossing:** Defined in Section 124 of the Act, a special crossing involves the addition of a specific bank's name on the face of the cheque, either with or without the words "not negotiable". This provides an even greater level of security, as the paying banker is directed to honor the cheque only when it is presented through the specific bank named in the crossing. The collecting bank may, however, appoint another banker as its agent for collection.
- **"Not Negotiable" Crossing:** The words "not negotiable" can be added to both general and special crossings. As per Section 130 of the Act, a person who takes such a cheque cannot acquire a better title to the instrument than the person from whom they received it. This means that if a cheque is stolen, the person who receives it, even in good faith and for value, will not have a valid claim against the true owner. This clause is a powerful deterrent against dealing with stolen instruments.
- **Restrictive or "Account Payee" Crossing:** This is a common banking practice, though the words "Account Payee" are not explicitly recognized by the Negotiable Instruments Act. This crossing is a vital instruction to the collecting banker to credit the proceeds of the cheque only to the account of the named payee. This is a critical security measure that prevents the cheque from being cashed or endorsed over to a third party.

Significance of Crossing

The primary purpose of crossing a cheque is to mitigate risk and ensure a clear audit trail. In a manual system, crossing prevented an unauthorized person from cashing a stolen cheque at the counter. In modern banking, the significance of crossing is amplified by the Bangladesh Automated Cheque Processing System (BACPS). Crossing now acts as a digital flag within this system, reinforcing the instruction that funds must be deposited into a bank account. This ensures that every cheque payment leaves a digital footprint, making it easier to trace the beneficiary and providing a powerful tool for fraud prevention.

A cheque can be crossed by the drawer, the holder, or a banker. A drawer can also cancel a crossing by writing "Pay Cash" and affixing their full signature, effectively converting the cheque back to an open cheque.

Summary

Crossing is a security mechanism on a cheque, created by drawing two parallel transverse lines on its face. The practice ensures that the cheque cannot be paid in cash over the counter but must be deposited into a bank account, providing an essential audit trail. There are two primary types of crossing: general, which allows the cheque to be cleared through any bank, and special, which specifies a particular bank for collection. The addition of words like "not negotiable" or "account payee" provides further security and legal safeguards, reinforcing the principle that the funds should reach the intended recipient's account.

Review Questions

1. Explain the meaning of "crossing" a cheque and its historical purpose.
2. What is the key difference between a general crossing and a special crossing?
3. Discuss the legal implications of a cheque that is crossed with the words "not negotiable."
4. Why is an "Account Payee" crossing, though not legally defined in the Act, considered a crucial security measure in banking practice?
5. Who has the authority to cross a cheque, and can a crossing be cancelled?

Lesson 3: Endorsement

After completion of this lesson you will be able to –

- Define endorsement and identify its purpose as a transfer mechanism.
- State the essentials of a valid endorsement.
- Explain the different kinds of endorsement.
- Differentiate between a cheque and a bill of exchange, and a cheque and a promissory note.

Key Terms

- **Endorsement:** The signature of the holder on the back or face of a negotiable instrument for the purpose of transferring the ownership to another person.
 - *Example:* Mr. Sharif receives a cheque and signs the back of it before giving it to his business partner, Ms. Ali. Mr. Sharif has endorsed the cheque.
- **Endorser:** The person who signs and transfers the negotiable instrument.
 - *Example:* In the above example, Mr. Sharif is the endorser.
- **Endorsee:** The person to whom the instrument is transferred.
 - *Example:* Ms. Ali is the endorsee.
- **In Blank Endorsement:** An endorsement where the endorser simply signs their name, without specifying a new payee. This makes the instrument payable to the bearer.
 - *Example:* A cheque payable to Mr. Kamal is endorsed by him by simply signing his name on the back. The cheque becomes a bearer instrument and can be transferred by mere delivery.

Introduction & Definition of Endorsement

Endorsement is the process of transferring the ownership of a negotiable instrument, such as a cheque, to another party. It literally means "writing on the back of the instrument". According to Section 15 of the Negotiable Instruments Act, 1881, endorsement occurs "when the maker or holder of a negotiable instrument signs his name, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper attached thereto". This signature, combined with the delivery of the instrument, completes the transfer of rights.

Essentials of a Valid Endorsement

A valid endorsement must adhere to the following essentials:

- **Location:** The endorsement must be on the back or face of the instrument. If there is no space, it must be made on a separate paper called an "allonge" attached to the instrument.
- **Made by the Holder:** The endorsement must be made by the legal holder or the maker of the instrument. A stranger cannot legally endorse it.
- **Signature:** It must be signed by the endorser.
- **Completed by Delivery:** The endorsement is not legally complete until the signed instrument is physically delivered to the endorsee.
- **Endorsement of the Entire Bill:** A partial endorsement, where a portion of the amount is transferred, is not considered a valid negotiation of the instrument and will be refused by the bank.

Kinds of Endorsement

Endorsements can be classified into several kinds, each with a different legal effect:

1. **Blank Endorsement:** Also known as a general endorsement, this occurs when the endorser simply signs their name on the back of the instrument. This converts a cheque payable to order into a bearer instrument, making it transferable by mere delivery.
2. **Special Endorsement:** Also called a full endorsement, this specifies the person to whom or to whose order the payment is to be made. For example, "Pay to X or order." This type of endorsement maintains the order nature of the instrument.
3. **Partial Endorsement:** This is an endorsement that purports to transfer only a part of the amount mentioned in the instrument. This is legally invalid for the purpose of negotiation.
4. **Restrictive Endorsement:** This type of endorsement prohibits the further negotiation of the instrument and limits the endorsee's right to collect the amount for a specific purpose. For example, "Pay X only" or "Pay X for my use."
5. **Conditional Endorsement:** An endorsement where the liability of the endorser is limited by a condition. For instance, "Pay A or order on his marrying B." While it does not invalidate the instrument, banks in modern automated systems may discourage or refuse such complex endorsements to ensure swift and simple clearing.

Legal Effects of an Endorsement

Endorsement has several significant legal effects, including:

- Transferring the property and legal title of the instrument to the endorsee.
- Giving the endorsee the right to sue the original parties and the endorser for recovery of the amount in case of dishonour.
- Providing the endorsee with the right to further negotiate the instrument to any person they choose.

Differences between a Cheque and a Bill of Exchange

All cheques are bills of exchange, but not all bills of exchange are cheques. The key differences are outlined in the table below:

Feature	Cheque	Bill of Exchange
Drawee	Always drawn on a specified banker.	Can be drawn on any person, including a banker.
Payable on Demand	Always payable on demand.	May be payable on demand or at a fixed future date.
Days of Grace	No days of grace are allowed as it is payable on demand.	Three days of grace are allowed for bills payable after a fixed period.
Acceptance	Requires no acceptance as it is intended for immediate payment.	Requires the drawee's acceptance to be valid and payable.
Crossing	Can be crossed for security.	Cannot be crossed.
Stamping	Does not require any stamp.	Must be properly stamped.
Stopping Payment	The drawer can countermand or stop the payment.	Once accepted, payment cannot be stopped by the drawer.

Distinguish Between a Cheque and a Promissory Note

The distinction between a cheque and a promissory note is equally important:

Cheque	Promissory Note
Number of Parties	Has three parties: drawer, drawee (banker), and payee.
Order vs. Promise	Contains an unconditional order to a banker to pay the money.
Drawee	Drawn on a specified banker.
Acceptance	No acceptance is required.

Summary

Endorsement is the legal act of transferring a negotiable instrument by signing it and delivering it to another party. A valid endorsement must be in writing, signed by the holder, and completed by delivery. There are various types of endorsements, including blank, special, restrictive, and conditional, each with a different effect on the instrument's negotiability and the endorser's liability. Understanding these distinctions is crucial for anyone dealing with negotiable instruments. While cheques, bills of exchange, and promissory notes are all negotiable instruments, they have distinct legal and functional differences that are important for both legal and commercial purposes.

Review Questions

1. What is endorsement, and what are the essential requirements for a valid endorsement?
2. Explain the difference between a blank endorsement and a special endorsement.
3. Discuss why a "partial endorsement" is considered legally invalid.
4. Describe at least three key differences between a cheque and a bill of exchange.
5. How do a cheque and a promissory note differ in terms of the number of parties and the type of command they contain?

Lesson 4: Holder and Holder in Due Course

After completion of this lesson you will be able to –

- Define "Holder" and "Holder in Due Course" as per the Negotiable Instruments Act, 1881.
- Explain the special privileges and protections afforded to a holder in due course.
- Distinguish between a simple holder and a holder in due course, based on key legal criteria.

Key Terms

- **Holder:** As defined by Section 8 of the Negotiable Instruments Act, a holder is any person who, in their own name, is entitled to the possession of a negotiable instrument and can legally recover the amount due on it from the liable parties.
 - *Example:* The payee of a cheque is a holder. A person who finds a lost bearer cheque is not a holder, as they do not have a legal title to it.
- **Holder in Due Course (HDC):** A person who, for valuable consideration, becomes the possessor of a negotiable instrument before its maturity, in good faith, and without having reason to believe that there is any defect in the title of the transferor.
 - *Example:* Ms. Ahmed gives a post-dated cheque to her supplier, Mr. Ali. Mr. Ali, a week later, endorses the cheque to a new supplier, Mr. Kamal, as payment for goods, and Mr. Kamal accepts it without knowing the original transaction. Mr. Kamal is a holder in due course, even if Ms. Ahmed's original cheque was later found to have a defect.

Holder

A holder is a person who holds a legal title to a negotiable instrument. This title must be legitimate and obtained in their own name. Simply possessing a negotiable instrument does not make a person a holder. For instance, a thief or a finder of a lost cheque, while in physical possession of the instrument, cannot be considered a holder because they lack the legal right to claim payment in their own name. Only a person with a legal right to the instrument can give a valid discharge for it and recover the amount due.

Holder in Due Course

A holder in due course (HDC) is a special and privileged class of holder. This concept is central to the free and safe circulation of negotiable instruments in commerce. As defined in Section 9 of the Negotiable Instruments Act, an HDC must fulfill several specific conditions to gain this special status:

- **For Valuable Consideration:** The person must have obtained the instrument in exchange for something of value. A person who receives an instrument as a gift or for an unlawful consideration cannot be an HDC.
- **Before Maturity:** The instrument must have been acquired before the date its payment becomes due. Acquiring an instrument after its maturity date means the person cannot be an HDC.
- **In Good Faith:** The person must have acquired the instrument honestly and without suspicion.
- **Without Notice of Defect:** The person must not have had any reason to believe that the title of the person from whom they received the instrument was defective. The HDC is protected by law even if there was a defect in the title of a prior party, provided they had no knowledge of it.

Privileges of a Holder in Due Course

A holder in due course occupies a unique position in the legal framework of negotiable instruments, enjoying certain rights that an ordinary holder does not:

1. **Instrument Cured of Defects:** Once an instrument passes through the hands of a holder in due course, it is purged of all defects in the title. This means that a subsequent holder, even a regular one, can also acquire a perfect title.
2. **Liability of Prior Parties:** All parties who signed the instrument before it reached the HDC (drawer, acceptor, endorser) remain liable to the HDC until the payment is made.
3. **Rights with Inchoate Instruments:** If a person signs and delivers a stamped but incomplete instrument, they cannot claim that it was completed against their authority when it is presented by an HDC.
4. **No Effect of Conditional Delivery:** A conditional delivery of an instrument cannot be used as a defense against a claim by an HDC.
5. **No Effect of Absence of Consideration:** The defense that the instrument was issued without consideration cannot be used against a claim by an HDC.

Distinction between Holder and Holder in Due Course

The table below outlines the key differences that separate a simple holder from a holder in due course:

Feature	Holder	Holder in Due Course (HDC)
Entitlement	Possesses the instrument and has a legal right to it.	Acquires the instrument for consideration.
Consideration	Consideration is not a mandatory requirement. An instrument may be received as a gift.	Consideration is a mandatory requirement.
Time of Possession	May acquire the instrument at any time, even after maturity.	Must acquire the instrument before its maturity date.
Title	Does not acquire a perfected title if the title of a prior party was defective.	Acquires a good and perfected title, even if a prior party's title was defective, provided they had no notice of the defect.
Presumption	A holder may or may not be an HDC.	The law presumes every holder is an HDC until proven otherwise.
Privileges	Enjoys no special privileges.	Enjoys special privileges and protections as provided by the Act.

Summary

A holder is a person with legal entitlement to a negotiable instrument and the right to receive payment. A holder in due course, however, is a privileged holder who has acquired the instrument for value, in good faith, and before it was due, without any knowledge of a defect in the previous title. This special status grants the HDC a number of important privileges, including a title free from all defects. The legal framework provides this special protection to encourage the free and confident circulation of negotiable instruments, as a person who accepts a cheque in good faith is assured of a strong legal position in the event of any disputes.

Review Questions

1. What is the definition of a "holder" under the Negotiable Instruments Act? Give an example of a person who is in possession of a cheque but is not a holder.
2. List and explain the key conditions that a person must satisfy to become a "holder in due course."
3. Explain how a holder in due course's title is different from that of an ordinary holder.
4. Describe at least three privileges enjoyed by a holder in due course.
5. "Every holder in due course must be a holder, but every holder may not be a holder in due course." Comment on this statement.

Lesson 5: Cheque Dishonour and Legal Recourse

After completion of this lesson you will be able to –

- Understand the legal framework and criminal nature of cheque dishonour in Bangladesh.
- Identify the common grounds for which a cheque may be dishonoured.
- Describe the step-by-step legal process for recourse under the Negotiable Instruments Act, 1881.
- Identify the penalties associated with the offense of cheque dishonour.

Key Terms

- **Dishonour of Cheque:** The refusal of a drawee bank to make a payment on a cheque when it is presented for encashment.
 - *Example:* A bank returning a cheque to the payee with a "Dishonour Slip" because the drawer's account has insufficient funds.
- **Section 138 of the NI Act:** The specific provision of the Negotiable Instruments Act, 1881, that makes cheque dishonour for insufficient funds a criminal offense in Bangladesh.
- **Dishonour Slip:** A document or slip issued by the drawee bank, which confirms that a cheque has been dishonoured and states the specific reason for its refusal.
- **Legal Notice:** A formal written notice sent by the payee to the drawer, demanding payment of the dishonoured cheque amount within a specific period, as required by law.

Introduction

In Bangladesh, a cheque is not merely a payment instrument; it is a legally binding commitment. When a cheque is issued, the drawer is implicitly promising that there are sufficient funds in their account to honor the payment. The legal framework has evolved to reflect this trust. A key development was the amendment of the Negotiable Instruments Act, 1881, to make the dishonour of a cheque a criminal offense rather than just a civil matter. This has provided a powerful legal recourse for payees and has become a crucial tool for upholding the integrity of the banking and credit system.

Legal Provisions and Grounds for Dishonour

The most significant legal provision is Section 138 of the Negotiable Instruments Act, 1881. This section explicitly states that if a person draws a cheque on a bank account for the payment of a debt or other liability and the cheque is returned as unpaid by the bank due to insufficient funds, or if the amount exceeds the limit of the arranged overdraft facility, a criminal offense has been committed.

A cheque can be dishonoured for a variety of reasons, including:

- **Insufficient Funds:** The most common reason for dishonour.
- **Signature Mismatch:** The drawer's signature on the cheque does not match the specimen signature held by the bank.
- **Post-Dated Cheque:** The cheque is presented for payment before the date written on it.
- **Stale Cheque:** The cheque is presented after its validity period has expired.
- **Payment Stopped:** The drawer has issued a stop-payment instruction to the bank.
- **Mutilated Cheque:** The cheque is torn or damaged to the extent that it cannot be processed.
- **Account Closed:** The account on which the cheque was drawn has been closed.

Legal Process for Recourse

To file a criminal case against a drawer for cheque dishonour under Section 138, the payee must strictly follow a specific legal process:

1. **Presentation of the Cheque:** The cheque must be presented to the drawee bank for encashment within its valid period, which is typically six months from the date of issue.
2. **Obtaining the Dishonour Slip:** If the cheque is dishonoured, the drawee bank will issue a "Dishonour Slip" stating the reason for the refusal. The payee must collect this slip within 30 days of the dishonour.
3. **Sending a Legal Notice:** Within 30 days of receiving the dishonour slip, the payee must send a formal legal notice to the drawer by registered post. The notice must demand the payment of the cheque amount.
4. **Failure to Pay:** A "cause of action" arises if the drawer fails to pay the amount within 30 days of receiving the legal notice.
5. **Filing a Complaint:** A criminal complaint can then be filed with a magistrate's court within one month of the cause of action being established. The complaint must be supported by the original cheque, the dishonour slip, a copy of the legal notice, and the postal receipts.

Penalties for the Offence

The legal framework imposes stringent penalties to deter the practice of issuing cheques without sufficient funds. The punishment for the offense of cheque dishonour can include imprisonment for a term of up to one year, a fine of up to three times the value of the cheque, or both. It is important to note that a separate case must be filed for each dishonoured cheque.

The criminal nature of this offense creates a strong deterrent. The potential for imprisonment, in addition to the financial penalty, provides a powerful incentive for individuals and businesses to maintain proper financial discipline and to ensure their accounts are adequately funded before issuing a cheque.

Summary

In Bangladesh, the dishonour of a cheque due to insufficient funds is a criminal offense under Section 138 of the Negotiable Instruments Act, 1881. This legal provision provides a clear and actionable path for a payee to seek legal recourse against a defaulting drawer. The process involves presenting the cheque within its validity period, obtaining a dishonour slip, sending a legal notice to the drawer, and, if necessary, filing a criminal complaint. The strict penalties, which include imprisonment and a significant fine, are a key feature of the law designed to foster confidence and stability in the country's financial system by making it a severe offense to issue a "bad" cheque.

Review Questions

1. What legal provision in Bangladesh criminalizes the dishonour of a cheque?
2. List at least five common reasons for a cheque to be dishonoured by a bank.
3. Explain the step-by-step legal process a payee must follow to file a case for a dishonoured cheque, including all relevant timeframes.
4. What are the possible penalties for the offense of cheque dishonour under the law?
5. How does the criminal nature of cheque dishonour contribute to the stability and trustworthiness of the banking system?

Lesson 6: Modern Cheque Clearing Systems in Bangladesh

After completion of this lesson you will be able to –

- Explain the evolution of cheque clearing from a manual to an automated system.
- Describe the function of the Bangladesh Automated Cheque Processing System (BACPS).
- Define "cheque truncation" and explain how it has revolutionized cheque clearing.
- Identify the security and design standards of modern cheques and their importance in automated systems.

Key Terms

- **Cheque Truncation System (CTS):** A system that stops the physical movement of a cheque by a presenting bank and instead transmits an electronic image and associated data to the paying bank through a central clearing house.
 - *Example:* A customer deposits a cheque at a bank. The bank scans the cheque and sends the image and data electronically for clearing, rather than physically moving the paper.
- **Bangladesh Automated Cheque Processing System (BACPS):** The centralized electronic clearing facility operated by Bangladesh Bank that uses Cheque Truncation and Imaging (CIT) technology to clear cheques between participating banks.
- **Magnetic Ink Character Recognition (MICR):** The technology used to print special magnetic characters on the bottom of a cheque. These characters are machine-readable and contain critical information for clearing, such as the cheque number, bank code, branch code, and account number.

Introduction: Evolution of Cheque Clearing

Historically, cheque clearing in Bangladesh was a manual, paper-based process. Cheques had to be physically transported from the bank of first deposit (the presenting bank) to the drawee bank, often in different cities, for verification and payment. This process was slow, susceptible to loss or damage, and lacked a centralized, real-time tracking system. A cheque could take several days to clear, especially if it was an "outstation" cheque, which created delays in financial transactions and commercial activities. This manual process was inefficient and carried inherent risks.

The paradigm shifted with the introduction of the Bangladesh Automated Clearing House (BACH), which includes the Bangladesh Automated Cheque Processing System (BACPS). This was a fundamental change that moved cheque clearing from a paper-based, manual system to a digital, image-based, and automated one.

Bangladesh Automated Cheque Processing System (BACPS)

BACPS is the central clearing house for all paper-based payments in Bangladesh, operated by Bangladesh Bank. The system processes a high volume of transactions and is designed to handle different types of cheque clearing, including high-value cheques (Tk. 5,00,000 or above) and regular-value cheques. BACPS provides a systematic, secure, and efficient settlement process for all participating banks. The system operates on a centralized model, with a main processing center in Dhaka and several regional sites that support both intra-regional and inter-regional clearing.

Cheque Truncation System (CTS)

Cheque Truncation System (CTS) is the core technology that powers BACPS. Truncation is the process of stopping the flow of the physical cheque at the presenting bank and replacing it with a digital image and electronic data for clearing purposes.

Here is how the CTS process works:

1. **Image and Data Capture:** When a cheque is deposited by a customer, the presenting bank scans the cheque and captures an electronic image along with the data from the MICR line.

2. **Digital Transmission:** This digital information (image and data) is then digitally signed and encrypted to ensure security and non-repudiation.
3. **Clearing House Processing:** The electronic data is sent to the BACPS (the clearing house), which processes the information, calculates the settlement between the banks, and routes the data to the paying bank.
4. **Final Payment:** The paying bank receives the digital image and data, verifies the cheque, and debits the drawer's account.

This process eliminates the need to physically transport cheques, a change that has fundamentally altered the legal and operational definition of "presentation." In the manual era, presentation meant physical delivery of the paper. In the CTS era, it means the electronic transmission of the image and data, which has a direct impact on the timeframes and legal recourse for dishonoured cheques.

Cheque Security and Design Standards

For the automated system to function efficiently, all cheques must conform to specific design and security standards. These include:

- **MICR Line:** Every modern cheque must have a MICR line at the bottom. This line contains essential information encoded in magnetic ink, including the routing number (bank and branch code), the account number, and the cheque's serial number. This is a critical feature for high-speed, automated sorting and processing.
- **Specialized Paper:** The cheques are printed on CBS1 standard paper, which has specific properties and security features to prevent fraud.
- **Security Features:** Physical security features such as watermarks, logos in invisible ink, and void pantographs are mandated to make forgery difficult. Digital security is also paramount, with end-to-end Public Key Infrastructure (PKI) used to secure the transmission of cheque images and data between banks.

Benefits of Automated Clearing

The shift to a modern, automated clearing system has provided numerous benefits:

- **Reduced Clearing Time:** Cheque clearing time has been drastically reduced from two to three days to a single day, regardless of geographic location.
- **Lower Costs and Risks:** The system eliminates the costs and risks associated with physically transporting millions of cheques across the country. There is no fear of loss or damage of physical instruments.
- **Increased Efficiency:** The automated system has enhanced the efficiency for both banks and customers. It has also enabled the development of other digital payment systems.
- **Enhanced Security:** The use of digital signatures and secure networks provides a high level of security for cheque transactions, reducing the instances of fraud and forgery.

Table: Manual vs. Automated Cheque Clearing (BACPS)

Feature	Manual Clearing System	Bangladesh Automated Cheque Processing System (BACPS)
Clearing Time	2-3 days, or more for inter-regional cheques.	Same-day clearing for most cheques country-wide.
Physical Movement	Cheques physically transported between banks.	Physical cheques are "truncated" at the presenting bank; only electronic images and data are transmitted.
Risk of Loss	High risk of physical loss or damage during transport.	Risk of loss is eliminated; physical cheques are archived securely at the presenting bank.
Technology Used	Manual sorting and physical delivery.	Cheque Truncation (CTS), Magnetic Ink Character Recognition (MICR), digital signatures, and secure networks.
Primary Security	Dependent on physical handling and secure transport.	Multi-layered security, combining physical features on the cheque with digital encryption and secure networks.

Summary

The Bangladesh Automated Cheque Processing System (BACPS) has fundamentally transformed cheque clearing in the country. This system, which relies on Cheque Truncation System (CTS) technology, has replaced the slow and risky manual process with a fast, secure, and efficient automated one. Modern cheques, designed with features like MICR lines and other security measures, are integral to this system, allowing for the quick and accurate processing of millions of transactions. The benefits of this automation, including reduced clearing times, eliminated transportation costs, and enhanced security, have strengthened the overall payment and settlement systems of Bangladesh.

Review Questions

1. What is "Cheque Truncation" and how does it work?
2. Explain the primary function of the Bangladesh Automated Cheque Processing System (BACPS).
3. Describe the key security features that are mandatory on modern cheques to make them compatible with automated clearing systems.
4. How has the implementation of BACPS and CTS benefited the banking sector and the economy of Bangladesh?
5. What information is encoded in the Magnetic Ink Character Recognition (MICR) line of a cheque, and why is it so important?

Loans and Advances

7

Unit Highlights

- Lesson 1: Introduction to Loans and Advances
- Lesson 2: Bank Credit and Loan

Technologies Used for Content Delivery

- ❖ BOUTUBE
- ❖ BOU LMS
- ❖ WebTV
- ❖ Web Radio
- ❖ Mobile Technology with MicroSD Card
- ❖ LP+ Office 365
- ❖ BTV Program
- ❖ Bangladesh Betar Program

Lesson 1: Introduction to Loans and Advances

After completion of this lesson you will be able to –

- Explain the general rules of sound lending as defined by both traditional banking principles and modern Bangladesh Bank (BB) regulations.
- Discuss the various forms of lending, including loans, cash credit, overdrafts, and bill discounting.
- Describe the merits and demerits of granting loans and other credit facilities.

Key Terms

- **Sound Lending:** The practice of granting credit facilities based on prudent principles to minimize risk and ensure the safety, liquidity, and profitability of a bank's funds.
- **Safety:** The primary lending principle ensuring the borrower's ability and willingness to repay the loan, thereby protecting the bank's capital and depositors' funds.
- **Liquidity:** The ability of a bank to convert its assets, including loans, into cash without significant loss of time or value to meet its financial obligations, particularly depositors' demands.
- **Working Capital:** The funds used to finance a business's day-to-day operations, such as purchasing inventory, raw materials, and managing accounts receivable.
- **Fixed Capital:** Long-term capital used to acquire fixed assets like land, buildings, and machinery for business operations.
- **Diversification:** The practice of spreading credit risk across different sectors, industries, and borrowers to mitigate the impact of a single failure.

Introduction

One of the primary and most critical functions of a commercial bank is to grant loans and advances. In Bangladesh, banks operate as crucial financial intermediaries, mobilizing deposits from the public and channeling a significant portion of these funds into productive sectors such as agriculture, industry, and commerce. This function is vital for the economic development of the country, as it provides the necessary capital for business expansion, infrastructural projects, and consumer spending.

The interest received on these loans and advances is the major source of a bank's income. However, since the funds used for lending are predominantly customer deposits, most of which are payable on demand or short notice, a bank has a profound responsibility to its depositors to ensure the safety and security of their money. Consequently, a banker must exercise extreme caution and judgment when granting credit. The principles governing this responsibility are not merely abstract concepts but are codified in the rigorous regulatory framework of Bangladesh Bank, which supervises and guides all lending activities to ensure a stable and sustainable financial system.

General Rules of Sound Lending

Effective lending is the cornerstone of a bank's stability and is guided by a set of fundamental principles. While these principles have a long history in banking, their application in Bangladesh is now meticulously defined and enforced by the Bangladesh Bank through its **Guidelines on Credit Risk Management (CRM)**. These guidelines move beyond traditional concepts to create a structured, data-driven approach to lending.

1. **Safety:** The most important rule of lending is the safety of the funds. This is the paramount concern because the bank's very existence depends on its ability to recover the loans it has extended. A bank must never sacrifice the safety of its funds for the prospect of a higher rate of interest. This principle is operationalized through a mandatory due diligence process. The

bank's credit risk management policy requires a thorough analysis of the borrower's financial viability, including an assessment of at least three years of historical financial statements to evaluate the quality and sustainability of their earnings and cash flow. Furthermore, for long-term projects, the bank must scrutinize projected financial performance to ensure that future cash flow will be sufficient to service the debt. This formal, regulatory-mandated process ensures that the bank's decision is based on objective, verifiable data rather than a subjective assessment.

2. **Liquidity:** The second golden rule is liquidity. It means the ability to convert loans back into cash without loss of time and money. Because deposits are often payable on demand, a bank cannot afford to tie up its funds for excessively long periods. Traditionally, this principle dictated that banks should lend only for short-term needs, such as working capital. However, in modern banking in Bangladesh, banks do provide long-term loans for fixed capital. To manage the liquidity risk associated with this, the Bangladesh Bank has implemented strict loan classification and provisioning rules. For example, under BRPD Circular No. 15/2024, if a single installment of a fixed-term loan becomes past due by a certain period, the entire loan is classified as substandard, requiring the bank to set aside a significant provision. This regulatory mechanism forces banks to actively manage and enforce repayment schedules, effectively mitigating the liquidity risk of long-term lending.
3. **Return or Profitability:** A bank must invest its funds to earn a reasonable return. This allows the bank to pay a fair rate of interest to its depositors, provide good salaries to its employees, and generate a profit for its shareholders. However, profitability should never be achieved at the expense of safety or liquidity. If two loan proposals have equal levels of safety and liquidity, the bank should opt for the one that offers a higher rate of interest. This principle is also balanced with the national interest through various concessional lending schemes.
4. **Diversification:** The age-old proverb, "One should not put all his eggs in one basket," perfectly illustrates this principle. A bank should not concentrate all its lending in a single industry or a small number of borrowers. If that industry or a few major borrowers were to fail, the bank's entire portfolio could be at risk. The Bangladesh Bank's CRM guidelines formalize this by requiring banks to have a clear credit strategy that defines their risk appetite and identifies target markets and business sectors. This strategy includes a statement of the bank's willingness to grant credit based on the type of economic activity, geographical location, and other factors, thereby promoting prudent diversification of its loan portfolio.
5. **Object of Loan:** A banker must thoroughly examine the purpose for which a client is seeking a loan. This enables the bank to assess the loan's safety and liquidity. A loan for a productive purpose, such as acquiring inventory or machinery for a viable business, is more likely to be repaid than a loan for an unproductive or speculative purpose. This principle is reflected in the wide range of purpose-based loan products available in the Bangladeshi market, such as specialized loans for agriculture, small and medium enterprises (SMEs), and consumer durables.
6. **Security:** A loan is considered "secured" when it is backed by tangible assets whose market value is not less than the loan amount. In case of a default, the bank can recover its funds by liquidating this security. While secured loans are generally preferred, modern banking in Bangladesh has increasingly embraced unsecured or partially secured loans, especially in priority sectors. For instance, the government and Bangladesh Bank encourage collateral-free loans for up to BDT 25 lakh for women entrepreneurs and other segments to promote financial inclusion. The risk in such cases is mitigated not by physical collateral but by other factors like the borrower's credit history and the project's viability.
7. **Margin Money:** In the case of a secured loan, a bank must ensure a sufficient margin between the loan amount and the value of the security. This margin acts as a buffer against fluctuations in the value of the collateral or accrued interest. For example, if the value of a security is BDT

10 lakh, a bank might grant a loan of only BDT 7 lakh, maintaining a 30% margin. This provides an additional layer of safety, as the loan might become unsecured if the value of the collateral falls below the outstanding loan amount.

8. **National Interest:** Banks in Bangladesh are not only commercial entities but also instruments of national economic policy. Bangladesh Bank exercises social control over banks, requiring them to lend a certain percentage of their funds to priority sectors, such as agriculture, SMEs, and export-oriented industries. This principle has evolved significantly. Today, it is expressed through modern initiatives like

Green Banking, where the central bank mandates that all banks develop a comprehensive green banking policy and disburse a portion of their credit to environmentally friendly projects. Bangladesh Bank offers specific refinance schemes for these green products at concessional interest rates, effectively incentivizing banks to align their lending with the country's sustainable development goals.

9. **Character of the Borrower:** A banker must carefully assess the character of the borrower. This concept, once a subjective judgment, has been transformed into a data-driven process. Character implies honesty, integrity, creditworthiness, and the capacity to repay. The modern banker relies heavily on objective data, particularly the **Credit Information Bureau (CIB) report**, to verify a borrower's credit history and assess their repayment behavior. This shift from a subjective "third eye" to a regulated, mandatory data check ensures that lending decisions are based on a documented history of financial integrity.

Forms of Lending (Advances) Banks offer various forms of credit facilities to meet the diverse needs of their clients for working capital and fixed capital. The most common forms are loans, cash credit, overdrafts, and the purchase and discounting of bills of exchange.

1. **Loans** This is the oldest and a very popular form of lending. In a loan facility, a fixed amount of financial assistance is granted for a specific purpose and for a fixed period. The customer can withdraw the entire sanctioned amount in a single lump sum. Consequently, interest is charged on the entire amount of the loan, regardless of whether the customer has utilized all of the funds. The loan is typically repaid in either a single lump sum at the end of the term or in fixed installments over the life of the loan. If the customer requires additional funds after repayment, they must submit a new application for a fresh loan or a renewal of the existing one.

Merits of Granting Loans

- **Simplicity and Predictability:** The loan method is simple to understand. The borrower knows the fixed amount they have received, the interest rate, and a clear repayment schedule in advance.
- **Better Recovery:** The structured repayment schedule, especially for installment-based loans, makes it easier for the bank to monitor the borrower's repayment discipline and for the borrower to plan their finances.
- **Profitability for the Bank:** Since interest is charged on the full sanctioned amount, even if the funds are not fully withdrawn, this method can be more profitable for the bank compared to other revolving credit facilities.

Demerits

- **Inflexibility:** This method is highly inflexible. The borrower cannot withdraw additional funds beyond the initial disbursement without a new application and approval process.
- **Potential for Over-borrowing:** Due to the inflexibility, a customer may borrow more than their immediate needs to account for potential contingencies, leading to over-borrowing and unnecessary interest costs.
- **More Formalities:** As a formal credit arrangement, the loan method involves more complicated documentation and a more rigorous application process compared to other facilities.

Review Questions

1. Explain how the Bangladesh Bank's Credit Risk Management (CRM) guidelines have transformed the traditional principles of "Safety" and "Character of the Borrower" into a modern, data-driven lending process.
2. In the context of the Bangladeshi banking sector, what is the significance of the "National Interest" principle in lending? Provide two specific examples of how this principle is implemented today.
3. Discuss the key differences between the traditional understanding of a bank's "Liquidity" principle and its modern application through Bangladesh Bank's loan classification circulars.
4. Why is diversification of a bank's loan portfolio considered a critical element of sound lending, and how is it related to Bangladesh Bank's CRM guidelines?
5. What are the main advantages and disadvantages of a traditional bank loan from both the borrower's and the bank's perspective?

Lesson 2: Bank Credit and Loan

After completion of this lesson you will be able to –

- Differentiate between the various forms of bank credit, including cash credit, overdrafts, and bill discounting.
- Explain the various types of loans and advances based on purpose, time, and security.
- Describe the modern process for determining a borrower's creditworthiness.
- Identify and explain the key sources of credit information in the Bangladeshi banking system.

Key Terms

- **Cash Credit:** A flexible, revolving credit facility for businesses, with a pre-approved limit. Interest is charged only on the amount actually withdrawn, making it ideal for managing working capital.
- **Overdraft:** A short-term line of credit that allows a current account holder to withdraw funds beyond their available balance, up to a pre-approved limit. It is typically granted on an existing current account.
- **Bill of Exchange:** A written order binding one party (the drawer) to pay a fixed sum of money to another party (the payee) at a specified future date.
- **Creditworthiness:** The assessment of a borrower's ability and willingness to repay a loan, typically evaluated based on their character, capacity, capital, collateral, and the conditions of the business and market (the '5 Cs' of Credit).
- **Credit Information Bureau (CIB):** An automated, centralized database maintained by Bangladesh Bank that stores the credit history of all borrowers from scheduled banks and non-bank financial institutions.
- **Collateral Information System (CIS):** A new database being developed by Bangladesh Bank to track and prevent fraudulent multiple mortgages on immovable assets used as loan collateral.

Cash Credit Cash credit is the most popular and widely used method of lending for working capital in Bangladesh. It accounts for more than two-thirds of the total bank credit disbursed. Under the cash credit system, a limit, known as the credit limit, is sanctioned by the bank, allowing the borrower to draw money up to that limit as needed. The borrower can withdraw and repay funds any number of times within the sanctioned limit.

A key feature of cash credit is that interest is charged only on the actual amount withdrawn and for the period the funds are utilized. The facility is typically granted against the security of tangible assets, such as inventory or accounts receivable.

Commitment Charges: To discourage borrowers from keeping large portions of the sanctioned funds idle, banks may levy a commitment charge on the unutilized portion of the credit limit. The original text's rigid rule of a 1% per annum charge on limits of BDT one crore or more is now outdated. Modern practices indicate that commitment charges and other fees are now often determined through mutual agreement between the bank and the customer.

Merits of Cash Credit

- **Flexibility:** The greatest advantage is its flexibility. A customer can withdraw and deposit money at will, making it an efficient tool for managing fluctuating working capital needs.
- **Economical:** The borrower pays interest only on the utilized amount and for the period of its use, which is more cost-effective than a traditional loan where interest is charged on the entire sanctioned amount.
- **Less Formalities:** Compared to a new loan, there are fewer formalities and documentation is less complicated, as the facility is typically renewed annually.

Demerits

- **Over-borrowing:** The annual limit setting can encourage a tendency for businesses to request a higher limit than they currently need to cover future contingencies, which can lead to over-borrowing and potentially fund diversion.
- **Lack of Control over Funds:** While the bank controls the amount of credit sanctioned, it has less direct control over the specific use of the withdrawn funds. This can result in borrowers diverting funds for purposes not approved by the bank, increasing risk.
- **Under-utilization of Funds:** In practice, a large amount of the sanctioned cash credit limit often remains unutilized, which can reduce the bank's profitability and credit fund management efficiency.

3. Overdrafts An overdraft is a short-term credit facility that is generally granted to a current account holder. It allows the customer to withdraw money or issue cheques that exceed their available balance, up to a pre-approved limit. Overdrafts are typically provided on a written request and are an implied facility in many current account relationships.

Similar to a cash credit, interest is charged only on the overdrawn amount and for the number of days it is utilized. An overdraft is a highly convenient and flexible solution for managing temporary cash flow mismatches without the need for extensive paperwork or a new account opening.

Distinction between Loan and Cash Credit To better understand these two facilities, their key differences are summarized in the table below.

Feature	Loan	Cash Credit
Amount	A fixed amount is sanctioned and disbursed in a lump sum or single instance.	A credit limit is sanctioned, and the borrower can withdraw funds up to that limit.
Period	Can be granted for a short, medium, or long term (1 to 20+ years).	Typically granted for a short period, usually up to one year, and is renewable.
Withdrawal	The entire amount is credited to the customer's account at once.	The customer can withdraw funds multiple times, up to the sanctioned limit.
Interest	Interest is payable on the entire sanctioned loan amount from the date of disbursement.	Interest is payable only on the amount actually withdrawn and for the period it is used.
Repayment	Ordinarily repaid in a single lump sum or in fixed installments over the term.	The borrower can repay any surplus amount at any time, and the facility is of a revolving nature.

Export to Sheets

Distinction between Cash Credit and Overdraft While their purpose and nature are similar, cash credit and overdraft facilities have distinct characteristics.

Feature	Cash Credit	Overdraft
Purpose	Primarily for a business's working capital requirements.	For a business's or individual's short-term and urgent financial needs.
Account	Requires a separate, dedicated cash credit account to be opened.	The facility is linked to an existing current account.
Security	Usually requires collateral in the form of tangible assets like inventory or receivables.	Often unsecured, based on the customer's credit history and relationship with the bank, although a guarantee may be requested for higher limits.
Interest Rate	Generally has a lower interest rate due to its collateral backing.	Tends to have a higher interest rate, as it is often unsecured.
Tenure	Typically a more formal arrangement with a one-year tenure, which is usually renewed.	Considered a temporary, demand-based facility.

Export to Sheets

4. Purchase and Discounting of Bills of Exchange The purchase and discounting of bills of exchange is a financial accommodation offered by banks to their customers, particularly in the context of trade transactions. When a customer receives a bill of exchange from a buyer, it is a promise of future payment. Rather than waiting until the bill's maturity date to receive the funds, the customer can "discount" the bill with their bank. The bank buys the bill from the customer at a discounted value, crediting the customer's account with the funds immediately. The difference between the bill's face value and the amount paid to the customer is the discount, which is the bank's fee for providing the immediate liquidity. The bank then holds the bill until its maturity date and presents it to the drawee for payment.

For Islamic banks, the conventional practice of bill discounting is a contentious issue. The International Islamic Fiqh Academy and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) consider bill discounting to be impermissible under Shariah law, as it is viewed as a loan with interest, which is known as *riba*. Therefore, Islamic banks in Bangladesh utilize alternative, Shariah-compliant financing models, such as

Murabaha or *Bai-Muajjal*, to finance trade transactions, where the bank purchases the goods and sells them to the client at a higher, agreed-upon price to be paid at a later date.

Types of Loans and Advances Loans and advances in Bangladesh can be classified in various ways, providing a clear overview of the market's structure and function.

A. Based on Object or Purpose This classification is based on the use of the loan proceeds and reflects the diverse needs of a modern economy.

- **Commercial Loans:** These are short-term loans granted to businesses to meet their working capital requirements, such as purchasing inventory and managing accounts receivable.
- **Consumer Loans:** Provided to individuals to finance household goods and personal needs, such as a car, a television, or a home. This category is a significant driver of the retail banking segment.
- **Agricultural Loans:** Tailored for farmers and agribusinesses to meet their short-term and long-term needs, such as buying seeds and fertilizers or purchasing farming equipment. Bangladesh Bank and other financial institutions offer specific schemes with concessional interest rates and flexible repayment plans aligned with seasonal income cycles.
- **SME Loans:** This is a crucial category for the Bangladeshi economy, as banks provide specialized credit facilities to small and medium enterprises (SMEs), cottage industries, and

micro-enterprises. These loans often come with simplified documentation and can be partially or fully unsecured, especially for women entrepreneurs, reflecting the government's push for financial inclusion.

- **Green Loans:** A new and growing category driven by Bangladesh Bank's Sustainable Finance policy. These loans are specifically for environmentally friendly projects, such as renewable energy, effluent treatment plants (ETPs), and sustainable machinery.

B. Based on Time

- **Short-term Loans:** Extended for a period of less than one year, primarily to meet working capital requirements.
- **Medium-term Loans:** Granted for a period ranging from one to five years, often for purchasing equipment, vehicles, or a small business expansion.
- **Long-term Loans:** Provided to meet long-term capital needs, with a tenure ranging from three to twenty years or more. These are typically for purchasing fixed assets like land, buildings, and heavy machinery.

C. Based on Security

- **Secured Loans:** These are loans granted against the security of tangible assets, such as real estate, machinery, or fixed deposits. In case of default, the bank has the right to realize the security to recover its funds. The market value of the security must be equal to or greater than the loan amount.
- **Unsecured Loans:** These loans are granted without any tangible security. The decision to grant an unsecured loan is based solely on the borrower's creditworthiness, character, and financial standing. While riskier for the bank, unsecured loans are a key tool for promoting financial inclusion for individuals and small businesses that lack conventional collateral.

D. Based on Form This classification refers to the type of credit facility provided, as discussed earlier: Loan, Cash Credit, and Overdraft.

Determining Creditworthiness For a bank, a loan is not merely a transaction; it is a critical assessment of risk. The process of determining a borrower's creditworthiness has evolved from a subjective appraisal to a formal, structured exercise guided by the '**5 Cs of Credit**' framework, as detailed in Bangladesh Bank's CRM guidelines. The modern banker does not rely on intuition; they use a systematic approach to assess the following factors:

- **Character:** The most important factor, representing the borrower's honesty, integrity, and willingness to repay the loan. This is no longer a matter of personal judgment but is objectively verified through the **Credit Information Bureau (CIB) report**, which provides a comprehensive history of the borrower's past financial obligations and repayment behavior.
- **Capacity:** The borrower's ability to generate sufficient cash flow to repay the loan. This is assessed by analyzing a minimum of three years of the borrower's historical financial statements and their projected financial performance.
- **Capital:** The borrower's financial strength and personal stake in the business. A higher equity contribution (a low debt-to-equity ratio) demonstrates the borrower's commitment and provides a buffer for the business against unexpected losses.
- **Collateral:** The security offered to back the loan. While some loans are unsecured, collateral provides a secondary source of repayment in case of default. The value and quality of the collateral, along with the bank's legal right to liquidate it, are meticulously assessed.
- **Conditions:** The broader economic, industry, and market conditions that could impact the borrower's ability to repay. A modern banker must analyze the borrower's position within their industry, key risk factors, and the overall business environment.

Sources of Credit Information Assessing creditworthiness requires accurate and reliable information. The original study guide's statement that there are "no specialised agencies" in Bangladesh is profoundly outdated. The banking sector has undergone a massive digital transformation, and the primary source of credit information is now a centralized, automated system.

1. **Credit Information Bureau (CIB):** Established by Bangladesh Bank in 1992, the CIB is a highly sophisticated online system that acts as the central repository for all credit-related information in the country. All scheduled banks and non-bank financial institutions are mandated to check the CIB report for all new credit requests. The CIB collects both positive and negative credit data, including credit card information, for any outstanding balance of BDT 1 and above. This system provides a comprehensive, two-year historical view of a borrower's financial obligations and is a cornerstone of a disciplined lending environment, significantly reducing default rates and preventing over-exposure.
2. **Collateral Information System (CIS):** Recognizing a major vulnerability in lending, Bangladesh Bank began developing a Collateral Information System in 2016. The primary purpose of this database is to store information on all immovable assets (land, flats, buildings) that are mortgaged against loans. This is a brilliant, forward-thinking initiative designed to prevent fraud and forgery where a single property is unlawfully used as collateral for multiple loans from different banks. This system complements the CIB by providing a central database for collateral, a critical element of risk management.
3. **The Borrower:** The initial source of information is the borrower themselves, who provides details through a carefully designed application form and supporting documents like bank statements and tax records. This information forms the basis of the bank's initial due diligence.
4. **Exchange of Credit Information:** Banks may also exchange credit information among themselves, a practice that is now protected by law in Bangladesh to encourage free and fair disclosure of a borrower's financial standing and history.

Review Questions

1. Explain the key differences between a Cash Credit and an Overdraft facility. Under what circumstances would a business prefer one over the other?
2. How has the development of the Credit Information Bureau (CIB) transformed the process of assessing a borrower's "Character" in Bangladesh? What data does a modern CIB report provide?
3. Discuss the significance of the new Collateral Information System (CIS) in mitigating credit risk. What specific type of fraud is it designed to prevent?
4. Why is the conventional practice of "Purchase and Discounting of Bills" considered problematic for Islamic banks in Bangladesh? What is the Shariah-compliant alternative?
5. Beyond the categories mentioned in the original text, identify and explain two new types of purpose-based loans that are prevalent in modern Bangladeshi banking. How do these loans support national economic policy?

Negotiable Instruments Law and Practice in Bangladesh

8

Unit Highlights

Lesson 1: Negotiable Instruments

Lesson 2: Promissory Note, Bill of Exchange and Cheque

Technologies Used for Content Delivery

- ❖ BOUTUBE
- ❖ BOU LMS
- ❖ WebTV
- ❖ Web Radio
- ❖ Mobile Technology with MicroSD Card
- ❖ LP+ Office 365
- ❖ BTV Program
- ❖ Bangladesh Betar Program

Lesson 1: Negotiable Instruments

After completion of this lesson you will be able to –

- Define a negotiable instrument according to both legal statute and commercial practice in Bangladesh.
- Explain the essential features that distinguish a negotiable instrument from other legal documents.
- Describe the types of negotiable instruments recognized under Bangladeshi law, including those by statute and custom.
- Analyze the legal and practical implications of "negotiability" and the unique concept of a "holder in due course."

Key Terms

- **Negotiable Instrument:** A transferable document that guarantees the payment of a specific amount of money, either on demand or at a set future time.
 - *Example:* A cheque is a negotiable instrument. It guarantees the payee a fixed sum and can be transferred to a third party by endorsement and delivery.
- **Negotiability:** The quality of an instrument that allows for its ownership and title to be transferred freely from one person to another, conferring a good title to a bona fide transferee for value.
 - *Example:* A person who receives a cheque in good faith, even from a person who had stolen it, can acquire a valid and indisputable title.
- **Holder in Due Course:** A person who has obtained a negotiable instrument for value and in good faith, before it was overdue, and without notice of any defect in the title of the person who transferred it.
 - *Example:* A shopkeeper who accepts a customer's cheque as payment for goods without knowing that the cheque was stolen is considered a holder in due course, and their interest in the instrument is protected by law.
- **Transferability:** The ability of an instrument to be passed from one person to another. This is a necessary feature of a negotiable instrument, but not all transferable instruments are negotiable, as transferability alone does not confer a good title on a transferee.
 - *Example:* A simple loan agreement is a transferable contract, but a person who receives it from a thief would not acquire a good title to the debt, as the thief had no title to transfer.
- **Bearer Instrument:** An instrument that is payable to whoever is in physical possession of it. Its title is transferred by mere delivery without any need for endorsement.
 - *Example:* A banknote is a bearer instrument.
- **Order Instrument:** An instrument that is payable to a specified person or to their order. Its title is transferred by endorsement and delivery.
 - *Example:* A cheque that is "Payable to the order of Mr. Ahmed" is an order instrument.
- **Indorsement:** The signature of the holder on the back of a negotiable instrument for the purpose of transferring its ownership.
 - *Example:* When a payee signs the back of a cheque to transfer it to a third party, they are endorsing it. An indorsement can be either "in blank" (just a signature) or "in full" (a signature with a direction to pay a specified person).

Introduction

Negotiable instruments are a cornerstone of modern financial systems, forming the basis for a significant portion of business and consumer credit transactions. These are legally defined, transferable documents that facilitate the secure and efficient movement of money without the need for physical currency. The law governing these instruments in Bangladesh is primarily enshrined in the Negotiable Instruments Act, 1881. Despite its colonial-era origin, this Act remains the fundamental legal framework and has been adapted through subsequent amendments to align with the country's evolving economic and legal landscape.

Historically, the use of negotiable instruments has been integral to commerce, particularly in the absence of advanced digital infrastructure. Over time, these instruments have evolved from simple handwritten documents to highly standardized forms like cheques and bills of exchange, each playing a specific role in credit creation and trade. While the legal decisions regarding these instruments in Bangladesh are fewer compared to other jurisdictions, it is a reflection of the legal system's preference for dispute settlement outside of court, rather than a lack of their commercial importance. Today, while the landscape of finance is rapidly digitizing, the foundational principles and legal concepts established by the Negotiable Instruments Act continue to inform and govern both traditional and emerging payment mechanisms.

Definition of Negotiable Instrument

The Negotiable Instruments Act, 1881, does not provide a comprehensive, all-encompassing definition of a negotiable instrument by way of a general principle. Instead, Section 13 of the Act provides a statutory list, stating that a "negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or bearer". This statutory approach identifies the three main instruments that are inherently negotiable by law. This specific identification does not, however, preclude other types of financial documents from acquiring the status of a negotiable instrument.

The legal framework in Bangladesh recognizes a dual nature of negotiability. While some instruments are negotiable by statute, others can achieve this status by established custom or usage of trade. For an instrument to be considered negotiable by custom, it must exhibit the fundamental characteristics of a negotiable instrument as recognized by commercial practice. This legal principle is also acknowledged by other related statutes, such as the Transfer of Property Act, 1882, which in its Section 137, references instruments that may be negotiable by law or custom. Therefore, the legal status of an instrument depends on its nature—whether it is explicitly named in the Act or has developed its negotiable character through commercial practice.

Essential Features of Negotiable Instruments

Negotiable instruments possess unique characteristics that differentiate them from other financial documents and legal contracts. These features are critical for fostering confidence in commerce and facilitating the free flow of capital.

A primary feature is the **unconditional nature** of the promise or order to pay. The payment of a negotiable instrument must not be made dependent on a future event that is not certain to happen. For instance, an order to pay "upon the marriage of my daughter" would be considered a conditional order and would not qualify the instrument as negotiable, as the event of marriage may or may not occur. However, if the payment is linked to an event that is certain to happen, such as "on the death of my uncle," the promise or order is still considered unconditional, even if the timing is uncertain. This principle ensures certainty of payment and removes ambiguity from the instrument.

Another vital feature is its **easy transferability**. The ownership of a negotiable instrument can be passed from one person to another, which is a key component of its functionality. The method of transfer depends on the type of instrument. If it is a bearer instrument, its ownership can be transferred by mere physical delivery. For an order instrument, the transfer requires both

endorsement by the holder and delivery to the new recipient. This ease of transfer allows instruments to circulate freely in the economy and serve as a substitute for cash.

Perhaps the most important and distinguishing characteristic is that a negotiable instrument confers an **absolute and good title on a bona fide transferee**. This principle is a major exception to the general legal maxim of

Nemo Dat Quod Non Habet—meaning "no one can give what they do not have." The general rule of law holds that if a person's title to a commodity is defective (e.g., they stole it), they cannot transfer a better title than the one they possess to another person, even if that person buys the item in good faith and for value. For example, if a thief sells a stolen car, the buyer, despite paying for it, will not acquire a good title, and the true owner can reclaim the car.

A negotiable instrument operates on a different legal footing to promote the reliability of commercial paper. A person who takes a negotiable instrument in good faith, for value, and without knowledge that the transferor had a defective title (e.g., the instrument was stolen) is legally protected. This person, known as the **holder in due course**, acquires a good title to the instrument, and the original owner's right to the instrument is extinguished. The original owner's recourse would be to sue the thief, not to recover the instrument from the holder in due course. This legal protection is fundamental to the entire system of credit and commerce; it allows businesses and individuals to accept these instruments with confidence, knowing they are protected by law, thereby fostering trust and liquidity in the market.

Finally, the **right to sue** upon the instrument is a direct consequence of the legal title. A holder in due course possesses the right to sue for the amount specified in the instrument in their own name and to recover the funds from the party liable to pay.

Types of Negotiable Instruments

Negotiable instruments can be broadly categorized into two main types based on their legal origin:

1. **Negotiable Instruments by Statute:** These are the instruments explicitly recognized and governed by the Negotiable Instruments Act, 1881. The Act specifies three such instruments:
 - **Promissory Note**
 - **Bill of Exchange**
 - **Cheque** These instruments are, by their very nature, considered negotiable and are subject to the legal provisions of the Act.
2. **Negotiable Instruments by Custom or Usage:** Over time, certain other documents have acquired the character of negotiability through long-standing commercial practice and trade custom. These instruments, while not explicitly mentioned in the Negotiable Instruments Act, are nonetheless recognized as negotiable because they embody all the essential features of a negotiable instrument. Examples of such instruments can include debentures and certain forms of Hundis, which were traditional Indian credit instruments. The recognition of these instruments by custom underscores the dynamic nature of commercial law, which adapts to the evolving needs of trade and finance.

There are also **exceptional cases** where an instrument, while a negotiable instrument by statute, can have its negotiability restricted or taken away by the drawer or the holder. For example, if a cheque is made payable to a specified person "only" and not "to his order or bearer," it cannot be transferred to any other person, and thus loses its negotiability. Another common example is a cheque crossed with the words "Not Negotiable". While such a cheque can still be transferred, it removes the crucial protection of the "holder in due course" rule. The transferee of a "Not Negotiable" cheque acquires no better title than that of the person who transferred it, meaning if the transferor's title was defective, the transferee's title would also be defective. This distinction is critical for understanding the practical application of negotiability in commercial transactions.

Summary of Lesson 1

Negotiable instruments are transferable financial documents that are legally recognized to guarantee payment. The law in Bangladesh, primarily the Negotiable Instruments Act, 1881, identifies a promissory note, a bill of exchange, and a cheque as negotiable instruments by statute. The core legal principle that makes these instruments unique is their ability to confer a good and absolute title to a holder in due course, even if the transferor had a defective title. This crucial feature, which is an exception to the general rule of law, is what gives negotiable instruments their high degree of trust and reliability in commercial transactions. Other key characteristics include their unconditional nature, ease of transferability, and the right of a holder to sue upon the instrument in their own name. While a cheque can be made non-negotiable by the drawer, it remains a transferable document, albeit without the full legal protection offered by the Act.

Review Questions

1. Explain, with an example, the concept of a "holder in due course" and why it is considered the most important feature of a negotiable instrument.
2. What is the difference between an instrument that is merely "transferable" and one that is "negotiable"?
3. Name the three instruments that are negotiable by statute in Bangladesh. Can any other documents be considered negotiable? If so, explain how.
4. Why is the unconditional nature of a promise or order to pay essential for a document to be a negotiable instrument?
5. What happens when a cheque is crossed with the words 'Not Negotiable'? How does this affect its transferability and the title of the transferee?

Lesson 2: Promissory Note, Bill of Exchange and Cheque

After completion of this lesson you will be able to –

- Define and differentiate between a promissory note, a bill of exchange, and a cheque.
- Analyze the roles of the parties involved in each instrument.
- Explain the legal and practical reasons for the declining use of paper instruments and the rise of digital alternatives.
- Describe the legal process and consequences of a cheque dishonour in Bangladesh, including recent judicial pronouncements.
- Discuss the impact of modern payment systems and cybersecurity laws on negotiable instruments.

Key Terms

- **Promissory Note:** An instrument in writing containing an unconditional promise, signed by the maker, to pay a certain sum of money to a specified person, or to their order, or to the bearer of the instrument.
- **Bill of Exchange:** An instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money to a specified person, or to their order, or to the bearer of the instrument.
- **Cheque:** A specific type of bill of exchange, always drawn on a specified banker and not expressed to be payable otherwise than on demand.
- **Drawer:** The person who writes or "draws" a cheque or bill of exchange.
- **Drawee:** The person (or bank) who is ordered to pay a bill of exchange or cheque.
- **Payee:** The person who is entitled to receive the payment from a negotiable instrument.
- **Maker:** The person who creates and signs a promissory note.
- **Cheque Dishonour:** The refusal by a bank to pay a cheque, typically due to insufficient funds or other discrepancies.
- **Digital Payments:** Financial transactions conducted through electronic means, such as Mobile Financial Services (MFS) or digital banking platforms.
- **Cyber Security Act, 2023 (CSA):** The primary legislation in Bangladesh governing online and digital activities, including financial transactions, which replaced the Digital Security Act, 2018.

Promissory Note

A promissory note is a fundamental debt instrument in which one party, known as the **maker**, makes an unconditional promise in writing to pay a determinate sum of money to another party, the **payee**, either on demand or at a predetermined future date. It is essentially a written acknowledgment of a debt with a commitment to repay it. Unlike a bill of exchange or cheque, a promissory note involves only two parties: the maker (the debtor) and the payee (the creditor). The document is signed by the maker, and no acceptance by the payee is required for it to be a valid, legally binding document.

While promissory notes were a staple in traditional credit transactions, their use has become more specialized in the modern Bangladeshi financial landscape. They are less common in general commercial transactions but continue to be used in specific contexts, such as in personal loans between individuals, for recording debts, and within corporate group structures to facilitate cashless equity subscriptions or internal loan repayments. They are an essential tool for tax and record-keeping purposes in these scenarios. A promissory note is typically unsecured unless it is combined with a separate security agreement, such as a mortgage.

Bill of Exchange

A bill of exchange is an instrument in writing that contains an unconditional order, signed by its maker, to pay a specific sum of money to a third party or to the bearer. The defining characteristic of a bill of exchange is that it involves three parties: the **drawer** (the person giving the order), the **drawee** (the person directed to pay), and the **payee** (the person to whom payment is to be made). The drawer and payee can be the same person. For a bill of exchange to become legally effective, it must be accepted by the drawee, who signifies their agreement to pay by signing the instrument. While the bill of exchange may seem anachronistic to those familiar with modern digital payments, it remains an indispensable instrument in **international trade and finance**. The primary purpose of a bill of exchange is to facilitate trade between importers and exporters, especially across borders. In a typical transaction, an exporter (the drawer and payee) can draw a bill on an importer (the drawee) for payment for goods shipped. The importer's acceptance of the bill provides a secure payment mechanism, mitigating the risks associated with international trade.

A key commercial practice related to bills of exchange is **bill discounting**. This involves a bank purchasing a bill from the holder (the exporter) before its maturity date and crediting the amount to the holder's account after deducting a discount charge. This practice provides immediate liquidity to the exporter, who might otherwise have to wait for an extended period for the importer to make the payment. In Bangladesh, the use of bills of exchange in this manner is a critical component of trade finance, particularly in the context of export bills drawn under letters of credit (LCs). The traditional use of these instruments may not be widespread among the general public, but they are a fundamental component of the country's trade and commercial ecosystem.

Cheque

A cheque is a special type of bill of exchange that is defined by two key characteristics: it is **always drawn on a specified banker** and is **always payable on demand**. A cheque does not require the drawee bank's acceptance before payment can be demanded by the payee. The parties involved are the drawer (the account holder writing the cheque), the drawee (the specified bank), and the payee (the person to whom the payment is directed). Cheques remain a popular instrument for large-scale business and official transactions in Bangladesh due to their security features and legal standing.

Cheque Dishonour: The Legal Framework and Consequences

Despite their widespread use, cheque transactions in Bangladesh are plagued by a high rate of dishonour, often due to a lack of sufficient funds in the drawer's account. A cheque is said to be dishonoured when the bank refuses to make the payment for any reason. To address this prevalent issue and promote trust in financial instruments, the legal framework was amended to introduce a criminal remedy. Chapter XVII of the Negotiable Instruments Act, 1881, specifically Section 138, deals with penalties in cases of dishonour of certain cheques. The criminalization of cheque dishonour was a deliberate legislative action aimed at deterring individuals from issuing cheques without the intent or means to honor them, thereby strengthening the legal accountability of drawers and fostering financial discipline.

Under Bangladeshi law, cheque dishonour is considered a criminal offense, punishable by imprisonment for a term that may extend to one year or a fine that may extend to three times the value of the cheque, or both. This legal recourse is considered more effective than a civil claim for debt recovery.

Legal Procedure for Filing a Case under Section 138

For a criminal prosecution to be initiated under Section 138, a specific, multi-step procedure must be meticulously followed. These steps, and their associated deadlines, are strictly enforced by the courts:

Step	Action Required	Legal Basis & Deadline
1. Cheque Presentation	The payee must present the cheque to the bank for encashment.	The cheque must be presented to the drawee bank within six months from the date of its issuance or within the period of its validity, whichever is earlier. Note: A cheque's validity period is typically three months, but the law allows up to six months.
2. Dishonour Slip	If the cheque is dishonoured, the bank will issue a dishonour slip (also known as a bank memo) stating the reason for the non-payment.	This slip serves as official proof that the cheque was returned unpaid.
3. Legal Notice	The payee must send a written legal notice to the drawer demanding payment of the cheque amount.	The notice must be sent within 30 days of receiving the dishonour slip from the bank. The notice can be delivered personally, by registered post with an acknowledgment due, or by publication in a national newspaper.
4. Grace Period	The drawer is given a period to make the payment after receiving the legal notice.	The drawer has 30 days from the date of receipt of the notice to pay the full amount.
5. Filing of Case	If the drawer fails to make the payment within the grace period, the payee may file a criminal complaint in court.	The case must be filed within 30 days from the expiry of the 30-day grace period.

The legal offense is considered complete only after all these conditions are met, from the drawing of the cheque to the failure of payment after receiving the legal notice.

Common Reasons for Cheque Dishonour

While the most common reason for a cheque to be dishonoured is insufficient funds, this is a frequent misconception. A cheque can be dishonoured for a variety of reasons, many of which are technical rather than financial.

Reason Category	Specific Reasons for Dishonour	Specific Reasons for Dishonour	- Funds Frozen: A court order or other legal instruction has frozen the funds in the account.		

Fund-Related	- Insufficient Funds: The most common reason; the balance in the account is not enough to cover the cheque amount.	- Insufficient Funds: The most common reason; the balance in the account is not enough to cover the cheque amount.	- Stale Cheque: The cheque has been presented after its validity period has expired.		
Technical & Formal	- Signature Mismatch: The drawer's signature on the cheque does not match the specimen signature held by the bank.	- Signature Mismatch: The drawer's signature on the cheque does not match the specimen signature held by the bank.		- Undated/Post-dated Cheque: The cheque is missing a date or has a future date that has not yet arrived.	- Material Alteration: Any unauthenticated alteration of the date, amount, or payee's name.
Account Status	- Account Closed/Dormant: The account on which the cheque was drawn has been closed or is inactive.	- Account Closed/Dormant: The account on which the cheque was drawn has been closed or is inactive.			

Recent Judicial Developments

The legal landscape regarding cheque dishonour is dynamic. In a landmark ruling in November 2022, the High Court Division issued a verdict that had a significant impact on commercial banking practices. The court ruled that banks and financial institutions were barred from filing criminal cases under the Negotiable Instruments Act for defaulted loans, even if the loan was secured by a cheque. The court directed that such cases should instead be filed as civil suits in the Artha Rin Adalat (Money Loan Court) for loan recovery. This ruling, which was later stayed by the Appellate Division, highlighted a shift in judicial interpretation, aiming to distinguish between a criminal offense (issuing a cheque with malicious intent to defraud) and a civil liability (failure to repay a loan), and to prevent the misuse of the criminal law to collect on commercial debt.

Distinguishing Features of Cheque, Bill of Exchange and Promissory Note

The three main negotiable instruments, while serving similar functions, have distinct features that define their purpose and legal standing.

Feature	Promissory Note	Bill of Exchange	Cheque
Legal Basis	Contains a promise to pay.	Contains an order to pay.	A special type of Bill of Exchange with additional features.
Parties Involved	Two: Maker (debtor) & Payee (creditor).	Three: Drawer (creditor), Drawee (debtor), & Payee.	Three: Drawer (account holder), Drawee (banker), & Payee.
Drawee	Not applicable.	Can be any person, firm, or company.	Always a specified banker.

Acceptance	Not required. The maker's signature is sufficient.	Required. The drawee must accept the bill to be liable.	Not required. It is payable on demand.
Liability	The maker has primary and absolute liability to pay the amount.	The drawer has secondary liability, while the drawee's liability is primary upon acceptance.	The drawer has secondary liability; the drawee bank is the primary payer.
Presentation for Payment	Not required to be presented for payment, but demand can be made on the maker.	Can be payable on demand or at a future date.	Always payable on demand.
Stamping	Required by the Stamp Act, 1899.	Required by the Stamp Act, 1899.	Not required to be stamped.
Primary Use	Personal loans, corporate finance, and debt acknowledgment.	International trade and commerce.	General commercial, business, and personal payments.

The Future of Negotiable Instruments in a Digital Economy

The traditional paper-based negotiable instruments are gradually being supplanted by digital payment methods in Bangladesh, a global trend driven by technology and a push for greater financial inclusion. This shift presents both challenges and opportunities for the banking and legal sectors.

The most significant disruption has come from the rise of **Mobile Financial Services (MFS)**. Since their introduction in 2011, MFS platforms such as bKash, Nagad, and Rocket have amassed a user base of over 200 million registered customers. These platforms offer a wide range of services, including person-to-person (P2P) transfers, bill payments, and even remittance disbursements, enabling financial transactions directly from a mobile phone. This has provided access to formal financial services for a vast unbanked population, especially in rural areas, effectively bypassing the need for traditional bank accounts and, by extension, cheques.

In response to this evolution, Bangladesh Bank and the government have launched a series of initiatives to promote a "cashless Bangladesh". A notable example is the introduction of

Bangla QR, a national QR code standard for retail payments. This interoperable system allows a merchant to display a single QR code that can be scanned by a customer using any participating bank or MFS app, regardless of which institution the customer uses. This low-cost solution is a direct competitor to cheques and physical cash, particularly for small and micro-merchants, and is a key driver of the digital payment ecosystem. The national payment infrastructure also includes electronic clearing systems such as the Bangladesh Automated Cheque Processing System (BACPS) and the Bangladesh Electronic Funds Transfer Network (BEFTN), which are designed to automate cheque clearing and provide a paperless interbank payment medium.

The legal framework is also evolving to accommodate this digital shift. The **Payment and Settlement Systems Act, 2024**, governs the operation of digital payment systems in the country. This is complemented by the

Cyber Security Act, 2023 (CSA), which replaced the controversial Digital Security Act, 2018 (DSA). The CSA aims to ensure digital security by identifying, preventing, and prosecuting offenses committed through digital means. While the stated purpose is to protect the digital realm, the CSA has faced criticism for retaining many of the regulatory frameworks of its predecessor, the DSA, which was widely seen as a tool for suppressing dissent. The CSA's broad and vague

provisions have raised concerns that they could be used to restrict the freedom of expression and the right to privacy, highlighting a continuing challenge in balancing security with individual rights in a rapidly digitizing economy.

Summary of Lesson 2

Promissory notes, bills of exchange, and cheques are the three primary negotiable instruments under Bangladeshi law, each with a distinct role. A promissory note is a promise to pay between two parties, while a bill of exchange is an order to pay involving three parties and remains critical for international trade. A cheque is a special type of bill of exchange, always drawn on a bank and payable on demand. The legal landscape for cheques is heavily focused on addressing the issue of dishonour, with the Negotiable Instruments Act, 1881, providing criminal penalties under Section 138 to ensure accountability. However, recent judicial pronouncements have redirected loan-related dishonour cases to civil courts, demonstrating the evolving nature of the law. The future of these paper instruments is intertwined with the rise of digital finance, as platforms like MFS and initiatives like Bangla QR are driving a cashless economy and reducing the reliance on traditional paper instruments.

Review Questions

1. In a bill of exchange, explain the roles of the Drawer, Drawee, and Payee. How does this differ from the parties involved in a promissory note?
2. Describe the step-by-step legal procedure a payee must follow to file a case for a dishonoured cheque under Section 138 of the Negotiable Instruments Act, 1881.
3. Why is a bill of exchange still considered an indispensable instrument in international trade, even in the age of digital payments?
4. Beyond insufficient funds, list and briefly explain four other common reasons for a cheque to be dishonoured by a bank.
5. Discuss the impact of Mobile Financial Services (MFS) and the Bangla QR system on the future of traditional negotiable instruments in Bangladesh.

Specialized Financial Institutions

9

Unit Highlights

- Lesson 1: The Role and Structure of Specialized Financial Institutions
- Lesson 2: Challenges, Performance, and Reforms of SFIs

Technologies Used for Content Delivery

- ❖ BOUTUBE
- ❖ BOU LMS
- ❖ WebTV
- ❖ Web Radio
- ❖ Mobile Technology with MicroSD Card
- ❖ LP+ Office 365
- ❖ BTV Program
- ❖ Bangladesh Betar Program

Lesson 1: The Role and Structure of Specialized Financial Institutions

After completion of this lesson you will be able to –

- Distinguish between specialized financial institutions (SFIs) and commercial banks.
- Describe the historical context and evolution of major SFIs in Bangladesh.
- Analyze the specific mandates, sources of funds, and management structures of key SFIs, including Bangladesh Development Bank Limited (BDBL), Bangladesh Krishi Bank (BKB), and Rajshahi Krishi Unnayan Bank (RAKUB).
- Evaluate the historical and contemporary challenges faced by these institutions in fulfilling their developmental roles.

Key Terms

- **Development Financial Institution (DFI):** A financial institution that provides long-term risk capital for economic development projects, often on concessional terms, with a long-term perspective. Unlike commercial banks, whose primary goal is profit maximization, DFIs are established to support strategic sectors like industry, agriculture, and housing that require patient capital.
 - *Example:* A DFI might provide a 15-year loan for a large infrastructure project, such as a power plant, which a commercial bank, relying on short-term deposits, would typically be unable or unwilling to finance.
- **Syndication Finance:** A loan in which multiple lenders (a syndicate) collectively provide funds to a single borrower. This approach is typically used for large-scale projects, allowing financial institutions to share the risk and provide the substantial capital required.
 - *Example:* A new steel mill project requiring 500 crore BDT might be financed by a syndicate of five banks, each contributing 100 crore BDT.
- **Non-Performing Loan (NPL):** A loan on which the borrower has failed to make scheduled payments for a specified period, typically 90 days or more. These loans are considered at high risk of not being repaid and are a key indicator of a bank's financial health and credit management practices.
 - *Example:* If a company takes a loan but stops paying its monthly installments for three consecutive months, that loan becomes a non-performing loan.
- **Underwriting:** A service in which a financial institution or investment bank guarantees the sale of a new issue of securities, such as shares, by agreeing to purchase any unsold portion. This ensures that the issuing company receives the required capital for its projects.
 - *Example:* When a company makes a public offering of its shares, an institution like the Investment Corporation of Bangladesh (ICB) might underwrite the issue, guaranteeing to buy any shares not purchased by the public.
- **Public Debt Recovery Act, 1913:** A legal instrument used by government-owned financial institutions in Bangladesh to recover loans as if they were arrears of land revenue. This legal power provides a more direct and expedited means of loan recovery compared to the conventional judicial process.
 - *Example:* Bangladesh Krishi Bank (BKB) can utilize this act to directly seize a farmer's land revenue if they default on their agricultural loan, bypassing the lengthy and often inefficient court system.

Structure of Specialized Financial Institutions

The government of Bangladesh established specialized financial institutions (SFIs), also known as development financial institutions (DFIs), to provide specialized services to crucial sectors of the economy, including industry, agriculture, commerce, housing, and investment. At the time of their

inception, the nascent commercial banking sector was not equipped to provide the long-term project financing necessary for these strategic sectors. Consequently, these institutions were mandated to fill a critical market gap and catalyze economic development.

Bangladesh Shilpa Bank (BSB) and Bangladesh Shilpa Rin Sangstha (BSRS)

The historical trajectory of BSB and BSRS exemplifies the challenges and eventual restructuring of Bangladesh's industrial DFIs. BSB was created by a Presidential Order in 1972, taking over the pre-liberation Industrial Development Bank of Pakistan. Similarly, BSRS was established in 1972, succeeding the East Pakistan operations of Pakistan Industrial Credit and Investment Corporation Limited (PICIC). Both institutions were tasked with providing credit facilities and other assistance to industrial concerns.

However, over decades, their performance was severely undermined by poor management, inefficiency, and mounting non-performing loans. By the mid-1980s, BSRS was under pressure from development partners to suspend new lending activities due to its high NPL ratio. The persistent financial struggles and dysfunction of these separate entities led to a significant strategic decision: their merger. On January 3, 2010, BSB and BSRS were formally consolidated into a new entity, the Bangladesh Development Bank Limited (BDBL).

The goal of this merger was to create a stronger, more commercially viable institution that could continue its development mandate while also engaging in commercial banking activities to diversify its sources of funds. BDBL's business programs include long-term project financing for industries, syndication finance, and working capital loans, alongside a full suite of commercial banking services such as deposit mobilization, trade finance, and remittances.

Despite this structural change, BDBL has largely struggled to achieve its new mandate. Its new loans have quickly turned into defaulted loans, and it has failed to find commercial success. A significant portion of its income now comes from building rent and stock market investments, rather than core banking operations. As of December 2023, the bank's non-performing loans stood at a staggering 42% of its total loans. This chronic underperformance has led to recent discussions and a proposal to merge BDBL with the much larger state-owned commercial bank, Sonali Bank, which further underscores the failure of the original merger to create a sustainable institution.

Bangladesh Krishi Bank (BKB) and Rajshahi Krishi Unnayan Bank (RAKUB)

BKB and RAKUB were established to provide dedicated financial services to the agricultural sector. BKB was formed in 1973 as the successor to the Agricultural Development Bank of Pakistan. To provide more focused support to the agricultural heartland of the country, RAKUB was carved out of BKB's operations in the Rajshahi Division in 1986. The primary mandate of both institutions is to provide credit for crop production, agricultural implements, agro-processing, and agro-industries. They also aim to promote the adoption of modern farming technologies and extend counseling services to farmers.

For much of their history, both banks have faced similar systemic issues, including poor loan collection and a perpetual dependence on refinancing from Bangladesh Bank. The original guide notes that a special feature of these banks is their legal authority to recover dues under the Public Debt Recovery Act, 1913, which allows them to seize land revenue. However, this legal power has not been an effective deterrent against widespread loan default. A primary cause of this poor loan portfolio management has been attributed to inefficiency, corruption, and political interference, which has frequently led to loan forgiveness and undermined the credit culture in the agricultural sector.

A significant and recent development, however, provides a rare success story in the state-owned banking sector. After 37 years of continuous losses, RAKUB achieved a net profit of 2.98 crore BDT in the fiscal year 2023–2024. This turnaround was accompanied by a reduction in its classified loan ratio from 19% to 16%. The success was the result of a concerted effort to embrace digital

services, including e-KYC and mobile banking apps, along with more effective loan management and a reduction in loss-making branches. This example of a focused, internal reform-driven turnaround stands in stark contrast to the failures of other government-owned institutions and provides a blueprint for what is possible within the sector. However, despite this success, the government has proposed merging RAKUB with BKB as part of a broader strategy to consolidate weaker institutions.

Summary of Lesson 1

Specialized financial institutions were created in Bangladesh to address the absence of long-term capital for critical development sectors. While their founding purpose was noble, their performance has been largely hampered by systemic issues such as governance failures and rampant non-performing loans. The merger of BSB and BSRS into BDBL serves as a case study of how a top-down structural change, without genuine reform, can fail to resolve underlying problems. Conversely, the recent turnaround of RAKUB demonstrates that focused internal reforms, technological adoption, and sound leadership can lead to a significant improvement in financial health, even for a state-owned enterprise. The current trend of forced mergers, however, suggests a top-down approach that may not fully consider these individual nuances.

Review Questions

1. Explain the fundamental difference between the founding purpose of a Development Financial Institution (DFI) and that of a commercial bank.
2. Discuss the historical context that led to the merger of Bangladesh Shilpa Bank (BSB) and Bangladesh Shilpa Rin Sangstha (BSRS). What was the outcome of this merger, and why has the new entity struggled?
3. Analyze the recent financial performance of Rajshahi Krishi Unnayan Bank (RAKUB). What specific measures contributed to its profit turnaround, and what broader lessons can be drawn from its success?
4. How does the Public Debt Recovery Act, 1913, provide a unique advantage to institutions like BKB and RAKUB? Has this legal power proven effective in practice? Explain why or why not.
5. Based on the challenges faced by BDBL, what are the potential risks and benefits of the government's current strategy of merging financially weak banks?

Lesson 2: Challenges, Performance, and Reforms of SFIs

After completion of this lesson you will be able to –

- Assess the performance of Investment Corporation of Bangladesh (ICB), BASIC Bank Ltd, and other specialized institutions.
- Analyze the root causes of the high non-performing loan (NPL) crisis in Bangladesh's banking sector.
- Discuss the impact of governance failures, particularly in the case of BASIC Bank.
- Evaluate the effectiveness of the government's and Bangladesh Bank's recent reforms aimed at stabilizing the financial system.
- Propose concrete suggestions for improving the performance of DFIs and the broader financial sector.

Key Terms

- **Capital Market:** A financial market in which long-term debt or equity-backed securities are bought and sold. It serves as a crucial platform for companies and governments to raise long-term funds for large-scale projects, complementing the short-term lending provided by banks.
 - *Example:* The Dhaka Stock Exchange (DSE) is a key component of Bangladesh's capital market, facilitating the trading of stocks and bonds.
- **Securitization:** The process of taking an illiquid asset, such as a large number of loans, and pooling them together to create a tradable security. This tool improves liquidity for the originating institution and allows for the diversification of risk among a wider pool of investors.
 - *Example:* A bank can bundle a large number of home loans and sell them as mortgage-backed securities to investors, freeing up capital to issue new loans.
- **Bank Resolution Ordinance 2025:** A recent legal framework that grants the central bank powerful tools to intervene and restructure failing banks. This includes the authority to take over troubled lenders, appoint administrators, and orchestrate mandatory mergers to protect depositors and the financial system.
 - *Example:* This ordinance gives Bangladesh Bank the authority to enforce a mandatory merger between a weak bank and a stronger one to prevent a systemic collapse.
- **Distressed Asset Management Act:** A proposed law aimed at creating a framework for licensing private asset management companies. The purpose of this act is to launch a platform for trading non-performing loans (NPLs), allowing banks to offload their bad debts and clean up their balance sheets.
 - *Example:* Under this act, a private company could purchase a portfolio of defaulted loans from a bank at a discounted price, taking on the responsibility of recovery.
- **Moral Hazard:** A situation in which one party, such as a bank, is encouraged to take on greater risks because the cost of failure will be borne by a third party, such as the government or taxpayers.
 - *Example:* A bank lending to an uncreditworthy borrower may exhibit moral hazard if it expects the government to bail it out or forgive the loan, particularly when lending to politically connected entities.

Investment Corporation of Bangladesh (ICB)

ICB was established in 1976 with the core objective of developing Bangladesh's nascent capital market. Its mandate included mobilizing savings, providing investment assistance, and engaging in key capital market activities such as underwriting public issues of shares, managing mutual funds, and acting as an issue manager. To execute these functions, ICB successfully created subsidiaries, including ICB Capital Management Ltd., ICB Assets Management Ltd., and ICB Securities Trading Company Ltd.

However, a review of recent financial data reveals a concerning trend. While its foundational role remains, ICB's recent financial performance has been poor, reflecting the broader volatility and weakness of the capital market it was designed to support. For example, in fiscal year 2024, ICB's revenue and earnings saw significant decreases of 41.91% and 57.88%, respectively, compared to the previous year. A more recent financial report for a quarterly period in late 2024 showed a net loss of 1.62 billion BDT.

The performance of ICB's subsidiaries also reflects these challenges. The mutual funds managed by ICB Asset Management Company have experienced a significant erosion of their portfolios and failed to declare dividends for two consecutive fiscal years, 2024 and 2025. This underperformance is directly tied to a volatile and declining stock market, which has negatively impacted the value of their holdings. The inability of ICB and its key subsidiaries to generate stable returns highlights a fundamental weakness in Bangladesh's capital market, which has failed to mature into a robust, alternative source of long-term financing for the economy.

BASIC Bank Ltd

The history of BASIC Bank stands as a tragic case study of how severe governance failures and political interference can lead to the catastrophic downfall of a financial institution. The original guide notes the bank's establishment in 1989 as a joint venture designed to finance small and cottage industries. For a time, it was a high-performing institution, known for its efficient management and a reputation that attracted talented students and profitable clients.

The bank's decline began in 2009 with the appointment of former lawmaker Sheikh Abdul Hye Bachchu as chairman. During his tenure, from 2009 to 2014, the bank was subjected to "unprecedented levels of corruption and mismanagement". Investigations later revealed that a staggering 45 billion BDT was embezzled through fictitious loans and fraudulent documents. A former chairman who succeeded him noted that loan approvals were not discussed in board meetings but were simply added to the resolutions, with loans often being disbursed for amounts far exceeding a client's request, with the excess being misappropriated by unscrupulous parties. The failure of the Bangladesh Bank and the finance ministry to intervene during this period has been widely criticized.

The consequences have been devastating for what was once a model bank. It is now classified as a "severely weak financial institution," with a staggering 64% of its loans classified as defaulted as of December 2023. The bank has incurred over 42.3 billion BDT in losses over the past decade. Faced with a severe crisis of depositor confidence, particularly after the announcement of a potential merger, the bank has been struggling to maintain regular operations and relies on assistance from the central bank. In a final act of desperation, BASIC Bank has formally requested the government to merge it with a state-owned bank, expressing objections to the proposed merger with a private one, City Bank PLC.

Other Specialized Institutions

- **House Building Finance Corporation (HBFC):** HBFC continues its original mandate of providing housing finance. In recent years, its policy focus has broadened to align with national sustainable development goals, with a new emphasis on financing "green residential buildings". This shift aims to reduce greenhouse gas emissions and promote resource efficiency in the

construction industry, consistent with the government's 8th Five-Year Plan for sustainable urbanization.

- **Ansar-VDP Unnayan Bank:** Much like RAKUB, this institution presents a rare success story in the state-owned sector. It has undergone a remarkable turnaround, moving from a loss of 44 crore BDT in the previous fiscal year to a net profit of 2 crore BDT in FY 2024-25. This was achieved through a series of strategic reforms, including the restructuring of its board, the implementation of a new integrated loan policy, and a push for full automation. The bank also significantly reduced its classified loans, recovering 191 crore BDT in cash in FY 2024-25, compared to 120 crore BDT the previous year.
- **Karma Sangsthan Bank:** This bank is dedicated to creating employment opportunities for unemployed youth. An assessment by the Asian Development Bank (ADB) has identified significant capacity constraints, particularly in handling fund flows, reporting, and managing sub-borrower eligibility. The assessment recommends extensive training to develop the bank's financial management capacity and a push for the full implementation of a Centralized Banking System (CBS) to improve operational efficiency.

Evaluation of DFI Performance

The original document's observation of high non-performing loans has now evolved into a full-blown systemic crisis. By the end of December 2024, NPLs in the entire banking sector had surged to a record 345,764 crore BDT, accounting for 20.2% of the total loans. The situation is particularly dire in state-owned banks, where the NPL ratio has reached a staggering 42.80%.

The high volume of NPLs is not merely a symptom of poor management but a direct result of deep-seated systemic failures. The primary causes include political interference and pressure to lend to specific, often uncreditworthy, individuals. The lack of accountability, weak corporate governance, and a lengthy and ineffective legal framework for loan recovery have exacerbated the problem. Furthermore, the Bangladesh Bank's previous policies of regulatory forbearance and lenient loan rescheduling, allowing for extended repayment periods and reduced down payments, have also contributed to the escalation of distressed assets.

This NPL crisis has created a severe liquidity crunch in the banking system, which in turn limits banks' ability to disburse new loans and hampers private sector credit growth. This has dire consequences for the economy, as credit is the engine of investment and job creation. The vacuum created by dysfunctional DFIs has been filled by commercial banks engaging in long-term project financing. This practice, which relies on short-term deposits, creates a dangerous structural asset-liability mismatch, threatening the long-term stability of the entire financial system.

Assistance to the Agricultural Sector by Banks

The original query on this topic remains highly relevant, and it is clear that the government is seeking to increase the participation of all scheduled banks in agricultural finance. While BKB and RAKUB are the primary agricultural banks, the Bangladesh Bank's Agricultural and Rural Credit Policy for the fiscal year 2025–26 now places increasing responsibility on private and foreign banks to contribute to the sector. The policy has set a farm loan disbursement target of 39,000 crore BDT for the new fiscal year, a 2.63% increase from the previous year. The policy also prioritizes financing for climate-resilient agriculture and the adoption of modern technologies. To ensure accountability, the central bank has implemented a new directive: any bank that fails to meet its disbursement target must deposit the shortfall into a Bangladesh Bank-managed fund, which will then be used to refinance other banks that are more willing to lend to the sector.

Suggestions for Improving SFI Performance and the Financial System

Improving the performance of SFIs and the stability of Bangladesh's financial system requires a multi-pronged, holistic approach that goes beyond temporary fixes.

1. **Strengthening the Legal and Regulatory Framework:** The government's recent legislative push, including the enactment of the **Bank Resolution Ordinance 2025** and the proposed **Distressed Asset Management Act**, must be fully and transparently implemented. The Bank Resolution Ordinance provides the central bank with the necessary tools to intervene in failing banks, while the Distressed Asset Management Act is designed to create a market for trading NPLs, thereby cleaning up bank balance sheets and freeing up capital for new lending. Furthermore, the **Money Loan Court Act** must be amended to streamline loan recovery and clear the existing backlog of cases. The distinction between "wilful" and "general" defaulters should be removed to reduce the arbitrariness in NPL recognition.
2. **Improving Corporate Governance:** The legal framework must be amended to curb the long-standing problem of political and family influence on bank boards. The appointments of board directors and managing directors must be based on merit and professional experience, not political affiliation. The Bangladesh Bank must be empowered to appoint directors in state-owned banks and hold them accountable.
3. **Developing a Robust Capital Market:** To address the dangerous asset-liability mismatch where commercial banks are forced to provide long-term credit, the capital market must be strategically developed. This includes creating a **mortgage bond market**, establishing a **mortgage warehouse** to facilitate securitization, and encouraging private sector investment in long-term bonds from institutions like insurance companies. DFIs can play a pivotal role in this process by drafting rules, supporting new institutions, and improving governance to attract long-term capital.
4. **Replicating Success Stories:** The rare and important success stories of RAKUB and Ansar-VDP Unnayan Bank provide a practical blueprint for the way forward. These institutions have demonstrated that internal reforms, focused and independent leadership, a commitment to technology, and results-oriented accountability measures can lead to a financial turnaround, even in a challenging environment. The lessons learned from these successes should be studied and applied across all state-owned financial institutions.

Summary of Lesson 2

Bangladesh's specialized financial institutions are largely struggling with a deep-seated crisis of governance, corruption, and a massive accumulation of non-performing loans. The case of BASIC Bank serves as a stark warning of the catastrophic consequences of political interference in the banking sector. While the government and Bangladesh Bank have initiated a new wave of comprehensive legal and regulatory reforms, their ultimate success will depend on a genuine commitment to institutional independence and accountability. The rare success stories of RAKUB and Ansar-VDP Unnayan Bank, driven by strong leadership and a focus on internal reforms, offer a glimmer of hope and a practical model for the way forward. The future of the sector depends on a multi-pronged approach that combines robust legal frameworks, strengthened corporate governance, and the strategic development of a deep and liquid capital market to create a more resilient and effective financial system.

Tables

Table 1: The Evolution of Key Development Financial Institutions (DFIs) in Bangladesh

Institution	Key Events and Current Status
Bangladesh Shilpa Bank (BSB)	Created in 1972 from the Industrial Development Bank of Pakistan (IDBP). Faced decades of poor management and high NPLs.
Bangladesh Shilpa Rin Sangstha (BSRS)	Established in 1972, taking over PICIC's operations. Also struggled with inefficiency and non-performing loans, leading to a suspension of new lending.
Bangladesh Development Bank Limited (BDBL)	Formed on January 3, 2010, from the merger of BSB and BSRS. It operates as a commercial bank but has struggled to find commercial success. Reports a high NPL ratio (42% in 2023) and is currently proposed for a new merger with Sonali Bank.

Export to Sheets

Table 2: Comparative Performance of Selected Specialized Financial Institutions (FY 2023–2024)

Institution	Key Financial Metrics
Bangladesh Krishi Bank (BKB)	Heavily dependent on refinancing from Bangladesh Bank, indicating poor loan recovery.
Rajshahi Krishi Unnayan Bank (RAKUB)	Achieved a net profit of 2.98 crore BDT. Reduced its classified loan ratio from 19% to 16%. A rare turnaround story driven by internal reforms and technology adoption.
BASIC Bank Ltd.	Classed as a "severely weak financial institution." Reported a staggering 64% NPL ratio. Proposed for a merger with a private bank due to its financial collapse.
Investment Corporation of Bangladesh (ICB)	Reported a net loss of 1.62 billion BDT in a recent quarter. Its mutual funds failed to pay dividends for two consecutive years due to capital market volatility.

Export to Sheets

Review Questions

1. Describe the key reasons for the failure of BASIC Bank. What are the broader implications of this scandal for confidence in Bangladesh's banking sector?
2. What are the primary causes of the high non-performing loan ratio in Bangladesh's banking sector, particularly in state-owned banks? Discuss how political influence and governance failures have contributed to this crisis.
3. Explain the core functions of the Investment Corporation of Bangladesh (ICB). Based on recent financial data, how has its performance and that of its subsidiaries reflected the overall health of Bangladesh's capital market?
4. Analyze the role of the new legal and policy frameworks, such as the Bank Resolution Ordinance and the Distressed Asset Management Act. How are these tools intended to address the systemic challenges in the banking sector?
5. Based on the research, what are the most critical and actionable suggestions for improving the performance of Bangladesh's specialized financial institutions and the stability of its financial system as a whole?

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