



Commercial Bank Operations

# Broad Learning Goals of This Chapter

**Definition of Commercial Bank and its Balance Sheet Composition**

**Different Liability Components of Commercial Banks**

**Different Asset Components of Commercial Banks**

**Common Risk Faced by Commercial Banks**



# Commercial Banks and their Balance Sheet Composition

# Definition of Commercial Banks



Interest Charged on Loan > Interest Paid on Deposit

The more the difference the more profit banks make.



## Commercial Banks in Bangladesh





# A Real Balance Sheet (Liability Component Only)

## BRAC BANK ANNUAL REPORT 2021

<b>LIABILITIES AND CAPITAL</b>		
<b>Liabilities</b>		
<b>Borrowings from other banks, financial institutions and agents</b>	<b>12</b>	<b>24,150,953,707</b>
<b>Borrowings from central bank &amp; government agencies</b>	<b>13</b>	<b>23,175,903,824</b>
<b>Money at call on short notice</b>	<b>14</b>	<b>-</b>
<b>Deposits and other accounts</b>	<b>15</b>	<b>364,337,612,226</b>
Current accounts and other accounts		164,425,455,280
Bills payable		2,367,889,416
Savings deposits		68,334,576,200
Term deposits		127,956,809,129
Other deposits		1,252,882,201
<b>Other liabilities</b>	<b>16</b>	<b>39,300,363,327</b>
<b>Total liabilities</b>		<b>450,964,833,084</b>
<b>Capital and shareholders' equity</b>		
Paid up capital	<b>17.2</b>	13,921,723,990
Share premium	<b>17.7</b>	3,853,767,032
Statutory reserve	<b>18</b>	10,067,956,958
Dividend equalization fund	<b>19</b>	355,218,455
Revaluation reserve on govt. securities	<b>20</b>	2,490,292,927
Fair value reserve		78,920,073
Foreign currency translation reserve		16,632,383
Surplus in profit and loss account/Retained earnings	<b>22.1</b>	26,402,962,532
<b>Total shareholders' equity</b>		<b>57,187,474,350</b>
<b>Non controlling interest</b>	<b>22.2</b>	<b>19,760,616,148</b>
<b>Total equity</b>		<b>76,948,090,498</b>
<b>Total liabilities and equity</b>		<b>527,912,923,582</b>

# Bank Sources of Funds

## **Deposit Accounts**

- Transaction deposits
- Savings deposits
- Time deposits
- Money market deposit accounts

## **Borrowed Funds**

- Federal funds purchased (borrowed)
- Borrowing from the Federal Reserve banks
- Repurchase agreements
- Eurodollar borrowings

## **Long-Term Sources of Funds**

- Bonds issued by the bank
- Bank capital

# Bank Sources of Funds

## Current Deposit Account/demand deposit account

- Depositing and withdrawing money any time using checks or online
- A conventional demand deposit account requires a small minimum balance
- Does not usually pay any interest for the deposited amount
- Suitable for business people who need to make multiple payments, receipts, and other transactions daily
- Minimum Balance

### Current Deposit Account

Trust Bank current Deposit account (CD Account) saves you the hassle of carrying around cash every month. The account is non-interest bearing and it comes with a free cheque book. You can just write a cheque whenever and wherever it's convenient. Open a CD Account at Trust Bank to suit your business needs, and avail of a range of benefits of the product

Source: Website of Trust Bank Limited





# Bank Sources of Funds

---

## 2. Saving Deposit Account

- Allow limited transactions especially for withdrawal (though unlimited withdrawal is also possible now)
- Customer can deposit money anytime they want
- Earn modest interest on the deposited amount
- No check writing facility
- Suitable for people who are salaried employees or have a monthly income

# Bank Sources of Funds



- **3. Special Notice Account (SND)**

- Advance notice is required for withdrawal
- Attractive interest is paid

## **SPECIAL NOTICED DEPOSIT ACCOUNT**

Any individual or corporate body can open Special Notice Deposit Account, which is an interest bearing deposit account, for a short period of time. However, 7 days of notice is required if the customer wishes to withdraw money from this account.

Source: Website of Agrani Bank Limited

# Bank Sources of Funds



## 4. Fixed Deposit/Term Deposit

Popularly known as “**FDR (Fixed Deposit Receipt)**” or **Certificates of Deposit**

A specified minimum amount of funds to be deposited for a specified period of time

Normally the fund can not be withdrawn before the maturity without incurring a penalty

Banks pay the highest interest on this deposit

- **Negotiable Certificates of Deposit**— Have a specified maturity and require a minimum deposit. Maturities are typically short-term, and the minimum deposit is \$100,000. A secondary market for NCDs does exist.

### Fixed Deposit (FDR)

Our Fixed Deposit (FDR) is meant for those investors who want to deposit a lump sum of money for a fixed time period; say for a minimum period of 1,3,6,12,24 and 36 months period, thereby earning a higher rate of interest in return. The prevailing rates of interest are shown below

#### Key Features

- Can be opened for 1M, 2M, 3M, 100 Days, 4M, 6M, 12M, 13M
- Early encashment possible

Source: Website of Premier Bank Limited

# Bank Sources of Funds

---



- **Money Market Deposit Accounts**

- Differ from conventional time deposits in that they do not specify a maturity.
- Provide limited check-writing ability, require a larger minimum balance, and offer a higher yield.

# Bank Sources of Funds

## ● **5. Borrowings from Other Banks/FIs**

- Commercial Banks are always in transaction with other Banks as well as Financial Institutions (Fis).
- They can take both short and long term loan from one another (if needed)

### **Call Money:**

- A short term loan which has to be paid immediately in full whenever the lender demands. So this call money does not have a fixed payment date time term loans. So the lender does not have to provide prior notice to the borrower when he/she needs money back with interest. Normally ranges from 1 to 14 days.

# Bank Sources of Funds

- **Federal Funds Purchased**
  - Represent a liability to the borrowing bank and an asset to the lending bank. (typically for one to seven days)
  - Intent is to correct short-term fund imbalances by banks.
  - The interest rate charged in the federal funds market is called the federal funds rate.



# Bank Sources of Funds

## Borrowing from the Federal Reserve Banks

- The Federal Reserve banks regulate certain activities of banks and provide short-term loans to banks.
- Often referred to as borrowing at the **discount window**.
- The interest rate charged is the **primary credit lending rate**.
- Mainly used to resolve a temporary shortage of funds.

## Repurchase Agreements

- Represents the sale of securities with an agreement to repurchase the securities at a specified date and price.
- Occur through a telecommunications network connecting large banks.

# Bank Sources of Funds



## **Bank Capital/Stockholders' Equity:**

Funds acquired by issuance of stock or retaining profits (earnings)



Unlike other sources, banks have no obligation to pay out these funds in the future



A bank must have enough capital to bear the operating losses

# Bank Sources of Funds

## **Bonds Issued by the Bank**

- Banks own fixed assets such as land, buildings, and equipment which are usually financed with long-term sources such as the issuance of bonds.
- Common purchasers of these bonds are households and various financial institutions.

# A Real Balance Sheet (Asset Component Only)

- BRAC BANK ANNUAL REPORT 2021

## Consolidated Balance Sheet

As at 31 December 2021

Particulars	Note	2021 Taka
<b>PROPERTY AND ASSETS</b>		
<b>Cash</b>	<b>3</b>	<b>23,459,424,430</b>
Cash in hand (Including foreign currency)		9,207,161,626
Balance with Bangladesh Bank and its agent bank(s) (including foreign currency)		14,252,262,804
<b>Balance with other banks and financial institutions</b>	<b>4</b>	<b>78,261,312,910</b>
Inside Bangladesh		70,561,465,538
Outside Bangladesh		7,699,847,372
<b>Money at call on short notice</b>	<b>5</b>	<b>3,500,000,000</b>
<b>Investments</b>	<b>6</b>	<b>70,068,593,304</b>
Government		60,998,642,835
Others		9,069,950,469
<b>Loans and advances</b>	<b>7</b>	<b>322,135,188,439</b>
Loans, cash credit, overdrafts etc.		169,128,372,833
Small and medium enterprises		150,749,009,625
Bills purchased and discounted		2,257,805,981
<b>Fixed assets including premises, furniture and fixtures</b>	<b>8</b>	<b>12,834,169,424</b>
<b>Other assets</b>	<b>9</b>	<b>16,222,224,464</b>
<b>Non-banking assets</b>	<b>10</b>	<b>4,541,700</b>
<b>Goodwill</b>	<b>11</b>	<b>1,427,468,911</b>
<b>Total property and assets</b>		<b>527,912,923,582</b>

# Bank Uses of Funds

---

- **Reserve (Cash in Hand + Cash balance held with Bangladesh Bank):**
- Banks must keep a certain percentage of their deposit in a Bangladesh Bank account
- They also keep cash in their vault to entertain withdrawal requests made by the depositors
- Unlike investments, cash does not give income to the Banks
- Money kept with the central bank as a reserve requirement also does not provide any interest
- Hence, commercial banks do not want to keep excess cash

# Bank Uses of Funds

---

## **Deposit with other banks or Financial Institutions (FIs):**

- Sometimes commercial banks also keep deposits to other banks or financial institutions if they have idle money and not better investment/credit opportunities. They can keep term deposits with other banks as well

## **Call Money:**

A commercial bank with sudden excess funds can lend the money to other banks at a call money rate. It can ask for repayment of the loan with interest any day without any prior notice.





# Bank Uses of Funds

## Investment in securities:

Banks can also buy both

- **Government Bonds:** Treasury Bills and Treasury Bonds.
- **Corporate Bonds:** Bonds issued by other company

# Cash Reserve Ratio (CRR) & Statutory Liquidity Ratio (SLR)

Suppose a commercial bank has total 100 crore in demand and term deposit. According to Bangladesh Bank's regulation it must keep 4 crore in CRR and 13 crore in SLR.

## Cash Reserve Ratio (CRR)

- Cash balance held with Bangladesh Bank or its agent bank
- 4% of total demand and term deposit

## Statutory Liquidity Ratio (SLR)

- **Components of SLR:** Cash held inside the bank, Gold, Government Securities, and Excess Reserve.
- 13% of total demand and term deposit

# Bank Uses of Funds

## 4 Loans and Advances:

### ● A. Business Loans:

**Term Loans:** These are loans taken typically to finance the purchase of fixed assets such as land, buildings, machinery, etc. Loans can range from 2 years to 10 years.

- The asset purchased with the loan amount can act as collateral of the loan

**Working capital loan:** (sometimes called a self-liquidating loan) — Designed to support ongoing business operations

**Restrictive Covenants:** Specific conditions imposed by the bank to protect it from loan default.

Fix maximum level of dividend is allowed, No new loan can be taken before the existing one ends

### **Repayment method:**

- **Equal Installments** which contain both interest and principal payments.  
(More Popular)

- **Balloon Payments:** Loan as bullet loans where the principal is paid only at the end of maturity. (Riskiness?)





# Bank Uses of Funds

---

- **A2: Direct Lease Loan (An alternative to Term Loans):**

- -Rather than buying the asset the business rent the asset from the bank. The bank remains the owner of the asset.
- -Hence, the bank can charge depreciation and get tax advantage.

-

# Bank Uses of Funds



- **A3: Informal Line of Credit:**

- Business can borrow up to specified amount for specified period of time.  
Useful for firms that have unpredictable need for funds/cashflows for their business.  
Interest rate (adjustable) charged on the fund depends on prevailing market condition.

- Banks do not have any legal obligation to supply funds when needed. (What about the reputation?)

- **A4: Revolving Credit Loan:**

- Banks have legal obligation/commitment to supply maximum amount for a specified time when needed.
- Commitment fees are charged on the unused limit.

-

# Bank Uses of Funds

## **B. Consumer Loans:**

### **B1: Installment Loans:**

These loans are taken to finance the purchase of personal car or other assets. These loans are taken to fulfill personal needs.

Repayments are usually made in monthly equal installments throughout the loan terms.

Loans may be secured or unsecured.



## Bank Uses of Funds

### **B2: Real Estate/Home Loans:**

For purchasing new flat, constructing a house or renovating existing home

Term ranges from 1 year to 25 years

Like car loan, this loan is backed by the asset purchased

Maximum amount 20 Million

Go through the **Subprime mortgage crisis (2007-08)** from your text book to understand the risk involved with Real Estate Loans

# Bank Uses of Funds

- **B3: Credit Cards:** A credit card is one type of loan from the bank and these cards are used to make payments for goods and services on credit. Here, not the merchant but the bank is providing you the credit opportunity.
- Each month the bank will provide you with a statement of your usage and provide you some time to repay the full balance without any interest.
- In return banks charge a **very high-interest rate** (the highest among all consumer loans). Banks also charge a fixed annual fee against credit cards.
- Each credit cards have a credit limit (Maximum amount you can owe the bank) based on income and employment profile

# Common Risks Faced by Commercial Banks

---

## Credit Risk/Default Risk:

---

**The likelihood that the borrower will not pay the promised interest and principal.**

---

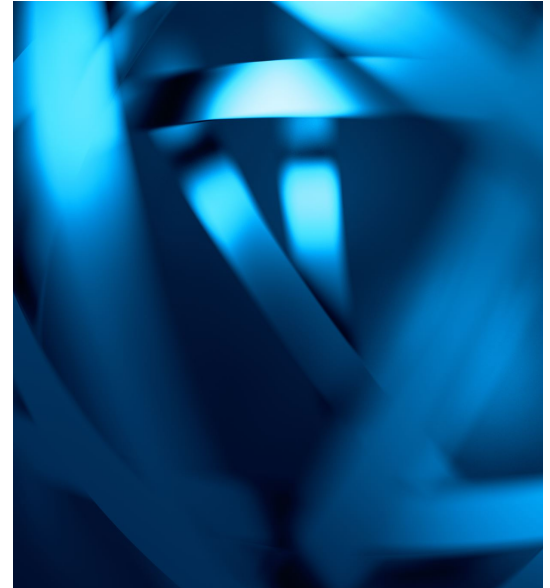
**Higher the probability, higher the interest rate is charged.**

---

**Banks make some group and categorize people and business organizations and attach probability of defaults accordingly.**

---

**YouTube video link: <https://www.youtube.com/watch?v=PkxxMyYKD4o>  
(1<sup>st</sup> 8 Minute only)**



# Common Risks Faced by Commercial



## Interest Rate Risk:



is the potential loss due to movements in interest rates.



This risk arises because bank assets (loans and bonds) usually have a significantly longer maturity than bank liabilities (deposits).

This risk can be conceptualized in two ways. First, if interest rates rise, the value of the longer-term assets will tend to fall more than the value of the shorter term liabilities, reducing the bank's equity. Second, if interest rates rise, the bank will be forced to pay higher interest rates on its deposits well before its longer-term loans mature and it is able to replace those loans with loans that earn higher interest rates.



# Common Risks Faced by Commercial Banks

## Foreign Exchange Risk:

is the risk that the value of the bank's assets or liabilities changes due to currency exchange rate fluctuations.

Banks buy and sell foreign exchange on behalf of their customers (who need foreign currency to pay for their international transactions or receive foreign currency and want to exchange it to their own currency)

and they also hold assets and liabilities in different currencies on their own balance sheets.

# Common Risks Faced by Commercial Banks

## Liquidity Risk:

Liquidity risk is the risk that a bank may not be able to meet its obligations to repay deposits and other funding, or to continue financing its assets.

The simplest way to lower this risk is to always hold sufficient cash to meet demands. However, this is not optimal when organizations seek to make a profit or expand operations.

This risk is more severe for companies which have a balance sheet that is too focused on illiquid assets.

Commercial banks plan their cashflows properly to mitigate the liquidity risk.



# Common Risks Faced by Commercial Banks

## Operational Risk:

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events.

Some examples include:

Cybersecurity Risk: Weaknesses in firms' IT infrastructure may result in loss of clients money.

Internal and External Fraud: Forgery, bribes, theft, check fraud, theft, hacking, system breaches, money laundering, data theft etc.

Business Disruptions and Systems Failures: Hardware or software system failures, and power failures may lead to serious obstacle in business and eventually to financial loss.