Independent Review of iRBD Bangladesh's Development

বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

What Lies Ahead for the Banking Sector in Bangladesh?

Presented by

Dr Fahmida Khatun

Executive Director, CPD

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Research Team

Team Members

Dr Fahmida Khatun, Executive Director, CPD

Mr Syed Yusuf Saadat, Research Fellow, CPD

Ms Ibnat Hasan, Programme Associate, CPD

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1. Introduction

Background

- The banking sector is an **important component of the financial system**.
- By mobilising resources for productive investments in a country, the sector contributes to economic development.
- A bank is a financial institution which acts as an intermediary between borrowers and savers, and thus enables efficient allocation of financial resources.
- People prefer to borrow long term and lend short term, so banks borrow short and lend long to bridge this maturity gap to maximise the funding and saving opportunities that are available
- Banks are the main source of indirect finance in a financial system.
- Bangladesh's financial sector is mainly **bank-based**, given that **financial markets are still underdeveloped.**

Context

- ❑ The banking sector of Bangladesh has expanded over the years in terms of **number of formal institutions**, types of **financing instruments**, and **volumes of assets.**
- ❑ However, the sector has been facing several serious challenges due to malpractices, scams, corruption and heists.
- ❑ These have affected the overall performance of the sector, which is **reflected through various efficiency and soundness indicators.**
- ❑ Relevant stakeholders have repeatedly expressed concerns regarding the constant deterioration of banking performance and its potential implications for the sector's sustainability.
- ❑ Given that the financial sector of the country is **mainly bank-based**, poor health of the banking sector will also impact economic growth. Therefore, fixing the problems is critically important.

Introduction

- Bangladesh's banking sector has demonstrated vulnerability over time, manifested through **high loan default rates** and **sub-par** performance across various indicators.
- This inherent fragility presents significant risks to the overall economy.
- Regrettably, the **government's commitments to safeguard the banking sector** expressed in various policy documents and election manifesto **remain unmet.**
- On the other hand, the need for a strong banking sector is increasing as the size of the economy is expanding.
- This presentation discusses recent trends in the banking sector, key measures taken by the policymakers, their outcomes, and what needs to be done going forward.

2. Performance of the banking sector: Key indicators

Profit growth in Q1 2024

- Many publicly traded banks in Bangladesh reported profit growth for the first quarter of 2024, driven by two key factors:
  - **Higher Income from Government Securities:** Banks earned more from holding government bonds (Treasury bills or T-bonds) due to a significant rise in their yields. This rise in yields is a consequence of the high inflation currently being experienced in Bangladesh.
  - **Increased Lending Rates:** Previously, a lending rate formula called SMART was used. Under SMART, banks were able to charge higher interest rates on loans, which boosted their income.
- However, there are also some challenges on the horizon for Bangladeshi banks:
  - **Rising Funding Costs:** Interest rates on deposits are increasing, and the central bank's recent policy rate hike has made it more expensive for banks to borrow money. This could put pressure on banks to keep their own costs down.
  - **Liquidity Issues:** Several banks reported negative net operating cash flow in the last quarter. This indicates that they are facing difficulties meeting their short-term financial obligations, suggesting potential liquidity problems.
  - **Non-Performing Loans:** Despite the profit growth, non-performing loans (NPL) (loans unlikely to be repaid) remain a concern.
  - **Stock Market Performance:** Banks account for a significant portion of the Dhaka Stock Exchange's market capitalization. However, the banking sector's price-to-earnings ratio (P/E ratio) is currently the lowest among all sectors on the exchange.
- The recent policy changes, including the central bank's rate hike and the return to market-based lending rates could have impact on future bank profits.
- Additionally, the ability of banks with negative cash flow to improve their liquidity situation remains to be seen.

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Excess liquidity and investment trends

- Recently, excess liquidity has increased, driven by strong deposit growth, but cash excess liquidity (immediately available funds) has decreased.
- Banks are investing more in government Treasury bills (T-bills) and bonds due to attractive interest rates.
- Banks are borrowing more from the short-term call money market due to lower liquidity.
- The Bangladesh Bank is using tools like repo to provide short-term liquidity support to banks.
- Increased government borrowing from commercial banks is contributing to tighter liquidity conditions.
- The central bank is taking measures to manage liquidity, but the situation requires close monitoring.

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Views of major international credit ratings agencies

Moody's (March 2024)

- **Outlook**
  - Profitability: Stable due to steady net interest margins and credit costs.
  - Capital: Stable due to internal capital generation and lender funding.
  - Liquidity: Tight but stable due to central bank measures.
- **Asset Risks**
  - Rising, but loan-loss provisions held steady by regulatory forbearance.
  - Stressed loans (including restructured loans) are expected to remain high.
  - State-owned banks remain undercapitalized due to weak earnings.
- **Funding & Liquidity**
  - Expected to stabilize due to import restrictions and government incentives.
  - Declining foreign currency reserves pose a risk to future access.
- **Structural Weaknesses**
  - Lax regulations and poor corporate governance persist.
- **Previous Downgrade (May 2023)**
  - Bangladesh's sovereign rating downgraded due to external vulnerabilities.
  - Ratings of 6 local banks downgraded due to sovereign risk.

S & P (July 2023)

- **Outlook**
  - Weakened liquidity position and political uncertainty raise concerns.
  - Risk of lower credit rating if external position worsens.
- **Government Borrowing**
  - Increased reliance on banks for funding could crowd out private sector credit.
  - Rising bank ownership of government debt may limit future lending capacity.
- **Limited Contingent Liabilities**
  - Banking sector assets are relatively small compared to GDP (<100%).
  - S&P classifies Bangladesh's banking sector risk as '9' (out of 10, with 10 being weakest).
- **State-Owned Banks**
  - Higher non-performing loan ratios compared to private banks.
  - Account for less than 30% of total banking sector assets.
- **Monetary Policy**
  - Central bank's independence and effectiveness limited by multiple mandates and underdeveloped markets.
  - Exchange rate regime: gradual shift towards a more market-determined system.

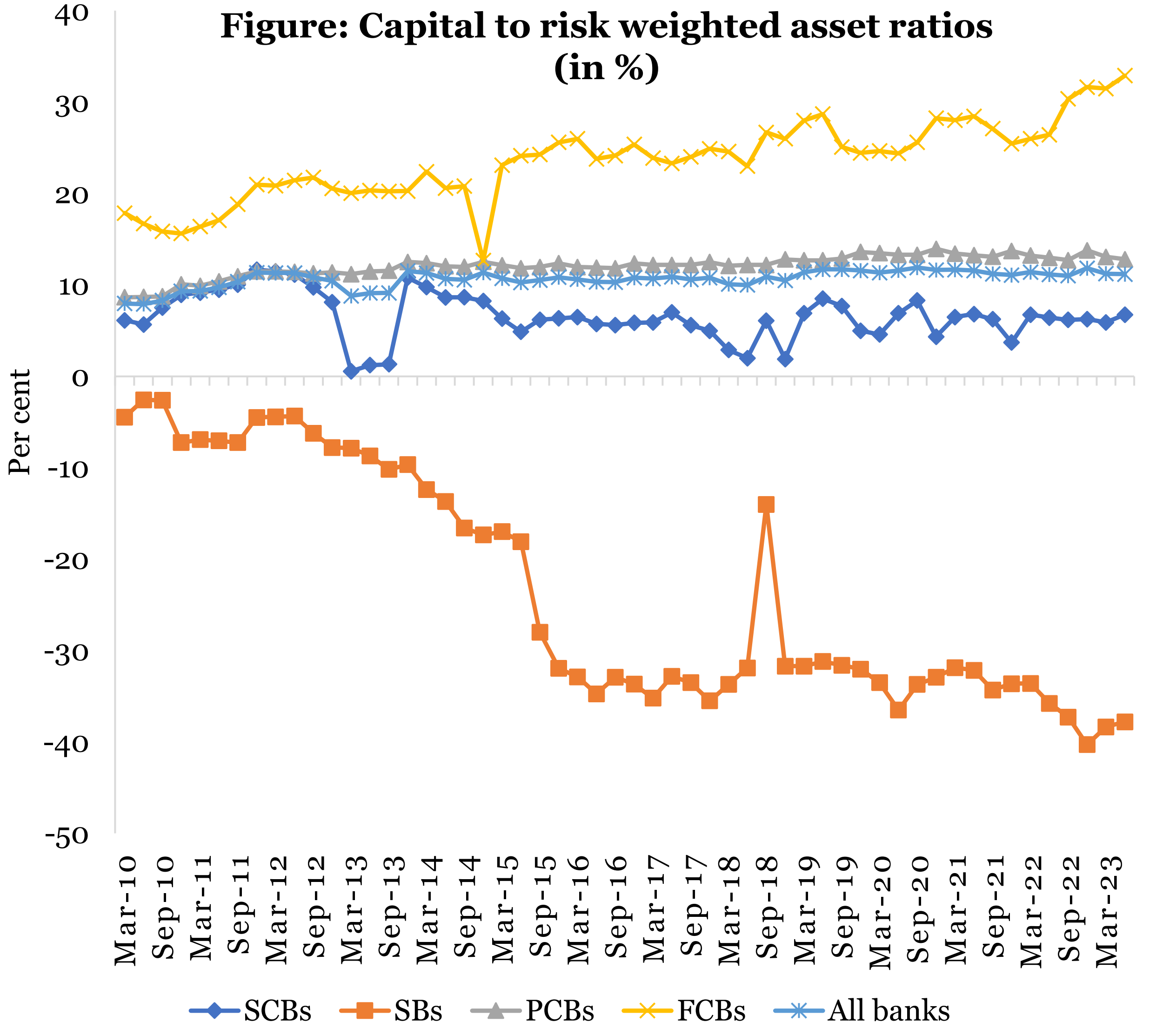
Fitch (September 2023)

- **Outlook**
  - Low revenue, weak banking sector, and governance issues.
- **Fiscal Risks**
  - Sustained budget deficits
  - Extended bank loan forbearance
  - Contingent liabilities from state-owned enterprises and banks
- **Weak Banking Sector Governance**
  - High system NPL ratio (8.8% as of Mar-2023)
  - Particularly problematic in state-owned banks (NPL ratio ~20%)
  - Potential for NPLs to rise further after forbearance ends
  - Thin bank capitalization raises concerns about future stress
- **Overall**
  - A weak banking sector could become a burden on the government if credit problems worsen.

Capital inadequacy of banks

- Bangladesh Bank's Guidelines on Risk-Based Capital Adequacy state that banks must maintain a minimum total capital ratio of 10% of a bank's risk-weighted assets (or minimum total capital plus capital conservation buffer of 12.5% of a bank's risk-weighted assets) by 2019, in line with BASEL III.
  - However, the SCBs have failed to maintain minimum requirements of capital adequacy.
  - On the other hand, the SBs have remained critically under-capitalised.
- **Without reducing NPLs, capital adequacy cannot be improved** since higher levels of NPLs lead to increased provisioning requirements, which results in capital shortfall.

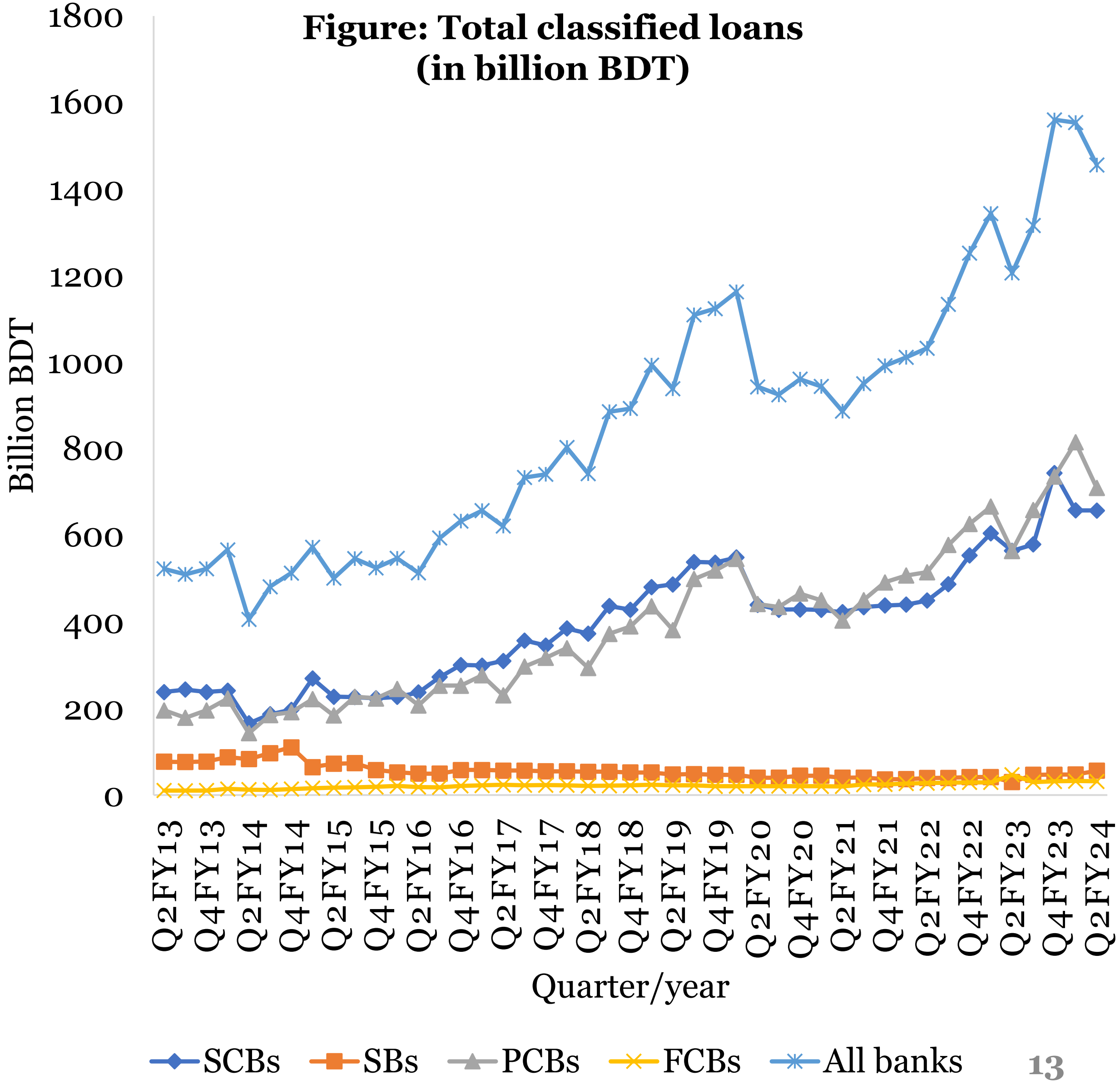
Figure: Capital to risk weighted asset ratios (in %)



High volume of Non-performing Loans (NPLs)

- The total volume of NPL has **increased by more than three times in the last ten years**, from BDT 427.25 billion in Q4FY12 to BDT 1456.33 billion in Q2FY24
- However, actual NPL will be much higher if loans in special mention accounts, loans with court injunctions, and rescheduled loans are included
- For instance, Bangladesh Bank's Financial Stability Report 2022 indicates that as of December 2022, the **total gross NPL** was BDT 1,206.49 billion, the outstanding balance of **written-off loans** was BDT 444.93 billion, and the total **rescheduled loans** outstanding was BDT 2,127.8 billion.
  - **Combined together, this amounts to BDT 3779.22 billion (BDT 3,77,922 crore)**

Figure: Total classified loans (in billion BDT)



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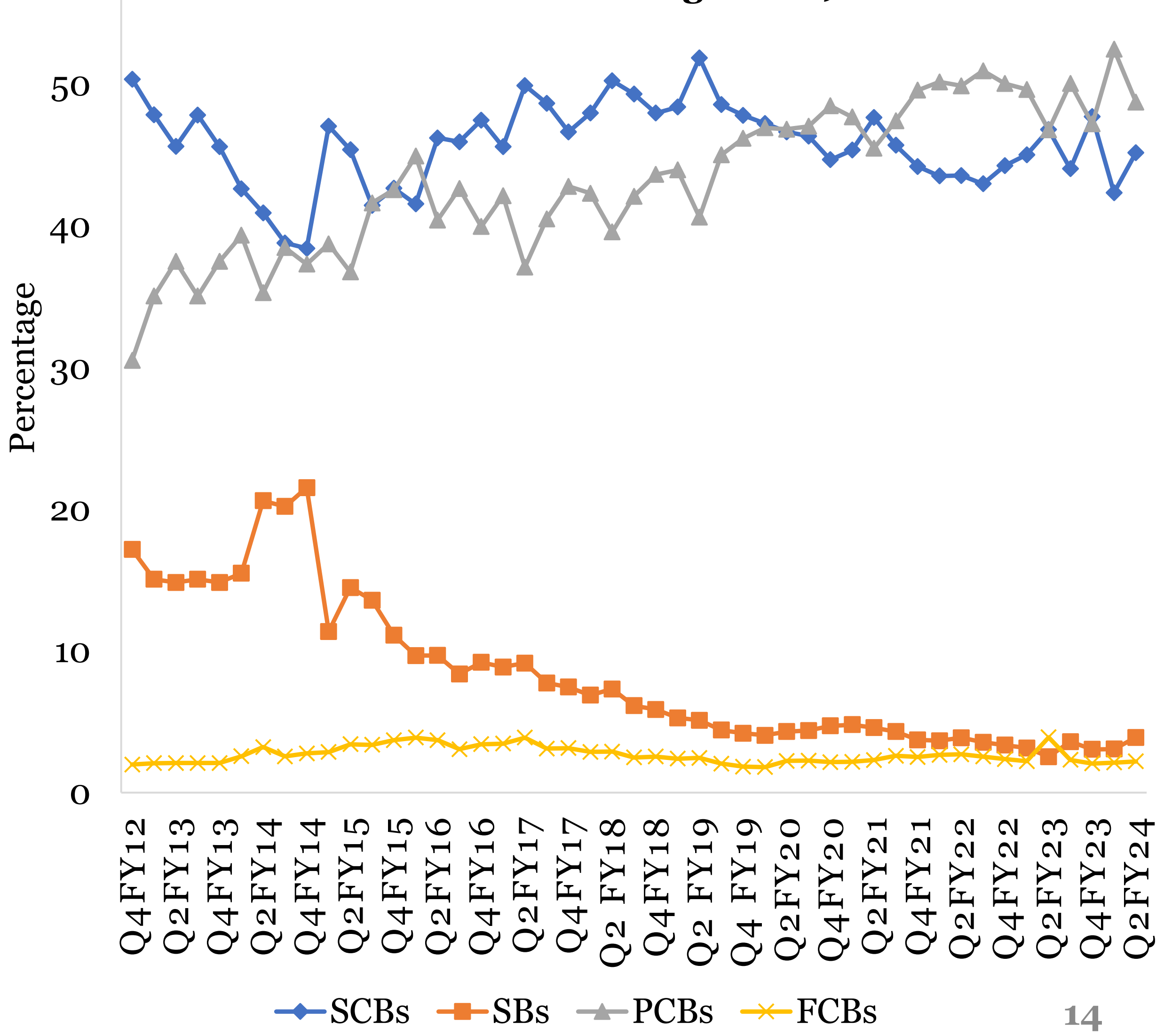
Non-performing Loans (NPLs) by type of bank

- The volume of NPLs in the PCBs as a percentage of the total NPLs in the banking sector increased from 31 per cent in Q4F12 to 49 per cent in Q2FY24
- **High concentration of NPLs is not only a problem for the SCBs but also the PCBs.**
- The increase in the share of NPLs in the PCBs shows that **the performance of the PCBs has worsened substantially over time**

Figure: Distribution of NPL by type of bank (as a percentage of total NPL in the banking sector)



Shortfall in loan loss provisioning requirements

- Provisions are assets on a bank's balance sheet that are put aside to cover losses that are expected to occur in the future.
- As of Q2FY24, the required loan loss provisioning was BDT 989.41 billion, whereas the actual loan loss provisioning maintained was only BDT 796.79 billion (80.5% of the requirement).
- **Hence, in Q2FY24, there was a shortfall of BDT 192.61 billion in loan loss provisioning in the banking sector**, including BDT 100.84 billion shortfall in SCBs and BDT 100.3 billion shortfall in PCBs.

Figure: Loan loss provisioning, required Vs. actual (in billion BDT)

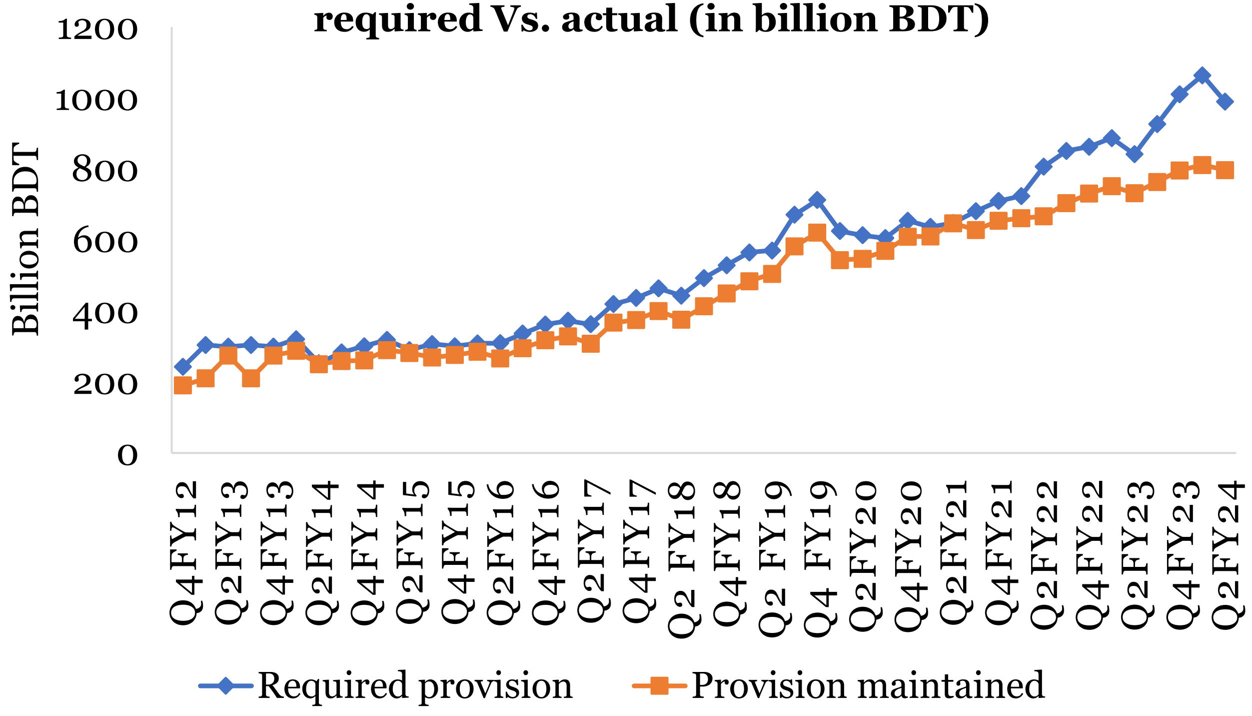
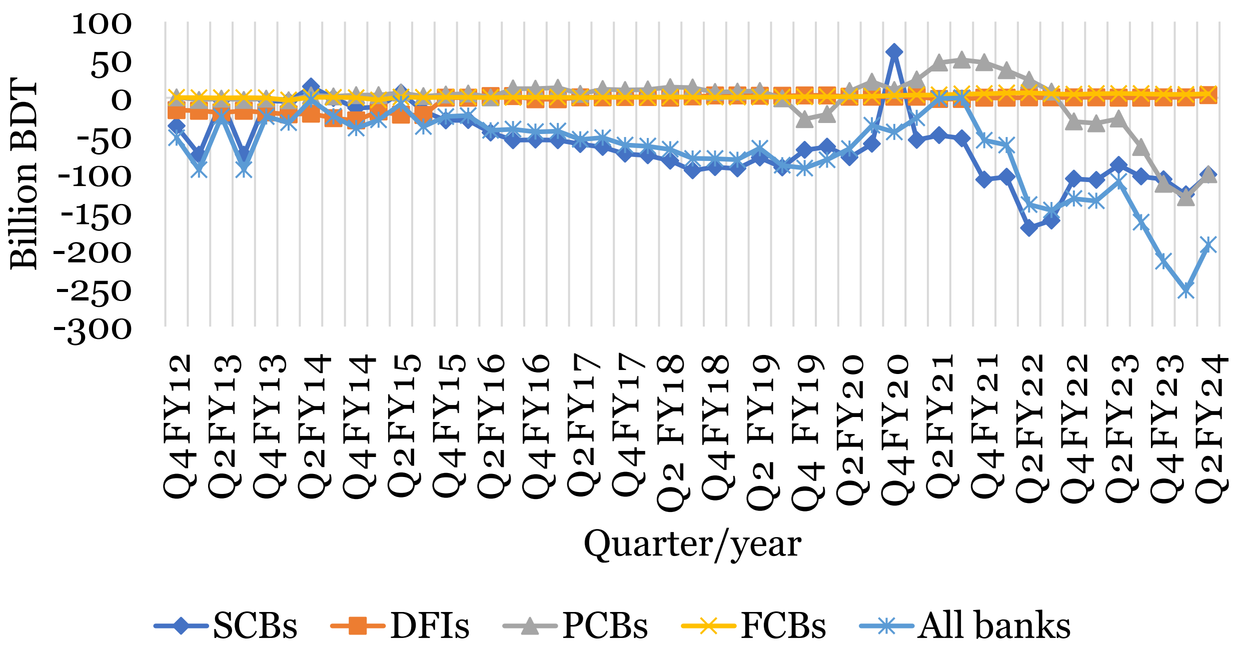


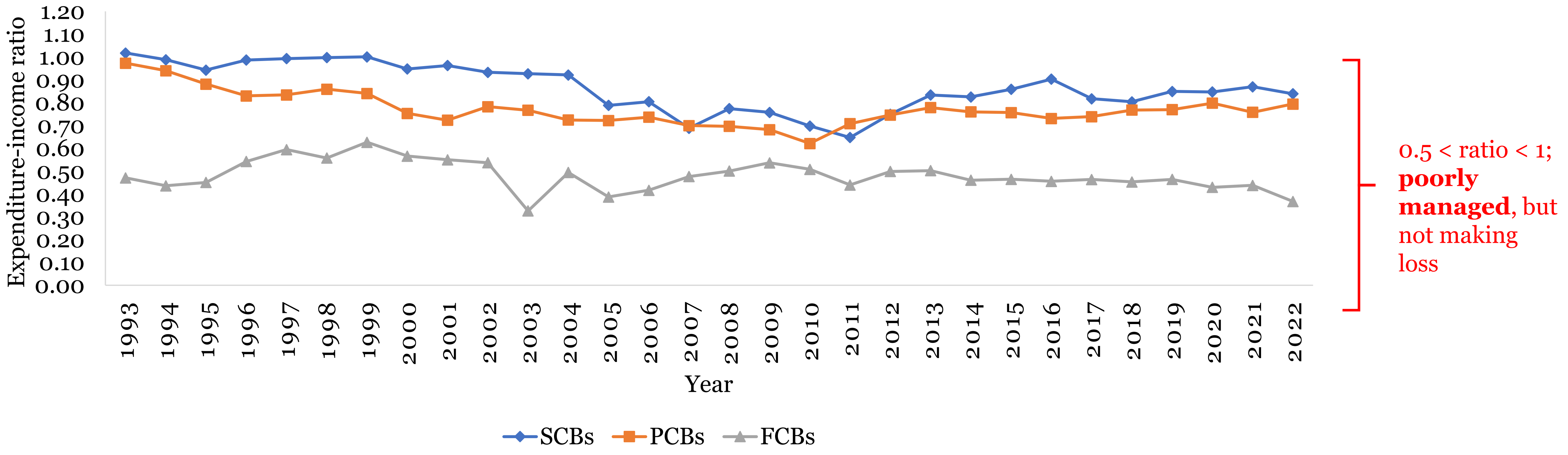
Figure: Excess or shortfall in loan loss provisioning (in billion BDT)



Management of commercial banks

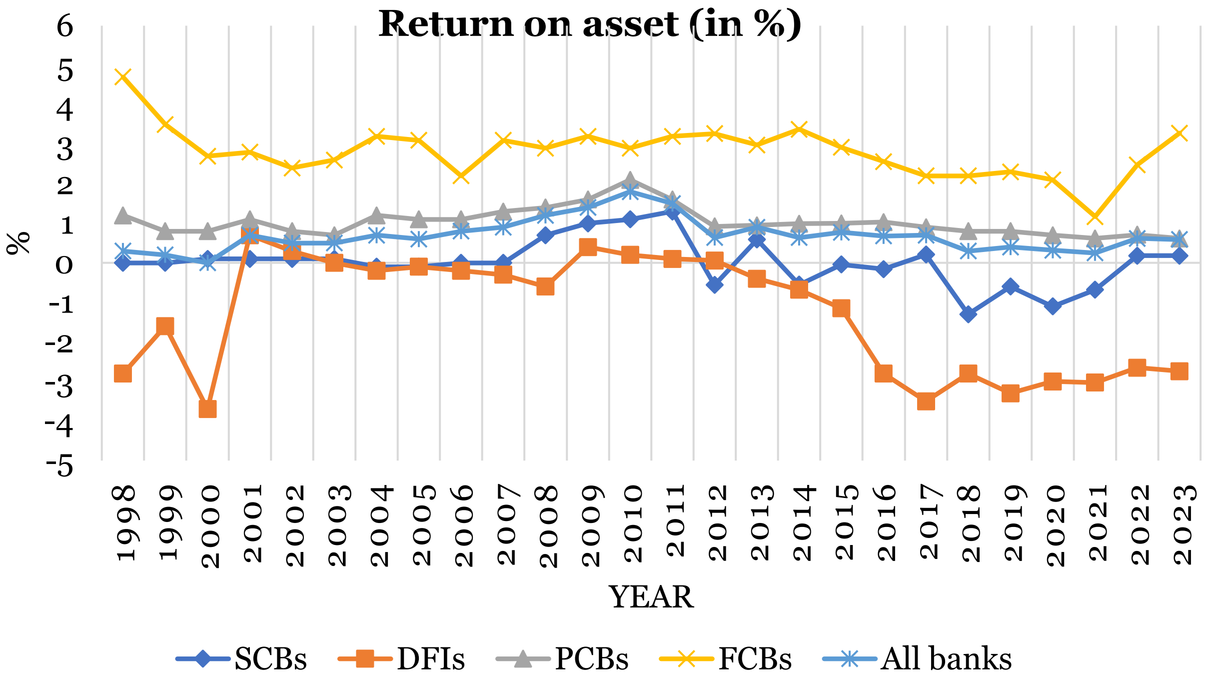
- From 2008 to 2022, the average expenditure-income ratio was 0.81 in SCBs and 0.74 in PCBs.
- An expenditure-income ratio between 0.5 and 1 indicates that a bank is poorly managed but not making a loss. A ratio below 0.5 indicates better managed banks.
- Management effectiveness of both SCBs and PCBs, even before the start of the pandemic, was poor

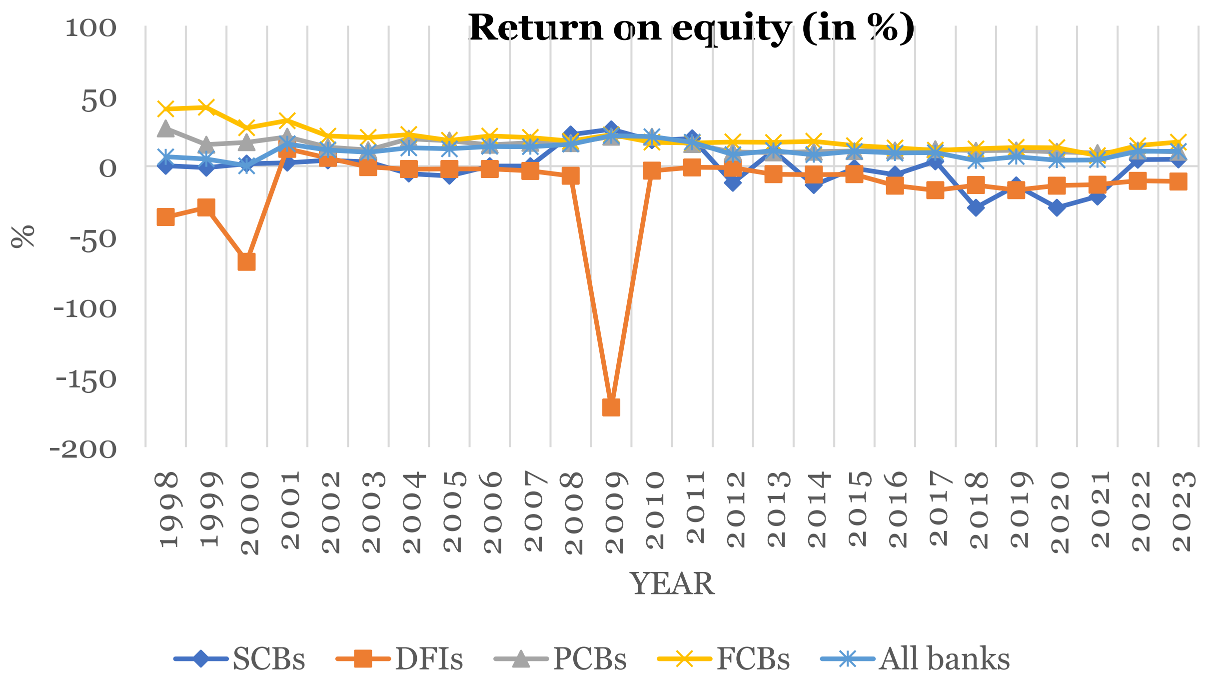
Figure: Expenditure –Income ratio (%)



Return on asset

- Return on asset (ROA) fell from 0.71% in 2022 to 0.62% in 2023 and return on equity (ROE) fell from 11.04% in 2022 to 10.13% in 2023 in the PCBs. This indicates **low profitability.**
- DFIs dug themselves into a deeper hole after the pandemic, as their ROA and ROE plummeted in 2023.
- FCBs saw their profitability rise in 2023 as their ROA and ROE increased.
- Profitability of SCBs increased only slightly in terms of ROE but remained unchanged in terms of ROA between 2022 and 2023.

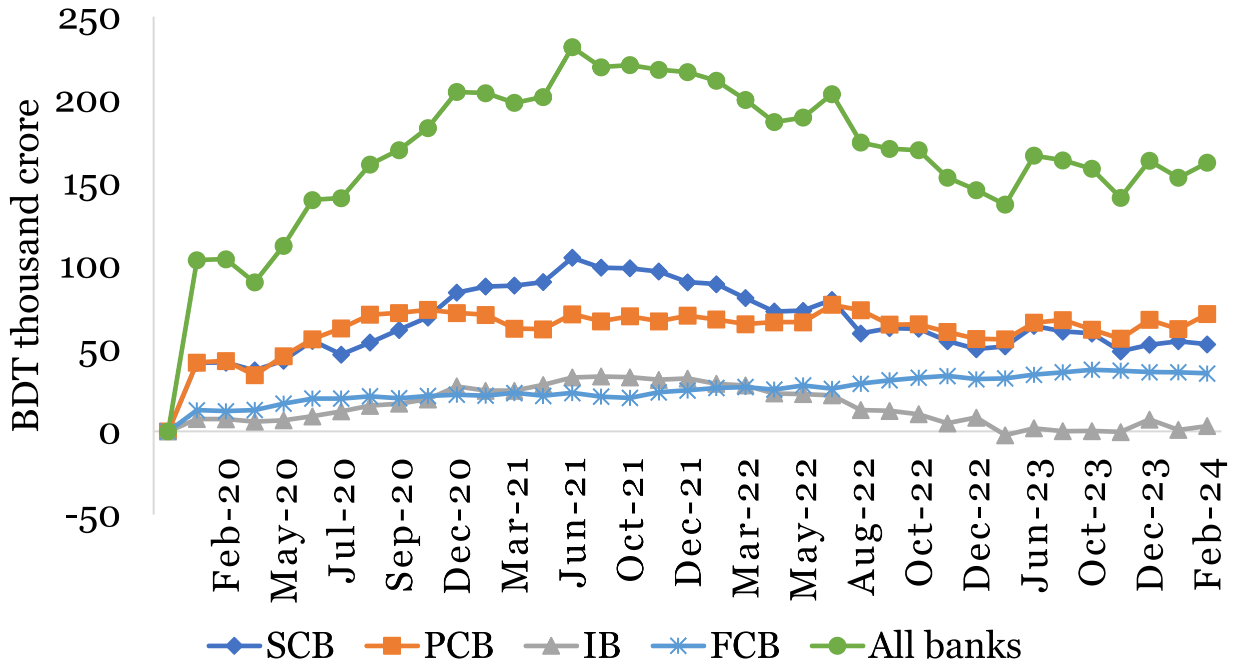




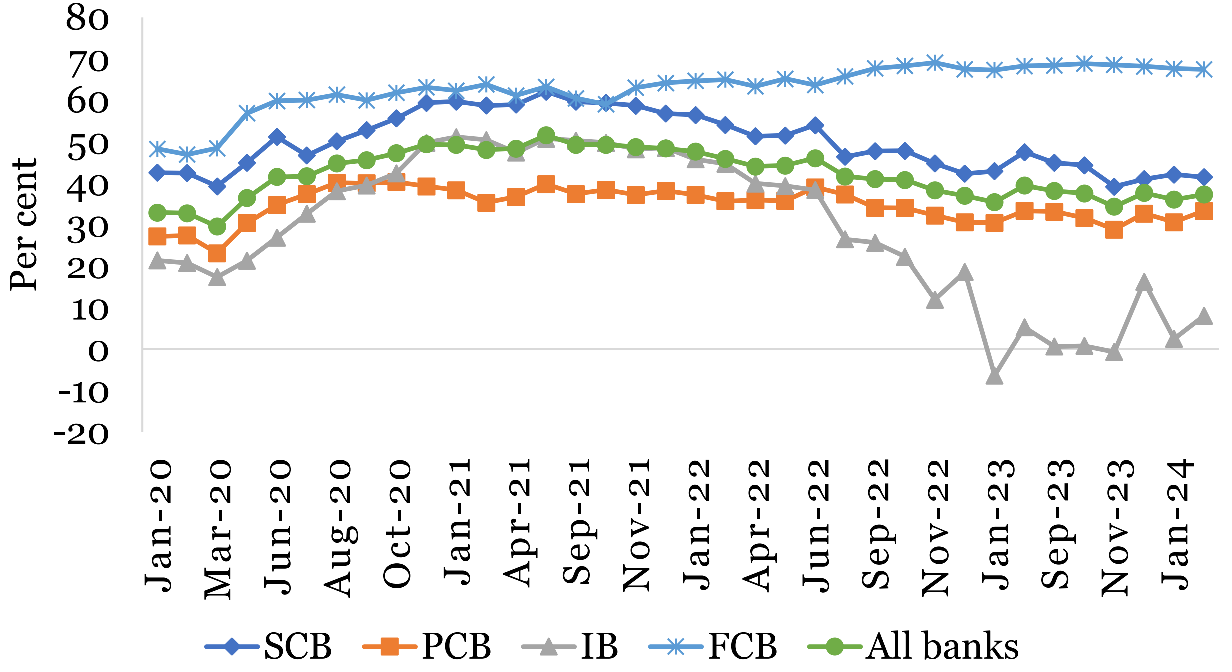
Decline in liquidity of banks

- Excess liquidity in the banking sector has declined **from BDT 232 thousand crore in June 2021 to BDT 162 thousand crore in February 2024.**
- Excess liquidity, as a share of the total liquid assets of the banking sector **declined from 52% in June 2021 to 37% in February 2024.**

Excess liquidity (BDT in thousand crore)

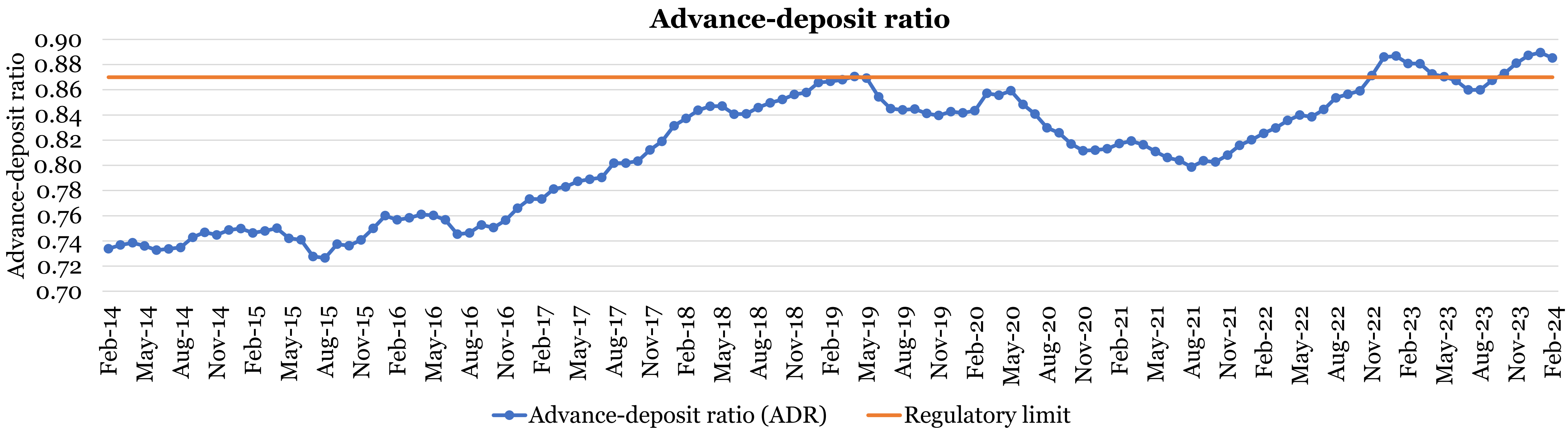


Excess liquidity (as % of total liquid assets)



Increase in advance-deposit ratio

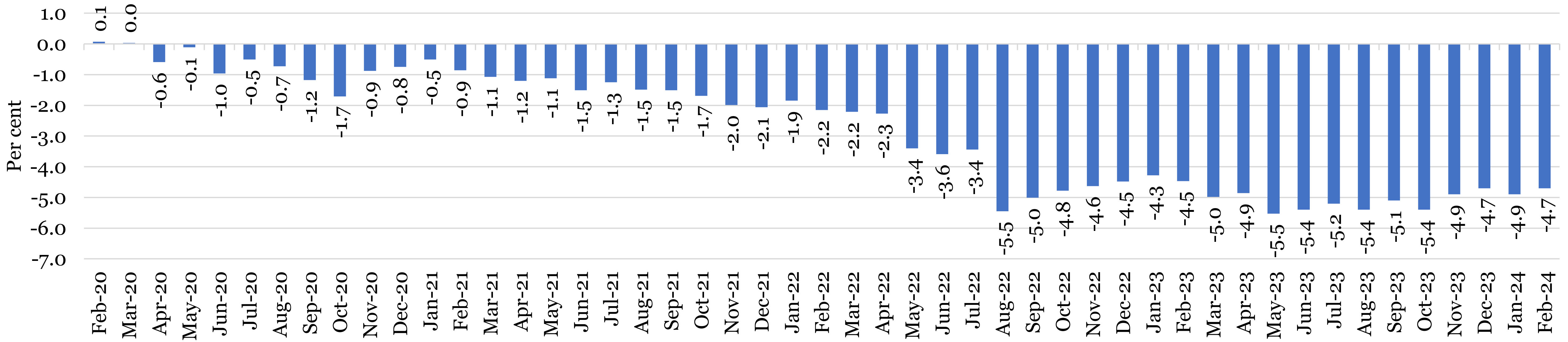
- Banks are experiencing pressure on their liquidity positions
  - Since the cost of living has increased, many people are forced to use their savings to make ends meet.
  - The advance-deposit ratio (ADR) has increased from 0.73 in February 2014 to 0.89 in February 2024
- The regulatory limit of ADR set by Bangladesh Bank is 0.87.



Negative real interest rate on bank deposits

- The *real deposit rate*, calculated as the weighted average of the monthly deposit rate of all scheduled banks adjusted with the point-to-point monthly consumer price index (CPI) inflation, **fell from 0.03 per cent in March 2020 to -4.7 per cent in February 2024**
- The negative real interest rate on bank deposits means that **a depositor becomes a net loser by keeping money in the bank**.

Figure: Real deposit rate in banks (in per cent)



3. Governance of the banking sector

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Reasons behind high volume of Non-performing Loans (NPLs) in Bangladesh

Institutional

- Appointments of bank directors, often based on political connections
- Loans sanctioned on political grounds
- Rescheduling of loans despite poor record of repayment
- Writing off loans to reduce tax burden and clean balance sheets of banks
- Weak internal control and compliance risk management of banks
- Inability of some banks to comply with BASEL III requirements

Regulatory

- Lack of independence of the Central Bank
- Dual regulation by the Financial Institutions Division and the Central Bank
- Flexibilities given to defaulters by the Central Bank
- Bank licenses given arbitrarily to crony capitalists
- Recapitalisation of banks by the government
- Quasi-monopolistic power of few bank oligarchs

Legal

- Amendments of Banking Company Act to favour vested interests
- Weaknesses in Financial Loan Court Act
- Loopholes in Bankruptcy Act
- Delays in judicial process and long backlog of cases
- Insufficient number of judges dealing with loan cases
- Lenient legal stance against willful defaulters

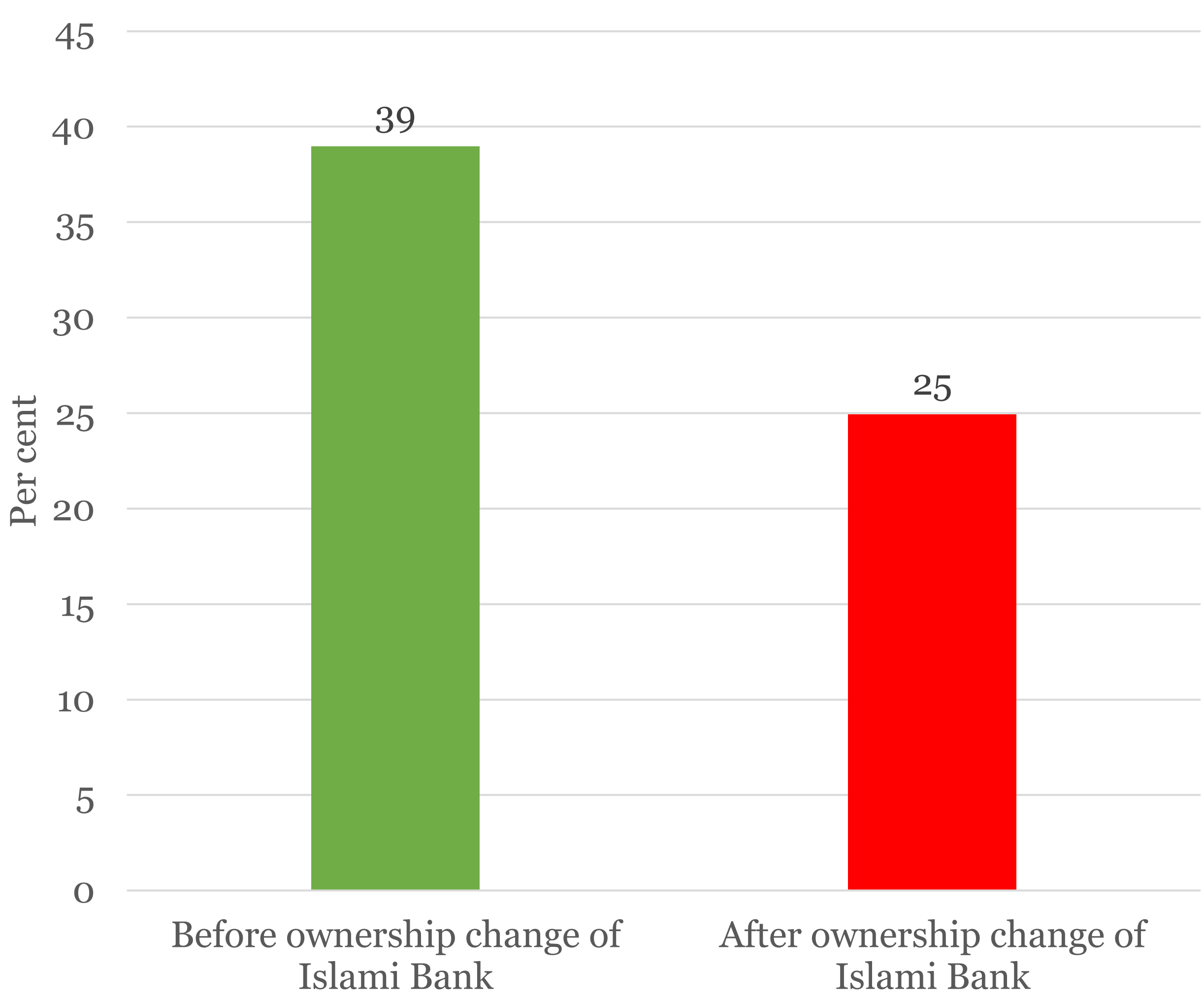
Data and information-related

- Limited access to timely data
- Apprehensions regarding quality of data
- Absence of disaggregated data
- Low reflection of data use in decision-making and policy measures
- Lack of transparency about use of data in decision-making process
- False information, forged documents and fake companies used for obtaining loans

The downfall of Islamic Shariah-based private banks

- This fall in excess liquidity has been mainly driven by the liquidity crisis in five of ten Islamic Shariah-based PCBs, plagued by poor governance since the ownership change of the banks.
- Analysis of the data shows that the **average excess liquidity as a share of total liquid assets** in IBs **from January 2011 to December 2016 was 39 per cent** but **fell to 25 per cent between March 2017 and February 2024** after Islami Bank's ownership change in January 2017.
- Before the ownership change of Islami Bank, IBs had excess liquidity of BDT 10112.63 crore in December 2016.
- However, after the ownership change of Islami Bank, IBs suffered a liquidity shortfall of BDT 2218.23 crore in January 2023

Figure: Average excess liquidity as a share of total liquid assets in IBs



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Importance of competition for good governance in the banking sector

When banks transform from being financial intermediaries to becoming monopolies, they become a growing cause for concern.

The monopolization of banking is usually accompanied with a deterioration in governance.

Banks are used as vehicles for reaching their goal of financial oligarchy under crony capitalism.

When financial capital becomes concentrated into the hands of few, monopolies extract supernormal profits at the cost of the welfare of the ordinary population.

Competitiveness and governance in the banking sector

- Historically, countries which have **fewer banks tend to have greater financial stability** since the **task of regulating banks can be accomplished more efficiently if the number of banks is small**
- As the structure of the banking market changes, so does the conduct and performance of the individual banks.
  - Big banks start to absorb, annex, or subordinate small banks.
  - The monopolisation of banking is usually accompanied with a deterioration in governance.
- Previous research by CPD has shown that
  - Decline in competitiveness **increases the probability of bank failures**
  - An improvement in governance **increases the competitiveness of the banking sector**
- **If policy makers turn a blind eye to governance issues, then the monopolization of the banking sector is inevitable**
- Independence of regulatory bodies and implementation of measures in line with policy guidelines are needed to prevent the repeated **collusion between businesses, banks, and the government**

A regulator for regulators?

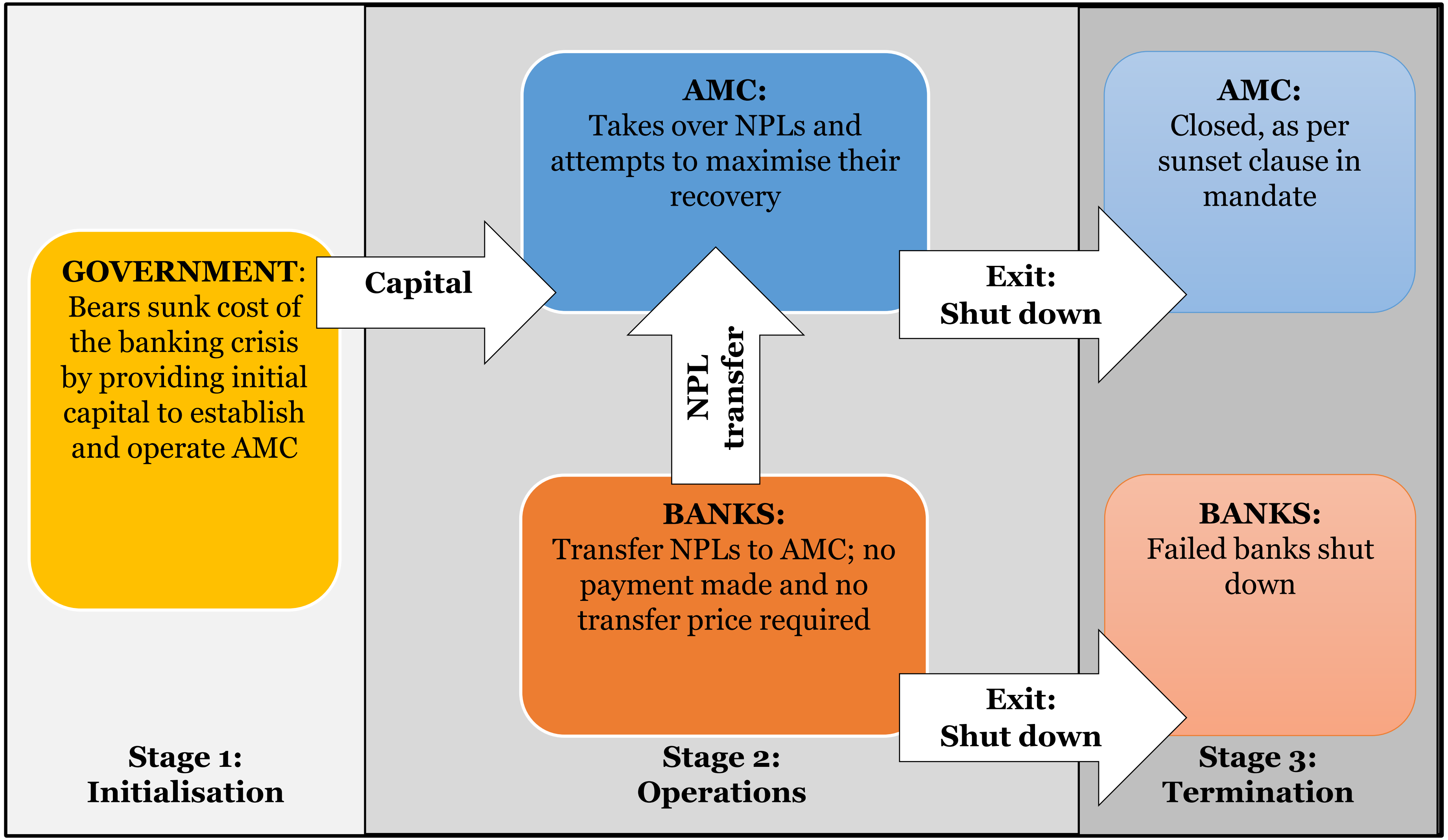
- Bangladesh Bank's sovereignty has been compromised by the establishment of the Financial Institutions Division (FID) of the Ministry of Finance (MoF)
- The **mandate of the FID** clearly states that the primary function of FID is the
  - "administration and interpretation of the Bangladesh Bank Order, 1972 (P.O. No. 127 1972) and orders relating to the specialized banks and other matters relating to state-owned banks, insurance and financial institutions".
- By asserting this function in its mandate, the **MoF's FID has established its authority to oversee Bangladesh Bank's governance.**
- This mandate is directly contradictory to Bangladesh Bank Order, 1972 (P.O. No. 127 1972) which states that
  - The main functions of the Bank shall be **to regulate and supervise banking companies and financial institutions**
- Since the establishment of FID, **new banks have been given licenses on political grounds, NPL has increased, and the overall state of governance in the banking sector has worsened significantly**.

4. Public asset management company: Will it be a quick fix?

Asset management company

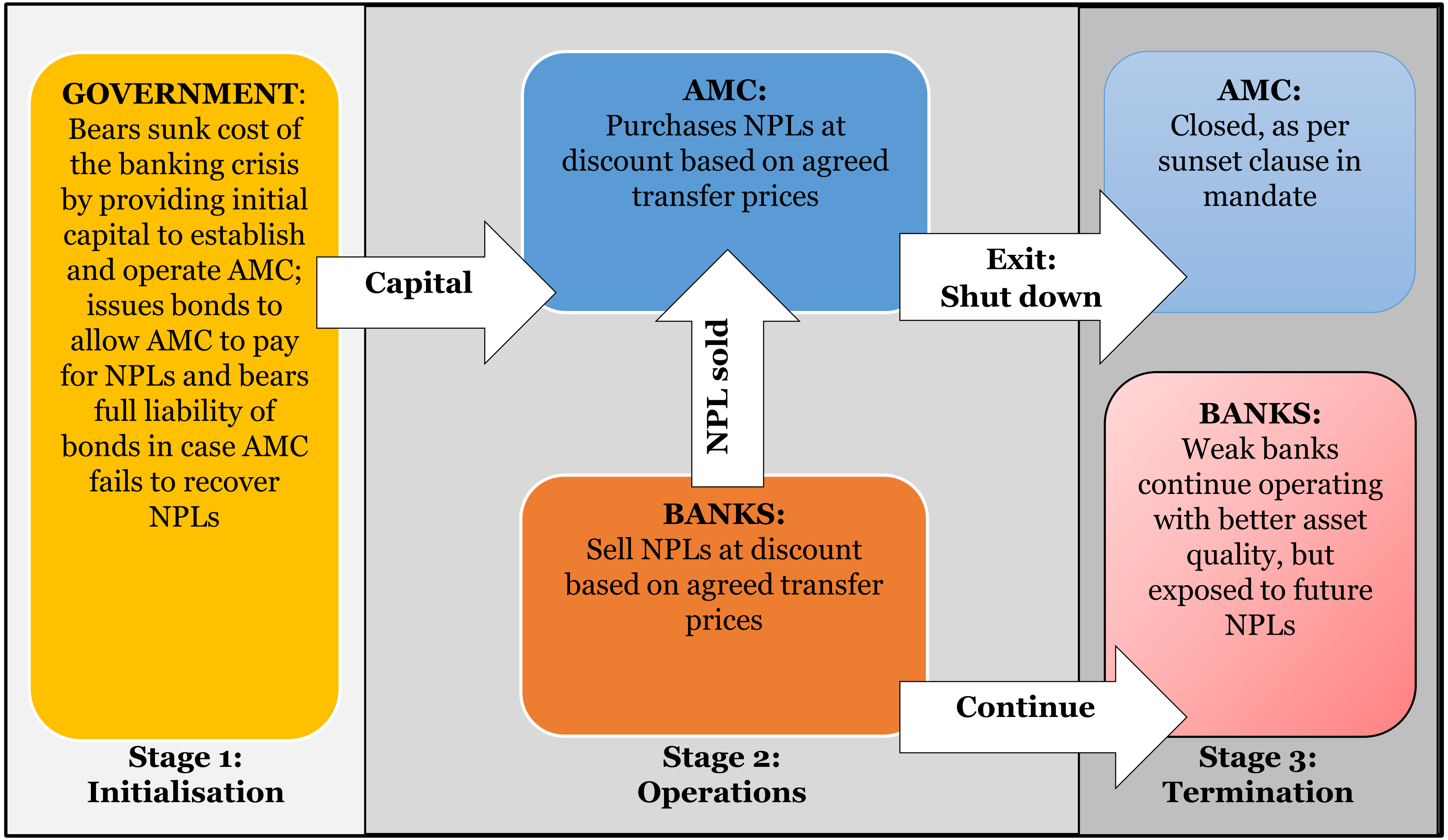
- To put simply, an Asset Management Company (AMC) is a public, private, or joint entity that manages non-performing assets removed from the financial system to maximise the recovery value of these assets.
- There are two types of AMCs:
  - Bank-resolution-type AMCs
  - Asset-purchasing-type AMCs

Figure: Schematic diagram of bank-resolution-type public AMC



Asset-purchasing-type public AMC

Figure: Schematic diagram of asset-purchasing-type public AMC



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Asset-purchasing-type public AMC vs bank-resolution-type public AMCs

- The draft Bangladesh Asset Management Company (BAMCO) Act 2020 was proposed by the MoF with the objective of reducing the burden of NPL.
- BAMCO is envisioned to be a state-owned company which will work under the FID of the MoF
- However, the initiative to set up a state-owned public asset management company has raised questions about efficiency, governance, operation, transparency, and accountability.
- In an ideal situation when some pre-conditions are met, **bank-resolution-type AMCs would be a better option since they involve less financial burden for the government and improve the overall efficiency of the banking sector by shutting down failed banks**.
- An asset-purchasing-type AMC may create a **double burden** on the government if it has to: (i) **finance its establishment** and (ii) then again **pay back the bonds in the event it fails**.
- **Since an asset-purchasing-type AMC depends on the funding of government-guaranteed bonds to purchase NPLs, it cannot function without a bond market.**

Weaknesses in the Bangladesh Asset Management Company Act 2020

- The draft law does not clearly mention **the exit policy of the proposed asset management company (AMC).** There should be a sunset clause about the closure of the AMC.
- There are no details about the **management of the AMC**. Who will be in charge? Will there be proper assessment of expertise within the government to run the AMC?
- The **governance issue** is the most critical in the case of the public AMC. Weak governance is one of the reasons for the poor performance of certain banks. How will good governance be ensured in the proposed AMC? How will conflict of interest be avoided?
- **Transparency and accountability of the whole process** of NPL reduction by the AMC must be ensured.
- People should be informed of the AMC's performance through regular publication of information.

Pre-conditions for setting up a public asset management company

- Since public AMCs are expensive to set up and operate, they should be established only if certain preconditions are met.

Precondition	Scenario in banking sector of Bangladesh	Condition met?
Commitment to comprehensive reforms	Measures taken by the government till date have been counterproductive, for instance the number of board members from one family, the tenure of board members, loan classification requirements, etc	**No**
Systemic crisis and risk of public funds	Currently the banking sector of Bangladesh is experiencing a systemic crisis due to which public funds are at risk	**Yes**
Solid diagnostic, critical mass and homogeneity of non-performing assets (when purchasing assets)	The actual amount of non-performing assets must be determined through authentic audits.	**Unclear**
Tradition of institutional independence and public accountability	The banking sector in Bangladesh has been captured by crony capitalists where the regulatory body has little independence and low public accountability	**No**
Robust legal framework for bank resolution, debt recovery and creditors' rights	The legal framework is outdated and dysfunctional	**No**

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Potential for NPL resolution: Should it be through a public or private AMC?

- The government has **already provided support** to state-owned commercial banks and weak private sector banks to rescue them at points in time. However, those have **not resulted in any improvement** in the health of the banks.
- Since the proposed AMC under the BAMCO 2020 is envisioned to be a state-run company, the **government will have to inject capital again for BAMCO to initiate operations**.
- **Repeated use of public funds** either to recapitalize weak banks or to create an AMC is a burden on the people since the **government's initial capital for the AMC is taxpayers' money**.

Potential for NPL resolution: Should it be through a public or private AMC?

- **In essence, a public AMC is a complex mechanism designed to provide taxpayers' money to failed banks via a prolonged and roundabout route.**
- A public AMC may **create more problems than it solves** if it becomes affected by the same virus of poor governance that it was designed to cure.
- The governance of the publicly-owned AMC may be compromised if its Board of Directors are not independent.
- Evidence from countries such as the Czech Republic, Indonesia and others suggest that **in the absence of strong governance and transparency, AMCs may fail to achieve their goals**.
- In view of the above limitations, the MoF should relinquish the proposal of resolving the NPL problem through a public AMC.
- Following international best practices, the MoF should invite private-sector AMCs and select reputed and reliable AMCs with global experience.

5. Bank mergers:
An attempt without assessing ramifications

Panic withdrawals and forced mergers: Indications of lack of trust

- The number of banks in Bangladesh is too high considering the size of the economy and the size of the country
- In 2013, the government approved licenses of 9 new private commercial banks: Meghna Bank Limited, Midland Bank Limited, Modhumoti Bank Limited, NRB Bank Limited, NRB Commercial Bank Limited, NRB Global Bank Limited, South Bangla Agriculture and Commerce Bank Limited, The Farmers Bank Limited, and Union Bank Limited, despite opposition from the central bank.
- License for opening a new commercial bank has become a tool for misappropriation of public money.
  - It is apprehended that this tendency to give bank licenses as gifts to crony capitalists may be continued now with digital bank licenses.
- The **fourth-generation banks** (9 newly approved commercial banks) are beset with large amounts of NPLs and are making losses.
- The central bank aims to merge weak banks with stronger ones to improve financial health, restore confidence and prevent bank failures.
- Under the merger plan, Padma Bank will join with Exim Bank, Bangladesh Development Bank is to merge with Sonali Bank, Rajshahi Krishi Unnayan Bank will join forces with Bangladesh Krishi Bank, National Bank will merge with United Commercial Bank and BASIC Bank will combine with City Bank.
- Depositors, worried about forced mergers, are reported to withdraw their savings despite government assurances.

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Concerns regarding proposed bank mergers in Bangladesh

Problems with Proposed Approach

- ❑***Forced mergers:*** Strong banks burdened with liabilities of weak banks.
- ❑***Rewarding failure:*** Weak bank directors potentially return to leadership positions, after a gap of five years.
- ❑***Lack of transparency:*** Concerns about accuracy of financial assessments of weak bank and the overall process.

Challenges of Mergers

- ❑***Job losses and integration:*** Employee layoffs and cultural clashes likely.
- ❑***IT Integration:*** Disruptions and data security risks due to incompatible systems.
- ❑***Customer confusion and concern:*** Uncertainty about accounts, deposits, service quality, and data security.
- ❑***Short-term focus and overlooking the underlying issues:***
  - ➢ Some banks' health may deteriorate and create new risks.
  - ➢ Accountability and transparency should be the focus.

Need for a strategic approach and a comprehensive plan

- Currently, the merger plan is on hold after initial discussions.
- Mergers are lengthy and difficult processes for which adequate preparation and transparency are needed.
- Mergers cannot be based on the arbitrary decisions of authorities.
- Successful mergers require a strategic approach that tackles the core issues of the banking sector, not just a quick fix.
- A strategic approach should include:
  - Clear Goals: Focus on operational efficiency, customer satisfaction, and addressing root causes.
  - Meticulous Planning: Ensure smooth IT integration and clear communication with customers.
  - Lessons from Past Mergers: Learn from past successes and failures.
- While successful mergers can bring positive outcomes in terms of reduced NPL and improved efficiency, the key issue of the banking sector remains the improvement of corporate governance and the establishment of accountability.

6. Some recent measures taken by the government

Recent policy measures by the Bangladesh Bank

Key Measures

- **Interest Rate Hikes**
  - Policy rate increased to 8.5% (from 8%)
  - Aims to control inflation and signal higher lending rates by commercial banks
  - Lending rates to be determined by commercial banks based on efficiency and market demand
- **Elimination of Interest Rate Cap**
  - Previously (April 2020) capped lending and deposit rates at 9% and 6%, respectively
  - Ineffective in controlling inflation and discouraged saving
- **Crawling Peg Exchange Rate**
  - Sets a mid-point rate (Tk 117/$1) for USD transactions with a flexible band
  - Aims to stabilize the taka and improve predictability for exporters and remitters
  - Potential for further adjustments based on market conditions

Potential Impacts

- **Increased Borrowing Costs**
  - Businesses may face higher borrowing costs due to rising interest rates
- **Improved Competitiveness**
  - Exporters may benefit from a weaker Taka, making their products more competitive internationally
- **Higher Import Costs**
  - Depreciation of the taka could lead to increased import costs and inflationary pressures
- **Government Spending**
  - Government import costs may rise due to the new exchange rate, potentially impacting the budget deficit
- **Debt Management:**
  - Increased government borrowing from commercial banks could raise debt servicing costs

Challenges and Considerations

- **Policy Coordination**
  - Monetary and fiscal policies need to work together for optimal outcomes
- **Implementation and Monitoring**
  - Careful implementation and adjustments are required based on market response
- **Business Environment**
  - Factors like good governance, improved infrastructure, better skills, and reduced corruption are crucial for business competitiveness beyond interest rates.
- **Policy Consistency**
  - Commitment to consistent and timely policy implementation and adjustment according to reality are essential

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Bangladesh Bank's roadmap for reducing NPL

	Action plan	Outcome	Measures taken so far
1	If loans from a scheduled bank are bad or harmful (or classified) for two consecutive years, then those loans have to be written off on condition of 100 per cent provision against those loans.	The reduced amount of classified loan will be equivalent to BDT 43,300 crore or 2.76 per cent. The bank will not face any risk since there is a 100 per cent provision.	BRPD Circular No. 04: Policy on Loan/Investment Write off and Formation of Written off Loan Recovery Unit and its Functions (Published on 18 February 2024)
2	To write off loans, a separate unit, namely "Written Off Loan Recovery Unit", will be formed under the direct supervision of the Chief Executive Officer, and the fulfilment of loan recovery should be attached to the performance indicators of the Managing Director.	Recovering written off loan will receive highest importance.	BRPD Circular No. 04: Policy on Loan/Investment Write off and Formation of Written off Loan Recovery Unit and its Functions (Published on 18 February 2024)
3	The necessary laws will be formulated to establish an asset management company in the private sector. A draft law has already been posted on the Financial Institutions Division of the Ministry of Finance website.	Banks can clean their balance sheets by selling bad loans and written-off assets to an asset management company and adding those funds to their income.	No specific circular on asset management since 4 February 2024. A draft law has already been posted on the Financial Institutions Division of the Ministry of Finance website.
4	The interest accrued on a stressed asset cannot be transferred to the income statement without actual recovery, and stressed assets should be shown in the balance sheet separately until they are recovered or become regular.	Since interest/profit can be transferred to the income statement based on actual recovery, the management will not allow regular loans to become stressed assets. Note that stressed assets may become defaulted in the future.	No recent circular was found on the changes in balance sheet accounting, including stressed assets, or loan write-offs after 4 February 2024 (introduction of the roadmap)

Bangladesh Bank's roadmap for reducing NPL

	Action plan	Outcome	Measures taken so far
5	There will be no further extension of facilities for flexible repayment of loans.	The repayment culture will be restored, and the liquidity crisis of commercial banks will be reduced. The cash flow of banks will increase, and new loan flow to the private sector can be increased by collecting old loans.	BRPD Circular Letter No. 17: Charging interest & repayment procedure of Term Loan. (Published on 8 March 2024)
6	The expiry date of term loans will be defined in accordance with international best practices. In this regard, the relevant guidelines and circulars will be amended or updated.	Commercial banks will come under international best practices, and financial sector reforms will be fulfilled.	BRPD Circular No. 09: Definition of Past due/Overdue of Fixed Term Loan (Published on 8 March 2024)
7	Strengthening the existing legal team/legal department in banks.	The money loan court cases will be settled quickly if the legal team is strong. Currently, 72,543 cases are pending in the Money Loan Court, with an outstanding amount of 1 lakh 78 thousand 277 crore Taka.	No recent circular found at the time of writing
8	Banks will be given targets to settle cases out of court through Alternative Dispute Resolution (ADR) under the Money Loan Court Act (2003)	The case will be settled quickly, and hence, the recovery of the bank's unpaid amount will also be faster.	BRPD Circular No. 11: Observance of Alternative Dispute Resolution (ADR) to accelerate recovery of defaulted loans. (Published on 12 May 2024)

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Bangladesh Bank's roadmap for reducing NPL

	Action plan	Outcome	Measures taken so far
9	Necessary policies to take action against wilful defaulters, as defined in the Bank Company (Amendment) Act, will be formulated and implemented.	Promulgating this policy will reduce the tendency of borrowers to default on their loans.	BRPD Circular No. 06: Identification & finalization of wilful defaulters and measures to be taken against them (published on 12 March 2024)
10	Special allowances will be provided to bank officials to encourage them to focus more on collecting classified loans.	Recovery of defaulted loans will speed up.	BRPD Circular No. 04: Policy on Loan/Investment Write off and Formation of Written off Loan Recovery Unit and its Functions. (Published on 18 February 2024)
11	There will be mandatory valuation of collateral provided against loans through listed collateral valuation institutes in addition to commercial banks' valuation.	Loans against overvalued collateral can be stopped if collateral valuation is done correctly. Proper collateral will facilitate the recovery of classified loans in the banking sector in the future.	No specific circular on collaterals was published after 5 February 2024.

7. Way forward: Recommendations and conclusions

Recommendations

- **A comprehensive reform agenda** should be devised and implemented to overcome the banking sector's ongoing challenges.

- The reform agenda **should aim to reduce the NPL and establish good governance** in the banking sector.

- *Some specific recommendations are presented below.*

Commercial banks need to be strengthened

- **Appointment of board members** of commercial banks should be depoliticised and based only on qualifications and experiences
- **Loans should be sanctioned based on** the Central Bank's "Guidelines on Internal Credit Risk Rating System for Banks"
- **Single borrower exposure limit** for commercial banks should be strictly enforced
- **Repeated rescheduling and write-offs of NPLs** should be stopped permanently
- **Internal Control and Compliance Departments** of commercial banks should be revitalised, and effective internal audits should be ensured
- The central bank should **appoint firm administrators** to oversee the operation of troubled banks which cannot comply with BASEL III requirements

Independence of Bangladesh Bank should be upheld

- **The autonomy of the central bank** should be upheld in line with the Bangladesh Bank Amendment Bill 2003
- **Recapitalisation** of poorly governed commercial banks **with public money should be stopped**
- **An exit policy for troubled banks** should be formulated by protecting depositors' money in those banks
- **No more licenses for new banks** should be given on political grounds without pragmatic assessment of the need for the economy
- A single individual or group of individuals **should not be allowed** to obtain majority ownership of more than one commercial bank

A conducive legal and judicial environment should be created

- **The Banking Companies Act should be amended** to reduce both the number of family members on the board of directors and the tenure of each director to enhance transparency and accountability
- **The number of judges** dealing with the Financial Loan Court Act 2003 and Bankruptcy Act 1997 should be increased to ensure speedy disposal of loan default cases and to reduce the backlog
- **The Bankruptcy Act** should be amended to remove mortgage-related loopholes that cause delays in settling cases
- Efforts should be made to **recover NPLs through out-of-court procedures** such as Alternate Dispute Resolution

Integrity and availability of timely data should be ensured

- **The report on banks and financial institutions** should be published regularly and made publicly available
- All commercial banks should be obliged to **make their mandatory disclosures under BASEL III** in a timely fashion
- Loans should be **classified according to international standards**, such as those outlined by the International Monetary Fund's Financial Soundness Indicators guide
- **A comprehensive risk management policy** should be implemented in all commercial banks to detect and deter fraud, forgery, fake companies, false identities, and other malpractices

Set up Independent Banking Commission

- A goal-specific, time-bound, inclusive, transparent, unbiased and independent Citizen's Commission on Banking should be set up to bring transparency to the prevailing situation, identify the root causes of the manifest problems, and suggest credible measures for improving the situation sustainably.

NPLs should be brought down through a comprehensive framework

- **Bank mergers** should proceed only after **proper auditing of weak banks** to determine their real balance sheets.
- **Board members of weak banks** should not be allowed to sit on the board of the strong banks after the merger.
- **The government should not inject any capital** into the proposed public AMC to buy NPL.
  - The government has already supported weak banks using taxpayers' money.
- The government should clearly spell out the **AMC's mandate, operation, management and governance.**
  - **Internationally reputed and experienced private AMCs** may be invited to resolve the NPL problem.
  - To encourage such companies, **the preconditions for setting up an AMC**, such as good governance, transparency and accountability **must be met**.

Conclusions

- **There has been an erosion of public trust in the banking sector due to the continuous deterioration of the health of the sector and inadequate measures taken by the policymakers.**

- **Sporadic measures have not been successful** since the nature and depth of the problem require **comprehensive due diligence and structural reforms**.

- Since reforms **will face resistance from the vested interest groups,** those **must be backed by political will.**

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